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Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, D.C. 20006-2803

Attn: Office of the Secretary

Re: Rulemaking Docket Matter No. 37  
Concept Release on Auditor  
Independence And Audit Firm Rotation

Members of the Board:

The Retail Industry Leaders Association (“RILA”) and its Financial Leaders Council (“FLC”) are pleased to submit the following comments on the Board’s *Concept Release on Auditor Independence and Audit Firm Rotation* (“Concept Release”), issued by the Board on August 16, 2011. RILA is the trade association of the world’s largest and most innovative retail companies. RILA members include more than 200 retailers, product manufacturers, and service suppliers, which together account for more than \$1.5 trillion in annual sales, millions of American jobs, and more than 100,000 stores, manufacturing facilities, and distribution centers domestically and abroad.

We strongly disagree with the proposals set forth in the Concept Release and do not believe that they will enhance auditor independence, objectivity, and professional skepticism. We are very concerned that mandatory audit firm rotation will result in a significant degradation in the quality of audits.

Mandatory audit firm rotation has been considered and rejected before,<sup>1</sup> and it should be rejected again. Indeed, even the Board acknowledges that it can establish no correlation between auditor tenure and the number of comments in PCAOB inspection reports. The Board also offers no evidence of any direct correlation between audit tenure and restatements or any other measure of audit effectiveness. As discussed further below, we believe that mandatory audit firm rotation

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<sup>1</sup> As part of the Sarbanes-Oxley reforms, Congress considered and rejected requiring mandatory audit firm rotation, determining that the issue needed further study and directing the GAO to do so. Following extensive study, the GAO failed to make any recommendations. General Accounting Office, Required Study on the Potential Effects of Mandatory Audit Firm Rotation (2003) (“GAO Report”).

would not only fail to achieve greater auditor independence, objectivity, and professional skepticism, but, instead, it would also cause audit quality to deteriorate.

We do not believe, as the Concept Release seems to imply, that the financial crisis was caused by a lack of auditor independence and do not believe that mandatory auditor rotation, had it been in place, would have prevented the crisis from occurring. We also note that because the Board's reviews are risk-based, its results are necessarily skewed and not fully representative.<sup>2</sup>

Importantly, no rule, including the mandatory audit firm rotation proposal, will ever completely eliminate violations (whether intentional or unintentional) of the rules established by various regulatory bodies, leading to failed audits, or bad actors. However, over the years, numerous statutory and regulatory changes aimed at enhancing the quality and reliability of audits have been enacted or promulgated to address the precise concerns expressed in the Concept Release. This extensive statutory and regulatory framework includes the following:<sup>3</sup>

- The requirement that the audit committee, and not management, hire the auditor and oversee their engagement<sup>4</sup>
- The significant restrictions placed on audit firms providing non-audit services
- Mandatory audit partner rotation
- Concurring audit partner reviews
- Required internal quality reviews
- Peer reviews
- Risk-based PCAOB reviews and, in some cases, publication of findings
- Strict independence rules promulgated by the SEC, PCAOB, and AICPA
- Rules restricting former audit firm employees from working at a former client

We believe that this existing statutory and regulatory framework continues to be the appropriate way in which to address such concerns. Even the Board acknowledges that the Sarbanes-Oxley reforms “have made a significant, positive difference in the quality of public company auditing,” and, again, the Concept Release provides no data proving that mandatory audit firm rotation will improve audit quality further.

In our view, mandatory audit firm rotation would significantly increase the cost of audits without necessarily increasing the quality of the audit or benefiting investors. This is precisely the conclusion reached by the GAO following its extensive study.<sup>5</sup> At least in the first years

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<sup>2</sup> We also question the extent to which the Board is classifying differing professional judgments as a lack of professional skepticism and note that as financial accounting standards migrate more toward a principles-based approach, differences in professional judgment will increase. Differences in professional judgment do not imply a degradation of audit quality.

<sup>3</sup> Certain requirements are applicable only to SEC registrants.

<sup>4</sup> The increased used of internal audit staff by audit committees also has been a beneficial development.

<sup>5</sup> “The potential benefits of mandatory audit firm rotation are harder to predict and quantify, though we are fairly certain that there will be additional cost.” GAO Report at 2, 8.

following a mandatory rotation, audit quality will likely *decrease*. This is because the effectiveness of an audit team generally increases each year as a result of the auditor's enhanced depth and breadth of understanding of the company, its operations, processes, and systems as well as the industry in which the company operates. The audit firm's collective, historical knowledge not only allows for more efficient audits, but also allows the auditor to better determine key risk areas and more effectively focus the audit on those areas. The research cited in the Concept Release supports this conclusion. We believe that mandatory audit firm rotation will force investors to trade the significant benefits of historical knowledge and expertise for the increased costs and dubious benefits of transitioning to a new audit firm.

Although partner rotation is mandatory and natural changes in personnel occur, the audit firm's institutional and industry knowledge is still largely intact when the audit firm itself remains on an engagement. An audit firm's institutional knowledge often plays a critical role in conducting a quality audit. We believe a mandatory change of audit firm will result in a significant loss of institutional knowledge. Notably, while one may mandate that information be shared with a successor firm, as a practical matter, a complete transfer of knowledge can never occur because historical work papers are generally not accessible to the successor auditor beyond an initial review prior to the successor auditor beginning its audit procedures. This decrease in knowledge will increase inefficiencies and cost and likely lead to a decrease in audit quality, all of which will negatively impact investors.

One important cost that is difficult to measure is the significant additional management and audit committee time that would be required to be spent on the audit (at the time any such proposal were adopted and in the early years following a mandatory rotation). For public companies, unless changes were made to the SEC's filing deadlines,<sup>6</sup> audit quality would face additional risks.

Mandatory audit rotation raises some very practical problems as well. For companies that are either complex in structure or operation, and for those in specialized industries, few firms will possess the technical industry expertise necessary to conduct an appropriate audit. For example, in the retail industry, not all audit firms are well versed in the industry itself or in specific industry requirements (such as specialized inventory methods, etc.). Multinational firms frequently use more than one audit firm because even the Big Four firms are not uniform in their expertise worldwide. For these companies, it is not clear how a mandatory rotation rule would operate and it could force a company to use a less expert firm in a particular country just to comply with a mandatory rotation rule. Because few public companies will use a firm other than a Big Four firm, there is a very limited number of firms they have to choose from in the first instance.

The available audit firms to choose as a successor would be further limited by the restrictions on auditors performing non-audit services, and, similar to the situation discussed above where multiple audit firms are used, could result in something akin to "musical chairs" among the audit firms and their various groups (e.g., tax, consulting) every time a company changes auditors. We

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<sup>6</sup> Such changes would be counter to the SEC's focus on accelerating filing deadlines.

also do not believe that it would be prudent to promulgate a rule that could force a company to disband its relationship with a firm that provides it with non-audit services due to rotational requirements. Any such requirement also would necessarily increase significantly the cost, time commitment, and training relative to such non-audit services.

Companies in relatively smaller markets would face an additional hurdle – not every firm has an office in such markets. Companies in those locations may be forced to engage a firm without a local office, which, in turn, would lead to additional complexity, cost, and inefficiencies.

In conclusion, we do not believe that the proposals in the Concept Release would improve audit quality and the Concept Release provides no data to support an alternative conclusion. Audit committees should be free to choose the auditor they believe is most expert in their industry or in a particular country. While a goal of improving independence, objectivity, and professional skepticism is appropriate, to the extent there is a belief that more needs to be done, we believe increased enforcement of existing rules and restrictions is the most appropriate method for addressing any concern. We thank you for the opportunity to comment on this proposal.

Sincerely,



Casey Chroust  
Executive Vice President, Retail Operations