
Appendix A - General Questions

Because the Board believes that the time has come to again explore mandatory auditor rotation, it is soliciting commenters' views on all aspects of the issues discussed in this release. Specific questions on various aspects of a potential rotation requirement are included in the next section. More important, however, at least preliminarily, are commenters' views on the following more general issues:

1. Should the Board focus on enhancing auditor independence, objectivity and professional skepticism?

   Yes; the principles stated above are foundational to the trust in the financial system and the financial reporting process. The Board should ensure that they are maintained and enhanced at all times.

   How significant are the problems in those areas relative to problems in other areas on which the Board might focus?

   The importance of having accurate, informative, and independent financial statements and disclosures cannot be understated.

   Should the Board simply defer consideration of any proposals to enhance auditor independence, objectivity and professional skepticism?

   No, this would fundamentally undermine the objective of high quality independent audits. Auditor independence, objectivity and professional skepticism are overarching principles, which are the foundation of a quality audit.

2. Would audit firm rotation enhance auditor independence, objectivity and professional skepticism?

   The majority of IIA respondents to a survey indicated that audit firm rotation would enhance independence and objectivity. However, the majority of IIA respondents also disagreed with the overall concept of audit firm rotation mainly due to the disadvantages listed in point #3 below such as increased costs, poor quality audits, etc. Further, among companies which experienced a change in auditors, the perception of the majority of internal auditors was that the independence, objectivity and professional skepticism of the new financial statement auditor was not markedly different than the prior firm.

3. What are the advantages and disadvantages of mandatory audit firm rotation?

   Advantages:
   Increased independence and objectivity, potential for fresh eyes and perspective, and potentially over time, increased quality of work.

Disadvantages:
Increased costs to company and/or audit firm, steep learning curve and loss of knowledge, poor quality audits, potential opportunities for opinion shopping, and the potential that mandatory rotation would diminish the role and influence of the audit committee.

If there are potential disadvantages or unintended consequences, are there ways a rotation requirement could be structured to avoid or minimize them?

In lieu of time-based mandatory rotation we suggest the PCAOB require auditor change in certain circumstances; such as restatements (which result in the Company's filing an 8k removing reliance on the prior filing), significant frauds in the companies audited, or other indicators of audit failure which impact investors. Please also see our responses to specific questions 3, 8, and 13-19 in Appendix B.

4. Because there appears to be little or no relevant empirical data directly on mandatory rotation available, should the Board conduct a pilot program so that mandatory rotation of registered public accounting firms could be further studied before the Board determines whether to consider developing a more permanent requirement? How could such a program be structured?

   In lieu of time-based mandatory rotation we suggest the PCAOB require auditor change in certain circumstances such as restatements (which result in the Company's filing an 8k removing reliance on the prior filing), significant frauds in the companies audited, or other indicators of audit failure which impact investors.

5. According to the 2003 GAO Report, large firms estimated that a rotation requirement would increase initial year audit costs by more than 20 percent. What effect would a rotation requirement have on audit costs?

   IIA members indicate that audit costs and scope increased in the early years after a change in auditors, and those increased costs declined over time; similar trends were noted with regard to efficiency.

   Are there other costs the Board should consider, such as the potential time and disruption impact on company financial reporting staff as a result of a change in auditors?

   First of all, if the Board chooses to move forward with this project, it would be important to perform a cost/benefit analysis. Some additional costs which may not be quantifiable include potential hidden costs initially borne by audit firms, but ultimately absorbed by companies such as staffing and recruitment costs that may have to be absorbed as staff turnover increases due to limited advancement opportunities. In addition, there is an increased burden on the company, its financial reporting staff and its audit committee members.

Are there implementation steps that could be taken to mitigate costs? The Board is particularly interested in any relevant empirical data commenters can provide in this area.

While cost containment will be an issue for firms that have auditor rotations, audit committees must consider an increased use of Internal Audit to mitigate costs. The new financial statement auditor should leverage the knowledge, skills, experience, and expertise of Internal Audit in planning and learning about the company, coordinate audit coverage, and place appropriate reliance on Internal Audit testing. These strategies will help to reduce costs and increase efficiency and audit effectiveness.

6. A 2003 report by the Conference Board Commission on Public Trust and Private Enterprise recommended that audit committees consider rotation when, among other factors, "the audit firm has been employed by the company for a substantial period of time (e.g., over 10 years)." To what extent have audit committees considered implementing a policy of audit firm rotation? If audit committees have not considered implementing such a policy, why not? What have been the experiences of any audit committees that have implemented a policy of rotation?

   The PCAOB should obtain insights from audit committees to directly address these questions; each audit committee may have unique views.

7. Are there alternatives to mandatory rotation that the Board should consider that would meaningfully enhance auditor independence, objectivity and professional skepticism? For example, should broader alternatives be considered that relate to a company's requirement to obtain an audit, such as joint audits or a requirement for the audit committee to solicit bids on the audit after a certain number of years with the same auditor?

   Our members strongly believe alternatives to mandatory rotation based solely on passage of time should be considered. Those alternatives include:
   a. Rotation of audit partner as implemented in most countries, including the US.
   b. Increased involvement of the audit committee.
   c. The audit committee could request the Board (PCAOB) to perform an enhanced inspection of the audit of their company and report back to them.
   d. Mandatory change of auditors in certain circumstances (see responses to Appendix B questions 6 and 17)
   e. A requirement that the audit committee solicit bids from other firms every X years.
   f. Enhanced use of a company’s Internal Audit’s knowledge and expertise to facilitate financial statement audits. Internal Audit is an independent, objective assurance and consulting activity. It is knowledgeable about the company’s governance structure, risk assessment and management

activities, control environment, policies and procedures, applicable laws and regulations, and internal control practices.

Could audit committee oversight of the engagement be otherwise enhanced in a way that meaningfully improves auditor independence?

Increased involvement of the audit committee could greatly enhance the auditor's role its independence and audit quality; the organization's Internal Audit activities can greatly support this involvement. Each year, the Audit Committee should review audit firm's performance and recommend change if deemed necessary.

8. Should the Board continue to seek to address its concerns about independence, objectivity and professional skepticism through its current inspection program?

Yes, this process should be ongoing. Where there are red flags, the inspection team should perform sufficient work to validate if independence, objectivity, and professional skepticism have been impaired. Mandatory rotation will increase workload on the inspection program due to higher risks associated with auditor changes.

Is there some enhanced or improved form of inspection that could better address the Board's concerns?

In lieu of time-based mandatory rotation we suggest the PCAOB require auditor change in certain circumstances such as restatements (which result in the Company's filing an 8k removing reliance on the prior filing), significant frauds in the companies audited, or other indicators of audit failure which impact investors. The PCAOB should permit audit committees to request the company's financial statement audit be subject to a PCAOB inspection.

If mandatory rotation were in place, could an enhanced inspection, perhaps focused particularly on professional skepticism, serve as a substitute in cases in which it would be unusually costly, disruptive or otherwise impracticable to rotate auditors?"

Yes. If mandatory rotation were in place but was impractical or disruptive to rotate an auditor, the audit committee should request the Board for a special waiver. If mandatory requirement could not be enforced due to limited choice of auditors please see the response in Appendix B question # 8.

Appendix B - Specific Questions

A. Term of Engagement

1. If the Board determined to move forward with development of a rotation proposal, what would be an appropriate term length?

   If mandatory rotation were to occur, the term length should be 10 or more years.

2. Should different term lengths for different kinds of engagements be considered? If so, what characteristics, such as client size or industry, should this differentiation be based on?

   No, we suggest keeping this simple. It would be difficult to define the characteristics and dimensions upon which to differentiate, many of which are not objective measures such as size or industry. Some examples of less objective factors which illustrate the potential complexity include:

   - Centralized control vs. decentralized control
   - Levels of management
   - Top-down vs. matrix reporting
   - Organizational culture
   - Staffing approach
   - Degree of changes in management, people, system, and processes
   - Automated vs. manual controls
   - Single ERP vs. many legacy systems
   - Regulatory environments, etc.

3. Does audit effectiveness vary over an auditor's tenure on a particular engagement? For example, are auditors either more or less effective at the beginning of a new client relationship? If there is a "learning curve" before auditors can become effective, generally how long is it, and does it vary significantly by client type?

   We believe that the quality of an audit will, generally vary over an auditor's life cycle. While assumptions are stated below, generally the efficiency and quality will be lower in the early years of a new audit relationship. As the relationship with the company matures in years, efficiency and quality should increase, given the auditor's cumulative knowledge about the company. New views are then introduced to challenge the cumulative knowledge and advance continuous improvement through audit firm staff turnover, mandatory rotation of the signing partner and changes in audit committee and management personnel. Additionally, audit quality is likely to be influenced by the complexity of the audit (see examples of factors in the response to question #2 above).

Assumptions: It is reasonable to expect a qualified firm to maintain the baseline level of quality and transition among firms aided by the following:

Large firms will have experience in key industries, gained from audits and/or non-audit services to other companies in an industry.

1) The incoming firm is a reputable, experienced firm with qualified, competent personnel,
2) Company management has good documentation supporting policies and procedures, comprehensive financial reporting control frameworks, tracking system for issues identified by the team and internal audit,
3) The firm can leverage the knowledge and work of internal audit, and
4) There is a well-defined transition plan with input from incoming and outgoing external auditors, the outgoing firm shares detailed documentation, historical background, and key issues with the incoming firm.

4. Some have also suggested that, in addition to being less effective at the beginning of an engagement, an auditor may be less diligent toward the end of the allowable term. On the other hand, others have suggested that auditors would be more diligent towards the end of the allowable term out of concern about what the replacement auditor might find. Would auditors become more or less diligent towards the end of their term? Does the answer depend on the length of the term?

Regardless of the length of the term, auditors have every incentive to be diligent throughout the term of an audit engagement given the risks to personal and firm reputations and the sizeable monetary risks of lawsuits from an audit that does not meet professional standards.

An additional incentive for auditor diligence, particularly near the end of a rotational term, is the risk of embarrassment, given that their work will be reviewed by another professional firm. However, it appears detection of errors by a peer is not viewed as an effective deterrent in the context of auditor rotation since the PCOAB concluded that peer reviews were ineffective and have replaced peer reviews with its own inspection program.

5. How much time should be required before a rotated firm could return to an engagement?

The appropriate time is at least five years.

B. Scope of Potential Requirement

6. Should the Board consider requiring rotation for all issuer audits or just for some subset, such as audits of large issuers? Should the Board consider applying a rotation rule to some other subset of issuer audits? For example, are there reasons for applying a rotation requirement only to audits of companies in certain industries?

If mandatory rotation is required, the Board should consider requiring rotation for all public companies. It would be difficult to justify requiring for some but not for others. Further, it is generally more difficult for an auditor to gain full knowledge about the larger organizations; further, it is less likely for significant financial statement errors to occur and remain undetected in the larger companies, given the number of company personnel being aware of the issues, the number of approvals required, the generally higher level of expertise and sophistication of personnel, and a more mature control environments.

In lieu of time-based mandatory rotation we suggest the PCAOB require auditor change in certain circumstances such as restatements (which result in the Company's filing an 8k removing reliance on the prior filing), significant frauds in the companies audited, or other indicators of audit failure which impact investors.

C. Transition and Implementation Considerations

7. To what extent would a rotation requirement limit a company's choice of an auditor? Are there specific industries or regions in which a rotation requirement would present particular difficulties in identifying an auditor with the necessary skills and expertise? Is it likely that some smaller audit firms might decide to leave the public company audit market due to the level of uncertainty regarding their ongoing client portfolios?

As noted by Chairman Doty at the Open Board Meeting held on August 16, 2011, according to the research firm Glass Lewis, between 2003 and 2006, more than 6,500 public companies, or 52 % of all public companies, voluntarily changed their auditors. Rotation requirements may limit a company's choice if there is a large group of companies due to rotate at the same time. If the proposal is adopted, PCAOB needs to provide sufficient lead time for implementation. Under free market conditions, the geographical distribution and specialization of the firms will be shifted to meet demands. Some smaller audit firms may merge to broaden their experience base. Some large firms may be split to create more entities to meet demands. In anticipation of these market dynamics, the implementation rules should require disclosure of affiliation history of the engagement partners. Required rotation may favor more providers, stimulate competition, and promote separation of audit-only and non-audit services firms. On the other hand, to mitigate risks, firms may choose to focus only on certain industries; this would actually reduce the number of practical options companies would have if rotation were mandated.

PCAOB should evaluate how mandatory rotation would impact competition, the market and the firms; this could be accomplished by studying past cases, as well as engaging economists and marketing experts to evaluate, and asking major firms how they might react to the proposed changes.

8. If rotation would limit the choice of auditors, are there steps that could be taken to allow a company sufficient time to transition out of non-audit service arrangements with firms that could be engaged to perform the audit? Are there other steps that could be taken to address any limitation on auditor choice?

PCAOB needs to provide sufficient lead time for planning and schedule a staggered transition. If term limits are known, the companies will be able to align terms of non-audit service with the rotation cycles. Seems that mandatory rotation could effectively either limit a company's choice of a best provider for a non-audit service, or if the company selected a firm best in auditing a particular industry to perform a restricted (independence impairing) service, they would be "forced" to select an auditor which is not as knowledgeable to conduct the audit, potentially putting at risk audit quality.

Many companies likely use multiple firms for non-audit services, and all these relationships would have to be examined prior to engaging a new audit firm. These factors together with increased audit risk for a new auditor support longer term limits.

9. If rotation were required, would audit firms have the capacity to assign appropriately qualified personnel to new engagements? If they do not currently have that capacity, could firms develop it in order to be able to compete for new clients, and would they do so?

Auditing is a service business run by professionals. Existing firms will need to develop new strategies to address this new business model. The firms will use their business acumen to adjust their strategies for the mandatory rotation model. For example, the firms may consider delaying retirement, increasing audit staff, and supplementing staff with subject matter experts vs. auditing experts. Large firms could split to address the demand for having more different entities conversely, firms may merge to create larger critical mass.

10. Would rotation create unique challenges for audits of multinational companies? For voluntary rotations that have taken place, what have been the implementation and cost issues and how have they been managed?

Among IIA members which changed auditors, audit costs and scope increased in the early years after the change, and those increased costs declined over time; similar trends were noted with regard to efficiency. Some of the reduction in efficiency resulted from less reliance by the financial statement auditor on the work of internal audit.

11. Would increased frequency of auditor changes disrupt audit firms' operations or interfere with their ability to focus on performing high-quality audits? How would any such disruption vary by firm size? For example, would a rotation requirement pose fewer or more implementation issues for small firms than for large ones?

Increased frequency of auditor changes could disrupt audit firms' operations and interfere with their ability to focus on performing high-quality audits if the firm does not adapt its structure, strategy, staff size, staff mix, etc. to respond to the changes. Having a reasonable lead time for implementation and the ability to respond are the key determinants, not size. Many firms have invested in learning certain industries; these are essentially investments in audit quality. It is unclear whether mandatory rotation would cause an increase or a reduction in such investments.

Not discussed and not known is the impact on audit firms' staffing. Would retention be impacted if a professional knew they could only participate in a given engagement for a set period of time? For example, how does a firm staff an engagement with only two years left to run before mandatory rotation? And what happens if staff moves from one firm to another?

12. Would audit firms respond to a rotation requirement by devoting fewer resources to improving the quality of their audits? Would firms focus more on non-audit services than on audit services?

It is unlikely that audit firms would knowingly compromise quality for the reputational and monetary risks stated above. Quality is the key safeguard against reputational and monetary risks of not performing a "quality" audit. Quality should be an integral part of its audit process and not an add-on. The firm needs to exercise due care in meeting professional standards. It would not be prudent to short-change quality. Whether the firms would focus more on non-audit services or audit services will depend on their brand equity, strengths, core competencies, business models, marketing strategies, etc. Based on scale, the firms may need to invest in certain industries, thus reducing the pool of firms for a given industry, and for conglomerates, thus reducing the pool of eligible firms able to perform an audit.

13. Would rotation have any effect on the market for non-audit services? Would any such effect be harmful or beneficial to investors?

Ultimately the impacts to investors could be harmful. This is because rotation would limit the selection of firms which could act in various capacities, potentially limiting the selection of the best firm for any given engagement. It is possible however, that mandatory rotation could give rise to new audit businesses to the audit firms and stimulate competition. Mandatory rotation could also prompt certain firms to specialize in audit or non-audit services, thus creating new firms or splitting existing firms. Increasing the number of service providers and having audit-only firms may address some of the investors' concerns.

14. Some have expressed concern that rotation would lead to "opinion shopping," or that in competing for new engagements firms would offer favorable treatment. Others have suggested that rotation could be an antidote to opinion shopping because companies would know that they could not stick with a firm promising favorable treatment forever. Would opinion shopping be more or less likely if rotation were required? If rotation limits auditor choice, could it at the same time increase opinion shopping?

If rotation limits auditor choice, that means there are fewer firms competing for audit services, this would reduce opportunities for opinion shopping.

15. What effect would a rotation requirement have on competition for audit engagements? If competition would be increased, how might that affect audit quality?

It is not clear whether rotation will stimulate or reduce competition. In the short term, as firms have capabilities in various areas, rotation would likely stimulate competition, but over time, if a firm is rotated out of certain industries, it is likely their skills will atrophy and reduce competition and/or audit quality.

16. Are there any requirements the Board should consider to mitigate any risks posed by rotation? For example, are there enhancements to firms' quality control systems that might address such risks?

Yes. The incoming audit firm should assess the risks of the engagement in accordance with professional standards and add to that other transition risks such as those posed by non-audit services provided to the client, adequacy of the staff in terms of experience, expertise, size and mix. The outgoing firm should bear some responsibilities in transitioning work to the incoming firm.

17. If the early years of an auditor-client relationship pose higher audit risks than later years, should the Board require firms to provide additional audit supervision and oversight in the first year or two of a new engagement? Should the Board impose such a requirement for auditor changes even if it does not further consider requiring audit firm rotation? If firms are accepting new clients but are unable to perform quality audits for them until several years have passed, should the Board require enhanced client acceptance procedures? What impact would additional requirements of this type have on audit costs?

If the early years of an auditor-client relationship pose higher audit risks than later years, the Board should require firms to provide additional audit supervision and oversight in the first two years of a new engagement. Likewise, PCAOB should also focus its inspection priorities on these higher risk cases.

In lieu of time-based mandatory rotation we suggest the PCAOB require auditor change in certain circumstances such as restatements (which result in the Company’s filing an 8k removing reliance on the prior filing), significant frauds in the companies audited, or other indicators of audit failure which impact investors.

If firms are accepting new clients but are unable to perform quality audits for them until several years have passed, PCAOB should require enhanced client acceptance procedures.

These additional requirements would increase audit costs. Risks associated with having a new audit firm and increased audit costs could be mitigated by leveraging the knowledge, core competencies, expertise and experience of internal audit as well as placing reliance on some of the work performed by internal audit.

18. If mandatory rotation were required, are existing standards relating to communications between predecessor and successor auditors sufficient? Should additional communications be required? For example, should the outgoing auditor provide the incoming auditor with a written report outlining audit risks and other important information about the company?

To facilitate the transition and transfer of knowledge to the successor, the successor auditor should leverage the relationship with internal audit and utilize the results of internal audit activities. Additionally, the predecessor auditor should have some responsibilities to reduce audit risk for the incoming firm, including providing the incoming auditor with the following:

- Overview of the company and management
- Risk profiles of key entities and functions
- Audit Risks
- Fraud Risk Assessment
- Most significant matters in the financial statements
- Significant accounting policy or practice
- Infrequent and unusual transactions
- Key events
- Audit challenges

19. Are there other audit procedures that should be required to mitigate any risks posed by rotation?

External auditors should leverage Internal Audit's knowledge and expertise to facilitate the transition. Internal Audit is an independent, objective assurance and consulting activity. It is knowledgeable about the company's governance structure, risk assessment and management activities, control environment, policies and procedures, applicable laws and regulations, and internal control practices. The company's Audit Committee oversees the work of Internal Audit. Audit work is governed by The Institute of Internal Auditors' International Professional Practices Framework (IPPF). Many audit professionals are certified and bound by the Professional Standards, Code of Ethics, and Continuing Professional Education requirements. High reliance on internal audit can be assured by the requirements to adhere to IIA's professional standards, including the requirement sof the internal audit department to have a quality assurance and improvement program with both an internal assessment (by the auditee) and a qualified, independent party. In addition, the incoming audit firm should:

- Review prior audit firm's workpapers Discuss audit risks with key engagement team members, management and partners
- Ensure key engagement personnel have specific industry knowledge
- Interview the Chief Audit Executive and internal audit management team
- Review prior internal audit reports
- Interview Corporate Controllers, Chief Accountant and SOX Team Leader
- Review prior SOX documentation and testing results

20. If the Board moved forward with development of a rotation proposal, should consideration be given to the recommendation for a cause restriction on the company's ability to remove an auditor before the end of a fixed term? Would such a provision be useful? Would there be unintended consequences of such a requirement? Should the Board work with the SEC on implementation of this recommendation? Are there other matters on which the Board should coordinate with the SEC?

If the Board moves forward with this proposal, there should not be a "cause restriction". However, the governing Board/Audit Committee should always have the right to remove an auditor before the end of a pre-determined term. Each year, the Audit Committee should review audit firm's performance and recommend change if deemed necessary.

21. What other transition issues might arise in the first year of a rotation requirement? How should the Board address these issues?

We have highlighted several transition matters above. One important way to reduce the transition costs and risks would be for the new auditor to leverage the work and knowledge of internal audit, coordinate with internal audit and place appropriate reliance on its work.