

December 9, 2011

Office of the Secretary  
PCAOB  
1666 K Street, N.W.  
Washington, D.C. 20006-2803

**Re: PCAOB Rulemaking Docket Matter No. 37**

Dear Board Members:

SanDisk Corporation appreciates the opportunity to respond to the Public Company Accounting Oversight Board ("PCAOB") Rulemaking Docket Matter No. 37 - Concept Release On Auditor Independence And Audit Firm Rotation.

SanDisk, a global technology company, is a global leader in flash memory storage solutions. Our products are used in a variety of large markets, and we distribute our products globally through retail and original equipment manufacturer channels. We are an S&P 500 company (NASDAQ:SNDK).

We support the continued efforts of the PCAOB to enhance the quality of public company auditing by bolstering auditor independence, objectivity and professional skepticism, but we do not believe the proposal for mandatory audit firm rotation meets its objectives for a number of reasons listed below, including our belief that mandatory audit firm rotation will not improve audit quality and the costs would far outweigh the benefits.

**Mandatory Rotation Will not Improve Audit Quality**

The presumed weakness by currently not having mandatory auditor rotation is that the auditors, who are paid directly by the companies they audit, are inherently interested in maintaining a long-standing revenue stream, which may then affect their professional skepticism in making objective auditing judgments and hence cause audit failures.

The Board believes that auditor independence is subject to the inherent risk in the auditor payment model. If an audit firm chooses to value the economic incentive of being paid over its "public responsibility" and "overriding duty to put the interests of investors first," then we feel it is illogical to assume shorter tenure will eliminate this incentive. The incentive to preserve a future revenue stream will still exist even if the period is capped, be it 5 years, 7

years or 10 years, since all audit firms will be on a level playing field to capture even this limited number of years of revenue. Furthermore, under the environment of mandatory rotation, audit quality might even deteriorate toward the end of the term since the firm will need to focus its attention on competing for their next clients.

We believe mandatory audit firm rotation would actually decrease overall audit quality. Business models can be complex and auditors need sufficient knowledge and understanding of a company's processes, controls and unique risks to properly interpret and apply the accounting rules to the complex accounting issues of the company and to exercise their professional skepticism. Gaining this knowledge takes time and there is simply no way to instantly replace the institutional knowledge that is acquired over time and through experience. We believe that mandatory audit firm rotation would make it more difficult for auditors to build this knowledge and expertise. This learning curve is more likely to result in audit decisions and positions being based on insufficient knowledge of the company's business, and such an outcome would have a negative impact on audit quality.

### **Audit Costs Will Increase**

We believe any good policy making should weigh the costs versus the benefits. We believe the overall economic costs of mandatory audit firm rotation will outweigh the benefits.

As the 2003 GAO report indicated, the initial year audit cost is estimated to increase by more than 20 percent as a result of the orientation effort by the audit firm, and the total cost incurred by the company will be even more. In addition to the higher audit fees that the audit firms will pass on, the company will incur more cost in selection and audit support. The additional internal administrative costs associated with the selection of a replacement auditor are not insignificant. Finance personnel, Senior Management and Audit Committees must spend time preparing invitations for bids, providing background information to bidders, evaluating responses, interviewing candidates and ultimately selecting a successor auditor.

In addition to the administrative costs in selecting a replacement auditor, the company will need to commit time and resources to bring a new audit firm up to speed, which has the potential to be even more material. With today's complex business models, company personnel will have to spend more time helping the auditor to understand the company's operations, processes and controls, applicable IT systems, accounting and financial reporting practices. That support can sometimes require hundreds of hours before the new auditor is knowledgeable enough about a business to exercise the proper application of accounting rules, regulations and interpretations. Most audit firms today absorb the transition cost in order to secure a new client, but if mandatory rotation is enacted, the transition costs would most likely be absorbed by the companies.

### **Mandatory Rotation Is Not Practical for Large Companies**

With only four large international public accounting firms, the audit market is highly concentrated. Under the restrictions on non-audit services under Sarbanes-Oxley (SOX),

most large companies already receive one service or another from every one of the four firms. If one of these Big Four accounting firms audits the Company, the other three often provide a host of advisory services in tax, M&A, valuations, etc. The pre-existing relationships of most large companies with all Big Four audit firms make it difficult to have a viable mandatory rotation plan. Pre-existing relationships would likely result in limiting the number of firms allowed to bid for an audit. Any disruption of non-audit services in order to rotate an audit firm could limit the ability of a company to select best-in-class non-audit services.

Furthermore, we believe audit firms may become distracted as they approach the end of their tenure as the auditors chase the soon-to-be-available audit clients coming off rotation.

### **Optimize Current Structure To Improve Audit Quality**

The Sarbanes-Oxley Act of 2002 instituted a number of significant provisions designed to bolster auditor independence, including the establishment of the PCAOB, mandatory audit partner rotation and the installment of the Audit Committee's responsibility to oversee the engagement. These significant reforms have enhanced audit independence and we believe if these standards are fully complied with, they are an appropriate solution to ensure audit quality.

As stated in the release, "since its creation, the PCAOB has conducted hundreds of inspections of registered public accounting firms each year," and based on its insight gained through these investigations, the Board has imposed appropriate sanctions to certain firms and more importantly, has established auditing, attestation, quality control, ethics and independence standards applicable to audits of public companies. Audit firms understand that any public company engagement can be selected by PCAOB for inspection, and this has driven the audit firms to focus on addressing issues identified by the PCAOB reviews and to focus on compliance and audit quality control. We believe the standards recently issued by the Board related to engagement quality review and the auditor's risk assessment process will have a positive effect on audit quality.

The required mandatory rotation of lead and reviewing audit partner after they have provided audit services to a public company for 5 consecutive years has also served as a solution to audit independence. After all, audit work is performed by people. We believe existing rules on partner rotation provide an environment in which the client auditor relationship is refreshed periodically and produces a sufficient environment of professional skepticism. We believe there could also be issues in certain markets where one firm or one large company has a dominant presence. In these instances, if companies switch audit firms, the new audit firm may need to hire staff below the partner level from the previous audit firm in order to properly staff the engagement as it is unrealistic that the new firm can relocate 50-100 staff from another geographic location. The movement of staff below the partner level between audit firms and related clients in the same geographic area will defeat the Board's goal of true rotation of firms and related teams.

Finally and most importantly, the current standards assign the Independent Audit Committee the responsibility of the appointment, compensation and oversight of the work of any

registered public accounting firm, and the audit firm reports directly to the Audit Committee. Current studies indicate that most audit committees actively monitor the functioning of internal controls and the relationship between the company and its auditors, and we can confirm that this active monitoring takes place at SanDisk. At SanDisk, during the private sessions, the Audit Committee reviews in detail the scope of the audit and quality of the auditors. In addition to the regular quarterly audit committee meetings on financial reporting issues, the Audit Committee Chairman also meets separately with the audit firm's regional leadership team to review audit quality and seek feedback. We believe with this kind of close monitoring and oversight, the Audit Committee will have a sufficient basis to exercise their responsibility to determine if and when a rotation of an audit firm is required to best meet the needs of the shareholders' interests.

One potential solution to mandatory auditor rotation would be for the Audit Committee to perform a more comprehensive review on a periodic basis. Instead of requiring a mandatory rotation, the Audit Committee, in conjunction with support from management, should perform a more in-depth review which would incorporate aspects such as quality and service level expectations, personnel quality, PCAOB inspection reports, global capabilities and industry expertise. Given the expected time to perform such an auditor review, this should be performed no more frequently than every 5 years, with a reasonable window of review being between 5 to 15 years. The Audit Committee would set the review cycle based upon company-specific factors. The proxy statement could be the vehicle for the Audit Committee to publish its review cycle (such as every 10 years) and the conclusion of its review (i.e. retain the current auditor or consider an open bid process to assess competing firms) once conducted.

We also recommend the PCAOB to establish a formal process of communicating with the company's Audit Committee on any public company inspection plan and inspection results regarding the inspected company. A formal process of communication will provide mutual benefits to both the PCAOB and the Audit Committee. The in-depth knowledge and insight of the Audit Committee will help the PCAOB gain a better understanding in creating the inspection plan, while the PCAOB sharing and reviewing the inspection results will provide the Audit Committee additional and essential information on audit quality for the periodic comprehensive review of an auditor.

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We thank you for providing us with the opportunity to provide our comments on concept release on auditor independence and audit firm rotation and you can reach us directly at the phone numbers below to discuss these issues further.

Sincerely,

/s/ Donald F. Robertson, Jr.

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Vice President,  
Chief Accounting Officer  
SanDisk Corporation  
(408) 801-1856

/s/ Catherine P. Lego

Catherine P. Lego  
Chairman,  
Audit Committee of the Board of Directors  
SanDisk Corporation  
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CC: Judy Bruner, Executive Vice President, Administration and Chief Financial Officer

## APPENDIX

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

Response: As we stated in our letter that we do not believe the proposed mandatory audit firm rotation will improve audit quality. We believe the current structure instituted by The Sarbanes-Oxley Act of 2002 including the formation of PCAOB, overall responsibility of independent audit committee and mandatory audit partner rotation has established the framework to further enhance auditor's objectivity and professional skepticism and should be fully optimized.

However, should the Board decide to move forward with the rotation proposal, term length has to be long enough for companies to develop a viable rotation plan and to minimize the cost. A longer term is also needed for a new audit firm to overcome the learning curve and gain knowledge and expertise about the client and industry in order to exercise professional skepticism. The determination of the optimal term length is subjective. In our view, the appropriate term length should at least be 10 years or longer.

*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?*

Response: Again, as we stated in our letter we do not support the proposed mandatory audit firm rotation and again the determination of different term lengths for different kinds of engagements will also be subjective. In our view, longer terms should be considered for large multinational companies due to the sharper learning curve the auditors will face and less viable rotation plans large companies will have.

*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?*

Response: Based on our experience, we do believe there is a "learning curve" in the early years of an engagement. Whenever there is key personnel change in the audit team, we, as a client, will need to spend more time explain background information and business processes of the company to the new comer even though they have access to previous years working paper and continuity from other team member. The inefficiencies caused by minor changes in an audit team are usually overcome within a year or two, but if it is a new audit firm, we believe the learning curve will be longer and sharper. Even though the predecessor auditors' working papers will help the new audit team to understand the interrelationships among processes and financial statement elements, the knowledge and insight gained over the years on the industry, the specific workings of the company and the personnel of the company is lost. It takes hundreds of hours on-site for new auditors to fully learn about the people employed by that new client and how they arrive at assumptions or make judgments. More

complex multi-national companies will take longer for an auditor to become effective. The time period to become effective can vary by global location, type of business and how disparate those business activities are. To make a global audit engagement run efficiently and effectively at a reasonable fee level that incorporates the Company's varied business and IT processes could easily take 5 or more years.

*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?*

Response: In our view, whether an auditor may be less diligent or more diligent toward the end of their term does not depend on the length of the term. However, under the environment of mandatory rotation, we believe audit firms may become distracted as they approach the end of their tenure as the auditors chase the soon to be available audit clients coming off rotation.

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

Response: As we stated in our letter and answers to question #1 and #2, we do not support the proposed mandatory audit firm rotation. We believe it is the Audit Committee's responsibility to determine if and when a rotation of an audit firm is required to best meet the needs of the shareholders' interests. By regulating the required time before a rotated firm could return to an engagement, we believe the Board would be further restricting the oversight of independent audit committee.

*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?*

Response: Again, as we stated earlier in this letter, we do not support the proposed mandatory audit firm rotation for a number of reasons. However, should the Board decide to move forward, then mandatory rotation should apply to all issuers, as there could be no fair or equitable option to identify specific industries or sizes of the issuers.

*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?*

Response: As we stated in our letter, we believe the rotation requirement will restrict a large company's choice of auditor. Due to the global presence, size, and complexity of large



companies as well as the financial risk and cost of insurance of audits, most large companies are usually only served by the Big Four international public accounting firms. And under the restrictions on non-audit services under Sarbanes-Oxley (SOX), most large companies already receive one service or another from every one of the four firms. If one of these Big Four accounting firms audits the Company, the other three often provide a host of advisory services in tax, M&A, valuations, etc. The pre-existing relationships of most large companies with all Big Four audit firms make it difficult to have a viable mandatory rotation plan. Pre-existing relationships would likely result in limiting the number of firms allowed to bid for an audit. And disruption of non-audit services in order to rotate an audit firm could limit the ability of a company to select best in class non-audit services.

*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?*

Response: We believe it is very difficult and impractical for large companies to design viable plans to allow sufficient time to transit out of non-audit service arrangements because the timing of other critical business transactions such as M&A, spin-offs, establishment of new joint ventures and set up of new manufacturing facilities all have their own time constraints and restrictions, which might not work out with the timing of rotation requirement. Having mandatory audit rotations and related non-audit services drive business transactions or the timing of business transactions would not be in the best interest of shareholders.

*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?*

Response: We believe there could also be issues in certain markets where one firm or one large company has a dominant presence. In these instances, if companies switch audit firms, the new audit firm may need to hire staff below the partner level from the previous audit firm in order to properly staff the engagement as it is unrealistic that the new firm can relocate 50-100 staff from another geographic location. The movement of staff below the partner level between audit firms and related clients in the same geographic area will defeat the Board's goal of true rotation of firms and related teams.

*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?*

Response: Yes, we believe mandatory rotation requirement will create unique challenges for large multinational companies due to the limitation of choice of auditors and the additional cost incurred by the sharper learning curve due to its complex business model. Please refer to our answer to question # 3, #7 and #8.



*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?*

Response: As stated in our letter, we believe under the environment of mandatory rotation, audit quality might deteriorate toward the end of the term since the firm will need to focus their attention on competing for their next clients. And the frequent re-allocation of resources caused by mandatory rotation will also pose a burden on audit firms' operations. We believe the increased frequency of auditor changes will pose more implementation challenges to smaller firms due to their smaller resource pool.

*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?*

No comment.

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

Response: Limiting the market for non-audit services due to mandatory rotation will adversely impact companies and their ability to hire and maintain long standing non-audit services from Big Four audit firms.

*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?*

No comment.

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

Response: We believe a rotation requirement will not increase the competition for audit engagements. The current environment without a rotation requirement is already highly competitive. The Sarbanes-Oxley Act of 2002 assigned the Independent Audit Committee the responsibility of the appointment, compensation and oversight of the work of the auditors. Auditors compete for re-appointment by the audit committees of their clients every year by providing high quality audit work, because they know they can be replaced if the audit committee deems that the replacement is in the best interest of the shareholders. A rotation requirement would not increase competition; it would merely remove the responsibility from the audit committee by skipping the analyzing process.

*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?*

Response: As stated in our letter, we believe the rotation requirement itself poses risks including potentially decreasing the overall audit quality, increasing cost and disrupting non-audit services. And we also believe that the significant reforms under the Sarbanes-Oxley Act of 2002 are designed to enhance audit independence and to improve audit quality.

*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?*

Response: As stated above, a big part of the learning curve in the initial years of an audit relate to the auditors' gaining understanding of the company's operations, processes and controls, applicable IT systems, accounting and financial reporting practices and learning about how the company arrives at assumptions and makes judgments. We do not believe this sort of knowledge and insight can be gained through additional requirements and procedures.

We believe the audit firms are fully aware of the higher audit risk for new engagements and that this higher risk is addressed by the audit firms with more hours and more review in the initial years to ensure audit quality. Most audit firms today absorb the transition cost in order to secure a new client, but if mandatory rotation is enacted, the transition costs would mostly surely be absorbed by the companies.

*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?*

Response: We do not support a mandatory rotation for reasons stated in our letter and some answers above. We believe it is the Audit Committee's responsibility to determine if and when a rotation of an audit firm is required to best meet the needs of the shareholders' interests. Mandatory rotation and any proposed additional requirements will pose more cost burden and resource burden on both the companies and the audit firms.

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

Response: Please refer to our answer to question #18.

*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?*

Response: Please refer to our answer to question #18.

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

Response: Please refer to our answer to question #18.