



December 14, 2011

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

**RE: Request for Public Comment - *Concept Release on Auditor Independence and Audit Firm Rotation*, PCAOB Rulemaking Docket No. 037**

Members of the Board,

BlackRock, Inc. ("BlackRock") appreciates the opportunity to comment on Public Company Accounting Oversight Board ("Board" or "PCAOB") *Concept Release on Auditor Independence and Audit Firm Rotation* dated August 16, 2011 ("Concept Release"). BlackRock is a global investment manager, overseeing \$3.35 trillion of assets under management at September 30, 2011. BlackRock and its subsidiaries manage approximately 3,500 investment vehicles, including registered investment companies, hedge funds, private equity funds, exchange-traded funds and collective investment trusts, in addition to separate accounts. Certain of BlackRock's wholly-owned subsidiaries operate as U.S. registered broker/dealers, U.K. registered life insurance companies, a U.S. federally-chartered trust bank and numerous investment advisory companies registered in jurisdictions throughout the world.

As an investment manager, BlackRock is in the position to provide commentary on the Concept Release from the perspectives of a) a corporate preparer, b) an investment fund preparer and c) a user (i.e., BlackRock's research analysts). As such, our comments take into account all three of these distinct perspectives.

**Overview**

We applaud the PCAOB's ongoing efforts to enhance auditor independence, objectivity and professional skepticism. As nearly a decade has passed since Congress passed the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act"), which included requirements that were designed to enhance auditor independence and objectivity, it is appropriate to consider whether additional enhancements would be beneficial. The Concept Release discusses mandatory auditor rotation and seeks feedback on other alternatives.

The Concept Release noted that the Board has analyzed several hundred cases that have been determined to be audit failures.<sup>1</sup> An audit failure is a failure to obtain reasonable assurance about whether financial statements are free of material misstatement. Lack of professional skepticism may be a factor in some of those failures. We encourage the Board to continue to understand the root causes of the cited audit failures from their inspection programs in order to provide further guidance to improve audit quality. We also encourage the Board to share as much

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<sup>1</sup> Concept Release, page 5

information as possible, on a no-name basis, with auditors and audit committees so that they may be better informed about how to enhance the audit process.

We do not support mandatory auditor rotation, principally because we are not aware of any empirical evidence that indicates that mandatory rotation would improve auditor independence and skepticism. While auditor rotation may theoretically reduce certain risks, it also is likely to create other risks, such as auditor loss of institutional knowledge and a reduced incentive for audit firms to invest in the audit relationship by relocating the most qualified personnel or investing in travel and training to learn the business. We believe it would be more appropriate to develop evidence on the causes of audit failures and to consider other measures such as a requirement for audit committees to adopt specific procedures with respect to auditor oversight, provision of non-audit services and the process around the annual renewal of the audit relationship. The PCAOB and the Securities and Exchange Commission (the “SEC”) also should explore other options, such as further restricting advisory services performed by audit firms, providing additional guidance for audit committees, and requiring registrants to disclose their policy with respect to periodic tendering of the audit and the date on which the most recent audit tender occurred.

We are concerned about the audit committee’s ability to select the most qualified audit firm given the limited number of audit firms able to serve large, global companies and because of SEC independence requirements which further exclude certain audit firms performing advisory services and audit firms which have other independence taints (e.g., former partners or employees of accounting firms who are in a “financial reporting oversight role” at a company). Any mandatory auditor rotation requirement would need to provide additional guidance on how registrants could address the transition to another audit firm given these independence matters. We also are concerned about the costs BlackRock, our sponsored investment companies (which, as noted above, total 3,500), and our corporate and fund shareholders and clients would bear related to auditor start-up time to learn our business, document controls and procedures, and relocate industry experts to build an audit team.

Certain aspects of the Concept Release bear further consideration and would further strengthen auditor independence and objectivity even while not requiring mandatory rotation. However, if mandatory rotation is required, given the limited number of public accounting firms that are able to serve multinational organizations, the complexity of global financial services organizations, and the complexities posed by auditor independence rules (especially for companies subject to the SEC’s Investment Company Complex independence requirements), we believe further steps will need to be taken, before mandatory rotation can be effected.

## **Term of Engagement**

The Sarbanes-Oxley Act included requirements to improve auditor objectivity, skepticism, and independence by mandating audit partner and staff rotation, establishing new responsibilities for the audit, and prohibiting certain non-audit services. Mandatory rotation of the audit partners and audit team achieves a benefit similar to firm rotation by limiting long-term personal relationships with clients and achieves the benefits of adding a ‘fresh set of eyes’ to enhance auditor independence, objectivity and professional skepticism.

The Board also requested input on whether an auditor's effectiveness on a particular engagement will vary based on tenure. As noted in a 1987 study of financial frauds<sup>2</sup>, a significant number of such cases involved companies that had recently changed their auditors. An auditor's effectiveness likely is lowest at the beginning of an audit relationship, because the auditor has not had time to learn all of the intricacies of the client's business and to tailor audit procedures to effectively address all audit risks. This learning curve may last for several years. Companies that operate in industries with specific reporting and accounting requirements (including industries with their own specialized industry accounting requirements) may have a longer learning curve. This risk may be mitigated for large audit firms, which presumably have in-house expertise, albeit perhaps not where the audit team is located. With respect to the end of an auditor's tenure, we have had auditor rotations at a corporate and investment fund level and have not experienced any deterioration in the quality of the audits performed toward the end of the term. The PCAOB preliminary analyses appear to show no correlation between auditor tenure and number of comments in PCAOB inspection reports.<sup>3</sup>

## **Scope of Potential Requirement**

If a mandatory rotation policy is adopted, it should apply to all issuer audits and not just for particular subsets, such as companies in certain industries. If adopted, the Board should implement a general rule and then issue exemptions to industries or issuers if there are rare and unique extenuating requirements. Those unique situations may involve the absence of capabilities in niche or specialized industries, or in specific geographic locations of material subsidiaries, where such expertise resides with only one or two audit firms. There also may be other extenuating circumstances, such as a pending or in-process business acquisition or disposition.

## **Transition and Implementation Considerations**

Since the initial divestiture of consulting services by three of the Big 4 public accounting firms, there has been a steady growth in the scope of non-audit services and in the absolute dollar value and percentage of revenues that such advisory services represent to all Big 4 firms. As a result, advisory services represent a growing component of the compensation potentially allocable to partners serving audit clients. Companies may be limited in their selection of a new audit firm if services performed for a company by the possible replacement firm are prohibited by existing independence rules. It is likely that some audit firms may decline the opportunity to tender for an audit and will elect to retain those non-audit services, which may be more profitable and subject to less oversight by regulatory agencies, including the PCAOB. This issue may be particularly pronounced for audit firms that provide recurring information systems, technology, project management, infrastructure-related advice, tax outsourcing, strategic planning or other similar advisory services. We further recommend that the SEC and PCAOB provide clear guidance to audit committees to consider the nature of services performed by their existing auditors to determine if the aggregate dollar amount and scope of services could provide possible conflicts or the appearance of lack of independence.

We recommend that the PCAOB and SEC further consider whether certain non-audit services, including bookkeeping, financial information systems design and implementation, appraisal or valuation services, or actuarial services may be performed by a company's independent auditor,

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<sup>2</sup> Concept Release, page 16, reference to 2002 congressional hearings testimony

<sup>3</sup> Concept Release, page 16

even when those services will not be subject to audit procedures during the client's financial statement audit. We also encourage the PCAOB and SEC to review the scope of other non-audit services performed by auditors to determine whether there are other non-audit related services that should be identified as a potential conflict and included in SEC Regulation S-X 210.2-01(c)(3), *Business Relationships*.

The SEC's far-reaching independence rules under Regulation S-X 210.2-01, *Qualifications of Accountants*, and 210.2-01(f)(14), *Investment Company Complex*, further expand the scope of potential independence conflicts with audit firms. For example, in BlackRock's case, an audit firm may be deemed to be not independent of BlackRock if a fund for which we serve as general partner (such as a private equity fund) controls a company for which that auditor performs prohibited services. This conflict arises because a general partner is assumed to control an advised fund, which in this case, in turn controls its investee. The audit firm performing the prohibited services at the fund's investee would not be independent of BlackRock, even though that auditor does not audit BlackRock or any of its subsidiaries or any of BlackRock's sponsored investment companies. As a result, rotation of auditors would be a complex process and would be limited by the number of audit firms that do not violate any of the independence rules. We support strengthening auditor independence requirements. However, we recommend the SEC review these requirements, including those requirements pursuant to the Investment Company Complex rules, in order to remove possible independence conflicts attributable to controlled investees of companies advised by a general partner, where such conflicts are both immaterial and remote.

As registered investment companies are overseen by independent boards of directors, and those funds must meet the Investment Company Complex independence requirements, auditors selected for our registered investment funds also must be independent of all corporate entities and of all non-registered funds. We also sponsor non-registered funds, which are overseen by other independent boards that may be subject to domestic independence requirements (e.g., rules prohibited by the AICPA in the United States or the Auditing Practices Board in the United Kingdom). Given BlackRock's sponsorship of 3,500 investment funds, our ability to rotate auditors involves multiple parties, including independent boards, which may need to reach agreement.

Our ability to select auditors is further limited by the need for specialized skills in a particular industry or location. For example, the investment company industry requires specialized knowledge for an effective audit. This expertise may be difficult to find in non-Big 4 audit firms and must be present in locations that correspond to our fund administration centers and service providers.

There may be a steep learning curve for new auditors on multinational companies. The larger and more complex an organization is, the more institutional knowledge is required to plan and perform an efficient and effective audit. An audit firm would need to invest significant time, especially in the early years of an engagement, to learn the organization over a relatively short period. Additionally, some statutory reports may have different reporting periods than the parent company, thereby complicating the transition and planning process. Also, different national regulations may require rotation at different maximum periods of time, which magnifies the complexity to manage auditor rotation. Mandatory rotation also may reduce the incentive for audit firms to make long-term investments and to relocate professionals with expertise to support a multinational client.

An audit firm subject to mandatory rotation would need to spend more marketing time and money in order to replenish audit work. The impact of mandatory rotation may be most severe at smaller firms, which do not have the critical mass and resources within a single office to absorb the loss of a large SEC registrant client, or to accommodate additional clients that invariably will not perfectly match the timing of departing clients or with the industry of the lost audit client. The strain on resources could force audit firms to unduly leverage their personnel, thereby potentially reducing audit quality, and to require significant relocations with the ebb and flow of clients. The uncertainty and ultimate client dislocations could make public accounting a less attractive career, although it also could provide additional breadth by exposing professionals to a broader set of clients and experiences.

Rotation would increase the importance of non-audit revenue, as a rotation requirement would reduce the predictability of audit fees. Some audit personnel likely would be retrained or reassigned to perform advisory services, perhaps before the end of the existing audit relationship. Prior to rotation, audit personnel would have an incentive to sell advisory services to audit clients in order to ensure ongoing revenues after mandatory rotation. However, most audit firms have internal quality control standards to ensure that such services meet independence standards.

We doubt that mandatory rotation would significantly affect incidents of opinion shopping. Professional standards currently exist to discourage opinion shopping. The ability to select an audit firm based on agreement with particular accounting policies exists currently and institution of mandatory rotation would not change that situation. Furthermore, a change in accounting policy, if material, would require communication to the firm's audit committee and likely would be subject to further scrutiny. Nonetheless, we agree that auditors would be more hesitant to offer their blessing to questionable accounting policies if they know such policies would be evaluated by another auditor at a later date.

The early years of an audit relationship generally involve a higher degree of learning than audits conducted in later years, due to the time it takes to understand a new audit client, their business, accounting practices and control infrastructure. Most audit firms have well developed new client transition plans that ensure adequate planning and audit coverage. However, it may be more difficult to focus on a particular new audit client if audit firms are dealing with multiple client changes each year, requiring continuous new client planning efforts. The additional resources needed could be expected to add audit cost, require a longer lead time to learn about the new client, and make the audit relationship more susceptible to "fire drills" caused by late discovery of accounting and disclosure issues. These factors could be particularly troublesome for audit clients served by smaller audit firm offices where new clients may require initial hiring and training of personnel and transfers from other domestic and foreign locations.

### **Alternatives to improve auditor objectivity, professional skepticism and independence**

We encourage the Board to study alternatives to improve auditor objectivity, independence and skepticism to address its concerns. Any study the PCAOB undertakes should build upon the requirements of the Sarbanes-Oxley Act and be made after extensive factual analysis. The PCAOB could analyze the results of inspections to identify whether there are any enhancements to the inspection process that could be made to better address the Board's concerns. As noted above, the Board also could explore means by which the audit committee could be better informed of the results of PCAOB inspection findings, as appropriate. Of course, all recommendations should first consider the integrity of the audit process, which must be designed to enable transparency for users of financial statements and ensure the objectivity of the audit

process, but also must consider the practicality of implementation and the cost to preparers. While not a solution by itself, we believe that required annual auditor training on independence, objectivity and professional skepticism should be important components of each state's ethics education requirement.

Given the complexity of many industries, such as depository institutions, insurance companies, investment companies, finance companies and public utilities, the Board should consider requiring auditing firms to designate one or more experts who would be required to consult on significant issues within that industry. This enhancement should be addressed currently, regardless of whether mandatory rotation is ultimately adopted.

The audit committee serves an important role in governance, ensuring auditor independence, overseeing audit services, and determining the compensation of the auditor. Additional guidance about how audit committees may meet those responsibilities would be useful. Overall, based on our experience as a corporate SEC registrant and a sponsor of SEC registered and unregistered investment companies, we are satisfied that the current audit and professional standards, quality control measures implemented as a result of the Sarbanes-Oxley Act, PCAOB inspections, and mandatory partner and staff rotation requirements result in high quality audits.

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We appreciate the opportunity to share our viewpoints on the possible revisions to the PCAOB standards related to reports on audited financial statements. As noted above, we applaud the Board's ongoing efforts to enhance auditor independence, objectivity and professional skepticism. While we do not support mandatory auditor rotation, certain aspects of the Concept Release bear further consideration, and certain measures we noted above may help achieve many of the same benefits as mandatory rotation.

If the Board has any questions regarding our comments, please contact Steven Buller at (212) 810-3501.

Sincerely,

Steven E. Buller  
Managing Director