

December 9, 2011

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington D.C. 200006-2803

Subject: PCAOB Rulemaking Docket Matter No. 37

The audit committee of Covidien plc (NYSE: COV) appreciates the opportunity to comment on PCAOB Release No. 2011-006, *Concept Release on Auditor Independence and Audit Firm Rotation* (the "Release"). We support the PCAOB's ongoing efforts to improve audit quality and enhance auditor independence, objectivity and professional skepticism. We do not believe, however, that a mandatory audit firm rotation requirement is the appropriate mechanism to achieve such improvements and enhancements. Rather, we are concerned that mandatory audit firm rotation may lead to a decline in audit quality, an increase in audit costs and inefficiencies and no measurable improvement in auditor independence, objectivity or professional skepticism.

Set forth below is a discussion of each of our concerns:

Audit Quality

Covidien is a large multinational company with annual revenues in excess of \$11 billion, across several different business lines. The financial statements of large multinational companies like Covidien are often affected by complex accounting standards that apply to significant components of their businesses. Additionally, large multinational companies often have complex tax structures. Accordingly, an audit firm cannot efficiently audit the financial statements of such companies without first developing a strong knowledge of their industry and underlying business and tax models.

Acquiring this knowledge is both time consuming and expensive, and is a frequent cause of frustration for audit clients during the early years of an audit relationship. Once this knowledge base has been obtained, audit firms are generally able to leverage their expertise to improve the quality and efficiency of their audit programs. A mandatory rotation program would cause a significant percentage of the audit firm's tenure to be spent learning about the client's business and industry.

As an example, Covidien previously changed audit firms in 2004. In management's estimation, it took approximately 3 years for its successor audit firm to acquire the requisite knowledge of Covidien's business and industry practices. The Release discusses possible scenarios involving mandatory rotation after 5 or 10 years. Under these scenarios, 30-60% of the audit firm's tenure would occur during a period of time when the audit firm was still learning key elements of the

client's business and industry. During this period, a financial statement error could be more likely to occur and be undetected by the audit firm due to the firm's lack of familiarity with a company, its business models and the industry in which it operates. Thus, 30-60% of the audits within each rotation cycle would potentially be at risk from a quality perspective.

Additionally, the investments made to improve the audit firm's business and industry knowledge during these first 3 years would have a limited return, as the next rotation would cause the client and its new audit firm to repeat the cycle all over again. This could potentially cause audit firms to be less inclined to invest in the proper levels of staffing and industry-specific expertise, thereby further reducing the quality of their financial statement audits.

Costs and Inefficiencies

The proposed mandatory audit firm rotation would significantly increase costs and inefficiencies for both the audit firms and their clients. Below is a listing of several potential examples:

- As previously discussed, a mandatory rotation program would require audit firms to spend a significant portion of each rotation cycle gaining familiarity with the client, its business practices and its industry. This process is both inefficient from an audit perspective and costly, and would likely result in higher ongoing audit fees for companies over the duration of each rotation cycle.
- The mandatory rotation process would require a significant investment of time by companies in anticipation of the next rotation cycle. Management and the audit committee would be required to spend several months soliciting, evaluating and ultimately selecting the next audit firm in the rotation. The time spent on this exercise would likely come at the expense of matters more critical to shareholders and other users of a company's financial statements, and would have minimal value if the existing audit firm was already performing its financial statement audits at a high level of quality.
- Covidien and other large multinational companies often enter into complex transactions or initiatives that require retrospective restatement, such as discontinued operations. Depending on the timing of the restatement, publicly traded companies could have to frequently engage two audit firms to opine on the financial statements reported in their Form 10-K filings. The newly appointed audit firm would issue an opinion on the most recently completed fiscal year, while the predecessor audit firm would have to be reengaged in order to provide an opinion and consent on the restated historical fiscal years.
- Recent U.S. GAAP exposure drafts were prepared with the goal of converging with International Financial Reporting Standards ("IFRS"), and more such literature is expected in future years. These standards are significant, may take several years to implement and may require retrospective restatement once effective. A mandatory auditor rotation could disrupt a company's ability to successfully adopt and implement

these new standards and/or fully converge with IFRS if this becomes a requirement in future years.

- A mandatory audit firm rotation could have the unintended consequence of causing a mandatory rotation of firms providing prohibited non-audit services as well. Generally, the only audit firms with the necessary resources to perform financial statement audits for large multinational companies like Covidien are the “Big Four” audit firms. If one of these firms is already engaged in performing a prohibited non-audit service and is selected to be the next audit firm in the rotation, the existing prohibited non-audit engagement will need to be terminated in order to establish the firm’s independence. This will force the company to engage a different “Big Four” firm for the prohibited non-audit services that were previously performed by the new audit firm. As a result, this will likely cause inefficiencies as the company will have to bring the new “Big Four” firm responsible for the prohibited non-audit services up to speed on the services previously performed by the predecessor firm.

Independence, Objectivity and Professional Skepticism

The Release suggests that a mandatory audit firm rotation would presumably end the practice of audit firms turning a new engagement into a “long-term income stream.” This, coupled with a “fresh perspective” by a new audit firm on a recurring basis could serve to enhance auditor independence, objectivity and professional skepticism. We disagree with these positions as described below.

Regardless of whether a rotation period is implemented, the audit firm will still generate a significant income stream from its audit clients. The rotation periods contemplated in the Release are still long enough in duration (5-10 years, or possibly greater) such that the audit firms would generate income from their clients over a sustained period of time. To the extent that the PCAOB is concerned about significant income from audit fees impairing an audit firm’s independence, this concern will not be alleviated for the audits of large companies even if the rotation period is set at 5 years. Among our closest peer companies, annual audit fees routinely exceed \$10 million, so a 5 year rotation period would still generate \$50 million or more of revenue for an individual audit.

Additionally, once a given audit firm completes its audit rotation for a large multinational company, the audit firm may have the opportunity to earn significant cash flows from prohibited non-audit services going forward. Large, multinational companies like Covidien routinely engage several or all of the “Big Four” firms for both audit and non-audit services at the same time. In many instances, the prohibited non-audit services are significant and equally or more profitable for the “Big Four” firms than the audit services. Because the choice in auditors for large multinational companies is effectively limited to four firms, it is likely that these companies will already have significant, pre-existing business relationships with the next audit firm in the rotation. This means that multiple firms may take the position that the overall business relationship with the client is a “long-term income stream”, and the audit services performed during the rotation period will just be one component of that stream.

Further, the “fresh perspective” on the audit would be employed by a firm that had previously earned significant cash flows from the company in a prohibited non-audit capacity, and would presumably be looking to re-engage in such services following the completion of the rotation period. Fundamentally, this would not appear to be an improvement over the current model where individual audit partners are rotated off of the audit after a specified period of time, but the audit firm as a whole continues to generate income from its client.

Conclusion

While we understand the PCAOB’s concerns regarding the adequacy of auditor independence, objectivity and professional skepticism, we do not believe that a mandatory audit firm rotation requirement will sufficiently address these concerns. On the contrary, we believe that implementing this requirement may compromise existing financial statement audit quality while causing companies and their shareholders to incur significantly greater costs and inefficiencies. Accordingly, we respectfully disagree with the mandatory audit firm rotation proposal submitted by the PCAOB.

Covidien appreciates the PCAOB’s consideration of this issue.

Respectfully,

A handwritten signature in black ink, appearing to read 'R. Brust', written in a cursive style.

Robert H. Brust
Audit Committee Chairman

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