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United States Government Accountability Office
Washington, DC 20548

December 14, 2011

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

Subject: PCAOB Rulemaking Docket Matter 037: PCAOB Release No. 2011-006:
Concept Release on Auditor Independence and Audit Firm Rotation

This letter provides the U.S. Government Accountability Office's (GAO) comments on the Public Company Accounting Oversight Board's (PCAOB) Concept Release to solicit public comment on ways that auditor independence, objectivity and professional skepticism could be enhanced.

We support the general premise of enhancing auditor objectivity and skepticism, and commend the PCAOB for seeking ways to strengthen auditor independence and improve audit quality. However, we are not convinced that the audit quality issues identified by the PCAOB in its Concept Release are caused by a lack of auditor independence or professional objectivity. The PCAOB's Concept Release identifies serious audit deficiencies that it has found during its inspections, but does not provide compelling evidence that the root cause of the audit quality issues is related to a break down in auditor independence. In fact, the PCAOB acknowledges in its Concept Release that the root causes of audit deficiencies are complex, vary in nature, and that audit deficiencies may not have necessarily resulted from a lack of objectivity or professional skepticism.

Even if the PCAOB could clearly establish that a lack of independence or objectivity is causing audit quality problems, it is unclear that such a problem would be prevented or mitigated by a mandatory audit firm rotation requirement. Finally, if based on the

audit deficiency data and inspection results, the PCAOB is able to establish the above links, then additional analysis would be needed to evaluate the impact and the costs and benefits of a mandatory audit firm rotation policy, and whether other alternatives exist that would address the issues.

GAO's study of mandatory firm rotation raised concerns that a requirement for mandatory audit firm rotation may not be the most efficient or effective way to enhance auditor independence and audit quality, and could actually place a strain on audit quality in the initial years of an auditor's tenure due to the new auditor's lack of specific knowledge of the client's operations, systems, and controls. In that report, we also concluded that a mandatory firm rotation requirement would likely increase audit fees and client costs and may decrease the number of audit firms willing and able to perform audit services given the Sarbanes-Oxley Act auditor independence requirements concerning prohibited non-audit services.

As a result of the additional information needed before serious consideration could be given to a requirement for mandatory audit firm rotation, we believe it is critical that the PCAOB further study audit quality issues to determine the root causes of the deficiencies, and propose a range of solutions that specifically address identified causes of audit deficiencies, along with additional analysis of costs and benefits of various alternative solutions.

A further study of audit quality issues by the PCAOB may point to the need to strengthen existing standards, such as those relating to evaluating management's representations, evaluating significant management judgments and estimates, and preparing audit documentation, as a means to improve audit quality. For example, as part of the Board's planned review of the fair value standard, the Board may need to clarify audit requirements related to auditor's consideration of alternative assumptions or outcomes, whether management has appropriately considered them, and whether it is reasonable to exclude them. Further, the Board should consider clarifying documentation requirements and guidance related to the auditor's considerations and

conclusions in audit areas that require more auditor judgment. More extensive documentation requirements will drive improvements in the sufficiency of evidence obtained and facilitate more effective supervisory review of the auditor's work and conclusions.

The PCAOB should also consider sharing data on audit deficiencies it has identified through its inspection process, in a format that is not identifiable to a specific audit firm, so that others can also study the causes of those audit deficiencies. Once the root cause of poor audit quality is determined, we would be in a better position to comment on whether mandatory audit firm rotation is a potential solution or whether there is a more viable solution to addressing audit quality issues.

We thank you for considering our comments on this important issue as the PCAOB considers ways to enhance auditor independence, objectivity and professional skepticism.

Sincerely yours,

A handwritten signature in black ink, appearing to read "James R. Dalkin". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

James R. Dalkin
Director
Financial Management and Assurance