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File Reference: PCAOB Rulemaking Docket Matter No. 37 – Concept Release on Auditor Independence and Audit Firm Rotation

Dear Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's ("PCAOB") Rulemaking Docket Matter No. 37 – Concept Release on Auditor Independence and Audit Firm Rotation. Equity Residential ("EQR") is a large accelerated filer with a market capitalization of approximately \$25.1 billion focused on the acquisition, development and management of high quality apartment properties in top U.S. growth markets. Equity Residential owns or has investments in 417 properties located in 15 states and the District of Columbia, consisting of 119,011 apartment units. While we support the continued efforts of the PCAOB to maintain and potentially enhance auditor independence, objectivity and professional skepticism, we do not support the proposal for mandatory audit firm rotation. Below, we respond to some of the Board's specific questions from the Concept Release.

Issue 1: Would audit firm rotation enhance auditor independence, objectivity and professional skepticism?

This question is based upon a premise that auditors lack sufficient independence, objectivity and professional skepticism. We find this a flawed premise while believing that certain provisions in the Sarbanes Oxley Act (the "Act"), including the establishment of the PCAOB, the prohibition of auditors providing non-audit services, the obligation of Audit Committees to hire and oversee auditors and mandatory audit partner rotation have enhanced the independence, objectivity and professional skepticism of auditors.

As mentioned in the Concept Release, the PCAOB has conducted hundreds of inspections of public accounting firms to gain insight into the state of the audit profession and the conduct of public company audits. It appears that these inspections have both improved the quality of audits and tasked public accounting firms with ensuring they are

promoting independence, objectivity and professional skepticism as these values are the cornerstones of their profession. Since the establishment of the Act, we have seen a decrease in the number of restatements as well as a focus on independence, objectivity and professional skepticism by auditors that is evidenced by a focus on hiring qualified personnel and extensive independence training at public accounting firms, a more stringent review process, including more frequent consultations with national practices on complex accounting issues, increased communication with Audit Committees as well as audit partners and their audits being subject to internal, peer and PCAOB reviews on a regular basis. In addition, companies are required to comply with expanded independence procedures, including director and officer certifications of independence with respect to both the company and the company's audit firm as well as continuous monitoring of new and/or existing business relationships involving key members of management, directors, officers or the company's auditors.

Although the Concept Release mentions continued audit failures, it appears that there is a lack of evidence supporting the connection between audit failures and audit firm tenure, which brings into question whether audit failures are truly driven by issues with independence, objectivity and professional skepticism required as part of each audit or rather by the complexity of the current accounting and auditing environments. In addition, the audits scrutinized by the PCAOB are not a representative sample from which to assess the general population of companies as they generally represent companies with higher risks due to complex accounting issues.

Issue 2: What are the disadvantages of mandatory audit firm rotation?

There are several disadvantages of mandatory audit firm rotation that support our opposition to the proposal and we outline them below.

- Audit quality would be diminished due to a new auditor's lack of familiarity with a company. It is important for auditors to have knowledge and understanding of a company, its business and its industry in order to exercise good judgment and professional skepticism as well as effectively deal with auditing and accounting issues. Given the complex business models and the complicated accounting issues that exist in the current environment, this knowledge is often gained over time and through experience. It can be extremely difficult to develop this knowledge appropriately in a short period of time. There is just no way to simply replace this institutional knowledge, which is critical for auditors to understand the risks and uncertainties faced by a company and then evaluate judgments and estimates inherent in the financial statements and footnote disclosures. The early years of a new audit are generally characterized by inefficiencies as the auditors spend additional, non-recurring time to get up to speed with the company, its risks and controls and its accounting issues. In addition, the potential for audit risk is increased during the period of time when the new auditor is developing its knowledge and understanding as the team may not be focused on the appropriate issues due to a lack of knowledge or understanding.

- Audit costs, both in money and time, would far outweigh the benefits. Studies have shown that a change in auditor generally results in an increase of approximately 20% to audit fees. This increase is primarily attributable to the additional time it takes a new auditor to overcome the learning curve associated with a new company and become comfortable with the key accounting and auditing areas; however, the increase may also include pass through costs related to the bidding or start-up processes. These potential pass through costs represent unnecessary additional costs to companies, especially during what is described in the Concept Release as a period of economic weakness and heightened global competition. Management will spend more time discussing with and educating new auditors on key accounting issues that may have previously been discussed and concluded on with predecessor auditors. In addition, both management and the Audit Committee will spend additional administrative time soliciting and reviewing bids, interviewing and selecting candidates and educating auditors, resulting in an unnecessary diversion from their primary responsibilities to the company. This could also result in audit firms spending additional time pursuing potential clients and less time on the audit, thus increasing audit risk and decreasing the quality of the audit.
- Limitations on the choice of an audit firm, especially in an environment where multiple firms can be and are engaged for a variety of audit and non-audit services, may result in hiring audit firms that are not qualified due to lack of expertise in specialized areas of accounting or lack of personnel to serve large public companies, ultimately increasing audit risk and decreasing the quality of the audit. Given that there are only four large public accounting firms with the qualifications and expertise necessary to serve the largest public companies, a viable rotation alternative does not exist when a company is using one firm for audit services and other firms for non-audit services. In the real estate industry, large public companies often engage one public accounting firm to perform audit services and other public accounting firm(s) to perform valuation and/or tax consulting services. This may result in only one or two firms being available to step in if rotation were required and the risk that neither of these firms have the appropriate real estate expertise necessary to perform a quality audit in many U.S. markets. The potential incorporation of IFRS into the U.S. Reporting System can only further exacerbate this issue as large public companies would likely engage another firm to aid in this process, leaving either one or no large public accounting firms available for potential rotation. Companies will have to spend additional administrative time tracking audit and non-audit services provided by each audit firm in order to ensure they are complying with mandatory audit firm rotation without violating independence rules. In addition, the independence gained from mandatory audit firm rotation is likely to be minimal given the small number of qualified audit firms available to large public companies.
- Disruption to the company's business activities could be significant. Companies may be required to untimely terminate an audit firm's engagement to provide non-audit services to ensure they are in compliance with independence rules before

engaging that same audit firm to provide audit services upon the current audit firm's rotation. This may be especially harmful to the business and can result in independence violations, especially if the rotation of the audit firm providing non-audit services or the audit firm providing audit services coincides with a significant transaction such as a merger or acquisition for which either or both firms are involved. In the real estate industry, acquisition transactions can be very complex, often taking several months and/or years to negotiate and often requiring consulting with executive members of the audit team and the respective firm's national practice. If a transaction of this type were to close shortly after the final year of an audit firm's tenure, the disruption to the company's business would be undeniably detrimental. The knowledge of the transaction, the conclusions on the accounting issues and the individuals involved with consulting on the transaction would be lost and the company would be required to spend a significant amount of time getting the new auditors up to speed and comfortable with the accounting for the transaction. In addition, there are immediate and significant reporting requirements necessary for the type of transaction described above that would be in danger of falling out of compliance if the new auditors could not get up to speed in a very timely manner. Mandatory audit rotation every five years would put companies in a position of needing consents from two firms, at a minimum, in two out of every five years whenever financial statements need to be re-issued for a registration statement or proxy. Further, in accordance with Accounting Standards Codification ("ASC") 205-20 Discontinued Operations, companies are required to retrospectively reclassify prior periods to report the results of properties disposed of or classified as held for sale in discontinued operations if financial statements are required in a registration or proxy statement or even where the filing incorporates by reference annual audited financial statements issued prior to the classification of the properties in discontinued operations. As the guidance currently stands for a company like Equity Residential, which owns 417 properties, even one property sale necessitates discontinued operations treatment. As soon as first quarter financial statements are on file and they treat even one current year property sale as a discontinued operation, restated audited financial statements for the prior three years must be filed to effectuate a new registration statement or proxy. Mandatory audit firm rotation every five years would put companies like Equity Residential in a position of needing re-audits, new opinions and consents performed by two firms in two out of every five years whenever financial statements need to be re-issued for a registration statement or proxy. In our opinion, this increased cost and time does not outweigh any benefits.

Issue 3: Are there alternatives to mandatory rotation that the Board should consider that would meaningfully enhance auditor independence, objectivity and professional skepticism?

While we believe that there are ways to continue to enhance the independence, objectivity and professional skepticism of auditors, we also believe that several

provisions within the Act meaningfully enhanced these cornerstones of the audit profession, which are outlined below.

- The establishment of the PCAOB has provided independent oversight of public accounting firms providing audit services. The oversight of the PCAOB has resulted in a significant improvement in the quality of audits. Audit firms have established extensive training to reinforce their workforce's focus on independence, objectivity and professional skepticism in all aspects of an audit. We believe auditors are very focused on independence regulations as well as their reputation and, as a result, often hold their personnel to more rigorous requirements. In addition, auditors have a very stringent review process, including more frequent consultations with national practices on complex accounting issues. The accounting issues on which our auditors are required to opine have become ever more complicated and have often required our auditors to spend additional time understanding and concluding. These judgments are not taken lightly and require extensive discussion before reaching agreement between all parties involved.
- Both the prohibition of providing certain non-audit services by public accounting firms providing audit services and mandatory audit partner rotation have served to improve the independence of audit firms. Given that companies are required to use different audit firms for both audit and certain non-audit services, this adds a significant degree of independence to the audit process as audit firms providing non-audit services such as valuation or tax consulting can be viewed as independent, qualified third parties on which the audit firms providing audit services can rely to conclude on accounting estimates or judgments. Mandatory audit partner rotation in addition to company and audit team turnover also add a significant degree of independence by providing a fresh opinion on complex accounting issues and a new relationship with company management. These changes are inherent in the normal course of business and serve to enhance independence by rotating individuals involved in the preparation, review and audit of company financial statements, footnote disclosures and supporting documentation.
- The Audit Committee has become more involved with the auditors as they have been charged with the responsibility to hire, oversee and compensate them. We believe the Audit Committee is best positioned to perform this audit oversight as the Audit Committee is a fully independent and capable body of individuals. We do not believe the PCAOB should take away responsibility from the Audit Committee as the Company, its shareholders and the auditors entrust the Audit Committee with making the retention decision and, if necessary, to ultimately change auditors. Our Audit Committee is very focused on auditor qualifications and independence. The auditors meet with our Audit Committee at least quarterly to discuss a wide range of topics beyond required audit communications, including disagreements with management, serious difficulties encountered in dealing with management when performing the audit, fraud and illegal acts,

significant deficiencies and material weaknesses and controversial or sensitive accounting matters. By limiting the Audit Committee's choice and influence, we are severely impairing its oversight responsibilities, which are clearly defined in the Audit Committee charter as follows:


- o The Committee shall have the sole authority to appoint or replace the independent auditors. The Committee shall be directly responsible for the compensation, retention, evaluation and oversight of the work of the independent auditors (including resolution of disagreements between management and the independent auditors regarding financial reporting) for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the Company. The independent auditors shall report directly to the Committee.

As mentioned above, we do believe there are other ways that the PCAOB could enhance auditor independence, objectivity and professional skepticism, including mandatory ethics training by all state CPA boards as part of annual continuing professional education ("CPE") requirements.


We do not believe that the Concept Release will enhance the independence, objectivity and professional skepticism of auditors for the reasons stated above and, as a result, we are strongly opposed to mandatory audit firm rotation.

We would be pleased to discuss our comments with the PCAOB at your convenience.

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