PCAOB PROPOSALS: TENURE, TRANSPARENCY AND INTERNATIONAL PARALLELS

(The ERB)

NASBA 2012 Regional Meetings

June 15th – Philadelphia
Panelists: Gaylen Hansen · Rick David · Rick Isserman
Moderator: Kim Tredinnick

June 28th – Anchorage
Panelists: Billy Atkinson · Gaylen Hansen · Ray Johnson
Moderator: Ted Lodden

Sarbanes-Oxley Act

SEC. 207. STUDY OF MANDATORY ROTATION OF REGISTERED PUBLIC ACCOUNTING FIRMS.

(a) STUDY AND REVIEW REQUIRED. - The Comptroller General of the United States shall conduct a study and review of the potential effects of requiring the mandatory rotation of registered public accounting firms.

(b) REPORT REQUIRED. - Not later than 1 year after the date of enactment of this Act, the Comptroller General shall submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on the results of the study and review required by this section.

(c) DEFINITION. - For purposes of this section, the term "mandatory rotation" refers to the imposition of a limit on the period of years in which a particular registered public accounting firm may be the auditor of record for a particular issuer.

Genesis of Independence Issue

- "Client Payor Model"
- In 2002, Congress considered mandatory firm rotation to address the Client Payor Model when it passed SOX
- Instead, Congress opted for partner rotation and told GAO to study firm rotation, which then stated in its 2003 report
  - *mandatory audit firm rotation may not be the most efficient way to enhance auditor independence and audit quality….*
  - *more experience needs to be gained* with SOX's requirements and that *it will take at least several years for the SEC and the PCAOB to gain sufficient experience with the effectiveness of the act…*
- In 2011, PCAOB decided it had "sufficient experience" and reopened rotation question

Other Drivers to Revisit Rotation

- Inspection deficiencies in critical high-risk areas requiring judgment and skepticism
  - Undue reliance on management judgment
  - "Auditing by Inquiry"
- Proposals by auditors to
  - "Partner" with the client
  - Support client position in National Office consultation
  - Stand by conclusions reached and not second guess joint decisions with clients
- International regulatory developments

PCAOB Concept Release

August 2011:

- Goal: Enhance independence and skepticism
- Consider mandatory rotation of audit firms
  - Tenures > 10 years
  - Largest audits
- Comment letters
  - Over 650 to date
  - Public roundtable March 21 & 22

PCAOB Concept Release
Some Questions Raised

- How grave are independence, objectivity & skepticism issues relative to other audit problem areas?
- Pros and cons of mandatory rotation?
- Should a pilot program be considered?
- Impact on audit costs?
- Alternatives?
  - Joint audits
  - Mandatory re-tendering
  - Audit-only firms
  - More restriction of non-audit services
  - Increase role of audit committee oversight

The International Scene

- European Commission laws proposed
  - Rotation after 6 years
  - Cooling off period 4 years
  - Firms must segregate audit and non-audit services into separate legal entities to form audit-only firms
- Netherlands – lower chamber approved law
  - Mandatory firm rotation after 8 years
  - Prohibits all advisory services

Where Things Stand Now

- Fierce lobbying efforts by large firms, U.S. Chamber of Commerce, NACD, FEI, AICPA and others
- Congressional hearings – March 28, 2012
  - Bill to bar PCAOB from mandating rotation
- PCAOB's current thinking
  - Thought to be backing off on rotation for now
  - Further study of the costs and pros and cons
  - Disclosures about firm tenure considered
  - Mandatory retendering (bidding) considered
  - Role of audit committees revisited
  - Root cause analysis
  - Further public roundtables being scheduled

Why Important to State Boards Sarbanes-Oxley Act

SEC. 209. CONSIDERATIONS BY APPROPRIATE STATE REGULATORY AUTHORITIES.

In supervising nonregistered public accounting firms and their associated persons, appropriate State regulatory authorities should make an independent determination of the proper standards applicable, particularly taking into consideration the size and nature of the business of the accounting firms they supervise and the size and nature of the business of the clients of those firms. The standards applied by the Board under this Act should not be presumed to be applicable for purposes of this section for small and medium sized nonregistered public accounting firms.