April 12, 2012

Sent via e-mail: comments@pcaobus.org

Public Company Accounting Oversight Board
Attention: Office of the Secretary
1666 K Street, NW
Washington, DC 20006-2803

File Reference: PCAOB Rulemaking Docket No. 037—Concept Release on Auditor Independence and Audit Firm Rotation

Introduction

This letter is the joint contribution of an accountant and a philosopher. The accountant, Mark Cheffers (CPA, MBA, ABV), is the CEO and founder of Audit Analytics, an independent research service that provides, among other data, audit related market intelligence to the audit, regulatory, academic and corporate communities. The philosopher, Michael Pakaluk (AB, MLitt, PhD), is a professor at Ave Maria University, a widely published author, and an internationally recognized expert on ethics. Cheffers has an expertise in accounting malpractice and accounting professionalism, and has teamed up with Pakaluk to write three books in accounting ethics, two of which are widely used in university courses (*Understanding Accounting Ethics*, 2nd edn, and *Accounting Ethics*). Pakaluk has an expertise in accounting ethics and accounting professionalism, and, besides co-authoring the aforementioned books with Cheffers, has served as Senior Research Analyst and Public Policy Consultant for the Ives Group, the parent company of Audit Analytics.

Cheffers attended a remarkable roundtable event held by the PCAOB in Washington DC several weeks ago. Taking our start in part from issues raised at that roundtable, we wish to make two contributions to the debate about auditor rotation: (i) a factual contribution, based on recent data, and (ii) a conceptual contribution, based on the nature and history of the accounting profession.

(i) The factual contribution: The data show that the "fresh eyes" of a new auditor, after an auditor change, make only a marginal contribution to the identification of issues requiring a restatement; therefore, a scheme of mandatory auditor rotation could at best make only a marginal contribution to audit quality.

We append to this comment letter two reports that Audit Analytics has released during the past three months:

- The first report ("Research on the Russell 3000 Population") presents data associated with auditor tenure, audit committee engagement, and CFO tenure, as well data about improvements in financial reporting quality since the introduction of Sarbanes-Oxley. It contains numerous informative charts regarding numbers of restatements, adverse internal controls, audit fees, audit committee rotation, going-concern audit opinions, CFO rotation and class action lawsuits.

- The second report ("A Restatement Analysis of the Russell 1000 Companies") presents Audit Analytic's study of the relationship between auditor change and restatements in the entire pool of available data. It examines the question: Do the number and timing of restatements provide evidence that, when a company changes its auditor, the new auditor's "fresh eyes" identify issues which would not otherwise have been brought to light?

The first report is valuable as providing the backdrop and context for the second. The first report shows that restatements among Russell 3000 companies have varied markedly in number over the last seven years. More specifically, they have decreased dramatically, apparently as a result of reforms instituted by Sarbanes-Oxley, and the resulting increased scrutiny of internal controls (see Restatement Analyses on pages 7-10). This general decline in restatements and, presumably, the corresponding general increase in audit quality, has occurred notwithstanding the preference for companies and auditors to foster long-term relationships (see Auditor Tenure Analysis, page 1).

Two specific lessons may be derived from this data, by way of backdrop, relevant to the question of auditor rotation:

- If restatements are taken as an index of audit quality, then the large variation in numbers of restatements would suggest that, in comparison, any improvement achieved through the device of auditor rotation would be purely marginal. That is to say, the great preponderance of the variance in audit quality should obviously be attributed to other variables.
- It would seem that the reforms of Sarbanes-Oxley are working, including not least the role which Sarbanes-Oxley envisioned for the PCAOB in raising auditing standards and audit quality.

Against this backdrop, the second report ("A Restatement Analysis") provides data relevant to the question of whether the "fresh eyes" which come with a change in auditor lead to the identification of financial reporting issues which would otherwise not have come to light. The question may be studied by looking at companies which change auditors and which also restate financial data: What proportion of those restatements are attributable to the new auditors – as opposed to the old auditors, the company's CFO or audit committee, or (as in some cases) the SEC itself? As the report indicates (see especially page 2), it turns out that only a small percentage, about 5.7%, of such restatements are attributable to the "fresh eyes" of the new auditor. However, this marginal gain in auditing quality comes at a cost, because an even larger percentage, about 13.2%, of such restatements take place *after* the change in auditor, for reporting periods that fall entirely within the engagement of the new auditor, and which therefore seem to be the result of the new auditor's lack of familiarity with the company's business.

The second report, then, provides data in support of the following conclusions:

- Among various procedures and mechanisms for identifying financial reporting issues that require a restatement, the "fresh eyes" of a new auditor make only a slight, marginal contribution.
- The contribution to audit quality made by the "fresh eyes" of a new auditor is more than offset by a decline in audit quality, as indicated by the number of restatements following a change in auditor.

Note that these conclusions clearly *would* apply equally to a regime of mandatory auditor changes at fixed periods.[1] To see why, consider the following. Take whatever improvements in audit quality you wish, which are hypothesized to be the likely result of a system of foreseen auditor rotation: for example, let us assume that, under such a scheme, the current auditor would maintain higher audit standards, because it would foresee that its work will be reviewed by another firm after its fixed term comes to an end; or suppose that the current auditor would maintain higher audit standards, because it would be less affected by management's threats of termination (since, after all, its tenure as auditor is limited and relatively short); and so on. Now, obviously, in a system in which there is no anticipated auditor rotation (such as the current system), these effects will not be operative. Hence audit quality will be lower. But this lower quality, to the extent that it exists, will result in deficiencies in financial reporting, and these deficiencies will be identified, surely, by the "fresh eyes" of the new auditor, after a change in auditor (for whatever reason the change took place). Thus, if the deficiencies identified now by the "fresh eyes" of the new auditor are marginal, then the hypothesized effects of anticipated, fixed auditor rotation must also be marginal.

That is to say: one can rely on the restatements attributable to the "fresh eyes" of a new auditor *now*, to provide a measure of the *maximum expected improvement in audit quality* which would result from a scheme of auditor rotation. But it turns out that the "fresh eyes" of a new auditor make only a marginal contribution to the identification of issues requiring a restatement. Therefore, the improvement in audit quality which would result from a scheme of auditor rotation would be marginal at best.

Given that auditor rotation can carry with it considerable expense, the data of the attached reports therefore support the view that any marginal improvements in audit quality which auditor rotation might bring will be offset both by higher costs and by a significant, albeit temporary, deterioration in audit quality in the years immediately following an auditor change.

(ii) The conceptual contribution: The proposed scheme of mandatory auditor rotation should be evaluated, not with respect to its effect on the auditor's "independence," but rather with respect to its effect on the auditor's professionalism, and, when evaluated in that way, mandatory auditor rotation appears to be either irrelevant or detrimental.

It seems that each profession has its particular challenge, that is, some special temptation or threat, which it in particular needs to deal with, to preserve its nature as a profession. A physician, for example,

[1] Contrary to what the PCAOB concept release suggests: "It is difficult, however, to extrapolate to an environment in which the engagement term would be fixed and assumed by the auditor and client from the outset of every engagement," (2011-006, page 16). The results we report may indeed be extrapolated, for the reasons given.

must constantly fight against being put in the role of a glorified plumber, and becoming a mere technician, who does the bidding of some supervisory agency, such as an insurer or HMO, rather than being free to pursue what accords with his best professional judgment, consistently with the ideals of that profession. A lawyer, one may presume, must be on constant guard against becoming essentially someone's glorified legal attack dog, whose goal is simply to prevail in legal contests, whatever the means. In a similar way, the accountant's perennial and specific task is to maintain the distinction between profession and business: accountancy is indeed a profession, but it has always had to ward off the temptation toward becoming a business.

That is why the first members of the fledgling accounting professions were asked to affirm their allegiance, not to a "Code of Ethics", but rather to "Rules of Professional Conduct", which were, precisely, rules which established in broad outline how an accountant, as a professional, must act differently from those who are engaged in a business enterprise. Since that time, all of the serious attacks on the integrity of accountancy have been threats which tended to convert the profession into a business. So, for example, in his foundational 1934 book on accounting ethics, *The Ethics of a Profession*, A. P. Richardson wrote the following, referring to an early threat of this type:

> The profitable nature of the practice of accountancy, especially during the Great War and its aftermath, attracted many people poorly qualified, and there was a deal of so-call accountancy which was really nothing but a trade – and some of it execrably done. The profession was *threatened with extinction* because of the purely financial ambitions of some of its members. They even denied that it was a profession at all and toiled night and day to convert it into a matter of business" (pp 150-1, emphasis added).

Closer to our own time, in the years leading up to Enron and WorldCom, the accounting profession was close to remaking itself as a business enterprises, as for example through the "partnership purge" at Andersen and other firms, the growing emphasis placed upon consulting and non-attest services, and even the proposed "ABC" credential, which, according to its proponents, was going to supplant the "CPA" designation. During that period, audit firms, led by certain prominent members in the profession, were promoting the idea of accountants becoming business advisors first and auditors second. The phrase "outstanding client service", became synonymous with all kinds of services being provided to clients, the audit being just one among many. The Enron and WorldCom debacles should be viewed as an unsurprising consequence of such trends.

Although "independence" is sometimes described as the bedrock foundational concept of accounting ethics, it is not. The foundational concept is, rather, professionalism, from which a certain independence follows as a natural consequence. Historically, the most important meaning of "independent" for purposes of the auditing of financial statements of public companies has been "member of the independent profession of accounting", which has meant on the one hand, negatively, "not an employee of the audited company," and, on the other hand, positively, "trained according to the scientific standards and the profession, and professing the ideals of that profession, so as to strive after, and to be capable of attaining to, the truth about a company's financial position and results of operations." [2] This core sense of independence may be deemed "professional independence," because it is the result of the professionalism of an accountant. It is the independence of a knowledgeable and experienced practitioner, who aims to formulate true judgments about the financial position and results of operations of an enterprise.

In contrast with this, we may identify a second notion of independence, which is the following: a professional is independent if the exercise of his or her professional judgment makes no difference financially to the professional, that is, if it implies, either directly or indirectly, no degree of improvement or diminution in his financial position, in any respect. Call this second notion of independence, "independence as financial indifference" or simply "financial indifference."

What is the relationship between these two notions of independence? The first and most important thing to note, is that "professional independence" does not require "financial indifference." Of course someone trained to think and act like a professional can succeed in making sound professional judgments, even if there are financial implications to these judgments. We take it for granted that fire fighters and police officers will carry out their professional responsibilities, even when faced with death and therefore a complete financial loss. We expect on good grounds that physicians will typically act in the true medical interests of their patients, even when financial incentives might lead in a different direction. The point is that the altruism required of a professional is attainable and has been satisfactorily attained in many professions. Professionals who act altruistically carry out what their profession requires even when this implies a loss of comfort, loss of sleep, loss of safety or even a loss of life; obviously, then, it is possible for professionals to act altruistically when what is implied is only a loss of money.

Second, "independence as financial indifference", even if it were attainable, would not suffice to secure professional independence. Actually, such indifference cannot be attained, short of paying accountants out of endowed blind trusts and, like Supreme Court Justices, giving them lifelong tenure. If, in the Securities Acts, Congress had decided to require that public company reporting be audited by government auditors, those auditors, while still being exposed to financial inducements, since they would be receiving salaries, would have been exposed additionally to political influences and pressures. Indeed, when in *US v Arthur Young* the Supreme Court writes, "This 'public watchdog' function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust," the "total independence" to which the Court is referring, clearly, is not financial indifference, since, after all, the Court is aware that the auditor is receiving a fee from the company for its auditing services.

This is not to say that financial indifference is unimportant, but rather that it is secondary and, as the founders of modern accounting believed, pertains more to what is called "the appearance of

[2] See Appendix A of the PCAOB concept release (2011-006), in which it is clear that for the purposes of the Securities Acts, these negative and positive notes were combined, and the phrase "independent accountant" meant a trained and licensed professional, not in the employ of the audited company. For more on this central concept of independence, see Pakaluk and Cheffers, *Accounting Ethics* (Sutton, MA: Allen David Press, 2011), Part III, "The Meaning of Accounting Professionalism."

independence" rather than to independence itself, which is a professional attitude of objectivity and state of mind: even if a professional's judgment in fact is not swayed or distorted by some financial ramification or interest, it will "look" as if that judgment is less liable to be affected, to the extent that any financial ramifications of, and interests related to, the decision are minimized. The notion of "independence as financial indifference" has come to assume a greater importance than is warranted, to the neglect of the more fundamental notion of "professional independence," only as a result of the Securities Acts, and the SEC's interpretation of those acts—because financial indifference is easier to operationalize by regulatory authorities, and that notion serves as a clearer basis for enforcement actions.[3]

We therefore urge that the question of auditor rotation be examined primarily in relation to "professional independence" and not "independence of financial indifference."

Mandatory auditor rotation seems to contribute to financial indifference: it reduces the threat, coming from management, of "You're fired!," by saying, in effect, as coming from the regulator, "You're all fired!" (after ten years). To that extent it might make a contribution to the *appearance* of independence of an auditor. Also, by making firms in effect fungible, and companies fungible (each year, some company out of a pool of companies will hire some auditor out of a pool of auditors), it seems to reduce the importance of *this particular fee* paid by *this particular company* to *this particular auditor*. But what is its effect on professional independence?

Actually, we wonder whether auditor rotation will indeed contribute to financial indifference. Management can still threaten *not to rehire*, in a later cycle. Also, in a system in which all engagements are ten years, then the loss of a few years of an engagement will assume a greater importance, and certainly the audit team if not the firm might find the threat of the premature loss of a client to be serious indeed. Moreover, since all systems can be gamed, management might come to see that (say) a three-times stronger threat then, to terminate a ten-year engagement, has the same threat-force as one-third weaker threat now, to terminate what might be expected to be a 30-year tenure. And as regards the greater fungibility of firms and companies which will result, if every ten years a firm, which is a member of a pool, needs to find a replacement client out of a pool of companies, will not firms become incentivized to make even more exaggerated promises of "exceptional client service" (see the concerns expressed in the PCAOB concept release 2011-006, page 7)?

On the other hand, we believe that mandatory auditor rotation would have either no effect, or a detrimental effect, on the more important reality of professional independence.

The reason for thinking it would have no effect, is that mandatory auditor rotation is aimed to address a perceived problem in "independence as financial indifference"; it does nothing to address obvious and serious problems in accounting professionalism.

The reasons for thinking that mandatory auditor rotation might have a detrimental effect, are the following:

[3] Again, see Pakaluk and Cheffers, *Accounting Ethics*, Part III.

- The proposal of mandatory auditor rotation rests on the presupposition that auditors cannot succeed in acting as professionals over time, that is, that they will either tend to exploit long term relationships of client service in order to increase their wealth, or that they will tend to be coerced by clients into departing from their professional judgment. However, any scheme which rests on that sort of presupposition about human behavior is likely to foster it, either in the manner of a self-fulfilling prophecy, or through what economists call the "crowding out" of a better sort of motive by a worse.[4]
- Through undermining the knowledge that a firm can acquire about the complex business of a client over time, mandatory auditor rotation weakens the competence on which professional independence rests, and therefore it weakens the security and independence of the auditor's judgment, as a professional. Immediately after a change in auditors, the new auditors must rely more on management's representations and are less able reliably to exercise independent professional judgment.
- The greater fungibility of firms and companies under a system of mandatory auditor rotation implies a greater impersonality of professional service; but all professionalism is personal; hence mandatory rotation will tend to erode professionalism. Since rotation among auditors is mandatory, in a scheme of auditor rotation, companies do not engage "this particular auditor" so much as one of a pool of auditors. It is as if the entire pool of auditors (or the pool of big four or six auditors) becomes over time the auditor of the company, rather than one particular firm. The system would therefore weaken the element of personal service which is essential to the notion of a profession. (The fact that even vast firms still identify themselves by personal names, such as "Ernst" or "Coopers," testifies to the historic importance of a personal relationship in professional service. The earliest Rules of Professional Conduct for accountants forbade accountants from practicing in the form of a corporation, precisely because it was thought that a customer of a corporation need not form a bond with a particular individual professional: accountants, as professionals, were obliged to practice together in partnerships.)

Conclusion

In sum, the two chief arguments in favor of mandatory auditor rotation are that it would (i) increase the quality of audits and (ii) increase the independence of the auditor. As regards (i), we have presented empirical evidence which indicates that it would produce at best only a marginal improvement in audit quality, at great cost, while also undermining audit quality in some respects. As regards (ii) we have presented conceptual and historical considerations for the conclusion that mandatory auditor rotation would make no contribution to, and potentially have a detrimental effect upon, the kind of auditor independence which truly matters, while possibly not even contributing to a secondary and derivative type of independence.

[4] See Cheffers and Pakaluk, *Understanding Accounting Ethics*, 2nd edn, chapter 1, "Introduction."

The Board's express concern that, in its inspections, it is continuing to discover issues in audit quality (see PCAOB concept release 2011-006, pages 5-7) is not an argument for instituting a scheme like auditor rotation, but rather robust evidence that the Board is fulfilling its role precisely as envisioned by Sarbanes-Oxley. We urge the Board to turn its attention instead to the pressing problem of how best to strengthen accountancy as a profession: How can professionalism best be encouraged, strengthened, and enhanced among accountants?

We appreciate the opportunity to comment on this issue. If you have any further questions, please do not hesitate to get in touch with Mark Cheffers (508-476-7007, mcheffers@ivesinc.com) or Michael Pakaluk (617-710-2757, mpakaluk@gmail.com).

Sincerely,

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Professor and Chairman of Philosophy, Ave Maria University

Appendices:
"Auditor Tenure, Financial Officer Turnover, and Financial Reporting Trends - Research on the Russell 3000 Population"
"A Restatement Analysis of the Russell 1000 Companies"

AUDIT ANALYTICS®

December 2011

AUDITOR TENURE, FINANCIAL OFFICER TURNOVER, AND FINANCIAL REPORTING TRENDS

RESEARCH ON THE RUSSELL 3000 POPULATION

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Introduction from the CEO of Audit Analytics

Why Audit Analytics?

Since we first launched the Audit Analytics service in September of 2003, we have been asked and challenged to bring context to a very public discussion on auditor market intelligence, the effects of Sarbanes-Oxley and the overall quality and reliability of public company financial reporting. It is important to note that we are an independent boutique research firm and our subscribers include leading accounting firms, premier public companies, law firms, regulators, investment banks and numerous major universities – all with an interest in understanding the effects of new regulations and public policy on the quality of financial reporting.

The following analysis, completely quantitative in nature, provides a fascinating glimpse into what has actually happened since the implementation of Sarbanes-Oxley and during the great financial crisis of 2008 through the passing of the Dodd-Frank Act and initial implementation. I am sure that you will find the data interesting.

We are making this report available to the attendees of the 2011 annual AICPA Conference on SEC and PCAOB developments and welcome any feedback or questions that you may have. We welcome the use of this analysis in your public or audit committee presentations and if you would like us to comment further, customize or provide some of the underlying data from this analysis, please give us a call.

Sincerely,

Mark Cheffers

Mark Cheffers

CEO, Audit Analytics

Auditor Tenure, Financial Officer Turnover, and Financial Reporting Trends

Research on the Russell 3000 Population

Tables

Page

Auditor Tenure 1

Audit Fees based on Tenure 2

Non-Audit Fees based on Tenure 3

CFO Departures 4

Audit Committee Chair Engagements 5

Audit Committee Engagements 6

Total Restatements per Year 7

Average Restatement Period per Year 8

Average Number of Issues per Restatement 9

Annual Restatements per Year 10

Average Annual Restatement Period per Year 11

Average Number of Issues per Annual Restatement 12

SOX 404 Disclosures 13

SOX 302 Disclosures 14

Going Concerns 15

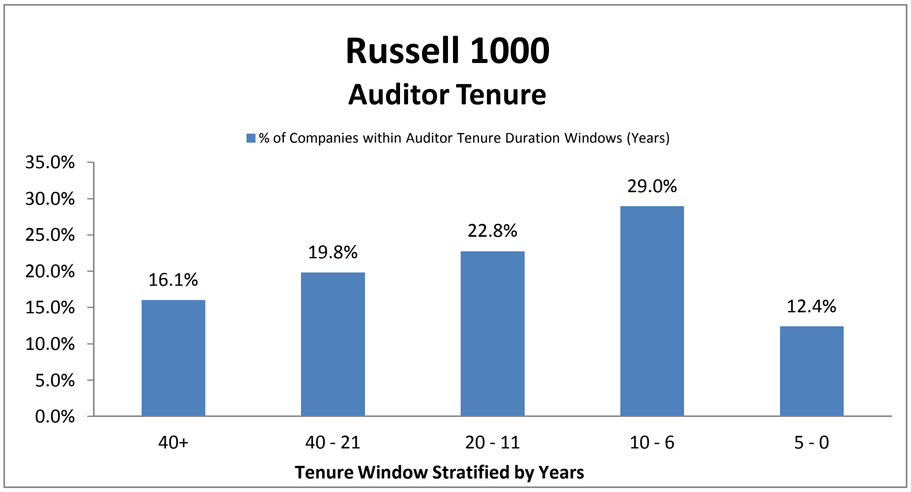
Disclosure of Late Filings 16

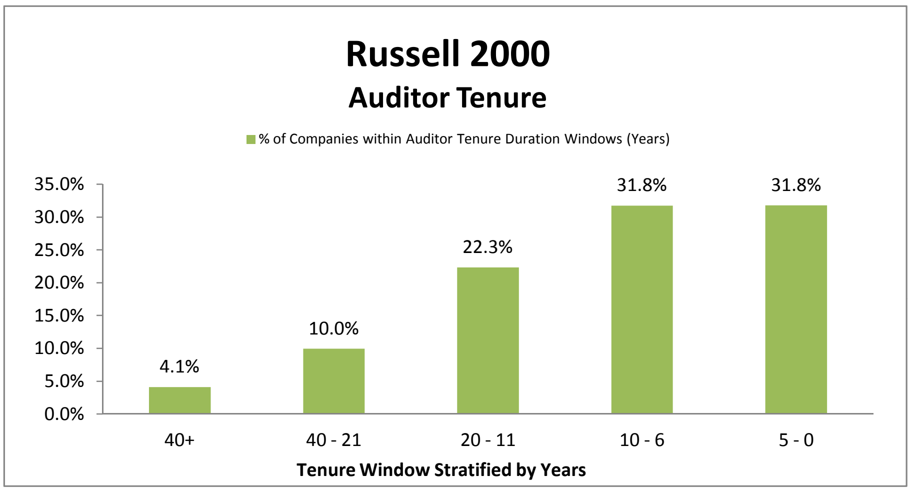
Federal Security Class Action Cases 17

SEC Comment Letters 18

Overview: Audit Analytics 19

Auditor Tenure Analysis of the Russell 3000 Companies





Tenure Stratification By Years	Auditor Engagement Window	Russell 1000		Russell 2000	
		Company Count	% of Total Companies (984 Total)	Company Count	% of Total Companies (1987 Total)
40+	1970 +	158	16.1%	82	4.1%
40 - 21	1971 - 1990	195	19.8%	198	10.0%
20 - 11	1991 - 2000	224	22.8%	444	22.3%
10 - 6	2001 - 2005	285	29.0%	631	31.8%
5 - 0	2006 - 2011	122	12.4%	632	31.8%

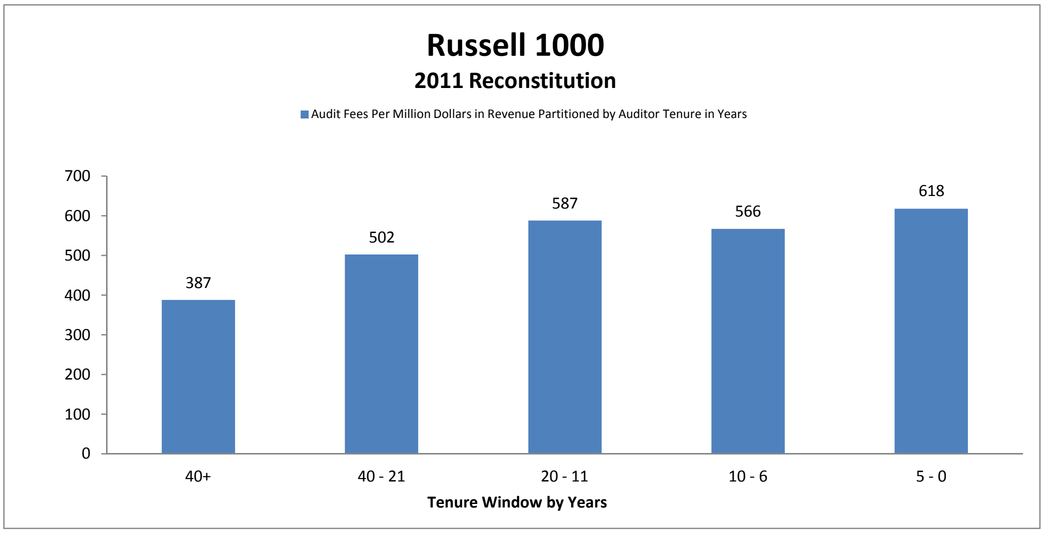
Notes:

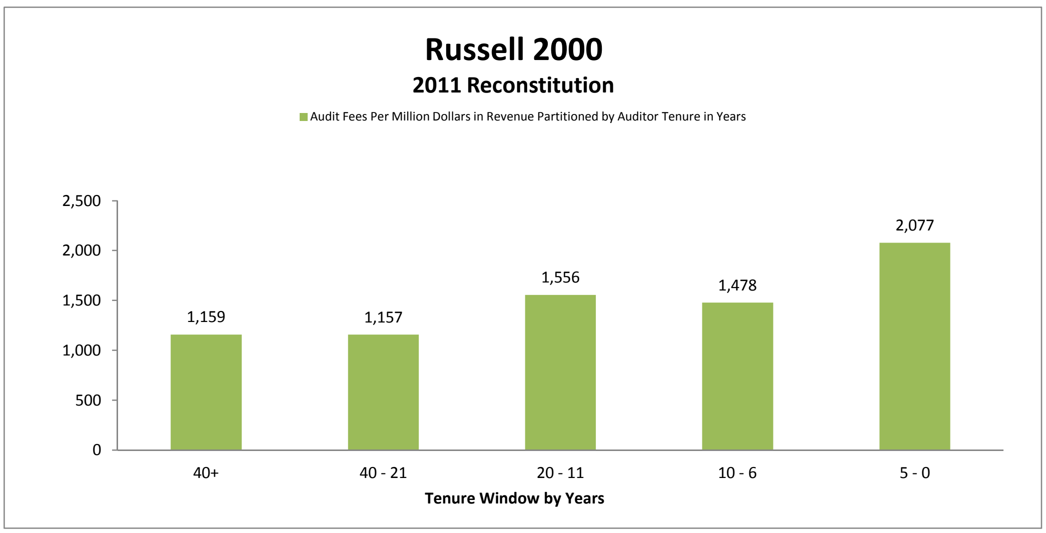
1) The research is based on a database download of October 5, 2011.

2) The research population comprises the 2011 reconstitution of the Russell 1000 and Russell 2000.

3) The data in the columns titled "**% of Total Companies**" equals the percentage achieved by dividing the "**Company Count**" by the number of Russell companies in the Audit Analytics database, the number displayed in the parenthetical in the title box. For example, 158 companies divided by 984 (the Russell population) equals 0.1606, which represents 16.1%.

Audit Fees Paid by Russell 3000 Companies Stratified by Auditor Tenure





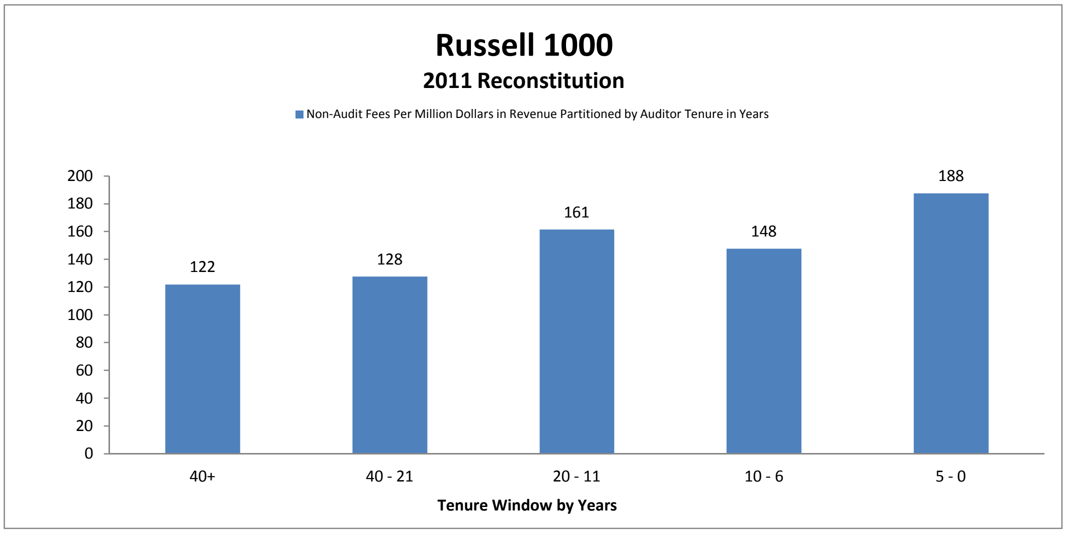
Tenure Stratification By Years	Tenure Stratification By Years	Russell 1000 (2011 Reconstitution)				Russell 2000 (2011 Reconstitution)			
		Company Count	Audit Fees ($)	Revenue ($)	Audit Fees Per $1 Million In Revenue	Company Count	Audit Fees ($)	Revenue ($)	Audit Fees Per $1 Million In Revenue
40+	1970 +	158	1,611,290,034	4,161,160,551,000	387	82	124,181,911	107,121,944,000	1159
40 - 21	1971 - 1990	195	1,063,028,608	2,117,180,873,000	502	198	224009637	193,583,291,598	1157
20 - 11	1991 - 2000	224	916,524,248	1,560,442,516,414	587	444	523283442	336,300,366,608	1556
10 - 6	2001 - 2005	285	1,233,302,612	2,177,792,692,000	566	631	628531670	425,349,575,578	1478
5 - 0	2006 - 2011	122	487,451,455	789,114,227,000	618	632	580109225	279,317,174,083	2077

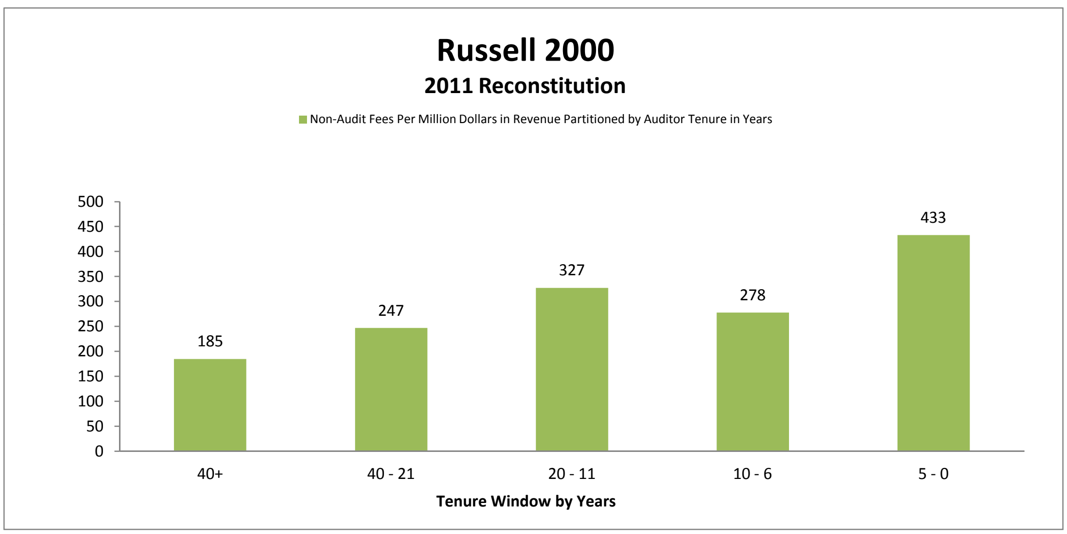
Notes:

1) The research is based on a database download of October 11, 2011.

2) The research population comprises the 2011 reconstitution of the Russell 1000 and Russell 2000.

Non-Audit Fees Paid by Russell 3000 Companies Stratified by Auditor Tenure





Tenure Stratification By Years	Tenure Stratification By Years	Russell 1000 (2011 Reconstitution)				Russell 2000 (2011 Reconstitution)			
		Company Count	Non-Audit Fees ($)	Revenue ($)	Non-Audit Fees Per $1 Million In Revenue	Company Count	Non-Audit Fees ($)	Revenue ($)	Non-Audit Fees Per $1 Million In Revenue
40+	1970 +	158	507,261,423	4,161,160,551,000	122	82	19,823,820	107,121,944,000	185
40 - 21	1971 - 1990	195	270,011,573	2,117,180,873,000	128	198	47758591	193,583,291,598	247
20 - 11	1991 - 2000	224	251,774,124	1,560,442,516,414	161	444	110093932	336,300,366,608	327
10 - 6	2001 - 2005	285	321,670,421	2,177,792,692,000	148	631	118265341	425,349,575,578	278
5 - 0	2006 - 2011	122	147,972,320	789,114,227,000	188	632	120944549	279,317,174,083	433

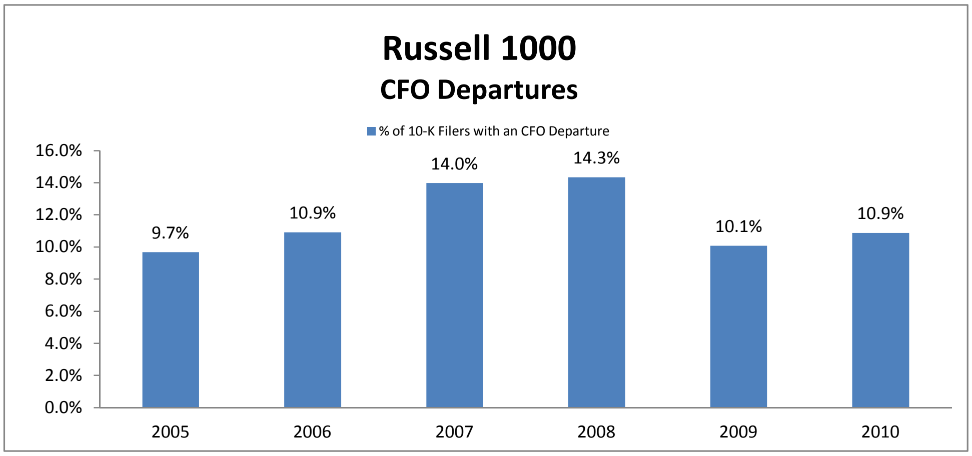
Notes:

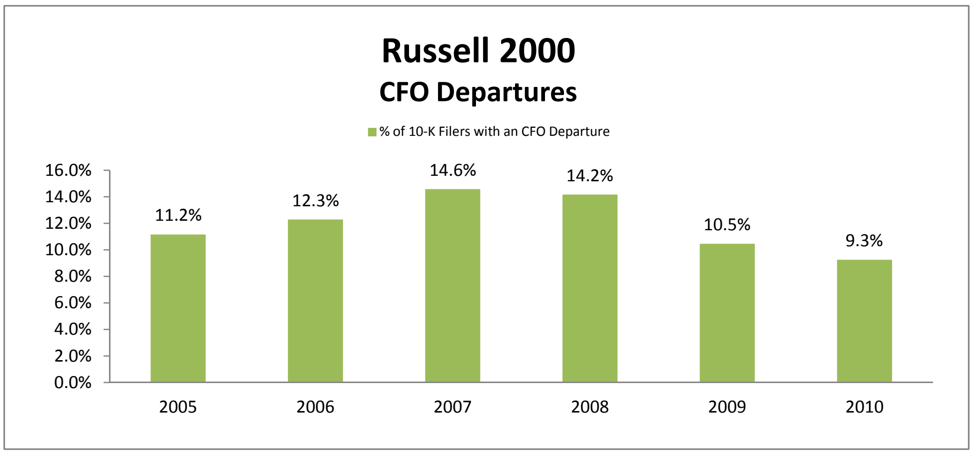
1) The research is based on a database download of October 11, 2011.

2) The research population comprises the 2011 reconstitution of the Russell 1000 and Russell 2000.

3) The total non-audit fees include the aggregate of all other disclosed fees that are not audit fees: (1) Audit-Related Fees, (2) Benefit Plan Related Fees, (3) FISDI Fees, (4) Tax Fees, and (5) Other/Miscellaneous Fees.

CFO Departures from the Russell 3000 Companies





Effective Year	Russell 1000					Russell 2000				
	Company Population	10-K Filers	CFO Departures			Company Population	10-K Filers	CFO Departures		
			#	# Co.	% 10-K Filers			#	# Co.	% 10-K Filers
2005	992	992	100	96	9.68%	1990	1990	232	222	11.16%
2006	991	990	114	108	10.91%	1990	1987	262	244	12.28%
2007	1020	1016	153	142	13.98%	1952	1942	299	283	14.57%
2008	1001	997	155	143	14.34%	1981	1970	305	279	14.16%
2009	967	963	103	97	10.07%	2017	2006	227	210	10.47%
2010	983	975	108	106	10.87%	2008	1988	194	184	9.26%
All Years (Aggregate)	1356	1347	911	658	48.85%	3362	3338	2361	1600	47.93%

Notes:

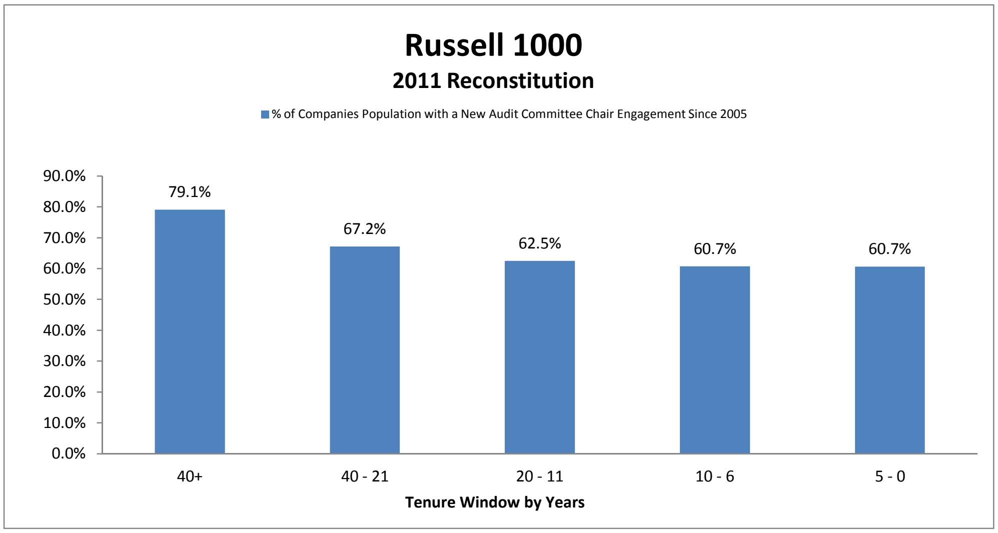
1) The research is based on a database download of October 13, 2011.

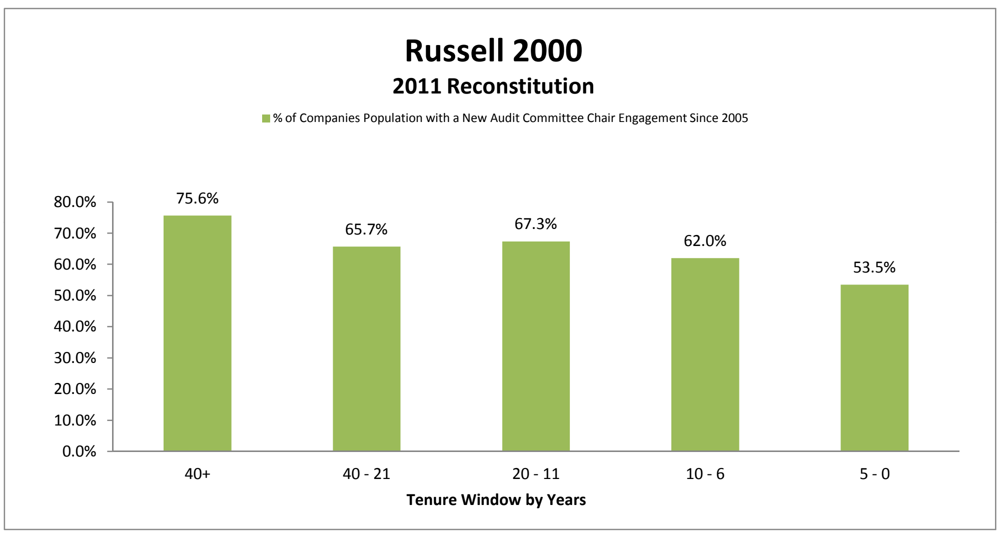
2) The population used for this research comprises the Russell 3000 companies that filed a 10-K as a annual report. The population is limited to 10-K filers pursuant to SEC Release 33-8400, which states that the 8-K disclosure requirements did not apply to foreign private issuers that file annual reports on Form 20-F or 40-F.

3) The column titled "**#**" provides the total number of CFO departures while the "**# Co.**" provides the unique number of companies that experienced one or more departures (does not count multiple departures by one company within the year). The "**% 10-K Filers**" equals the percentage achieved when "**# Co.**" is divided by the number of companies identified as "**10-K Filers**."

4) The "**All Years (Aggregate)**" row provides data for the aggregate Russell population (the total population of companies that were in the Russell population at least once during the six-year period under review by this research).

Audit Committee Chair Turnover by the Russell 3000 Companies Since 2005 Stratified by Auditor Tenure





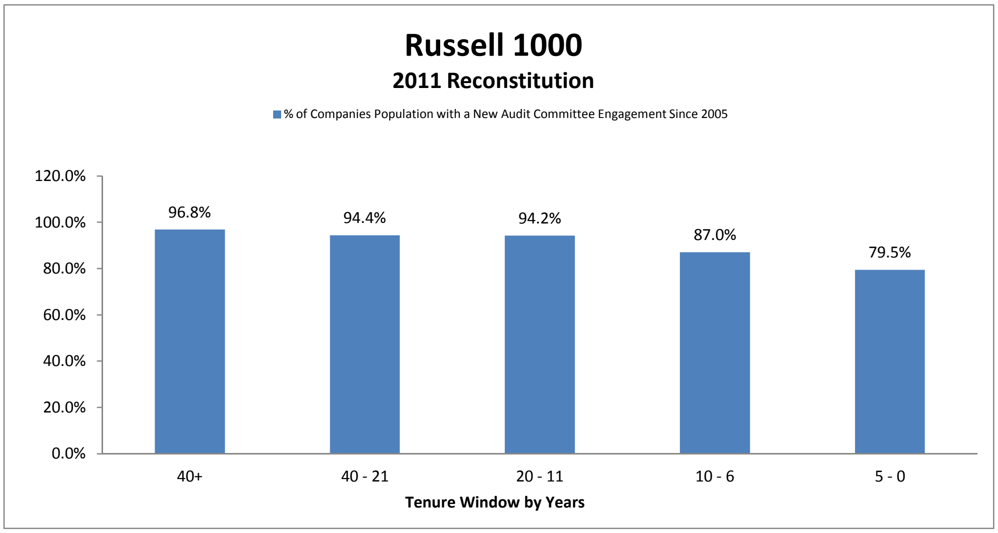
Tenure Stratification By Years	Tenure Stratification By Years	Russell 1000 (2011 Reconstitution)				Russell 2000 (2011 Reconstitution)			
		Company Population	Total Chair Changes (Engagements)	Unique Companies With Changes	% of Co. Pop. With A Change Since 2005	Company Population	Total Chair Changes (Engagements)	Unique Companies With Changes	% of Co. Pop. With A Change Since 2005
40+	1970 +	158	186	125	79.1%	82	86	62	75.6%
40 - 21	1971 - 1990	195	198	131	67.2%	198	193	130	65.7%
20 - 11	1991 - 2000	224	206	140	62.5%	444	461	299	67.3%
10 - 6	2001 - 2005	285	260	173	60.7%	631	556	391	62.0%
5 - 0	2006 - 2011	122	105	74	60.7%	632	515	338	53.5%

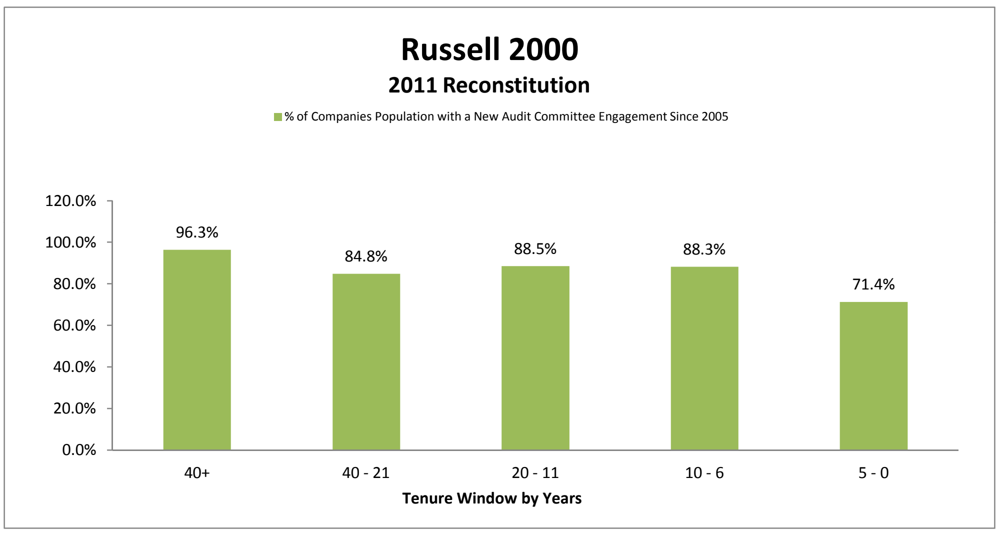
Notes:

1) The research is based on a database download of October 17, 2011.

2) The column titled "**% of Co. Pop. With A Change Since 2005**" equals the percentage achieved when dividing the "**Unique Companies With Changes**" by the "**Company Population**."

Audit Committee Turnover by the Russell 3000 Companies Since 2005 Stratified by Auditor Tenure





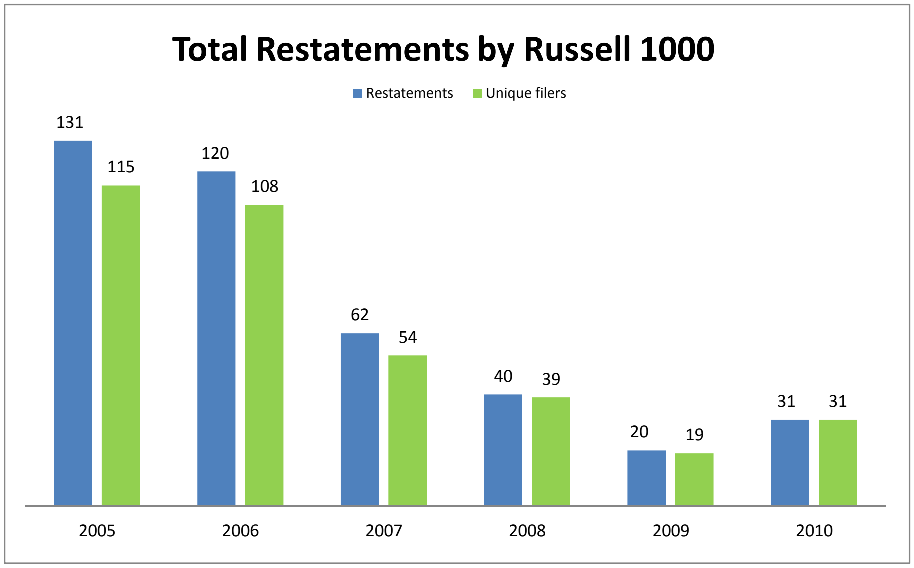
Tenure Stratification By Years	Tenure Stratification By Years	Russell 1000 (2011 Reconstitution)				Russell 2000 (2011 Reconstitution)			
		Company Population	Total Changes (Engagements)	Unique Companies With Changes	% of Co. Pop. With A Change Since 2005	Company Population	Total Changes (Engagements)	Unique Companies With Changes	% of Co. Pop. With A Change Since 2005
40+	1970 +	158	640	153	96.8%	82	265	79	96.3%
40 - 21	1971 - 1990	195	611	184	94.4%	198	548	168	84.8%
20 - 11	1991 - 2000	224	690	211	94.2%	444	1216	393	88.5%
10 - 6	2001 - 2005	285	870	248	87.0%	631	1623	557	88.3%
5 - 0	2006 - 2011	122	324	97	79.5%	632	1411	451	71.4%

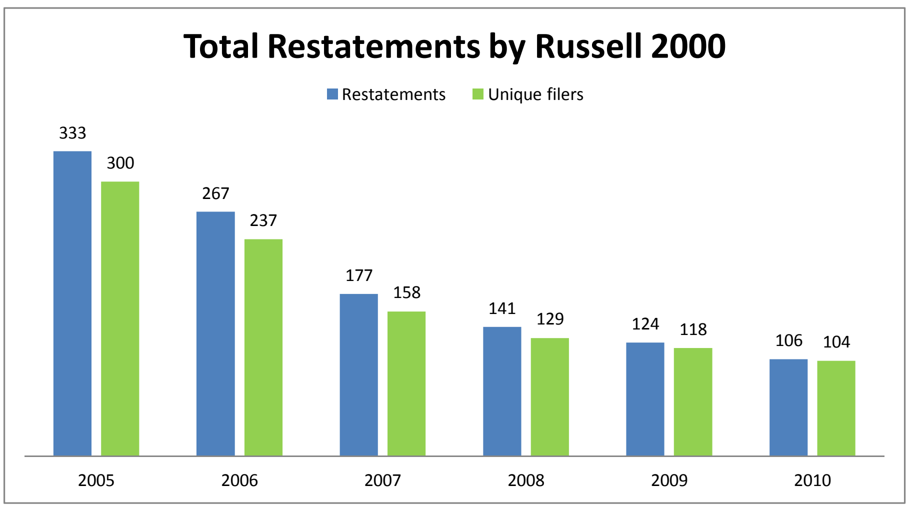
Notes:

1) The research is based on a database download of October 17, 2011.

2) The column titled "**% of Co. Pop. With A Change Since 2005**" equals the percentage achieved when dividing the "**Unique Companies With Changes**" by the "**Company Population**."

Restatement Analysis of Russell 3000
Total Restatements per Year





Disclosure Year	Russell 1000				Russell 2000			
	Company Pop.	Restatements	Unique Filers	% of Co. Pop.	Company Pop.	Restatements	Unique Filers	% of Co. Pop.
2005	992	131	115	11.6%	1990	333	300	15.1%
2006	991	120	108	10.9%	1990	267	237	11.9%
2007	1020	62	54	5.3%	1952	177	158	8.1%
2008	1001	40	39	3.9%	1981	141	129	6.5%
2009	967	20	19	2.0%	2017	124	118	5.9%
2010	983	31	31	3.2%	2008	106	104	5.2%
All Years	1356	526	380	28.0%	3362	1711	1204	35.8%

Notes:

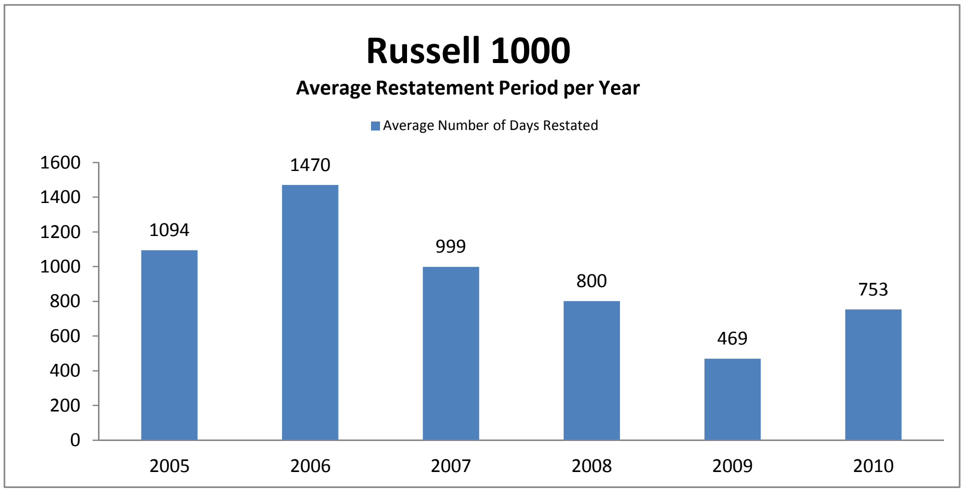
1) The research is based on database download of October 12, 2011.

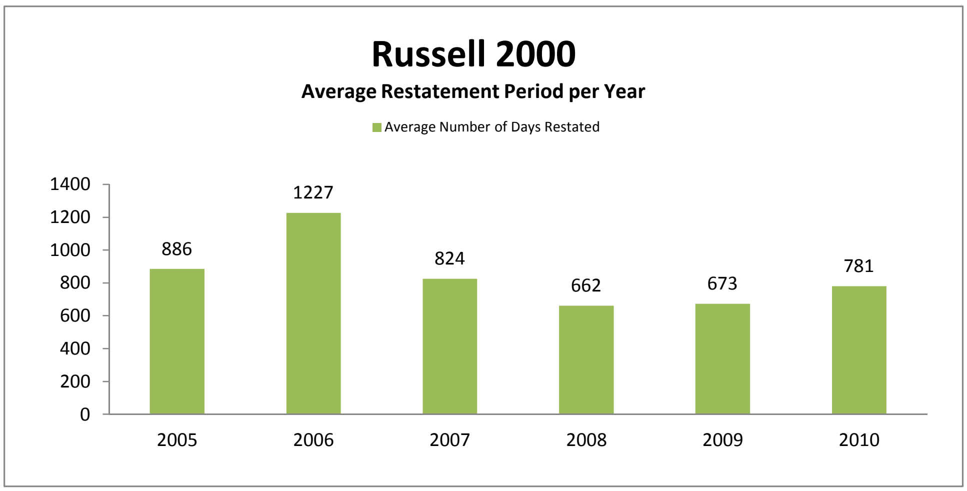
2) The "**Restatements**" column counts all restatements when a registrant files multiple restatements. The "**Unique Filers**" column provides the number of unique companies that filed one or more restatement.

3) The "**% of Co. Pop.**" equals the percentage attained when dividing the number of "**Unique Filers**" by the number of companies in the "**Company Pop.**"

4) The "**All Years**" row provides data for the aggregate Russell population (the total population of companies that were in the Russell population at least once during the six-year period under review by this research).

Restatement Analysis of Russell 3000
Average Restatement Period per Year





Disclosure Year	Russell 1000			Russell 2000		
	Company Pop.	Restatements	Average Number of Days Restated	Company Pop.	Restatements	Average Number of Days Restated
2005	992	131	1094	1990	333	886
2006	991	120	1470	1990	267	1227
2007	1020	62	999	1952	177	824
2008	1001	40	800	1981	141	662
2009	967	20	469	2017	124	673
2010	983	31	753	2008	106	781
All Years	1356	526	1081	3362	1711	830

Notes:

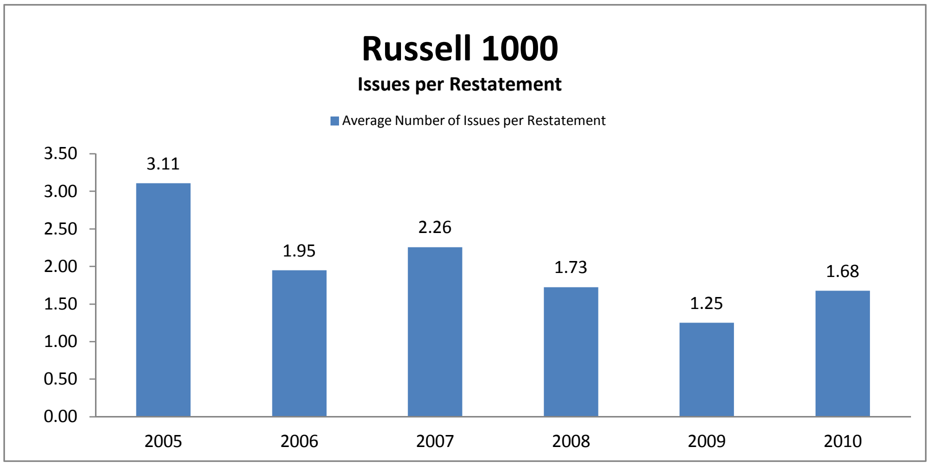
1) The research is based on database download of October 12, 2011.

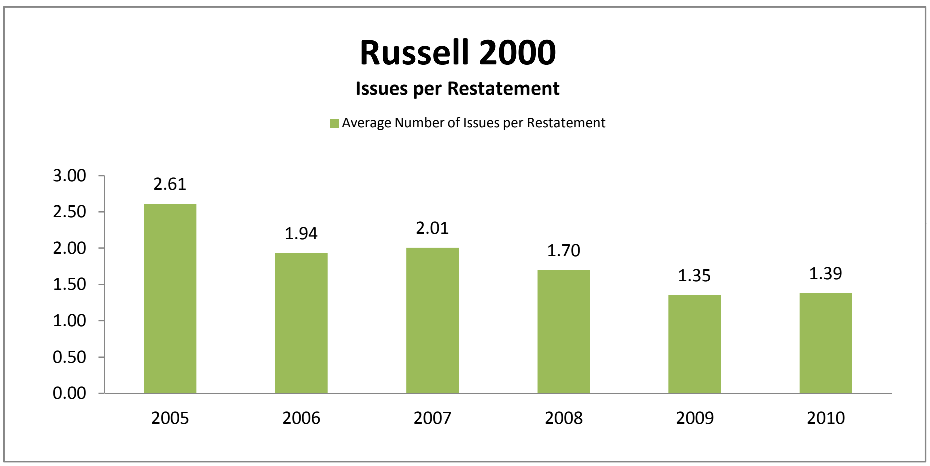
2) The "**Restatements**" column counts all restatements when a registrant files multiple restatements.

3) The Total Days Restated is based on the non-reliance period disclosed by entities in their 8-K filings. The actual restated period may differ from the period disclosed in an 8-K.

4) The "**All Years**" row provides data for the aggregate Russell population (the total population of companies that were in the Russell population at least once during the six-year period under review by this research).

Restatement Analysis of Russell 3000
Average Number of Issues per Restatement





Disclosure Year	Russell 1000				Russell 2000			
	Company Pop.	Total Issues Restated	Total Restatements	Average # of Issues per Restatement	Company Pop.	Total Issues Restated	Total Restatements	Average # of Issues per Restatement
2005	992	407	131	3.11	1990	870	333	2.61
2006	991	234	120	1.95	1990	517	267	1.94
2007	1020	140	62	2.26	1952	355	177	2.01
2008	1001	69	40	1.73	1981	240	141	1.70
2009	967	25	20	1.25	2017	168	124	1.35
2010	983	52	31	1.68	2008	147	106	1.39
All Years	1356	1195	526	2.27	3362	3428	1711	2.00

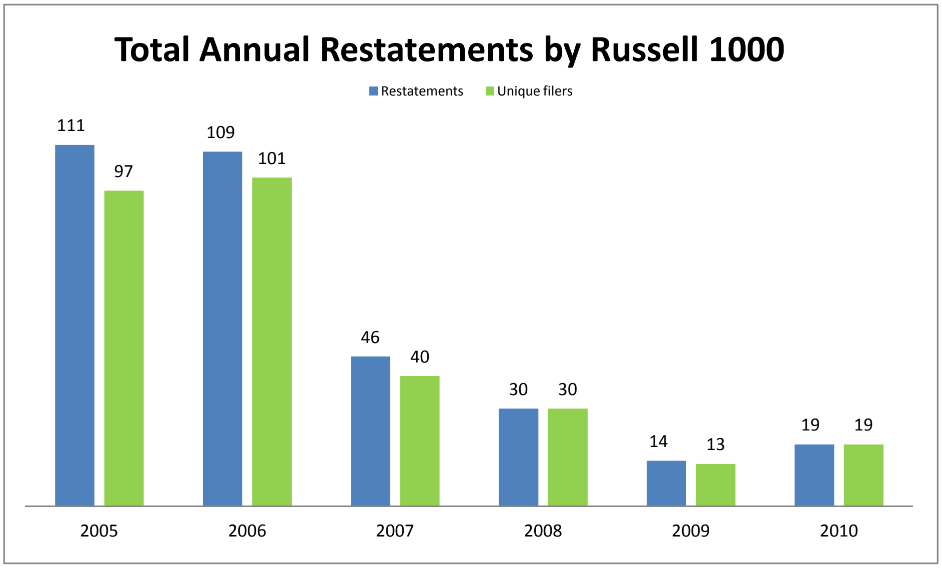
Notes:

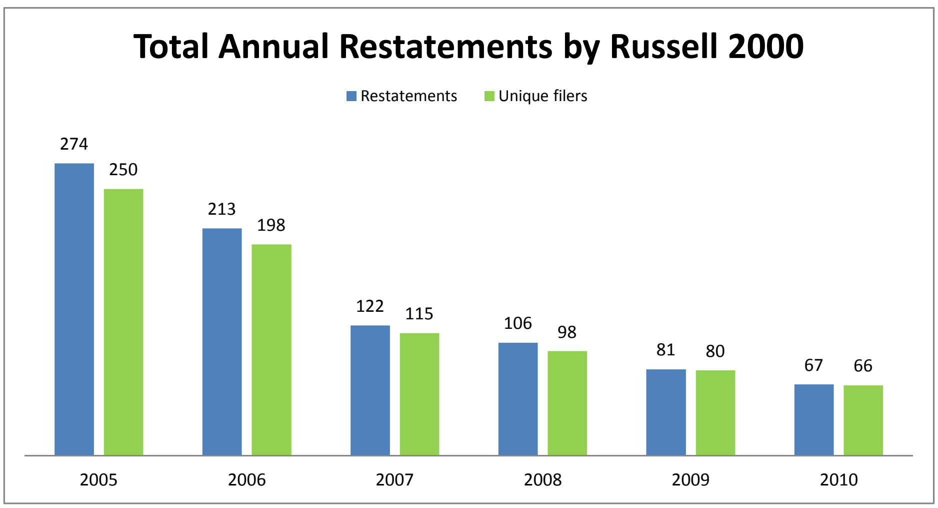
1) The research is based on database download of October 12, 2011.

2) The Issue count is based on 24 primary issues within the taxonomy developed by Audit Analytics. For a list of the issues under review, contact Audit Analytics.

3) The "**All Years**" row provides data for the aggregate Russell population (the total population of companies that were in the Russell population at least once during the six-year period under review by this research).

Restatement Analysis of Russell 3000
Total Annual Restatements per Year





Disclosure Year	Russell 1000				Russell 2000			
	Company Pop.	Annual Restatements	Unique Filers	% of Co. Pop.	Company Pop.	Annual Restatements	Unique Filers	% of Co. Pop.
2005	992	111	97	9.8%	1990	274	250	12.6%
2006	991	109	101	10.2%	1990	213	198	9.9%
2007	1020	46	40	3.9%	1952	122	115	5.9%
2008	1001	30	30	3.0%	1981	106	98	4.9%
2009	967	14	13	1.3%	2017	81	80	4.0%
2010	983	19	19	1.9%	2008	67	66	3.3%
All Years	1356	414	308	22.7%	3362	1206	940	28.0%

Notes:

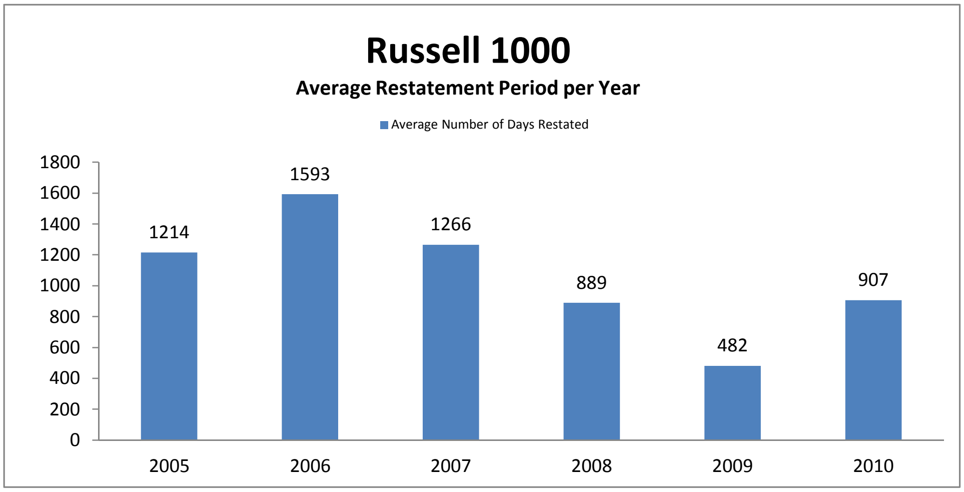
1) The research is based on database download of October 12, 2011.

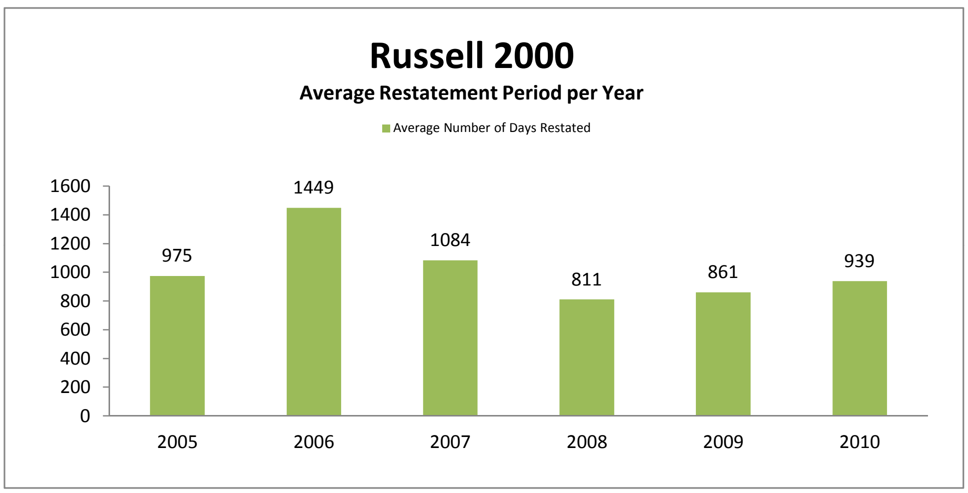
2) The "**Annual Restatements**" column counts all restatements with a 10-K noted in its history. This count includes all annual restatements when a registrant files multiple annual restatements. The "**Unique Filers**" column provides the number of unique companies that filed one or more annual restatements.

3) The "**% of Co. Pop.**" equals the percentage attained when dividing the number of "**Unique Filers**" by the number of companies in the "**Company Pop.**"

4) The "**All Years**" row provides data for the aggregate Russell population (the total population of companies that were in the Russell population at least once during the six-year period under review by this research).

Annual Restatement Analysis of Russell 3000
Average Restatement Period per Year





Disclosure Year	Russell 1000			Russell 2000		
	Company Pop.	Annual Restatements	Average Number of Days Restated	Company Pop.	Annual Restatements	Average Number of Days Restated
2005	992	111	1214	1990	274	975
2006	991	109	1593	1990	213	1449
2007	1020	46	1266	1952	122	1084
2008	1001	30	889	1981	106	811
2009	967	14	482	2017	81	861
2010	983	19	907	2008	67	939
All Years	1356	414	1257	3362	1206	1017

Notes:

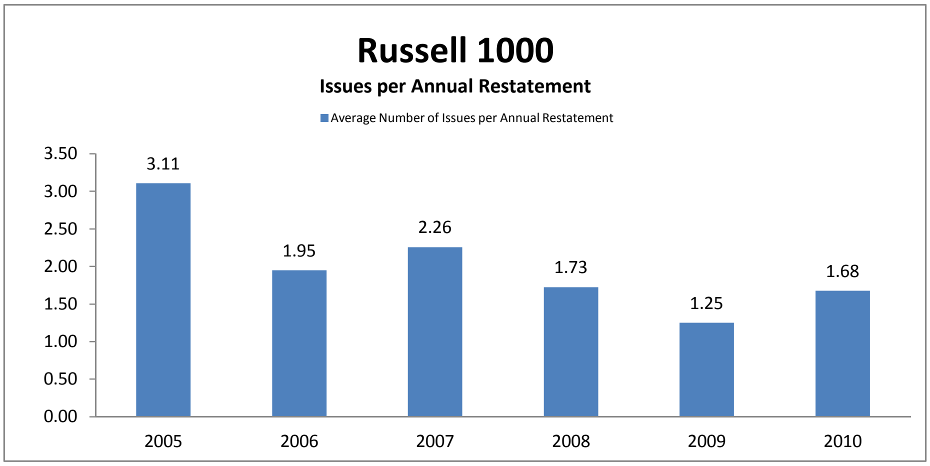
1) The research is based on database download of October 12, 2011.

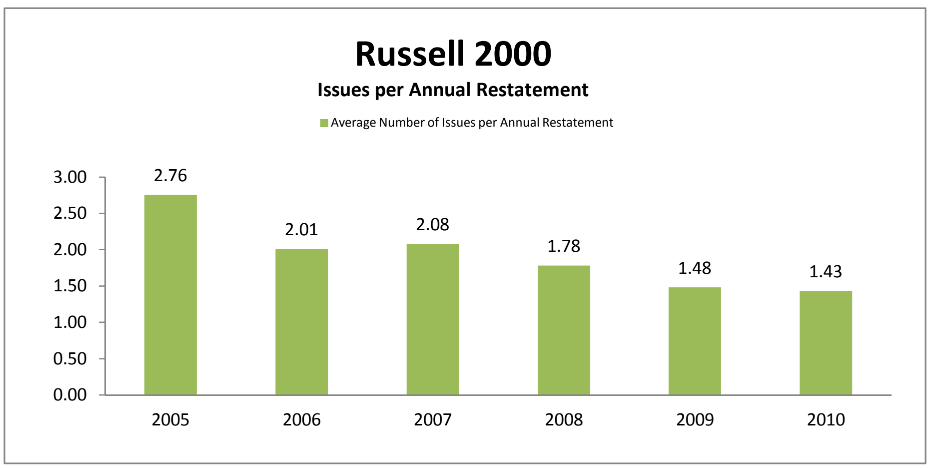
2) The annual restatements are identified as those restatements with a 10-K in its history.

3) The Total Days Restated is based on the non-reliance period disclosed by entities in their 8-K filings. The actual restated period may differ from the period disclosed in an 8-K.

4) The "**All Years**" row provides data for the aggregate Russell population (the total population of companies that were in the Russell population at least once during the six-year period under review by this research).

Restatement Analysis of Russell 3000
Average Number of Issues per Annual Restatement





Disclosure Year	Russell 1000				Russell 2000			
	Company Pop.	Total Annual Restatements	Total Issues Restated	Average # of Issues per Restatement	Company Pop.	Total Annual Restatements	Total Issues Restated	Average # of Issues per Restatement
2005	992	111	357	3.22	1990	274	755	2.76
2006	991	109	206	1.89	1990	213	428	2.01
2007	1020	46	117	2.54	1952	122	254	2.08
2008	1001	30	54	1.80	1981	106	189	1.78
2009	967	14	14	1.00	2017	81	120	1.48
2010	983	19	29	1.53	2008	67	96	1.43
All Years	1356	414	978	2.36	3362	1206	2544	2.11

Notes:

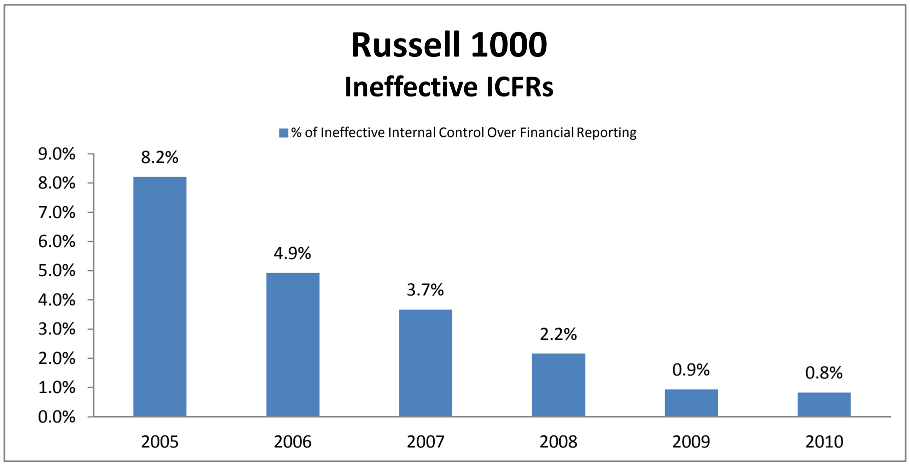
1) The research is based on database download of October 12, 2011.

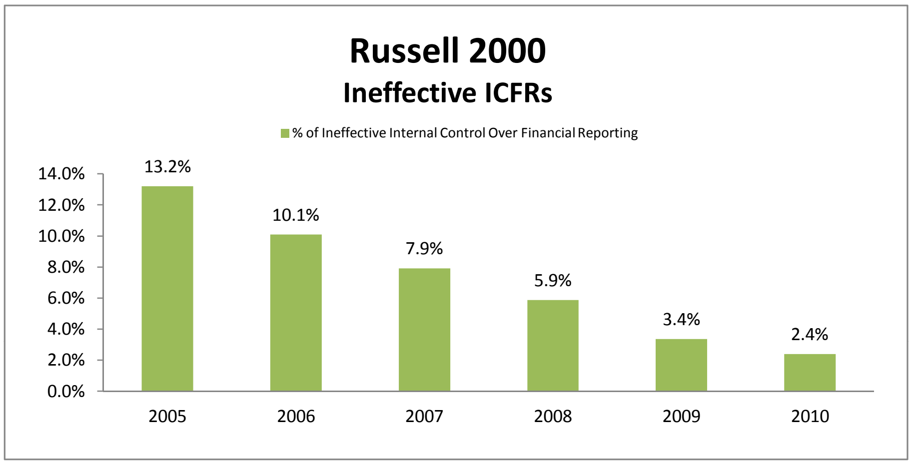
2) The annual restatements are identified as those restatements with a 10-K in its history.

3) The Issue count is based on 24 primary issues within the taxonomy developed by Audit Analytics. For a list of the issues under review, contact Audit Analytics.

4) The "**All Years**" row provides data for the aggregate Russell population (the total population of companies that were in the Russell population at least once during the six-year period under review by this research).

SOX 404 Disclosures of Russell 3000 Companies





Year	Russell 1000					Russell 2000				
	Company Population	SOX 404 Auditor Attestations		Ineffective Internal Controls Over Financial Reporting		Company Population	SOX 404 Auditor Attestations		Ineffective Internal Controls Over Financial Reporting	
		#	# Co.	# Co.	% Co.		#	# Co.	# Co.	% Co.
2005	992	968	950	78	8.21%	1990	1905	1856	245	13.20%
2006	991	972	955	47	4.92%	1990	1852	1814	183	10.09%
2007	1020	986	981	36	3.67%	1952	1794	1755	139	7.92%
2008	1001	975	971	21	2.16%	1981	1901	1875	110	5.87%
2009	967	959	957	9	0.94%	2017	1927	1904	64	3.36%
2010	983	964	962	8	0.83%	2008	1840	1831	44	2.40%
All Years (Aggregate)	1356	6935	6873	260	3.78%	3362	14499	14284	1111	7.78%

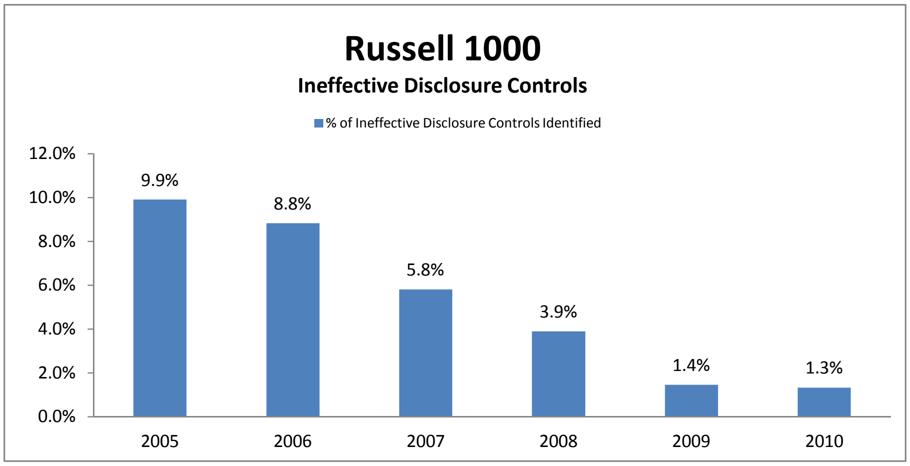
Notes:

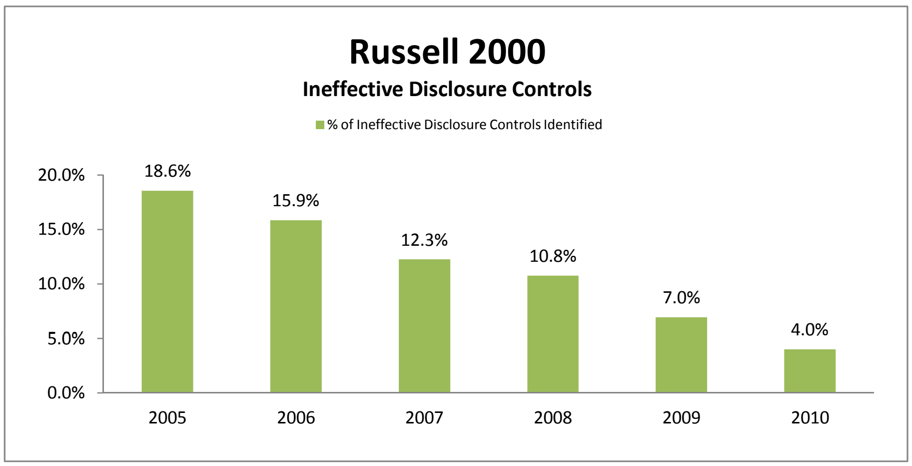
1) The research is based on a database download of October 12, 2011.

2) The column titled "**#**" provides the total number of auditor attestations while the "**# Co.**" provides the unique number of companies (does not count multiple attestations by one company). The "**%Co.**" equals the percentage achieved when "**# Co.**" in the Ineffective ICFRs column is divided by the "**# Co.**" in the Auditor Attestation column.

3) The "**All Years (Aggregate)**" row provides data for the aggregate Russell population (the total population of companies that were in the Russell population at least once during the six-year period under review by this research).

SOX 302 Disclosures of Russell 3000 Companies





Year	Russell 1000					Russell 2000				
	Company Population	SOX 302 Disclosures		Ineffective Disclosure Controls Identified		Company Population	SOX 302 Disclosures		Ineffective Disclosure Controls Identified	
		#	# Co.	# Co.	% Co.		#	# Co.	# Co.	% Co.
2005	992	3919	989	98	9.91%	1990	7850	1986	369	18.58%
2006	991	3893	985	87	8.83%	1990	7733	1973	313	15.86%
2007	1020	3972	1016	59	5.81%	1952	7521	1949	239	12.26%
2008	1001	3912	1001	39	3.90%	1981	7716	1978	213	10.77%
2009	967	3808	967	14	1.45%	2017	7897	2014	140	6.95%
2010	983	3878	979	13	1.33%	2008	7784	1998	80	4.00%
All Years (Aggregate)	1356	28151	7241	428	5.91%	3362	65490	17066	2122	12.43%

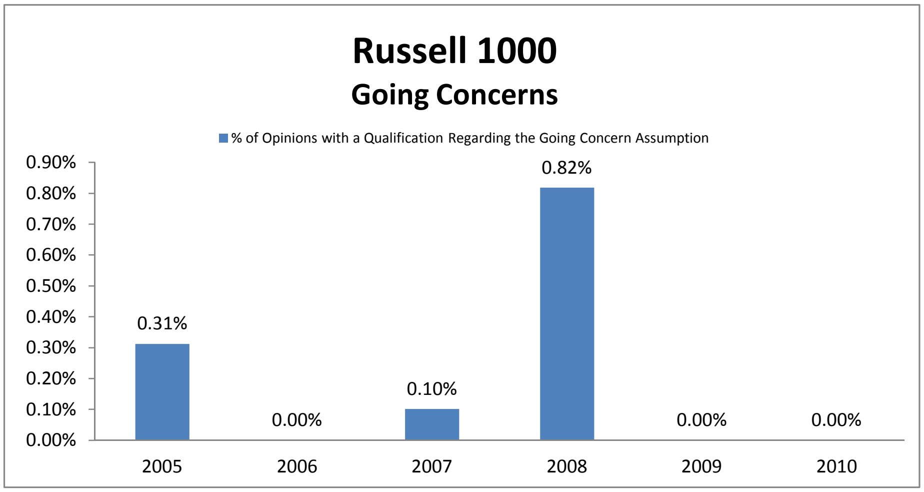
Notes:

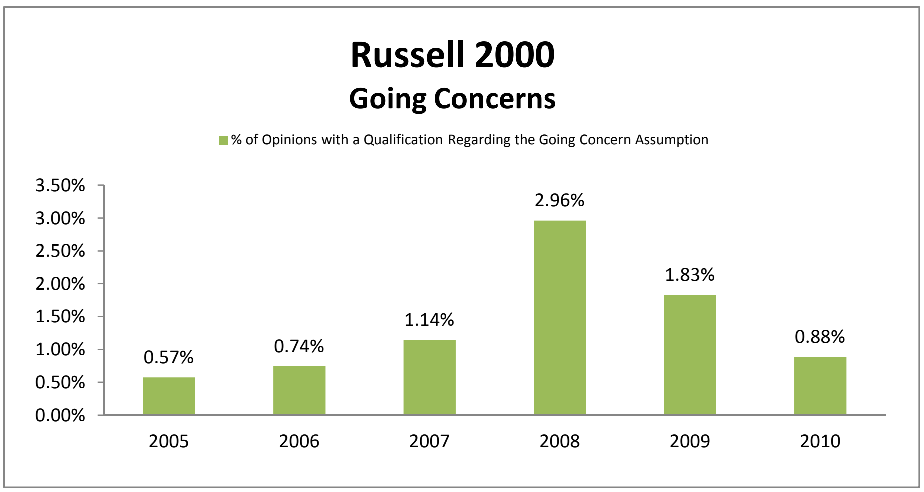
1) The research is based on a database download of October 14, 2011.

2) The column titled "**#**" provides the total number of auditor attestations while the "**# Co.**" provides the unique number of companies (does not count multiple attestations by one company). The "**%Co.**" equals the percentage achieved when "**# Co.**" in the Ineffective Disclosure Controls column is divided by the "**# Co.**" in the SOX 302 Disclosures column.

3) The "**All Years (Aggregate)**" row provides data for the aggregate Russell population (the total population of companies that were in the Russell population at least once during the six-year period under review by this research).

Audit Opinion Analysis of Russell 3000
Going Concerns





Disclosure Year	Russell 1000					Russell 2000				
	Company Pop.	Audit Opinions	Audit Opinions (Unique)	Going Concerns	% of Opinions	Company Pop.	Audit Opinions	Audit Opinions (Unique)	Going Concerns	% of Opinions
2005	992	1000	960	3	0.31%	1990	1993	1918	11	0.57%
2006	991	989	962	0	0.00%	1990	1948	1880	14	0.74%
2007	1020	1018	987	1	0.10%	1952	1895	1837	21	1.14%
2008	1001	1148	978	8	0.82%	1981	2149	1924	57	2.96%
2009	967	1053	958	0	0.00%	2017	2078	1967	36	1.83%
2010	983	1,018	966	0	0.00%	2008	1985	1925	17	0.88%
All Years	1356	7707	7161	48	0.67%	3362	17867	16826	516	3.07%

Notes:

1) The research is based on a database download of October 17, 2011.

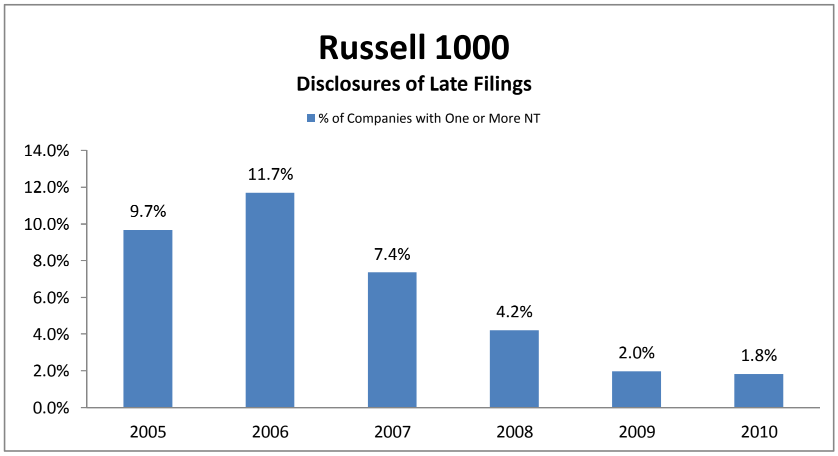
2) The "**Audit Opinions**" column includes all audit opnions when a registrant files multiple opinions. The "**Audit Opinion (Unique)**" column provides the number of unique companies that filed one or more opinion.

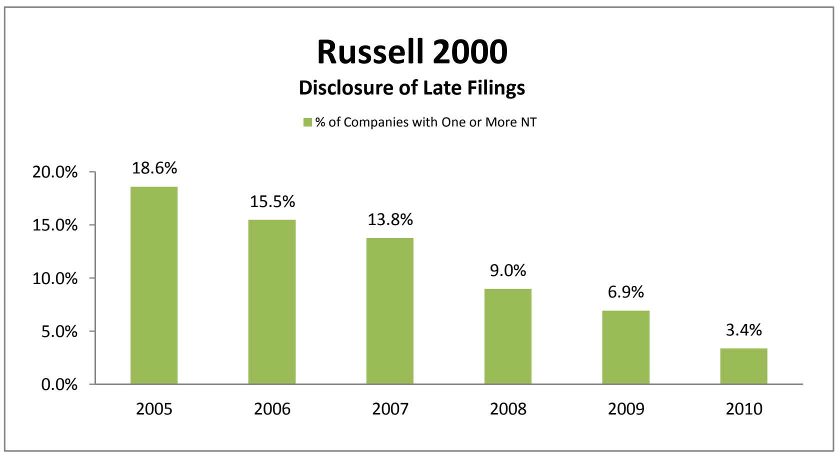
3) The "**Going Concern**" column quantifies the number of audit opinions qualified by an uncertainty regarding the going concern assumption.

4) The "**% of Opinions**" equals the percentage attained when dividing the number of "**Going Concerns**" by the number of "**Audit Opinions (Unique)**."

5) The "**All Years**" row provides data for the aggregate Russell population (the total population of companies that were in the Russell population at least once during the six-year period under review by this research).

Disclosure of Late Filings by the Russell 3000 Companies





Year	Russell 1000						Russell 2000					
	Company Population	Late Notifications			Part 4.3 Disclosure		Company Population	Late Notifications			Part 4.3 Disclosure	
		#	# Co.	% Co. Pop.	# Co.	% Co. Pop.		#	# Co.	% Co. Pop.	# Co.	% Co. Pop.
2005	992	137	96	9.68%	56	5.65%	1990	515	370	18.59%	206	10.35%
2006	991	176	116	11.71%	82	8.27%	1990	508	308	15.48%	204	10.25%
2007	1020	134	75	7.35%	43	4.22%	1952	439	269	13.78%	160	8.20%
2008	1001	55	42	4.20%	22	2.20%	1981	250	178	8.99%	112	5.65%
2009	967	24	19	1.96%	7	0.72%	2017	180	140	6.94%	88	4.36%
2010	983	19	18	1.83%	13	1.32%	2008	90	68	3.39%	37	1.84%
All Years (Aggregate)	1356	813	534	39.38%	339	25.00%	3362	3651	2430	72.28%	1516	45.09%

Notes:

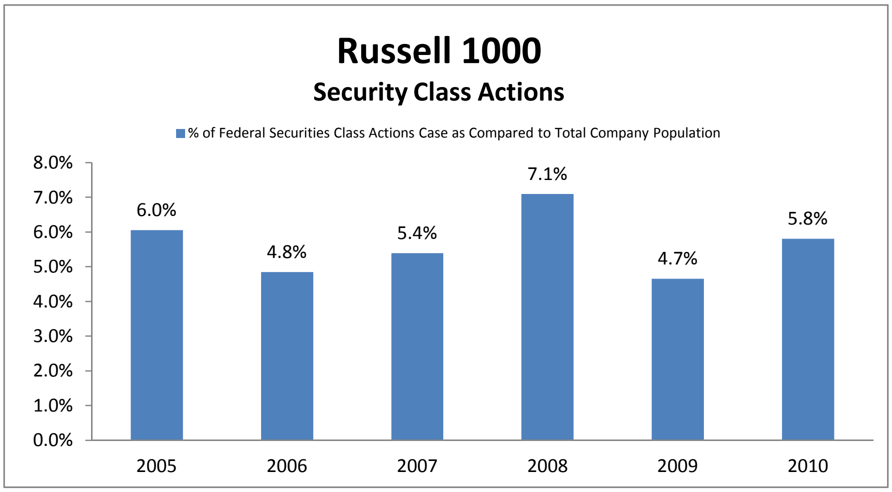
1) The research is based on a database download of October 17, 2011.

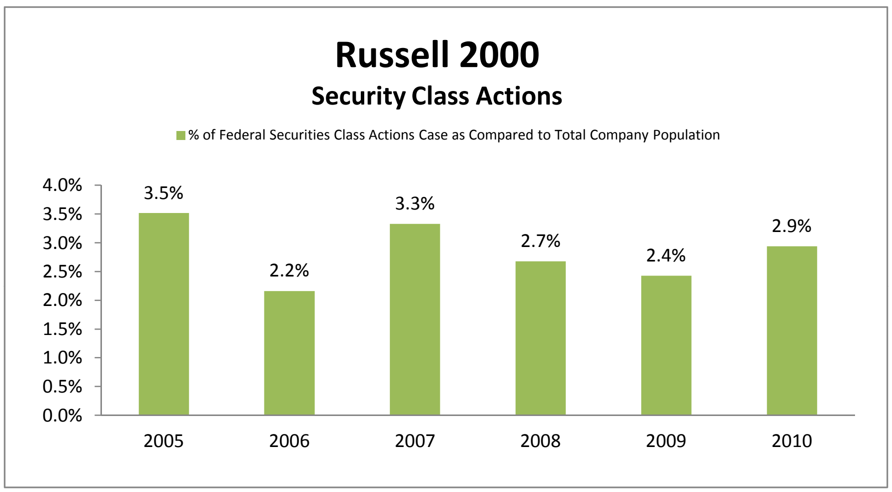
2) The column titled "**#**" provides the total number of NT filings (late notifications) while the "**# Co.**" provides the unique number of companies the filed one or more NTs. (does not count multiple NT filings by one company). The "**%Co.**" equals the percentage achieved when dividing "**# Co.**" by the "**Company Population**."

3) The "**Part 4.3 Disclosure**" columns provide data regarding NT filings that indicates "Yes" for the following question: "Is it anticipated that any significant change in results of operations from the corresponding period for the last fiscal year will be reflected by the earnings statements to be included in the subject report or portion thereof?"

4) The "**All Years (Aggregate)**" row provides data for the aggregate Russell population (the total population of companies that were in the Russell population at least once during the six-year period under review by this research).

Litigation Analysis of Russell 3000
Federal Security Class Action Cases





Disclosure Year	Russell 1000				Russell 2000			
	Company Pop.	Security Class Actions	Unique Companies	% of Pop.	Company Pop.	Security Class Actions	Unique Companies	% of Pop.
2005	992	80	60	6.05%	1990	91	70	3.52%
2006	991	99	48	4.84%	1990	53	43	2.16%
2007	1020	77	55	5.39%	1952	81	65	3.33%
2008	1001	136	71	7.09%	1981	63	53	2.68%
2009	967	96	45	4.65%	2017	62	49	2.43%
2010	983	76	57	5.80%	2008	74	59	2.94%
All Years	1356	648	292	21.53%	3362	597	443	13.18%

Notes:

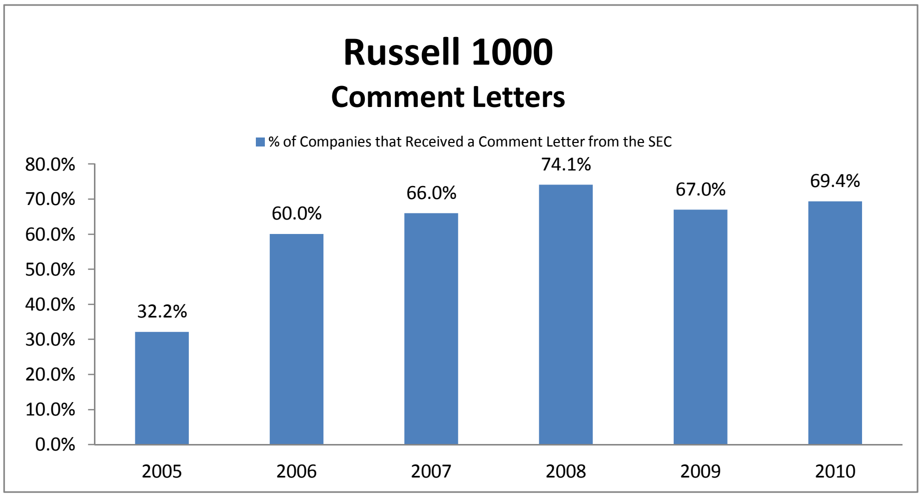
1) The research is based on a database download of October 18, 2011.

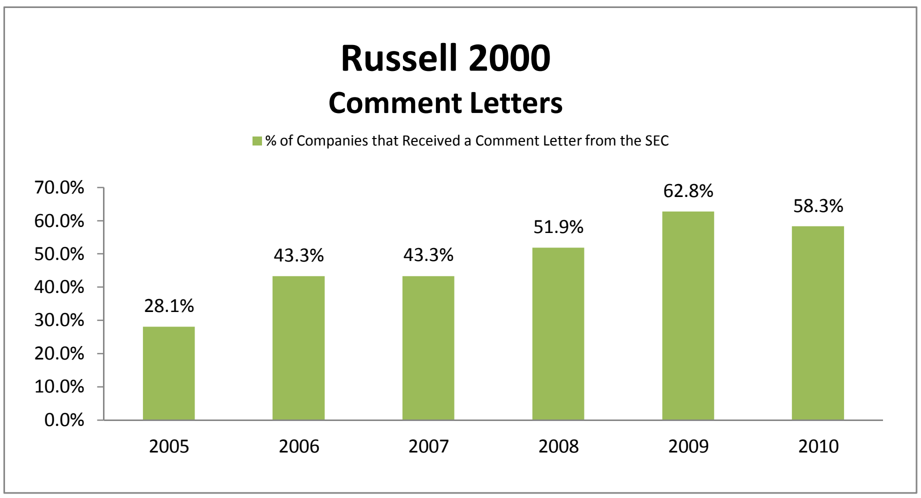
2) The data above includes all securities class actions filed in federal district court.

3) The column titled "**Security Class Actions**" provides the total number of security class actions naming a Russell company as a defendant. The "**Unique Companies**" column provides the unique number of companies that were named in one or more security class action cases (does not count multiple cases by one company within the year). The "**% of Pop.**" equals the percentage achieved when "**Unique Companies**" is divided by the "**Company Pop.**"

4) The "**All Years**" row provides data for the aggregate Russell population (the total population of companies that were in the Russell population at least once during the six-year period under review by this research).

SEC Comment Letter Analysis of Russell 3000





Disclosure Year	Russell 1000				Russell 2000			
	Company Pop.	Comment Letters	Unique Companies	% of Companies	Company Pop.	Comment Letters	Unique Companies	% of Companies
2005	992	983	319	32.16%	1990	1078	559	28.09%
2006	991	967	595	60.04%	1990	1954	861	43.27%
2007	1020	1001	673	65.98%	1952	1827	846	43.34%
2008	1001	1020	742	74.13%	1981	2272	1028	51.89%
2009	967	991	648	67.01%	2017	3316	1266	62.77%
2010	983	983	682	69.38%	2008	2926	1171	58.32%

Notes:

1) The research is based on a database download of October 11, 2011.

2) The column titled "Comment Letters" provides the total number of Upload letters (initial letter from the SEC) received by a company while the "**Unique Companies**" column provides the unique number of companies that received one or more Upload letter (does not count multiple Upload letters by one company within the year). The "**% of Companies**" equals the percentage achieved when "**Unique Companies**" is divided by the "**Company Pop.**"

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2012

A RESTATEMENT ANALYSIS OF THE RUSSELL 1000 COMPANIES:

THE EXTENT TO WHICH THE "FRESH EYES" OF A NEWLY ENGAGED AUDITOR PROVIDED ASSISTANCE IN THE DISCOVERY OF THE MISSTATEMENT

UPDATED

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Audit Analytics Report Index

	Page
Introduction	1
Reason for the Update: To Change the Category of One Restatement	1
Executive Summary	2
Additional Observations	3
Research Method and Results	4
Russell 1000 Research Steps and Results (Table)	7
Detector Breakdown of Step 7 Table Results (Chart)	8
Overview: Audit Analytics	9

Introduction

In August 2011, the PCAOB issued a Concept Release on Auditor Independence and Audit Firm Rotation.[1] According to the Concept Release, proponents of mandatory rotation are concerned that long-tenured auditors may not stand up to management on difficult accounting issues and assert that new auditors would bring a "fresh look" at the company's accounting. Opponents of mandatory rotation, on the other hand, are concerned about the loss of accumulated auditor knowledge about the company, which could undermine audit quality.

To bring insight and information to these issues, Audit Analytics performed an extensive analysis of six years of restatements by Russell 1000 companies that changed auditors (a restatement-auditor departure event).[2] We sought to determine the extent to which a "fresh look" by newly engaged auditors led to the restatements ("fresh eyes" restatements). If the concerns of the proponents of mandatory rotation are valid, then one would expect to find a significant proportion of the restatements to be "fresh eyes" and a relatively small proportion to be detected by long-tenured auditors. On the other hand, if the views of the opponents are valid, then one would expect to find relatively few "fresh eyes" restatements due to the limited initial knowledge of the newly engaged auditors.

The research focused on the Russell 1000 companies, as the Concept Release indicates that the PCAOB is interested in comments, among other things, as to whether it should considered any auditor rotation requirement for the largest issuer audits. As explained in the Research Method section, Audit Analytics reviewed 1,355 companies, 378 restatements, and 173 auditor departures to identify 53 Annual Restatements disclosed by companies that also experienced an auditor departure. The ultimate goal was to identify misstatements found, in part, by the "fresh eyes" of the recently engaged auditor. This process, however, also found other restatement categories of interest.

Reason for the Update: To Change the Category of One Restatement

The updated report reflects a change in category of one restatement from a "fresh eyes" detection to an "SEC eyes" detection.

After the initial publication of the Audit Analytics "Fresh Eyes" Restatement Report, Audit Analytics responded to a number of questions. While addressing a question concerning the "fresh eyes" restatements, Audit Analytics discovered an SEC comment letter sent to Precision Castparts (CIK 79958) four months prior to its restatement of May 29, 2008. This comment letter inquired about matters that ultimately caused Precision Castparts to restate.

In the initial "Fresh Eyes" Restatement Report, the restatement disclosed by Precision Castparts was categorized as a "fresh eyes" restatement that was not disclosed in an 8-K, Item 4.02 (did not undermine reliance on prior financial statements). With the discovery of the SEC comment letter of January 29, 2008 to Precision Castparts, this updated report categorizes the restatement as one resulting from an inquiry made by the SEC.

The consequence of this one change is reflected in the following text. In the pie chart below, an "SEC eyes" detection is presented in the "**Companies or their Regulator**" slice of the pie. Therefore, a total of 9 detections (17.0%) are attributable to the "Companies or their Regulators" and 3 detections (5.7%) are attributable to the "Fresh Eyes" of a newly engaged auditor.

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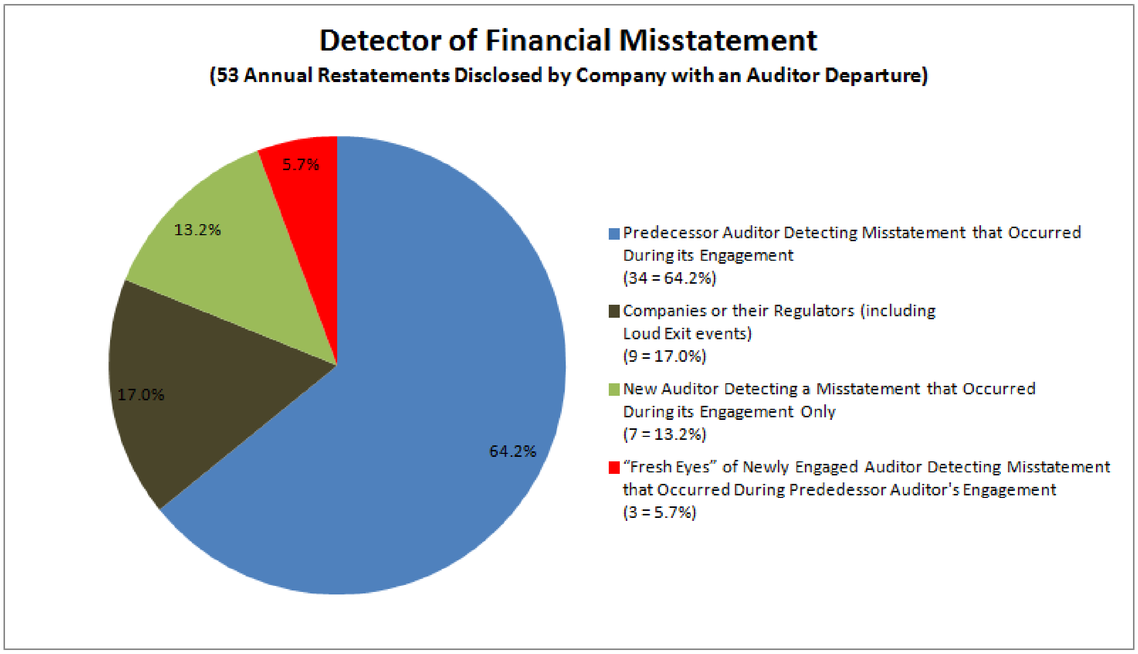
[1] The release is available at http://pcaobus.org/Rules/Rulemaking/Docket037/Release_2011-006.pdf . See also, the public meetings announcement regarding the matter: http://pcaobus.org/News/Releases/Pages/02022012_PublicMeeting.aspx .

[2] More specifically, with a database download of October 28, 2011, we analyzed all restatements disclosed since January 1, 2006 and, in order to obtain prior auditor change history, analyzed all auditor departures since January 1, 2005.

Executive Summary

The analysis explained in the Research Method section found 291 Annual Restatements disclosed on or after January 1, 2006 by 1,355 Russell 1000 companies (the aggregate population over six years). Of the 291 restatements, 53 were disclosed by companies that also experienced an auditor departure since January 1, 2005. The following pie chart summarizes the detectors of the 53 Annual Restatements involving Russell 1000 companies that also changed auditors:



1) About 5.7% of the Annual Restatements linked to an auditor departure were detected, in part, by the "fresh eyes" of the newly engaged auditor.

As noted, the pie chart above displays a breakdown of the 53 Annual Restatements disclosed since January 1, 2006 by Russell 1000 companies that also experienced an auditor departure since January 1, 2005. Out of these 53 restatements, 3 were identified as "fresh eyes" restatements, restatements adjusting a misstatement that occurred during the predecessor auditor's engagement and was found with the assistance of the newly engaged auditor. This number represents 5.7% of the 53 Annual Restatements identified.

2) About 64% of the Annual Restatements linked to an auditor departure were detected prior to the auditor's departure.

As shown in the pie chart above, 34 restatements disclosed by Russell 1000 companies that also experienced an auditor departure were restatements disclosed prior to the predecessor auditor's departure. Therefore, these misstatements were addressed before the engagement of the new auditor and represent about 64% of the 53 Annual Restatements identified.

3) About 17% of the Annual Restatements linked to an auditor departure were detected by the companies themselves or their regulators.

The analysis of the 53 Annual Restatements determined that 9 misstatement detections were attributable to the company or its regulators (about 17% of the 53). Of these 9 restatements, as discussed in the Research Method section of this report, the SEC helped find 4 misstatements, the company's own audit committee found 1, a company's internal investigation of its stock option practices found 2, and the events surrounding an auditor's "Loud Exit" found 2. As described more fully in footnote 6, a "Loud Exit" is considered a situation where the company and incoming auditor are fully aware of many shortcomings and the departed auditor's efforts to address the shortcomings is cut short by its dismissal. The company engages the new auditor while already investigating its own issues.

4) About 13% of the Annual Restatements linked to an auditor departure were restatements that corrected only misstatements that occurred after the new auditor's engagement.

A review of the 53 Annual Restatements disclosed by companies that also experienced an auditor departure found that 7 (about 13% of the 53) adjusted misstatements that occurred only after the new auditor was engaged. A review of the new auditor's time with the new client determined that 5 misstatements were detected within the period of 2.5 years since the engagement and 2 were detected thereafter.[3]

Additional Observations

The Executive Summary focused on a detector breakdown of the 53 Annual Restatements disclosed since January 1, 2006 by 1,355 Russell 1000 companies (the aggregate population over six years) that also experienced an auditor departure since January 1, 2005. As noted in the Research Method section of this report, instead of directly determining the 53 restatements of primary interest, Audit Analytics approached the research in a manner that determined underlying populations of restatements and auditor departures in order to provide context to the final results. These underlying populations allow for a broader review of the Russell 1000. Conversely, Audit Analytics performed a review of individual restatements from certain categories above to obtain additional insight about the restatements identified. Additional observations, both broad and narrow follow:

- **About 82% of the Annual Restatements disclosed by the Russell 1000 were disclosed by companies that did not experience an auditor departure.**

  As explained in the Research Method section, an analysis of all the restatements disclosed on or after January 1, 2006 by the 1,355 Russell 1000 companies (the aggregate population over six years) identified 291 Annual Restatements. The analysis also identified 53 Annual Restatement disclosed by companies that also experienced an auditor departure. Therefore, 238 Annual Restatements were disclosed by companies while maintaining their ongoing relationship with their auditor. This figure shows that about 82% of Annual Restatements were disclosed by companies that experienced no auditor departure.

- **The total auditor changes experienced by the Russell 1000 since January 1, 2005 had a "fresh eyes" restatement discovery rate of no more than about 2.3%.**

  Since January 1, 2005, the research population of 1,355 Russell 1000 companies (the aggregate population over six years) experienced 173 auditor changes. An analysis of all restatements filed since January 1, 2006 identified 291 Annual Restatements. Of the 291 Annual Restatements, 3 were discovered, to some extent, by the assistance of the "fresh eyes" of a newly engaged auditor. Therefore, 3 "fresh eyes" restatements resulted from 173 auditor changes (less than one per year). These numbers represent a discovery rate of approximately 1.7%. As explained in the Research Method below, the analysis looked at one more year of auditor departures than restatements to obtain historical information on the latest restatements. Since 3 "fresh eyes" restatements were identified within the nearly-six-year restatement period reviewed (since January 1, 2006), the inclusion of 2005 would be expected to create no more than one additional "fresh eyes' restatement, which would increase the discovery rate to 2.3%.

- **Two of 3 "fresh eyes" restatements were triggered by an auditor change that occurred before the suggested mandatory auditor rotation period of ten years.**

  As noted in the pie chart above, Audit Analytics identified 3 "fresh eyes" restatements. An individual review of the 3 companies found that Hovnanian had its auditor for 27 years before the auditor departure and subsequent "fresh eyes" restatement. The other 2 "fresh eyes" restatement events, however, fell outside the application of the suggested mandatory auditor rotation period of ten years. PNC Financial had its auditor for 5 years prior to the departure. Likewise, GLG Partners filed their S-1 on December 6, 2007 and thus the ten-year anniversary would not apply until December 6, 2017.

[3] Another restatement is noted in the Research Method section of this report but not discussed here because the restatement only dealt with stock option backdating issues.

- **In addition to the 3 "fresh eyes" restatements, 7 restatements corrected misstatements that occurred after the engagement of the new auditor, 5 of which may be attributable to a lack of familiarity the recently engaged auditor had with its new client and the business.**

  The pie chart provided in the prior section shows 10 Annual Restatements involving the new auditor: 3 restatements (5.7%) detected by "fresh eyes" and 7 restatements (13.2%) that corrected misstatements that occurred only after the new auditor's engagement. As noted in the Research Method section below, academic papers have indicated that auditor rotation can provide a fresh viewpoint and increased professional skepticism on one hand, but on the other hand, can increase the chance of a misstatement due to the recently engaged auditor's lack of familiarity the new clients' businesses, operations, and systems. (Myers et al. 2003, p. 1-3). This lack of familiarity appears to diminish after two years. (Id. at 2). A further review of the 7 restatements that corrected misstatements occurring after the engagement of the new auditor found 5 restatements disclosed within 2.5 years after the engagement ("newly engaged" restatements) and 2 restatements were disclosed thereafter. The 5 "newly engaged" restatements may have resulted, to some extent, from the lack of familiarity the new auditor had with its new client and the new client's business. An 8-K review of these 5 restatements revealed 1 of the 5 "newly engaged" restatements required an Item 4.02 disclosure. Therefore, 4 of the "newly engaged" restatements did not undermine reliance on past financial statements.

Research Method and Results

Since the PCAOB is considering mandatory audit firm rotation for the largest issuers, this research focused on the Russell 1000 companies. The research population includes every public registrant listed in one or more Russell 1000 reconstitution from 2005 to 2010, inclusive: a total of 1,355 companies. The table on page 7 presents the order and results of each step of the research process. Instead of immediately identifying companies that experienced both a restatement and auditor change to find promising restatement-auditor departure events, Audit Analytics adopted a more deliberate approach in order to quantify the underlying populations to allow the final results to be placed in context. The restatement analysis included all restatements disclosed on or after January 1, 2006.[4] To obtain prior auditor change history of the companies with older restatements, the auditor departure analysis covered all disclosures on or after January 1, 2005.

As shown in the table on page 7, research on the 1,355 Russell 1000 companies found 173 auditor departures from 168 unique companies since January 1, 2005 and 378 restatements from 298 unique companies since January 1, 2006. Since quarterly restatements do not address audited financials, Audit Analytics determined which restatements affected a period greater than 353 days ("Annual Restatement"). Application of this criterion found 291 Annual Restatement disclosed by 239 unique companies. An auditor change analysis of the 298 companies that filed one or more restatements found 55 auditor departures experienced by 54 unique companies. When the analysis focused on the 239 unique companies that disclosed an Annual Restatement, 42 auditor departures from 41 companies were identified.

The research then focused on the 54 unique companies that disclosed a restatement since January 1, 2006 while also experiencing an auditor departure since January 1, 2005. These companies were candidates for disclosing restatements that corrected misstatements discovered, in part, by the "fresh eyes" of a recently engaged auditor. These companies disclosed 74 restatements and 53 Annual Restatements. A total of 41 unique companies filed the 53 Annual Restatements.

The last step of the analysis categorized the 53 Annual Restatements linked to an auditor departure. An initial category bifurcation concentrated on the restatement disclosure date and the auditor departure date. If the company disclosed the restatement before the auditor departure, the new auditor was clearly not involved in the discovery of the misstatement.[5] A total of 34 restatements fell under this category and 31 of these restatements were followed by an auditor dismissal (as opposed to a resignation). This group of restatements would contain some occurrences where the need to disclose a restatement harmed the relationship the auditor had with the

[4] The research in this report is based on a database download of October 28, 2011.

[5] This category includes restatements where another auditor was engaged, but the departing auditor remained active after the engagement date to wrap up outstanding work and thus stayed for some time after the new auditor's engagement date.

client and resulted in a decision on the part of the client to dismiss the auditor. The other three restatements, linked to an auditor resignation, could contain situations where the auditor lost faith in the client and chose to sever the relationship.

The remaining 19 (out of 53) Annual Restatements were disclosed after the auditor departure and thus continued to be candidates for occasions where the "fresh eyes" of a recently engaged auditor aided in the discovery of a pre-existing financial misstatement. This group of restatements was broken into three subsets.

1) The next filter compared the auditor at the restatement disclosure with the auditor listed for the opinion period end during the restated period. If the two auditors were different, a potential existed for a "fresh eyes" discovery. A total of 8 restatements fell within this category. An individual review of these 8 restatements found 1 restatement where the corrected misstatement appears to have been found, to some extent, with the assistance of the "fresh eyes" of the recently engaged auditor. This "fresh eyes" restatement was disclosed on February 4, 2008 by PNC Financial Services Group (CIK 713676) after an auditor departure on November 15, 2006. In contrast, the SEC appears to deserve some credit for the discovery of the misstatements adjusted in 3 restatements within this group. The SEC issued a comment letter to Shaw Group (CIK 914024) that seemed to have resulted in 2 restatements and began an investigation of ConAgra (CIK 23217) that appeared to have caused a restatement. In addition, one restatement in the group, a restatement by Metropcs Communications (CIK 1283699), adjusted a misstatement discovered by the audit committee. One restatement was categorized separately, because the restatement only dealt with stock option backdating issues. Lastly, two restatements from this group concerned misstatements that were discovered after a "Loud Exit."[6] As explained more fully in the footnote, a "Loud Exit" describes an auditor engagement where the incoming auditor appears to have assisted in the discovery of a misstatement, but was fully warned of outstanding issues that greatly heighten the likelihood that undetected misstatements existed. The predecessor auditor identified numerous shortcomings, but its efforts to address them were cut short by its departure.

2) The next filter identified those restatements that adjusted work occurring during both the predecessor auditor's engagement and the new auditor's engagement. Again, such a restatement presents a potential for an adjustment found, in part, by the "fresh eyes" of the recently engaged auditor. Three restatements fit this criterion. Further review found 2 restatements appear to have been detected with the assistance of "fresh eyes." If a company determines that its past financials should "no longer be relied upon," a company (if it is a 10-K filer) must disclose this determination in Item 4.02 of a form of 8-K filing.[7] If a restatement is not preceded by an Item

[6] A "Loud Exit" describes an auditor engagement where the incoming auditor appears to have assisted in the discovery of a misstatement, but was fully warned of outstanding issues that greatly heighten the likelihood that undetected financial misstatements exist while the predecessor auditor's efforts were apparently cut short by its departure. One restatement in this category is a restatement disclosed on May 24, 2006 by Coldwater Creek (CIK 1018005). On March 9, 2005, the company disclosed a restatement that adjusted lease and capitalization issues. On June 20, 2006, KPMG filed a restated SOX 404 auditor attestation noting a number of material weaknesses in the company's internal controls over financial reporting (IFCRs) including revenue recognition issues. The company dismissed KPMG on April 19, 2006 and engaged Deloitte. About one month later, on May 24th, the company disclosed a new restatement (the restatement at issue in this analysis). As a rule, when reviewing all restatements, Audit Analytics erred on the side of allocating "fresh eyes" credit on finding the misstatements, and the 8-K, Item 4.02 noted that the company discovered the misstatement on May 22nd "based on review and consultation with it independent auditor," but this scenario is not a clean "fresh eyes" discovery since Deloitte accepted the engagement fully aware of ongoing concerns. The misstatement was discovered very quickly after the engagement and it appears that KPMG's efforts to address concerns were cut short. The second Loud Exit restatement was the Toys R Us (CIK 1005414) restatement disclosed on May 15, 2007. On April 28, 2005, E&Y filed a SOX 404 auditor attestation noting a numerous material weaknesses in the company's IFCRs and about three months later, on July 26th, E&Y was dismissed. The company engaged Deloitte and it took over two years of work before Deloitte could file a clean SOX auditor attestation on May 2, 2008. During this time, on May 15, 2007, the company disclosed a restatement. Since E&Y's efforts were cut short, a Load Exit designation was given to this scenario.

[7] In response to Section 409 of the Sarbanes-Oxley Act of 2002, entitled "Real Time Issuer Disclosures," the SEC identified new reportable items that must be disclosed in an 8-K. This new set of disclosure requirements became effective on August 23, 2004 and applied to all registrants that file 10-Ks for annual reports. (See SEC Form 8-K Directions: www.sec.gov/about/forms/form8-k.pdf .) One of the new reportable events that triggered a disclosure, within four business days, is the conclusion that a past financial statement should "no longer be relied upon." Such an event is to be disclosed in an 8-K under Item 4.02. Pursuant to SEC Release 33-8400, the population of registrants that must file 8-K disclosures are those companies that file an annual report other than on Form 20-F or 40-F. (http://www.sec.gov/rules/final/33-8400.htm)

4.02, past financials are still reliable. Therefore the presence or absence of an Item 4.02 provides some indication of a restatement's severity. Out of the 2 "fresh eyes" restatements identified in this group, one required an Item 4.02 and one did not.[8] A review of the background of the restatement disclosed by Precision Castparts (CIK 79958) on May 29, 2008 found that it was caused by an inquiry contained in an SEC comment letter of January 29, 2008 and, thus, the restatement is under the "SEC eyes" category.

3) The last category of restatements identified was those restatements that adjusted work that occurred only under the new/current auditor's engagement. These restatements do not implicate the participation of "fresh eyes," but introduce another element of auditor rotation. Academic papers addressing auditor rotation have noted that "[t]he mandatory rotation of audit firms has long been recommended as a means to improve audit effectiveness and, in turn, improve the quality of financial reporting," but, in contrast, studies "of substandard auditor performance, found indications that a lack of familiarity with new clients' businesses, operations, and systems, in first- or second-year audits was potentially more detrimental to audit quality than was any 'over familiarity' or close relationship due to long-term auditor tenure." (Myers, J., L. Myers, Z-V. Palmrose, and S. Scholz. 2004. *Mandatory auditor rotation: Evidence from restatements.* Working paper, University of Illinois: p. 1-2.) The restatements in this last category are candidates for the latter effect: misstatements occurring soon after an auditor is engaged due the auditor's lack of familiarity ("newly engaged" restatement). A review of the last 8 restatements found 5 that could fall within the "newly engaged" category, but only 1 of the 5 was accompanied by an Item 4.02. Four of these restatements did not require an Item 4.02. Two of the restatements were disclosed over 2.5 years after the engagement and thus categorized separately. In addition, another restatement was categorized separately because the restatement only dealt with stock option backdating issues.

As a side task, Audit Analytics performed an individual review of each of the 3 companies that disclosed the "fresh eyes" restatements to determine the tenure of the auditor that departed prior to the disclosure of the restatement. This review found that Hovnanian Enterprises (CIK 357294) had a 27-year relationship with its auditor before the departure and subsequent "fresh eyes" restatement. The other two "fresh eyes" restatement events, however, fell outside the application of the suggested mandatory auditor rotation period of ten years. PNC Financial Services Group (CIK 713676) engaged its auditor for 5 years prior to the "fresh eyes" restatement. Likewise, GLG Partners (CIK 1365790) filed their S-1 on December 6, 2007 and thus the ten-year anniversary would not apply until December 6, 2017.

In summary, a database analysis of 1,355 Russell 1000 companies (the aggregate population over six years) found 378 restatements – of which 291 were Annual Restatements – disclosed on or after January 1, 2006. The same 1,355 companies experienced 173 auditor departures on or after January 1, 2005. The research steps described above found a total of 3 Annual Restatements where the misstatement was discovered, to some degree, with the assistance of the "fresh eyes" of the recently engaged auditor. (See Pie Chart on page 8.) Two of the 3 "fresh eyes" restatements required the filing of an Item 4.02 (past financials can no longer be relied upon) and 1 did not. Also, 2 of the 3 "fresh eyes" restatements presented a scenario outside the application of the suggested 10-year auditor rotation period because the auditor that departed had not reached the 10-year mark prior to the departure. The analysis also found other categories of interest. Two other restatements involved "fresh eyes" but were said to be discovered after a "Loud Exit" because the incoming auditor was given full warning of many shortcomings and the departed auditor's efforts to address the shortcomings was cut short by its departure. In addition, the SEC was given credit for the discovery of the issues addressed in 4 restatements and an audit committee was given credit for the discovery of 1 misstatement. The possible negative consequence of an auditor change is the new auditor's lack of familiarity with the new clients businesses, operations, and systems. The research identified 5 restatements that could possibly be attributable to a lack of familiarity, but only one of the 5 required an Item 4.02.

[8] GLG Partners (CIK 1365790) restatement of April 15, 2008 was disclosed in Item 4.02 while the Hovnanian Enterprises (CIK 357294) restatement of December 22, 2010 was not.

Russell 1000
Research Steps and Results (Updated)

Research Steps and Data Description			#
1) Research Population: Companies that were in the Russell 1000 at Least Once During a 6 Year Period: 2005 to 2010			
Russell 3000 Population, 6 Year Aggregate from 2005 to 2010 companies			1,355
Population Breakdown:	U.S.		1,308
	Canada		2
	Foreign		45
2) Auditor Departures Experienced by Research Population since Jan. 1, 2005			
Auditor Departures			173
Unique Companies with One or More Departures			168
3) Restatements Filed since Jan. 1, 2006 by Those with Auditor Departures Identified Above			
Total Restatements			378
Unique Companies with One or More Restatements			298
Total Annual Restatements (Restate Period > 353 days)			291
Unique Companies with One or More Annual Restatements			239
4) Auditor Departures by the 298 Unique Companies that Filed Restatements (as Identified Above)			
Auditor Departures			55
Unique Companies with One or More Departures			54
Auditor Departures from Those with Annual Restatements			42
Unique Companies with Annual Restatement & One or More Departures			41
5) Restatements Filed since Jan. 1, 2006 by the 54 Companies that also Experienced an Auditor Departure Since Jan. 1, 2005.			
Total Restatements			74
Unique Companies with One or More Restatements			54
6) Annual Restatements Filed since Jan. 1, 2006 by the 41 Companies that also Experienced an Auditor Departure Since Jan. 1, 2005.			
Total Annual Restatements (Restate Period > 358 days)			53
Unique Companies with One or More Annual Restatements			41
7) Categorizing the 53 Annual Restatements Filed since Jan. 1, 2006 by the 41 Companies that also Experienced an Auditor Departure Since Jan. 1, 2005.			
Restatements that Occurred Before Auditor Departure and thus misstatement discovered without "fresh eyes"			34
Restatements that Occurred After an Auditor Departure **AND**			
	1) Auditor at the Restatement Disclosure Date is NOT an Auditor listed as Auditor for the Opinion Period End During the Restated Period.		
		• Incoming Auditor's "fresh eyes" appears to have assisted; 8-K, Item 4.02 disclosure	1
		• Incoming Auditor's "fresh eyes" appears to have assisted; no Item 4.02	0
		• "**SEC** eyes" initiated (comment letter or investigation)	3
		• Misstatement discovered after "Loud Exit"[2]	2
		• Audit Committee inquiry prior to new auditor engagement	1
		• Auditor restates due to stock option backdating	1
	2) Restatements that adjust work during prior auditor's engagement and work during present auditor's engagement and thus "fresh eyes" appear to have assisted; 8-K, Item 4.02 disclosure filed.		1
	Restatements that adjust work during prior auditor's engagement and work during present auditor's engagement and thus "fresh eyes" appear to have assisted; no Item 4.02.		1
	Restatements that adjust work during prior auditor's engagement and work during present auditor's engagement, but "**SEC** eyes" (comment letter inquiries) appear to have assisted; no Item 4.02.		1
	3) Restatements that adjust only work during current auditor's engagement and thus No "fresh eyes."		
		• Auditor restates own work (possibly due to lack of familiarity)[3]	1
		• Auditor restates own work (possibly lack of familiarity/no Item 4.02)	4
		• Auditor restates own work (no lack of familiarity/over 2.5 years engaged)	2
		• Auditor restates due to stock option backdating	1

Notes:

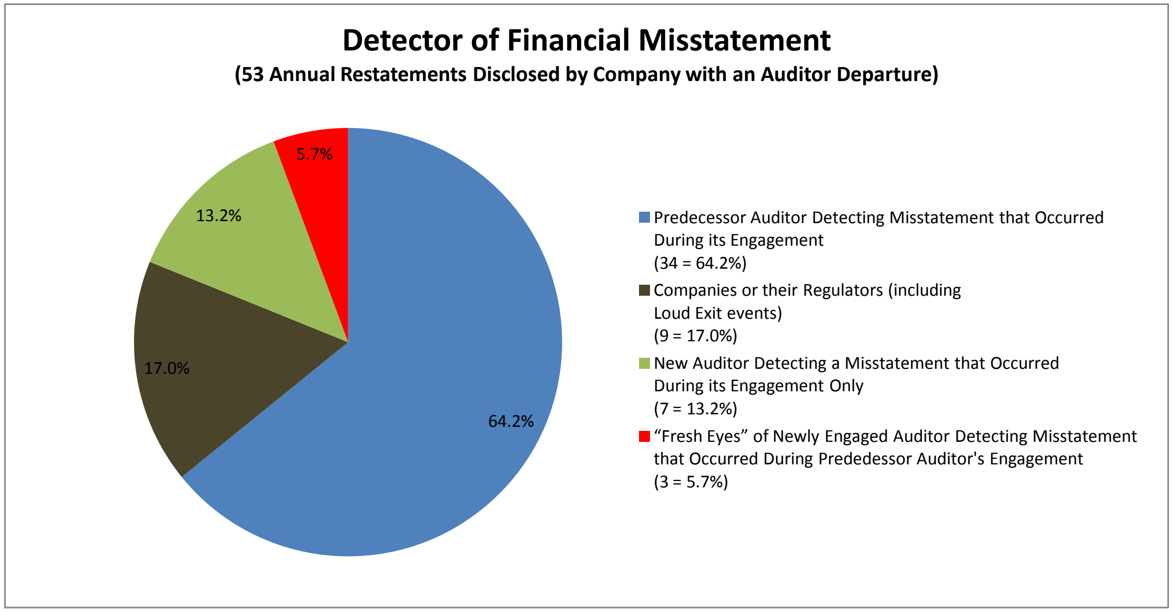
1) Research based on a database download of October 28, 2011. As explained in the report, the update changes one detection from "fresh eyes" to "SEC eyes."

2) A "Loud Exit" describes an auditor engagement where the incoming auditor was fully warned of outstanding issues that greatly heightened the likelihood that undetected financial misstatements existed. For a full description of this type of restatement, see footnote 4 in the text of the report.

3) By lack of familiarity, we refer to a "new client's businesses, operations, and systems." (Myers, J., L. Myers, Z-V. Palmrose, and S. Scholz. 2004. Mandatory auditor rotation: Evidence from restatements. Working paper, University of Illinois: p. 2.)

4) The EXCO restatement (key 13949) is counted as a restatement but not an annual restatement because it addressed an unaudited footnote.

Detector Breakdown of Step 7 Table Results (Updated)



7) Categorizing the 53 Annual Restatements Filed since Jan. 1, 2006 by the 41 Companies that also Experienced an Auditor Departure Since Jan. 1, 2005.		Predecessor Auditor	Company or Regulator	New Auditor	"Fresh Eyes"
Restatements that Occurred Before Auditor Departure and thus misstatement discovered without "fresh eyes"	34	34			
Restatements that Occurred After an Auditor Departure **AND**					
1) Auditor at the Restatement Disclosure Date is NOT an Auditor listed as Auditor for the Opinion Period End During the Restated Period.					
• Incoming Auditor's "fresh eyes" appears to have assisted; 8-K, Item 4.02 disclosure	1				1
• Incoming Auditor's "fresh eyes" appears to have assisted; no Item 4.02	0				0
• "**SEC** eyes" initiated (comment letter or investigation)	3		3		
• Misstatement discovered after "Loud Exit"[2]	2		2		
• Audit Committee inquiry prior to new auditor engagement	1		1		
• Auditor restates due to stock option backdating	1		1		
2) Restatements that adjust work during prior auditor's engagement and work during present auditor's engagement and thus "fresh eyes" appear to have assisted; 8-K, Item 4.02 disclosure filed.	1				1
Restatements that adjust work during prior auditor's engagement and work during present auditor's engagement and thus "fresh eyes" appear to have assisted; no Item 4.02.	1				1
Restatements that adjust work during prior auditor's engagement and work during present auditor's engagement, but "**SEC** eyes" (comment letter inquiries) appear to have assisted; no Item 4.02.	1		1		
3) Restatements that adjust only work during current auditor's engagement and thus No "fresh eyes."					
• Auditor restates own work (possibly due to lack of familiarity)	1			1	
• Auditor restates own work (possibly lack of familiarity/no Item 4.02)	4			4	
• Auditor restates own work (no lack of familiarity/over 2.5 years engaged)	2			2	
• Auditor restates due to stock option backdating	1		1		
		34 = 64.2%	**9 = 17.0%**	**7 = 13.2%**	**3 = 5.7%**

Note: This table has been updated since the initial publication of the report to insert a new "**SEC** eyes" row for Category 2, and to transfer the detection of the misstatement from "fresh eyes" to "**SEC** eyes" in response to the discovery of an SEC comment letter regarding the restatement (with no 8-K,Item 4.02) disclosed by Precision Castparts (CIK 79958).

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