International Federation of Accountants
545 Fifth Avenue, 14th Floor New York, NY 10017
T +1 212 286 9344 F +1 212 286 9570
www.ifac.org

December 14, 2011

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

By e-mail: comments@pcaobus.org

Dear Sir/Madam

Re: PCAOB Concept Release on Auditor Independence and Audit Firm Rotation Release No. 2011-006; August 16, 2011

The International Federation of Accountants (IFAC) values the opportunity to comment on the Concept Release examining auditor independence and audit firm rotation. Through its membership, currently 167 professional accountancy bodies in 127 countries and jurisdictions, IFAC represents approximately 2.5 million accountants in public practice, industry and commerce, government, and education.

IFAC recognizes that independence is the cornerstone of auditing. It welcomes initiatives aimed at improving audit quality, including through strengthening independence, and enhancing the auditors' objectivity and skepticism when undertaking audit engagements.

However, it is not clear to IFAC what specific "lessons" for auditors, and the auditing profession, have been learned from the global financial crisis in respect to independence. IFAC considers that proposals to introduce mandatory audit firm rotation requirements in an effort to promote greater independence should be subject to appropriate assessment of the effects of such reforms, and cost/benefit analysis, to ensure that the desired outcomes are achievable in an efficient and effective manner. In recent years, the auditing profession has been subject to continuous scrutiny, and high levels of regulatory oversight, inspection, and debate. A raft of major changes to independence requirements, such as legislatively mandated audit partner rotation requirements and prohibitions on the provision of certain non-audit services, were introduced in many countries, including the US, over the past five to seven years. These changes are still relatively new, and have not been in place sufficiently long enough to objectively assess their impact. To propose and implement further changes at this time makes it virtually impossible to determine with any certainty the effectiveness of past, and future, regulatory reforms in the audit profession.

The global financial crisis highlighted the inter-connectedness of the global economy, and how events in one country can have ramifications throughout many other regions. For the accountancy profession, including auditors, it is vital that governments and regulators recognize the importance of global regulatory convergence. The need for one set of high-quality internationally accepted auditing standards, consistent globally accepted independence, registration and reporting requirements, and consistent regulatory oversight arrangements are all important objectives in attaining convergence. With this in mind, IFAC stresses the importance of ensuring that governments and regulators, including the Public Company Accounting Oversight Board (PCAOB), strive for consistency in audit independence arrangements throughout the globe, in order to: minimize systemic risks created by inconsistent regulatory arrangements; reduce the costs and inefficiencies that come from differences in arrangements; and minimize the potential for regulatory arbitrage.

IFAC recognizes that the issue of mandatory audit firm rotation has been raised, and is being considered, by several jurisdictions outside of the US. It encourages the PCAOB to ensure that it considers consultations, studies, and proposals from other jurisdictions in forming its conclusions. However, in doing so, it is important for the PCAOB to be cognizant of the underlying premise for proposing changes to audit firm rotation. While the PCAOB has clearly identified it as being related to enhancing independence, objectivity, and professional skepticism, in other jurisdictions it has been related to a desire for structural reform in the audit firm market and the promotion of audit firm market competition.

In relation to audit firm rotation and enhancing auditors' professional skepticism, IFAC outlined its position in its response to the European Commission (EC)'s Green Paper, *Audit Policy: Lessons from the Crisis*.[1]

On mandatory audit firm rotation, IFAC is of the view that the engagement of audit firms should not be time-limited. Substantially all research in this area indicates that mandatory firm rotation can undermine audit quality. Several studies of mandatory firm rotation—including one undertaken by the Università Bocconi[2]—demonstrate that it can have adverse impacts. Some adverse effects noted include: a reduction in audit quality; increases in market concentration for audits of listed companies; and increases in total audit costs. IFAC considers that audit committees and/or shareholders should have the authority to make the decision to change audit firms at any time.

As there are a number of measures, including prohibitions and safeguards, to protect auditor independence—including those provided in the International Ethics Standards Board of Accountants (IESBA) Code of Ethics for Professional Accountants with respect to rotation of key audit partners for public interest entities—IFAC does not believe that sufficient evidence exists to support the view that mandatory firm rotation would bring an incremental benefit to auditor independence that would outweigh the risks to audit quality. Indeed, for public interest entities (which would include public companies in the US), IFAC supports mandatory partner rotation after a fixed period of time.

In respect to professional skepticism, IFAC notes that it has always been and continues to be a critical aspect of both the auditor's independence and of audit quality, and should be continually reinforced. Professional skepticism is at the very core of performing an audit in accordance with high-quality auditing standards, such as the International Standards on Auditing (ISAs). Professional education plays a critical role in equipping the auditor with skills for exercising professional skepticism, and International Education Standards (IESs), which are developed by the International Accounting Education Standards Board (IAESB), identify requirements for professional skills, general education, and competence for audit professionals. These standards are developed within an international context and, when adopted as part

[1] Refer letter dated December 8, 2010: www.ifac.org/publications-resources?publication-type=23&source=29&issues=&language=&x=60&y=10

[2] SDA Università Bocconi, *The impact of mandatory audit rotation on audit quality and on audit pricing: the case of Italy,* 2002

of accounting educational training curricula, can contribute to the continual reinforcement of professional skepticism.

Additionally, IFAC suggests that further research be undertaken to empirically assess the extent to which there is a lack of professional skepticism. More research should be undertaken to explore the behavioral elements that may compromise professional skepticism: for example, factors that lead individuals to compromise their professional skepticism despite stringent regulations, related oversight and enforcement regimes. Research in this area might well draw on the assessments of audit regulators in a range of countries, including, importantly, those where the financial crisis had relatively less impact.

Finally, IFAC notes that a recent independent academic assessment[3] of relevant specific questions raised in the EC Green Paper indicated that—of those respondents who are not part of the audit profession—over 80 percent were not in favor of either mandatory audit firm rotation or of imposing a limited audit tenure. While the responses from the audit profession were somewhat more varied, a majority of respondents did not favor these proposals.

Responses to each question raised in the Concept Release are included in the attachment to this letter.

Please do not hesitate to contact me should you wish to discuss any of the matters raised in this submission.

Sincerely,

Ian Ball
Chief Executive Officer

Attachment

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3 Böcking et al, "*Analysis of the EU Consultation on the Green Paper 'Audit Policy: Lessons from the Crisis'*", Goethe-University Frankfurt, Working Paper, November 21, 2011

ATTACHMENT

General Questions

The Board is interested in comment on whether mandatory auditor rotation would significantly enhance auditors' objectivity and ability and willingness to resist management pressure. Would audit firm rotation enhance auditor independence, objectivity and professional skepticism?

IFAC is not familiar with any research evidence to support the notion that mandatory audit firm rotation would enhance auditors' objectivity and ability and willingness to resist management pressure.

An auditor's objectivity and ability and willingness to resist management pressure are important aspects of an auditor's ethical behavior. Expectations of ethical behavior are typically detailed in codes of ethics, such as the international *Code of Ethics for Professional Accountants*, issued by the International Ethics Standards Board for Accountants (IESBA). In this Code, objectivity is identified as one of the five fundamental principles with which all professional accountants must comply.

IFAC encourages the PCAOB to consider the importance of adopting and enforcing a high-quality accepted code of ethics as a means of influencing auditors' behavior. This would be preferable to proposing reforms, the results of which are uncertain, and which might lead to a reduction in audit quality, according to existing evidence.

Does payment by the audit client—inherent in the framework established by Congress in 1933—inevitably create, in the words of the European Commission, "a distortion within the system"?

IFAC acknowledges that there may be potential perceived conflict of interest and independence threats in respect of the auditor being appointed and remunerated by the audit client. However, IFAC believes that these conflicts and threats are appropriately and sufficiently mitigated with certain measures, such as corporate governance initiatives that: emphasize the importance of the selection, appointment, and remuneration of the auditor being independent of management and/or executive directors; strengthen the role and responsibilities of the audit committee (assuming that it is largely composed of non-executive directors); and strengthen the role of the shareholders in the selection of the auditor.

Is it possible that distortion is amplified when auditors know at the outset of any new engagement that the stream of audit fees they could receive from a new client is unlimited?

It is not appropriate to suggest that, at the outset of any new engagement, an auditor believes that a stream of audit fees from a new client would be unlimited. In most cases, the auditor would have just been through a highly competitive tendering process to have secured the new engagement. The auditor would be aware that competitive pressures in the market, and the close scrutiny afforded audit firms by regulatory oversight bodies, necessitates the delivery of high-quality audit services.

If mandatory rotation would not eliminate the distortion—the company under audit would still be paying the fee—could rotation dramatically reduce it?

As noted in response to an earlier question, IFAC considers that there are measures that exist and/or can be put in place to mitigate the risks of potential perceived conflict of interest and independence threats in respect of the auditor being appointed and remunerated by the audit client.

A firm that knows at the outset that it is going to "lose the client" eventually, no matter what it does, might have much less reason to compromise its independence, risking the firm's own reputation and potentially its continued viability, in order to preserve the relationship.

IFAC is not aware of any research evidence to support the notion that an auditor who knows at the outset that an engagement is for a limited tenure has less reason to compromise their independence, or risk the firm's own reputation and potentially its continued viability, in order to preserve the relationship.

Auditors, as professional accountants, and by their affiliation with the accounting profession (generally through professional accountancy organizations), are obliged to comply with professional standards of conduct and ethics. Adherence to these standards ensures that the auditor works to safeguard against potential threats to independence.

The Board is also interested in views on whether a periodic "fresh look" at a company's financial statements would enhance auditor independence and protect investors.

The Concept Release highlights the different perspectives on this question. These views must be balanced: a new audit engagement may be associated with potential enhanced professional skepticism; at the same time, audit quality may be enhanced as the engagement period lengthens and the auditor attains a greater understanding of the audit client's operations. However, IFAC notes that substantially all research in this area indicates that mandatory firm rotation can undermine audit quality.

As noted previously, potential threats to the independence and the quality of work of the auditor relate to the ethical behavior of the auditor. Expectations of ethical behavior are typically detailed in codes of ethics, such as the international *Code of Ethics for Professional Accountants* issued by the IESBA. In this Code, objectivity is identified as one of the five fundamental principles with which all professional accountants must comply.

Finally, in approaching the following questions, commenters are urged to consider whether alternatives to mandatory rotation exist that would enhance independence, objectivity and professional skepticism. Commenters are also urged to consider whether the current state of the audit profession, in light of engagement partner rotation and audit committee practices following the passage of the Act, as well as recently promulgated and pending changes to the Board's auditing standards, may have rendered some of the historical perspectives on rotation, summarized above, no longer relevant. The Board is also interested in the evolution of audit committee practices and the increased complexity of the audit as these phenomena may affect the appropriateness of both mandatory firm rotation and other available practices or requirements as means of enhancing auditor independence, objectivity and professional skepticism. More important, however, at least preliminarily, are commenters' views on the following more general issues:

- **Should the Board focus on enhancing auditor independence, objectivity and professional skepticism? How significant are the problems in those areas relative to problems in other areas on which the Board might focus? Should the Board simply defer consideration of any proposals to enhance auditor independence, objectivity and professional skepticism?**

While IFAC fully supports initiatives that aim to enhance audit quality, it encourages the PCAOB to consider whether there is need for regulatory reforms in respect to auditor independence.

The effectiveness and impact of the major regulatory reforms pertaining to auditor independence, introduced in the last five to seven years (particularly in relation to audit partner rotation, which in many cases is now at, or just past, the first mandated rotation), have yet to be fully assessed. Therefore, it seems neither appropriate, nor an efficient allocation of resources, to embark on further regulatory reform at this time. The PCAOB should encourage independent research to assess the effectiveness of recent reforms.

In relation to enhancing professional skepticism, IFAC "suggests that further research be undertaken to empirically assess the extent to which there is a lack of professional skepticism. In addition, more research should be undertaken to explore the behavioral elements that may compromise professional skepticism: for example, factors that lead individuals to compromise their professional skepticism despite stringent regulations, related oversight and enforcement regimes. Research in this area might well draw on the assessments of audit regulators in a range of countries, including, importantly, those where the financial crisis had relatively less impact".[4]

- **What are the advantages and disadvantages of mandatory audit firm rotation? If there are potential disadvantages or unintended consequences, are there ways a rotation requirement could be structured to avoid or minimize them?**

The Concept Release discusses the range of key advantages and disadvantages of mandatory audit firm rotation. IFAC does not have any further comments to add in this regard.

- **Because there appears to be little or no relevant empirical data directly on mandatory rotation available, should the Board conduct a pilot program so that mandatory rotation of registered public accounting firms could be further studied before the Board determines whether to consider developing a more permanent requirement? How could such a program be structured?**

As noted previously, substantially all available research indicates that mandatory firm rotation can undermine audit quality, with several studies—including one undertaken by the Università Bocconi[5]—demonstrating that it can have adverse impacts.

Therefore, while a proposal to conduct a pilot program has intuitive appeal, matters pertaining to the timing and structure of such a program require careful consideration. IFAC notes that in proposing and implementing a study of this kind, the PCAOB needs to cognizant of:

- the independence and objectivity of the researchers. The study must be structured in such a way that enables all potential outcomes an equal chance of occurring, and does not dictate a

[4] Refer letter dated December 8, 2010: www.ifac.org/publications-resources?publication-type=23&source=29&issues=&language=&x=60&y=10

[5] SDA Università Bocconi, *The impact of mandatory audit rotation on audit quality and on audit pricing: the case of Italy,* 2002

preferred result. Researchers independent of the PCAOB should be engaged to perform the study;

- the fact that the study will suffer from a selection bias. That is, the "subjects" of the study will be aware of the purpose of the study, and can act in a manner that influences the results. The PCAOB will need to consider how to control for such bias; and

- the need to have a control group, or constant base, against which to assess the outcomes of the study. As noted previously, it is not clear what the impact of recent regulatory changes in respect of auditor independence (e.g., audit partner rotation) has been on audit quality. A new study has to be structured in such a way as to be able to distinguish between the impact of those changes made in recent years, and those which are being proposed.

- **According to the 2003 GAO Report, large firms estimated that a rotation requirement would increase initial year audit costs by more than 20 percent. What effect would a rotation requirement have on audit costs? Are there other costs the Board should consider, such as the potential time and disruption impact on company financial reporting staff as a result of a change in auditors? Are there implementation steps that could be taken to mitigate costs? The Board is particularly interested in any relevant empirical data commenters can provide in this area.**

IFAC is not aware of relevant empirical data that purports to support the estimated increase in audit costs outlined in this question. The PCAOB is correct in identifying increased costs to be borne by the audit client. Not only will there be the time and disruption impact on financial reporting staff, there will also be potential impact on other facets of the audit client's operations, including the board, management, management experts (e.g., engaged to undertake valuations), banks, debtors (e.g., asked to confirm balances), creditors, and so on, who are required to become familiar with the new auditor.

Additionally, there will be costs borne by the audit client in relation to the resources devoted by the audit committee to the tendering and appointment process for a new auditor. Potentially, there may be additional costs passed on by the outgoing auditor, who may factor in the need to be consulted by the incoming auditor into the final years' audit costs.

Finally, an empirical question of interest relates to whether the increase in tendering and appointment activity would lead to an overall increase, or decrease, in the total costs of audits in the marketplace. Simple market theory would suggest that a larger number of audit tenders would increase competition among the suppliers of audit services, and hence drive down the costs of audits. Alternatively, as audit firms are required to submit a greater number of tender bids, the costs associated with making bids will be factored into audit prices—with the firm knowing that the proportion of successful tender bids will potentially decline.

- **A 2003 report by the Conference Board Commission on Public Trust and Private Enterprise recommended that audit committees consider rotation when, among other factors, "the audit firm has been employed by the company for a substantial period of time— e.g., over 10 years." To what extent have audit committees considered implementing a policy of audit firm rotation? If audit committees have not considered implementing**

such a policy, why not? What have been the experiences of any audit committees that have implemented a policy of rotation?

IFAC is not aware of empirical data that supports the recommendation of the Conference Board Commission.

However, IFAC makes the point that there is a difference between an audit committee considering audit firm rotation, and an audit committee that actually implements a policy of audit firm rotation. It would be an interesting, and potentially insightful, academic question to examine the relationship between the consideration of rotation by an audit committee, and actual audit firm rotation. The results of such a study would assist in identifying features, characteristics, and events that lead an audit committee that is considering rotation to proceed with a tendering process. Furthermore, it would be insightful to know whether, in cases where an audit committee does proceed to tendering, what proportion subsequently lead to a change of auditor—and the reasons why it does, or does not.

- **Are there alternatives to mandatory rotation that the Board should consider that would meaningfully enhance auditor independence, objectivity and professional skepticism? For example, should broader alternatives be considered that relate to a company's requirement to obtain an audit, such as joint audits or a requirement for the audit committee to solicit bids on the audit after a certain number of years with the same auditor? Could audit committee oversight of the engagement be otherwise enhanced in a way that meaningfully improves auditor independence?**

IFAC expressed its views on joint audits and mandatory audit tendering in its response to the EC's Green Paper, *Audit Policy: Lessons from the Crisis*.[6] It noted that in respect to joint audits, a regulatory intervention of this type would require further evidence and market analyses to demonstrate that it would achieve the intended purpose. Current evidence points to a mixed record of effectiveness of such arrangements, depending upon the jurisdiction. Therefore, joint audits should not be mandated until further research is undertaken. Further evidence would be helpful in determining the following:

(a) That such a model would achieve a reasonable balance of costs and benefits in terms of the pricing of such services, the time required to execute such joint audits, and most importantly, the quality of the audit; and,

(b) Whether such market intervention would have other negative consequences, which—due to the lack of research currently available—remain unrecognized or not yet understood.

On mandatory tendering, IFAC outlined its view that audit committees and/or shareholders should have the authority to make the decision to change audit firms at any time. If research can demonstrate that periodic tendering will result in the benefits that are expected, one area that could be explored is a "comply or explain" mechanism for audit committees in regards to their periodic tendering considerations. Periodic tendering would only be justifiable over long intervals of time, as it could be potentially costly and time-consuming.

[6] Refer letter dated December 8, 2010: www.ifac.org/publications-resources?publication-type=23&source=29&issues=&language=&x=60&y=10

Alternatives to mandatory audit firm rotation that may be considered by the PCAOB include enhancing the role of the audit committee, in respect to auditor independence. In particular, the transparency and accountability of the audit committee may be enhanced through arrangements requiring the committee to communicate to shareholders, in a timely manner, its processes and decision-making in respect to auditor appointment, performance evaluation, and remuneration. Furthermore, while current arrangements require that the audit committee must include at least one member with financial literacy, the benefits that accrue from have a diversity of experience and views should not be discounted. Another alternative is to consider requiring audit firms to furnish to its audit clients with a declaration that it maintained independence—in line with mandated independence laws and requirements—throughout the audit engagement. Such a declaration, as is now required in Australia, would be made publicly available in the client's financial report. Furthermore, a similar declaration could be considered for the audit report itself. Public disclosure of the auditor's independence by the auditor heightens the accountability of the auditor, and is more likely to ensure that the auditor considers all aspects of the declaration before making it.

- **Should the Board continue to seek to address its concerns about independence, objectivity and professional skepticism through its current inspection program? Is there some enhanced or improved form of inspection that could better address the Board's concerns? If mandatory rotation were in place, could an enhanced inspection, perhaps focused particularly on professional skepticism, serve as a substitute in cases in which it would be unusually costly, disruptive or otherwise impracticable to rotate auditors?**

IFAC does not suggest any enhanced or improved form of inspection. However, it is of the view that the PCAOB should endeavor to strive for the most robust, efficient and effective inspection program—that adequately considers matters of auditor independence, objectivity, and professional skepticism—regardless of whether or not there is a requirement for mandatory audit firm rotation. As noted previously, IFAC considers that adherence to high-quality professional and ethical standards means that auditors' adherence to independence requirements, and levels of professional skepticism, will remain unchanged whether there is mandatory audit firm rotation or not. Consequently, the PCAOB inspection program would also be expected to remain unchanged.

<u>Specific Questions</u>

Term of Engagement

1. **If the Board determined to move forward with development of a rotation proposal, what would be an appropriate term length?**

IFAC does not express a view on what length of time might be appropriate if an audit firm rotation proposal was to be adopted. IFAC encourages the PCAOB to consult widely (including internationally), and consider all manner of research in this area before making any decision.

2. **Should different term lengths for different kinds of engagements be considered? If so, what characteristics, such as client size or industry, should this differentiation be based on?**

Notwithstanding IFAC's view that the duration of an audit firm's tenure should not be limited, there appears to be no basis for differentiating engagement term lengths for public companies according to client size or industry. The *Code of Ethics for Professional Accountants*, issued by the IESBA, describes independence requirements for audit and other assurance engagements. It makes a distinction between requirements for engagements where a public interest entity (which includes public companies in the US) is the client, and engagements where the client is not a public interest entity. Differences in requirements include, for example, partner rotation and prohibitions on providing certain non-audit services for public interest entity engagements. IFAC refers the PCAOB to Section 290 of the Code:

www.ifac.org/publications-resources/2010-handbook-code-ethics-professional-accountants

3. Does audit effectiveness vary over an auditor's tenure on a particular engagement? For example, are auditors either more or less effective at the beginning of a new client relationship? If there is a "learning curve" before auditors can become effective, generally how long is it, and does it vary significantly by client type?

The Concept Release discusses some of the research, which suggests that the quality of the audit is potentially lower in the first years of a new audit engagement. IFAC is not aware of evidence that definitively indicates what an appropriate learning curve period might be, including whether there is any difference based on the client type.

4. Some have also suggested that, in addition to being less effective at the beginning of an engagement, an auditor may be less diligent toward the end of the allowable term. On the other hand, others have suggested that auditors would be more diligent towards the end of the allowable term out of concern about what the replacement auditor might find. Would auditors become more or less diligent towards the end of their term? Does the answer depend on the length of the term?

IFAC does not support the view that the diligence of an auditor varies according to the length of tenure of an audit engagement. In complying with a high-quality, internationally accepted code of ethics, an auditor will maintain the highest standards of professional conduct on all engagements. The fundamental principles embodied in the *Code of Ethics for Professional Accountants*, issued by the IESBA, require that an auditor behaves professionally, demonstrates professional competence and due care, maintains confidentiality, and acts with integrity and objectivity.

5. How much time should be required before a rotated firm could return to an engagement?

IFAC does not express a view on what length of time might be appropriate before a rotated firm could return to an engagement.

Scope of Potential Requirement

6. Should the Board consider requiring rotation for all issuer audits or just for some subset, such as audits of large issuers? Should the Board consider applying a rotation rule to some other subset of issuer audits? For example, are there reasons for applying a rotation requirement only to audits of companies in certain industries?

Refer response to Question 2 (above).

Transition and Implementation Considerations

7. **To what extent would a rotation requirement limit a company's choice of an auditor? Are there specific industries or regions in which a rotation requirement would present particular difficulties in identifying an auditor with the necessary skills and expertise? Is it likely that some smaller audit firms might decide to leave the public company audit market due to the level of uncertainty regarding their ongoing client portfolios?**

This question asks respondents to consider the issue of audit firm rotation from a market structure and competition perspective, rather than from a strictly auditor independence perspective (which is the focus of the Concept Release).

IFAC considers that the PCAOB should recognize these two perspectives, and ensure that respondents are clear about the objective of any proposed reform. That is, if the PCAOB determines that audit firm rotation is an essential component of auditor independence, that then becomes the "standard" to be met for an auditor to be considered independent from a public interest viewpoint. Therefore, decisions about the implementation of such reforms should focus on the demand side for audit services (e.g., perhaps making distinctions between requirements for public companies as audit clients—refer response to Question 2, which notes the distinction made between public interest entities and non-public interest entities in terms of independence requirements for assurance engagements in the IESBA *Code of Ethics*), rather than the supply side for audit services (which then necessitates consideration of market structure issues, and confines "independence" to be something that varies according to the then-current market environment for a particular industry, region, type of firm, or particular economic condition).

8. **If rotation would limit the choice of auditors, are there steps that could be taken to allow a company sufficient time to transition out of non-audit service arrangements with firms that could be engaged to perform the audit? Are there other steps that could be taken to address any limitation on auditor choice?**

Refer response to Question 7 (above).

9. **If rotation were required, would audit firms have the capacity to assign appropriately qualified personnel to new engagements? If they do not currently have that capacity, could firms develop it in order to be able to compete for new clients, and would they do so?**

IFAC notes that audit firm rotation may potentially create resourcing problems. While the "pool" of available qualified staff would remain unchanged, it may be difficult to appropriately match specialized skills with rotating arrangements.

This question also appears to be asking respondents to consider the issue of audit firm rotation from a market structure and competition perspective, rather than from a strictly auditor independence perspective.

10. **Would rotation create unique challenges for audits of multinational companies? For voluntary rotations that have taken place, what have been the implementation and cost issues and how have they been managed?**

IFAC does not have evidence to present in respect to implementation and cost issues associated with voluntary audit firm rotations for audits of multinational companies.

However, IFAC reiterates the importance of global regulatory convergence, which is particularly relevant for multinational companies. IFAC encourages the PCAOB to ensure that it considers consultations, studies, and proposals from other jurisdictions in forming its conclusions on audit firm rotation.

11. Would increased frequency of auditor changes disrupt audit firms' operations or interfere with their ability to focus on performing high- quality audits? How would any such disruption vary by firm size? For example, would a rotation requirement pose fewer or more implementation issues for small firms than for large ones?

Auditor changes do not, of themselves, impair the ability of the auditor to perform a high-quality audit. In complying with high-quality, internationally accepted auditing standards and code of ethics, an auditor will maintain the highest standards of professional conduct on all engagements. The fundamental principles embodied in the *Code of Ethics for Professional Accountants*, issued by the IESBA, require that an auditor behaves professionally, demonstrates professional competence and due care, maintains confidentiality, and acts with integrity and objectivity. However, it is clear that, in the early stages of an engagement, greater investment will be required by the auditor to understand the client's operations and risks. These additional audit costs should reduce over time as the auditor's understanding of the client improves.

It appears obvious to suggest that increased frequency of audit firm changes—that is, where a firm was more frequently taking on new clients and losing existing clients—would be disruptive to an audit firm's operations. It could be assumed that larger audit firms would have greater capacity and resourcing than smaller audit firms to devote toward the increasing number of audit tenders that would need to be considered—in terms of the background work required to determine whether or not to make a bid, as well as preparing the tender documents and making presentations to potential audit clients.

12. Would audit firms respond to a rotation requirement by devoting fewer resources to improving the quality of their audits? Would firms focus more on non-audit services than on audit services?

It is not clear to IFAC what impact mandated audit firm rotation would have on firms' decisions to devote resources toward the provision of non-audit services vis-à-vis audit services. However, IFAC recognizes that audit firms devote considerable resources to enhancing audit quality, such as through the development of audit methodology that is responsive to revisions to standards and changes to regulatory requirements. IFAC is of the view that audit firms will devote the necessary resources towards ensuring that an audit engagement is conducted in accordance with the highest standards of professional conduct.

13. Would rotation have any effect on the market for non-audit services? Would any such effect be harmful or beneficial to investors?

IFAC is not aware of any evidence to demonstrate the impact of audit firm rotation on the market for non-audit services.

14. Some have expressed concern that rotation would lead to "opinion shopping," or that in competing for new engagements firms would offer favorable treatment. Others have suggested that rotation could be an antidote to opinion shopping because companies would know that they could not stick with a firm promising favorable treatment forever. Would

opinion shopping be more or less likely if rotation were required? If rotation limits auditor choice, could it at the same time increase opinion shopping?

IFAC notes the different views on the potential impact on "opinion shopping," but is not aware of any evidence that supports either view. Also, IFAC does not support the notion that an auditor would offer favorable treatment to a client. In complying with a high-quality, internationally accepted code of ethics, an auditor will maintain the highest standards of professional conduct on all engagements. The fundamental principles embodied in the *Code of Ethics for Professional Accountants*, issued by the IESBA, require that an auditor behaves professionally, demonstrates professional competence and due care, maintains confidentiality, and acts with integrity and objectivity.

This question and the Concept Release discuss "opinion shopping" only from the perspective of companies attempting to attain more favorable treatment. It does not focus on "opinion shopping" from the perspective of a company attempting to avoid an unfavorable audit opinion. Therefore, the PCAOB needs to be aware of the potential negative ramifications of audit firm rotation—that is, allowing companies to end a relationship with an audit firm where that firm refuses to offer favorable treatment. If a decision to implement audit firm rotation was made, consideration would need to be given to whether the term agreed was a fixed term. Therefore, consideration would also need to be given to arrangements that restrict an audit firm from resigning, or being changed by the client, prior to the expiration of that term; at least without the express permission of the PCAOB, which would need to be informed of the reason for the change.

15. What effect would a rotation requirement have on competition for audit engagements? If competition would be increased, how might that affect audit quality?

Refer response to Question 7 (above).

16. Are there any requirements the Board should consider to mitigate any risks posed by rotation? For example, are there enhancements to firms' quality control systems that might address such risks?

In respect of quality control systems, IFAC recognizes the importance of audit firms establishing and maintaining quality control systems to ensure compliance with professional standards and applicable legal and regulatory requirements, including those pertaining to auditor independence. By ensuring that firms adhere to such quality control standards, the PCAOB is acting to enhance auditor independence. At the international level IFAC notes that the internationally accepted quality control standard is International Standard on Quality Control 1, issued by the International Auditing and Assurance Standards Board.

17. If the early years of an auditor-client relationship pose higher audit risks than later years, should the Board require firms to provide additional audit supervision and oversight in the first year or two of a new engagement? Should the Board impose such a requirement for auditor changes even if it does not further consider requiring audit firm rotation? If firms are accepting new clients but are unable to perform quality audits for them until several years have passed, should the Board require enhanced client acceptance procedures? What impact would additional requirements of this type have on audit costs?

Audit firms would typically provide additional audit supervision and oversight to audit engagements, where necessary, utilizing a risk-based approach. Such an approach takes account of a range of matters, including the client's situation and operations, the length of tenure of the engagement, the experience of the staff, and other regulatory requirements (e.g., for particular industries, such as banking). IFAC is of the view that the PCAOB should not mandate additional audit supervision and oversight in the first year or two of a new engagement, as decisions about such arrangements should be the domain of the audit firm conducting the engagement.

One of the primary arguments against audit firm rotation is the view that it takes some time (e.g., one to two years) for an auditor to develop a very good understanding of the operations of the client company. If this is the case, then it is possible that enhanced client acceptance procedures would not necessarily address the key concerns.

18. If mandatory rotation were required, are existing standards relating to communications between predecessor and successor auditors sufficient? Should additional communications be required? For example, should the outgoing auditor provide the incoming auditor with a written report outlining audit risks and other important information about the company?

IFAC considers that existing standards relating to communications between predecessor and successor auditors are sufficient. They are written to address situations where auditors have changed, and are not predicated on whether the change has been voluntary or required.

Furthermore, a report from an outgoing auditor outlining audit risks has the potential to impair the independence of an incoming auditor, if they were seen to be relying upon the report. This would be contrary to the purpose of having mandatory rotation.

19. Are there other audit procedures that should be required to mitigate any risks posed by rotation?

IFAC has no specific comment to offer on this question.

20. If the Board moved forward with development of a rotation proposal, should consideration be given to the recommendation for a cause restriction on the company's ability to remove an auditor before the end of a fixed term? Would such a provision be useful? Would there be unintended consequences of such a requirement? Should the Board work with the SEC on implementation of this recommendation? Are there other matters on which the Board should coordinate with the SEC?

Refer response to Question 14.

21. What other transition issues might arise in the first year of a rotation requirement? How should the Board address these issues?

IFAC has no specific comment to offer on this question.
