

W. Ron Hinson  
Senior Vice-President,  
Corporate Comptroller and  
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December 14, 2011

Mr. J. Gordon Seymour  
Secretary  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, D.C. 20006-2803

**PCAOB Rulemaking Docket Matter No. 37  
Concept Release on Audit Independence and Audit Firm Rotation**

Dear Mr. Seymour:

Southern Company is a leading U.S. producer of electricity, and owns electric utilities in four states, a growing competitive generation company, as well as fiber optics and wireless communications. Southern Company has 4.4 million customers and more than 42,000 megawatts of generating capacity and a grid of transmission and distribution lines. Based in Atlanta, Georgia, Southern Company is one of the largest generators of electricity in the nation, serving both regulated and competitive markets across the southeastern United States.

Southern Company provides retail electric service as regulated by the public service commissions in the states it serves and by federal energy agencies. Public service commissions determine fair electric rates, oversee what investment costs can be recovered (e.g., environmental controls or plant construction), and determine the return on equity utilities can recover in retail markets. Southern Company also sells power in the wholesale market and transmits wholesale power for other providers. A FORTUNE 500 company, Southern Company had revenues of \$17.5 billion in 2010.

We appreciate the opportunity to submit comments to the Public Company Accounting Oversight Board (PCAOB or the Board) on its concept release regarding auditor independence and audit firm rotation (Concept Release).

**Summary**

We would like to begin by stressing to the Board that we believe the enhancements to the auditor independence requirements and the function of the audit committee required under Sarbanes-Oxley significantly improved the audit process and have resulted in higher quality audits. While the Board has found instances of what it deems "audit failures," we believe that, without these enhancements, we would have seen a greater number of financial reporting failures along the lines of Enron and WorldCom. While we acknowledge that further improvements can be made to ensure "that auditors approach the audit with the required independence, objectivity and professional skepticism," we

believe that the Board must carefully weigh any expected benefits in light of the substantial costs that may be required.

## Concerns

**Identification of root causes.** In reading the Concept Release, we were most concerned with the Board's admission that it needs to "deepen its understanding of root causes" for findings the Board has deemed audit failures in its inspections. It seems counterintuitive to us to attempt to address an issue without some basis for believing that the proposed solution (in this case, auditor rotation) would significantly reduce the number of audit failures. Given the potential costs to the shareholders of U.S. public companies from mandatory auditor rotation, we believe that the Board should first perform further research to determine **why** auditors failed to apply the appropriate level of skepticism and objectivity noted in the Board's review of audits. Only when armed with the most complete information possible can the Board and the audit profession hope to address the root causes of the issue.

To echo comments that the Board has already received on the Concept Release, we are convinced that mandatory auditor rotation would result in significantly higher audit costs for public companies and their shareholders. These increased costs would be a direct result of the amount of time and effort it would require for a successor auditor to obtain an adequate understanding of a company's business and operations, as well as its financial reporting issues. The successor auditor would be required to spend a significant amount of time developing the firm's audit approach based on the company's business and the associated risks. Additional time (and costs) would be required on the part of both the successor auditor and the predecessor auditor related to inquiries of the predecessor auditor and the review of predecessor auditor workpapers. Beyond the increased audit costs, companies would undoubtedly incur additional costs in the auditor selection process as the audit committee performed the due diligence required to select a successor auditor.

Beyond the issue of cost, we believe that a periodic rotation of auditors would expose each company to the very risk that the Board is attempting to mitigate with its proposal: audit failure. We concur with the commonly held belief that the likelihood of an audit failure occurring would be significantly greater in the first few years of the successor auditor's engagement. Given the incredible complexity of today's companies and their operating environments, we believe that it would be extremely difficult for the successor auditor to gain a proper understanding of all of the issues facing a company and to adequately address those issues in its audit approach during the first year (and possibly even the second year) of auditing the company. While we acknowledge that this risk is present whenever there is a change in auditor, we question the logic in mandating over a thousand public companies to go through this process each year with an increased risk of an audit failure.

**Unintended Consequences.** Beyond these cost/benefit concerns, we believe there are several other unintended consequences of mandatory auditor rotation that the Board should consider.

- **Needless restatements** – We are concerned that a mandated change in auditors could potentially lead to the restatement of financial statements when there is little justification for doing so. Audit firms often have slight differences in the interpretation of GAAP in certain areas and the successor auditor may unreasonably demand that the company restate its financial statements for these differences, or for differences in professional judgment, when the restatement would be of little value to investors.
- **Auditor independence issues** – If Southern Company were to limit our selection of potential audit firms to the Big Four (as we would expect to be the case), we would be further limited in

our choice of auditors due to: i) independence concerns and ii) the current concentration of industry expertise. At the moment, we believe only one of the remaining three firms would be considered independent and thereby eligible to accept our engagement. While we could obviously take steps to terminate our existing relationships with the other firms in order for them to be considered independent in the future, we feel that excluding these firms from consideration for future non-attest engagements for which they may be the best qualified is illogical and counterproductive. Beyond the issue of independence, we believe that only one or two of the other Big Four firms even has the depth of knowledge and expertise of the utility industry to effectively audit Southern Company and its registrant subsidiaries.

### **Suggested alternative**

Rather than requiring mandatory auditor rotation for all companies, we believe that any requirement for auditor rotation should be limited to actual audit failures where the Board could consider requiring a change in auditors as a remedy for a lack of independence on the part of the auditor and possibly the failure of the audit committee to adequately perform its duties.

### **Conclusion**

In conclusion, we strongly oppose the mandatory rotation of auditors proposed by the Board. Rather than require mandatory auditor rotation, we believe that the Board should attempt to better understand the reasons for the audit failures that it has seen and work specifically to address those issues. In the meantime, we believe that the Board should continue to evaluate the effectiveness of changes under Sarbanes-Oxley, such as required partner rotations, which are just beginning to occur.

Sincerely,

A handwritten signature in black ink that reads "W. R. Hinson". The signature is written in a cursive, flowing style.

W. Ron Hinson  
Senior Vice President, Corporate Comptroller, and Chief Accounting Officer