United States General Accounting Office

GAO

Report to the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services

February 2004

MANDATORY AUDIT FIRM ROTATION STUDY

Study Questionnaires, Responses, and Summary of Respondents' Comments

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Accountability ★ Integrity ★ Reliability

GAO-04-217

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Highlights

Highlights of GAO-04-217, a report to the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services

February 2004

MANDATORY AUDIT FIRM ROTATION STUDY

Study Questionnaires, Responses, and Summary of Respondents' Comments

Why GAO Did This Study

The Sarbanes-Oxley Act of 2002 required GAO to study the potential effects of requiring public companies registered with the Securities and Exchange Commission (SEC) to periodically rotate the public accounting firms that audit their financial statements. On November 21, 2003, GAO issued its report entitled *Public Accounting Firms: Required Study on the Potential Effects of Mandatory Audit Firm Rotation* (GAO-04-216). This supplemental report contains a copy of each questionnaire used in our study, annotated to show summary responses for each question and selected comments from respondents. GAO is issuing this supplemental report to provide additional detail on the responses to our surveys on the potential effects of mandatory audit firm rotation and to facilitate future research efforts in performing studies related to these matters.

www.gao.gov/cgi-bin/getrpt?GAO-04-217.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Jeanette M. Franzel at 202-512-9471 or franzelj@gao.gov.

What GAO Found

In its November 2003 report, *Public Accounting Firms: Required Study on the Potential Effects of Mandatory Audit Firm Rotation* (GAO-04-216), GAO reported that, considering the costs and benefits of mandatory audit firm rotation and the recent reforms being implemented as a result of the Sarbanes-Oxley Act of 2002, several years' experience will be needed to evaluate the effects of the act. GAO concluded that the most prudent course of action at this time is for the SEC and the Public Company Accounting Oversight Board (PCAOB) to monitor and evaluate the effectiveness of the Sarbanes-Oxley Act's requirements for enhancing auditor independence and audit quality. In that respect, GAO reported that audit committees, with their increased responsibilities under the act, can play a very important role in enhancing auditor independence and audit quality. For example, if audit committees regularly evaluate whether audit firm rotation would be beneficial, given the facts and circumstances of their companies' situation, and are actively involved in helping to ensure auditor independence and audit quality, many of the intended benefits of audit firm rotation could be realized at the initiative of the audit committee rather than through a mandatory requirement.

As part of the study cited above, GAO surveyed the 97 public accounting firms that reported having 10 or more SEC clients and drew a random sample of 330 of the Fortune 1000 public companies' chief financial officers and their audit committee chairs. This report contains summary survey responses to each question received from 74 of the public accounting firms, 201 chief financial officers, and 191 audit committee chairs.

A number of the survey questions also provided an opportunity for respondents to explain their answers to certain questions, write in other answers to the questions rather than the choices provided, and to provide any other comments on the issues presented in the surveys. Selected comments to some of the open-ended questions included in the surveys reflect the range of views that were provided by the respondents. While they provide valuable insights, the number of comments reproduced in this report is not necessarily proportional to the number of similar responses, and, therefore, the comments are not meant to be representative of the views that might be found in each of the populations as a whole.

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Abbreviations

AICPA	American Institute of Certified Public Accountants
GAAP	generally accepted accounting principles
GAAS	generally accepted auditing standards
NAICS	North American Industry Classification System
PCAOB	Public Company Accounting Oversight Board
SEC	Securities and Exchange Commission

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Accountability * Integrity * Reliability

United States General Accounting Office
Washington, D.C. 20548

February 27, 2004

The Honorable Richard C. Shelby
Chairman
The Honorable Paul S. Sarbanes
Ranking Minority Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Michael G. Oxley
Chairman
The Honorable Barney Frank
Ranking Minority Member
Committee on Financial Services
House of Representatives

On November 21, 2003, we reported[1] on mandatory audit firm rotation[2] as required by Section 207 of the Sarbanes-Oxley Act of 2002.[3] GAO reported that, considering the costs and benefits of mandatory audit firm rotation and the recent reforms being implemented as a result of the Sarbanes-Oxley Act of 2002, several years' experience will be needed to evaluate the effects of the act. We concluded that the most prudent course of action at this time is for the Securities and Exchange Commission (SEC) and the Public Company Accounting Oversight Board (PCAOB) to monitor and evaluate the effectiveness of the Sarbanes-Oxley Act's requirements for enhancing auditor independence and audit quality. In that respect, we reported that audit committees, with their increased responsibilities under the act, can play a very important role in enhancing auditor independence and audit quality. For example, if audit committees regularly evaluate whether audit firm rotation would be beneficial, given the facts and circumstances of their companies' situation, and are actively involved in

[1] U.S. General Accounting Office, *Public Accounting Firms: Required Study on the Potential Effects of Mandatory Audit Firm Rotation*, GAO-04-216 (Washington, D.C.: Nov. 21, 2003).

[2] Mandatory rotation is defined in the Sarbanes-Oxley Act as the imposition of a limit on the period of years in which a particular public accounting firm registered with the Public Company Accounting Oversight Board may be the auditor of record for a particular public company. For purposes of this report, the auditor of record is the public accounting firm issuing an audit opinion of the public company's financial statements.

[3] Pub. L. No. 107-204, 116 Stat. 745.

helping to ensure auditor independence and audit quality, many of the intended benefits of audit firm rotation could be realized at the initiative of the audit committee rather than through a mandatory requirement. Our November 21, 2003, report contains the views of the larger public accounting firms (referred to in the report as Tier 1 firms) and Fortune 1000 public companies' chief financial officers and their audit committee chairs, population estimates of these views, and disclosures of sampling errors as well as nonsampling errors generally found in surveys. Nearly all of the respondents opposed mandatory audit firm rotation for public accounting firms registered with the PCAOB.

Our study methodology included developing detailed questionnaires to obtain the views of public accounting firms and public company chief financial officers and their audit committee chairs on the issues associated with mandatory audit firm rotation. This supplemental report contains a copy of each questionnaire, annotated to show summary survey responses to each question for the Tier 1 firms and the Fortune 1000 public companies' chief financial officers and their audit committee chairs, and selected narrative comments to some of the open-ended questions included in the surveys. We are issuing this supplemental report to provide additional detail on the responses to our surveys on the potential effects of mandatory audit firm rotation and to facilitate future research efforts in performing studies related to these matters.

Appendixes I, II, and III of this report contain the questionnaires administered to the Tier 1 firms and the Fortune 1000 public companies' chief financial officers and their audit committee chairs, respectively, annotated with summary responses for each question. Our questionnaires were developed after extensive research of studies and other documents that addressed issues concerning auditor independence and audit quality associated with the length of a public accounting firm's tenure and the costs and benefits of mandatory audit firm rotation. We used the issues identified to develop detailed questionnaires that were pretested with public accounting firms and public companies prior to administering the surveys. Appendixes IV, V, and VI of this report present selected comments to some of the open-ended questions included in the questionnaires for the Tier 1 firms and the Fortune 1000 public companies' chief financial officers and their audit committee chairs, respectively. The number of comments of a particular type is not necessarily proportional to the number of other similar responses, and therefore, the comments are not meant to be representative of the views that might be found in each of the populations as a whole.

Our survey population of Tier 1 firms included 92 public accounting firms that were members of the American Institute of Certified Public Accountants' (AICPA) self-regulatory program for audit quality that reported having 10 of more SEC clients in 2001 and 5 public accounting firms that were not members of the AICPA's self-regulatory program but had 10 or more public company clients registered with the SEC in 2001. We requested that the Tier 1 firms' chief executive officers or managing partners, or their designated representatives, complete the survey. We received responses from 74 of the 97 Tier 1 firms, or 76.3 percent.

After removing 40 private companies from the Fortune 1000 list, we drew a random sample of 330 public companies and asked their chief financial officers and audit committee chairs to complete separate questionnaires. Of the 330 Fortune 1000 public companies sampled, we received responses from 201 (60.9 percent) of their chief financial officers and 191 (57.9 percent) of their audit committee chairs.

As discussed in our November 21, 2003,[4] report, a significant part of our study included comprehensive research and discussions regarding the development and administration of the survey instruments to gather experienced-based views on the potential costs and benefits of mandatory audit firm rotation, and the compilation and analysis of survey data. Our work for the November 21, 2003, report was conducted in Washington, D.C., between November 2002 and November 2003 in accordance with U.S. generally accepted government auditing standards. This supplemental report is based on the survey work performed for the November 21, 2003, report. For additional information on the scope and methodology for our study, including further details about the samples, response rates, and a discussion of sampling and nonsampling errors and efforts to follow up with nonrespondents to our surveys, see appendix I to our November 2003 report (GAO-04-216).

We are sending copies of this report to the Chairman and Ranking Minority Member of the House Committee on Energy and Commerce. We are also sending copies of this report to the Chairman of the Securities and Exchange Commission, the Chairman of the Public Company Accounting

[4] GAO-04-216.

Oversight Board, and other interested parties. This report will also be available at no charge on GAO's Web site at http://www.gao.gov.

If you or your offices have any questions concerning this report, please contact me at (202) 512-9471 or William E. Boutboul, Assistant Director, at (202) 512-6924. Key contributors are acknowledged in appendix VII.

Jeanette M. Franzel
Director
Financial Management and Assurance

Public Accounting Firm Survey on Mandatory Audit Firm Rotation

UNITED STATES GENERAL ACCOUNTING OFFICE
PUBLIC ACCOUNTING FIRM
SURVEY ON MANDATORY AUDIT FIRM ROTATION

INTRODUCTION

The Sarbanes-Oxley Act of 2002 (the Act) contains various requirements to protect investors by improving the accuracy and reliability of financial reporting of public companies registered with the Securities and Exchange Commission (SEC). The Act also mandated certain studies, one of which (contained in Section 207) requires the General Accounting Office (GAO), the independent audit, investigative, and evaluation arm of the Congress, to study the potential effects of requiring mandatory rotation of public accounting firms registered with the new Public Company Accounting Oversight Board (PCAOB).

To provide a thorough, fair and balanced report to Congress on this issue, it is essential that we obtain the experiences and viewpoints of a representative sample of public accounting firms. Your firm has been selected from a group of public accounting firms comprising the American Institute of Certified Public Accountants' (AICPA) SEC Practice Section member firms and other public accounting firms that performed audits of public companies registered with the SEC, which are not members of the AICPA's SEC Practice Section.

In conducting the study, the GAO is asking for your cooperation and assistance by providing the views of your public accounting firm on the potential effects of mandatory audit firm rotation. This survey should be completed by the senior executive of your firm (e.g. the Chief Executive Officer/Managing Partner) or their designated representative.

The results of the survey will be compiled and presented in summary form only as part of our report, and GAO will not release individually identifiable data from this survey, unless compelled by law or required to do so by Congress. Proprietary business information is protected by a federal law (18 U.S.C. 1905, the "Trade Secrets Act") that makes unauthorized disclosure a crime.

Relevant Definitions:

- **"public company"** refers to issuers of securities subject to the financial reporting requirements of the Securities Exchange Act of 1934, the Investment Company Act of 1940, and registered with the Securities and Exchange Commission (SEC). For purposes of this survey, mutual funds and investment trusts that meet the statutory definition of issuer of securities are considered public companies.

1

- **"multinational or foreign public company"** is a public company with significant operations (10 percent or more of total revenue) in one or more countries outside the United States.

- **"domestic public company"** is a public company with no significant operations (10 percent or more of total revenue) outside the United States.

- **"auditor," " auditor of record" and "public accounting firm"** refer to an independent public accounting firm registered with the SEC that performs audits and reviews of public company financial statements and prepares attestation reports filed with the SEC. In the future, these public accounting firms must be registered with the Public Company Accounting Oversight Board (PCAOB) as required by the Sarbanes-Oxley Act.

- **"mandatory audit firm rotation"** refers to the imposition of a limit on the number of consecutive years in which a particular registered public accounting firm may be the auditor of record for a public company (an "issuer").

- **"audit quality"** refers to the auditor conducting the audit in accordance with *Generally Accepted Auditing Standards* (GAAS) to provide reasonable assurance that the audited financial statements and related disclosures are (1) presented in accordance with *Generally Accepted Accounting Principles* (GAAP) and (2) are not materially misstated whether due to errors or fraud. This definition assumes that reasonable third parties with knowledge of the relevant facts and circumstances would have concluded that the audit was conducted in accordance with GAAS and that, within the requirements of GAAS, the auditor appropriately detected and then dealt with known material misstatements by (1) ensuring that appropriate adjustments, related disclosures, and other changes were made to the financial statements to prevent them from being materially misstated, (2) modifying the auditor's opinion on the financial statements if appropriate adjustments and other changes were not made, or (3) if warranted, resigning as the public company's auditor of record and reporting the reason for the resignation to the SEC.

- **"audit failure"** refers to audits for which audited financial statements filed with the SEC contained material misstatements whether due to errors or fraud, and reasonable third parties with knowledge of the relevant facts and circumstances would have concluded that the audit was not conducted in accordance with GAAS, and, therefore, the auditor failed to appropriately detect and/or deal with known material misstatements by (1) ensuring that appropriate adjustments, related disclosures, and other changes were made to the financial statements to prevent them from being materially misstated, (2) modifying the auditor's opinion on the financial statements if appropriate adjustments and other changes were not made, or (3) if warranted, resigning as the public company's auditor of record and reporting the reason for the resignation to the SEC.

2

Public Accounting Firm Background[1]

1. Is your public accounting firm currently a member of the AICPA's SEC Practice Section?
   N=73

1.	Yes	**97%**
2.	No	**3%**
3.	No answer	

2. At this time, does your public accounting firm plan to register with the PCAOB?
   N=72

1.	Yes	**96%**
2.	No	**1%**
3.	Uncertain	**3%**
4.	No answer	

3. In total and for each of the following categories, approximately how many public companies **did your public accounting firm serve as auditor of record during your firm's last fiscal year?** *Enter numeric digits in each box.*

   Total Audit Clients
   Total number of public companies for which your firm served as auditor of record during your last fiscal year. __________

   N=72 **Mean=143** **Median=20** **Range=2 - 2528**

   Multinational or Foreign Public Company Audit Clients
   Revenue of $5 billion or more __________
   N=*
   Revenue of more than $1 billion but less than $5 billion __________
   N=*
   Revenue of more than $100 million but less than $1 billion __________
   N=*
   Revenue of less than $100 million __________
   N=16 **Mean=9** **Median=3** **Range=1 - 65**

[1] The appearance of * in place of a statistic indicates that there were 3 or fewer responses to that question.

3

Domestic Public Company Audit Clients

Revenue of $5 billion or more ________
N=*

Revenue of more than $1 billion but less than $5 billion ________
N=*

Revenue of more than $100 million but less than $1 billion ________
N=18 Mean=35 Median=2 Range=1 - 495

Revenue of less than $100 million ________
N=70 Mean=44 Median=18 Range=2 - 659

If you had no public company audit clients during your last fiscal year, please skip to question 7.

4. With respect to your public company audit, review, and attest clients during your firm's last fiscal year, did your firm serve as auditor of record for one or more public companies that taken together represented over 25% of the market share of a specific industry?
N=72

1.	Yes	**6%**
2.	No	**94%**
3.	No answer	

5. Please identify each industry for which your public company audit, review, and attest clients last fiscal year, represented in the aggregate, at least 25 percent of the public company market share in the industry. In addition, for each industry you identified please also provide your firm's estimate of the aggregate market share your public company clients represented and the basis your firm used for estimating market share (for example, share of the number of public companies in an industry, share of industry revenue, share of industry market capitalization, etc.)

____
____
____
____
____
____
____

4

6. With respect to your public company audit, review and attest clients during your firm's last fiscal year, please indicate those industries **for which 5 percent or more of your public company audit, review and attest practice resources (based on hours, staff, etc.) were devoted** to public companies whose primary business activity was in a specific industry. [Note: the following industry classification is based on the North American Industry Classification System (NAICS). Generally, we have included classifications covering each NAICS industry sector and, with respect to the Manufacturing sector, selected sub-sectors.]

- ☐ Accommodations and Food Services **N=4**
- ☐ Administrative and Support Services and Waste Management and Remediation Services **N=3**
- ☐ Agricultural, Forestry, Fishing, and Hunting **N=0**
- ☐ Ambulatory Health Care Services **N=1**
- ☐ Arts, Entertainment, and Recreation **N=8**
- ☐ Construction **N=3**
- ☐ Educational Services **N=1**
- ☐ Finance and Insurance **N=30**
- ☐ Information Services **N=18**
- ☐ Management of Companies and Enterprises **N=1**
- ☐ Manufacturing—Chemical **N=4**
- ☐ Manufacturing—Computer and Electronic Products **N=12**
- ☐ Manufacturing—Food **N=2**
- ☐ Manufacturing—Paper **N=0**
- ☐ Manufacturing—Primary Metal **N=1**
- ☐ Manufacturing—Transportation Equipment **N=2**
- ☐ Manufacturing—Other **N=24**
- ☐ Mining **N=8**
- ☐ Professional, Scientific, and Technical Services **N=17**
- ☐ Public Administration **N=1**
- ☐ Real Estate and Rental and Leasing **N=8**
- ☐ Trade—Retail **N=5**
- ☐ Trade—Wholesale **N=8**
- ☐ Transportation and Warehousing **N=2**
- ☐ Utilities **N=3**
- ☐ Other—please specify in box below **N=30**

If you checked "Other" industries – specify below:

____
____
____

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7. During your firm's **last three fiscal years, approximately how many times did your firm succeed another public accounting firm as auditor of record for a public company client?** ___________________________________

   N=72 **Mean=38** **Median=10** **Range=1 - 500**

8. Since December 31, 2001, approximately how many times did your firm succeed Arthur Andersen as auditor of record for a public company audit, review, and attest client? _____________________________________

   N=28 **Mean=44** **Median=2** **Range=1 - 308**

POTENTIAL EFFECTS OF MANDATORY AUDIT FIRM ROTATION

Auditor Knowledge and Experience

The following questions address issues concerning how mandatory audit firm rotation may affect the auditor's **ability to detect** financial reporting issues that may indicate material misstatements in a public company's financial statements.

9. In your opinion, how important are each of the following factors in affecting the auditor's **ability to detect** financial reporting issues that may indicate material misstatements in a public company's financial statements? Please check one button in each row.

6

	Very Great Importance	Great Importance	Moderate Importance	Some Importance	Little or No Importance	Don't Know
Appropriate staff education, training and experience **N=73**	**70%**	**30%**	**0%**	**0%**	**0%**	**0%**
Appropriate knowledge of Generally Accepted Accounting Principles **N=73**	**59%**	**36%**	**5%**	**0%**	**0%**	**0%**
Appropriate knowledge of Generally Accepted Auditing Standards **N=73**	**59%**	**33%**	**8%**	**0%**	**0%**	**0%**
Appropriate audit team staffing level **N=73**	**60%**	**36%**	**4%**	**0%**	**0%**	**0%**
Appropriate access to the firm's technical resources (whether locally or nationally) **N=73**	**48%**	**32%**	**19%**	**1%**	**0%**	**0%**
Appropriate firm experience within the public company's industry **N=73**	**38%**	**41%**	**21%**	**0%**	**0%**	**0%**
Appropriate risk assessment process for the client acceptance process **N=73**	**34%**	**43%**	**16%**	**4%**	**3%**	**0%**
Appropriate knowledge of the client's operations, systems, and financial reporting practices **N=73**	**73%**	**22%**	**5%**	**0%**	**0%**	**0%**

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10. Please describe any relevant factors not listed above that you believe would likely affect the auditor's **ability to detect** financial reporting issues that may indicate material misstatements in a public company's financial statements and, in your response, please specify the level of its importance using the same categories as above.

___

___

11. Recognizing that auditors of record likely respond to their less specific knowledge and experience of new public company clients by applying additional audit resources during the early years of an audit engagement, **how long, on average, does it take your firm, for each category of public company listed below, to become "sufficiently familiar"** with a new client's operations and financial reporting practices to no longer require the additional audit resources often associated with a new public company client?

	1 Year	2 - 3 Years	4 - 5 Years	More than 5 Years	No experience or basis with this category of public company
Multinational or Foreign Public Company with revenue of $5 billion or more **N=60**	**0%**	**7%**	**0%**	**0%**	**93%**
Domestic Public Company with revenue of $5 billion or more **N=61**	**0%**	**8%**	**0%**	**0%**	**92%**
Multinational or Foreign Public Company with revenue of $100 million but less than $5 billion **N=60**	**0%**	**18%**	**2%**	**0%**	**80%**
Domestic Public Company with revenue of $100 million but less than $5 billion **N=59**	**7%**	**42%**	**3%**	**0%**	**48%**
Multinational or Foreign Public Company with revenue of less than $100 million **N=65**	**8%**	**41%**	**8%**	**2%**	**41%**
Domestic Public Company with revenue of less than $100 million **N=69**	**25%**	**65%**	**8%**	**1%**	**1%**

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12. Under mandatory audit firm rotation, new audit firms would provide a “fresh look” at clients’ operations and financial reporting practices. In general, how does the fresh look a new auditor provides affect the likelihood that the **new auditor will detect financial reporting issues that may materially affect a public company’s financial statements,** which the previous auditor may not have detected?
N=73

1. Significantly increased likelihood	**2%**
2. Somewhat increased likelihood	**29%**
3. No effect on likelihood	**33%**
4. Somewhat decreased likelihood	**18%**
5. Significantly decreased likelihood	**18%**
6. No answer	

13. Under mandatory audit firm rotation, how would you compare the new public accounting firm’s likely initial level of knowledge of the client’s specific operations and financial reporting practices to the previous auditor of record’s level of knowledge of the client’s operations and financial reporting processes?
N=73

1. Significantly less	**54%**
2. Somewhat less	**41%**
3. About the same	**4%**
4. Somewhat more	**0%**
5. Significantly more	**1%**
6. No answer	

If you answered question 13 by selecting 3, 4 or 5, please skip to question 15.

14. If, under mandatory audit firm rotation, the new public accounting firm is likely to have initially less specific knowledge of the client’s operations and financial reporting practices, how would this less specific knowledge likely affect the risk that the new auditor would not detect material misstatements in the financial statements during the first year of the auditor’s tenure?
N=69

1. Significantly increase the risk	**36%**
2. Somewhat increase the risk	**57%**
3. Neither increase nor decrease the risk	**6%**
4. Somewhat decrease the risk	**1%**
5. Significantly decrease the risk	**0%**
6. No answer	

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15. Under mandatory audit firm rotation, how would you rate the potential value of **the PCAOB requiring additional and/or enhanced audit procedures** (as listed below) to assist the new auditor of record in **reducing the risk of not detecting** material misstatements in the client's financial statements to an acceptable level? Please select one box in each row.

	Very Great Value	Great Value	Moderate Value	Some Value	Little or No Value	Don't Know
Additional procedures in areas material to the financial statements over what would likely be applied if the firm was more client experienced **N=72**	**3%**	**22%**	**22%**	**25%**	**22%**	**6%**
Additional verification of client-supplied statements and data likely to be material to the financial statements **N=72**	**3%**	**18%**	**22%**	**21%**	**32%**	**4%**
Enhanced access to key members of the previous firm's audit engagement team **N=72**	**4%**	**28%**	**28%**	**22%**	**17%**	**1%**
Enhanced access to audit documentation of the previous firm's audit engagement team **N=72**	**7%**	**29%**	**27%**	**21%**	**15%**	**1%**

16. Please describe other additional and/or enhanced audit procedures not listed above that you believe would be of added value to the new auditor of record in reducing the **risk of not detecting** material misstatements in a public company's financial statements and, in your response, please indicate the level of its value using the same categories as above.

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17. Under existing generally accepted auditing standards, does your firm, as auditor of record, have sufficient flexibility to implement the audit procedures without the PCAOB requiring the additional and/or enhanced audit procedures, including those listed above, needed to reduce your firm's **risk of not detecting** material misstatements in a public company's financial statements to an acceptable level?
N=73

1. Yes	**95%**
2. No	**5%**
3. No answer	

18. Please identify which audit procedures listed above the PCAOB should consider requiring under mandatory audit firm rotation to further reduce your firm's risk of not detecting material misstatements to an acceptable level.

____
____
____

19. Do you have any additional comments on the issues covered in this section or comments concerning mandatory audit firm rotation as related to the auditor's client-specific knowledge and experience (including any other issues not covered)?

____
____
____

Auditor Independence

Some say a public accounting firm's and/or its partners' independence may be adversely affected by economic pressures to retain the audit client as well as by developing too close a relationship with the public company and its management. These pressures may cause a public accounting firm and/or its partners to not appropriately challenge the client's accounting and financial reporting practices.

Concern about auditor independence relates to the public accounting firm's and its partners' ability and willingness to **appropriately deal** with known financial reporting issues that may indicate materially misstated financial statements.

An auditor **appropriately deals** with financial reporting issues that arise during an audit by (1) ensuring that appropriate adjustments, related disclosures, and other changes are made to the financial statements to ensure that they are fairly stated in accordance with generally accepted accounting principles, (2) modifying the auditor's opinion on the financial statements if appropriate adjustments and other changes are not made, or (3) if warranted, resigning as the public company's auditor of record and reporting the reason for the resignation to the SEC.

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20. In your opinion, under mandatory audit firm rotation, what is the likely impact that the new auditor's focus ("fresh look") on a client's operations and financial reporting practices would have on the **auditor's potential for dealing more appropriately** with financial reporting issues that may indicate material misstatements in a public company's financial statements?
N=72

1. Significantly increase the potential	**6%**
2. Somewhat increase the potential	**21%**
3. Neither increase nor decrease the potential	**54%**
4. Somewhat decrease the potential	**15%**
5. Significantly decrease the potential	**4%**
6. No answer	

21. How would you rate the **pressure on your public accounting firm and the engagement partner(s) to retain clients** as a factor in whether or not they appropriately deal with financial reporting issues that may materially affect a public company's financial statements?

	Significant Factor	Strong Factor	Moderate Factor	Small Factor	No Factor	Don't Know
Pressure on the firm **in the absence of mandatory audit firm rotation N=72**	**3%**	**3%**	**18%**	**22%**	**53%**	**1%**
Pressure on the firm **with mandatory audit firm rotation N=72**	**1%**	**1%**	**16%**	**29%**	**50%**	**3%**
Pressure on the engagement partner(s) **in the absence of mandatory audit firm rotation N=72**	**3%**	**3%**	**22%**	**22%**	**49%**	**1%**
Pressure on the engagement partner(s) **with mandatory audit firm rotation N=72**	**1%**	**3%**	**14%**	**32%**	**49%**	**1%**

12

22. How would you rate the **pressure on your public accounting firm and the engagement partner(s) to retain clients** as a factor in whether or not they appropriately challenge "overly aggressive and/or optimistic" financial reporting positions taken by public company management in interpreting and applying generally accepted accounting principles?

	Significant Factor	Strong Factor	Moderate Factor	Small Factor	No Factor	Don't Know
Pressure on the firm **in the absence of mandatory audit firm rotation N=72**	**0%**	**1%**	**15%**	**24%**	**60%**	**0%**
Pressure on the firm **with mandatory audit firm rotation N=72**	**1%**	**0%**	**15%**	**24%**	**59%**	**1%**
Pressure on the engagement partner(s) **in the absence of mandatory audit firm rotation N=72**	**0%**	**1%**	**17%**	**26%**	**56%**	**0%**
Pressure on the engagement partner(s) **with mandatory audit firm rotation N=72**	**1%**	**0%**	**17%**	**26%**	**56%**	**0%**

13

23. How would you rate the **potential of a subsequent lawsuit and/or regulatory action against the public accounting firm and/or the engagement partner(s)** as a factor in whether or not the public accounting firm and the engagement partner(s) appropriately deal with financial reporting issues that may materially affect a public company client's financial statements?

	Significant Factor	Strong Factor	Moderate Factor	Small Factor	No Factor	Don't Know
Pressure on the firm **in the absence of mandatory audit firm rotation N=72**	**21%**	**22%**	**18%**	**15%**	**24%**	**0%**
Pressure on the firm **with mandatory audit firm rotation N=72**	**24%**	**22%**	**18%**	**14%**	**22%**	**0%**
Pressure on the engagement partner(s) **in the absence of mandatory audit firm rotation N=72**	**21%**	**22%**	**18%**	**15%**	**24%**	**0%**
Pressure on the engagement partner(s) **with mandatory audit firm rotation N=72**	**24%**	**22%**	**18%**	**14%**	**22%**	**0%**

24. **In the absence of mandatory audit firm rotation**, to what extent do you believe that **the possibility of being replaced by another firm as auditor of record** is a factor in whether or not the incumbent audit firm appropriately deals with financial reporting issues that may materially affect the public company client's financial statements?
N=71

1. A significant factor **1%**
2. A strong factor **6%**
3. A moderate factor **16%**
4. A small factor **38%**
5. No factor **39%**
6. No answer

14

25. **Under mandatory audit firm rotation**, to what extent do you believe **the incumbent audit firm's knowledge that a new firm will replace the incumbent firm as auditor of record at the end of a specified audit tenure period** would be a factor in whether or not the incumbent firm appropriately deals with financial reporting issues that may materially affect the public company client's financial statements?
N=71

1. A significant factor	**3%**
2. A strong factor	**4%**
3. A moderate factor	**20%**
4. A small factor	**35%**
5. No factor	**38%**
6. No answer	

26. How would **establishing a limit on a public accounting firm's tenure** as a public company's auditor of record **affect the perception of the auditor's independence** held by the following:

	Significantly Increase	Somewhat Increase	Neither Increase or Decrease	Somewhat Decrease	Significantly Decrease	Don't Know
Perception of auditor independence held by the capital markets (including analysts, banks, brokers, exchanges, and rating agencies) **N=71**	**4%**	**30%**	**52%**	**1%**	**0%**	**13%**
Perception of auditor independence held by institutional investors **N=71**	**4%**	**30%**	**52%**	**1%**	**0%**	**13%**
Perception of auditor independence held by individual Investors **N=71**	**6%**	**36%**	**44%**	**1%**	**0%**	**13%**

16

27. Traditionally, a change in the auditor of record for a public company has been viewed as a "red flag" signal to the capital markets and the public to inquire into the underlying reason for the change in auditor. What impact would **the scheduled change in auditors required under mandatory audit firm rotation have on the "red flag" signal** otherwise associated with a change in auditor?
N=70

1. Significant likelihood of retaining the "red flag" signal	**47%**
2. Some likelihood of retaining the "red flag" signal	**42%**
3. No change in the "red flag" signal	**11%**
4. Some likelihood of eliminating the "red flag" signal	**0%**
5. Significant likelihood of eliminating the "red flag" signal	**0%**
6. No answer	

28. **Assuming that under mandatory audit firm rotation** public companies and public accounting firms can, on the initiative of either party, terminate their relationship, how likely is it that **for any unscheduled change in the auditor of record**, the traditional "red flag" signal to the capital markets and the public would be retained (an unscheduled change would be one that does not occur as a direct result of an audit firm rotation requirement)?
N=71

1. Significant likelihood of retaining the "red flag" signal	**48%**
2. Some likelihood of retaining the "red flag" signal	**35%**
3. No change in the "red flag" signal	**17%**
4. Some likelihood of eliminating the "red flag" signal	**0%**
5. Significant likelihood of eliminating the "red flag" signal	**0%**
6. No answer	

29. Do you have any additional comments on the issues covered in this section or comments concerning mandatory audit firm rotation as related to the auditor's independence (including any other issues not covered)?

____
____
____

17

Audit Quality and Audit Failure

A **quality audit** occurs when the audit, conducted in accordance with GAAS, of a public company's financial statements filed with the SEC provides reasonable assurance that the audited financial statements and related disclosures are presented in accordance with GAAP and not materially misstated whether due to errors or fraud. An **audit failure** occurs when audited financial statements filed with the SEC contained material misstatements whether due to errors or fraud and reasonable third parties with knowledge of the relevant facts and circumstances would have concluded that the audit was not conducted in accordance with GAAS.

30. As the end of a set audit tenure approaches under mandatory audit firm rotation, **how likely is it that the audit firm will move its most knowledgeable and experienced audit personnel from the current audit engagement** to other efforts or engagements to enhance the firm's ability to attract and retain other clients?
N=71

1. Very likely	**13%**
2. Somewhat likely	**46%**
3. Neither likely nor unlikely	**28%**
4. Somewhat unlikely	**7%**
5. Very unlikely	**6%**
6. No answer	

If you answered question 30 by selecting 3, 4 or 5, please skip to question 32.

31. If under mandatory audit firm rotation, public accounting firms move their most knowledgeable and experienced audit personnel from the current audit engagement to other efforts to enhance the firm's ability to attract and/or retain clients in the future, **how would this affect the risk of audit failure on the current audit engagement?**
N=42

1. Significantly increase the risk	**14%**
2. Somewhat increase the risk	**72%**
3. No change in the risk	**14%**
4. Somewhat decrease the risk	**0%**
5. Significantly decrease the risk	**0%**
6. No answer	

18

32. Based on public company audit clients your firm served during the firm's last fiscal year, what is your **estimate of the average period** for which the firm has served your public company clients as auditor of record (the average audit tenure period)?
N=68

☐ 0 years	**0%**
☐ 1-5 years	**41%**
☐ 6-10 years	**46%**
☐ 11-15 years	**12%**
☐ 16-20 years	**1%**
☐ 21-25 years	**0%**
☐ More than 25 years	**0%**
☐ No answer	

33. For approximately how many of your firm's public company audit clients has your firm served as auditor of record for more than 25 years? ________________
N=67

No public companies	**N=53**	**79%**
1-5 public companies	**N=11**	**16%**
6-10 public companies	**N= 3**	**5%**

34. In your opinion, how would mandatory audit firm rotation likely change the future average audit tenure period for your firm's public company audit clients?
N=70

1. Average audit tenure period would likely increase	**0%**
2. Average audit tenure period would likely stay the same	**24%**
3. Average audit tenure period would likely decrease	**76%**
4. No answer	

If you answered question 34 by selecting either 1 or 2, please skip to question 36.

35. If your firm's average audit tenure period would likely decrease under mandatory audit firm rotation, what will be the affect on your firm's **existing incentives to invest the resources needed to understand the client's operations and financial reporting practices** in order to devise effective audit procedures and tools?
N=53

1. Existing incentives will be significantly reduced	**11%**
2. Existing incentives will be somewhat reduced	**25%**
3. There is likely to be no change on existing incentives	**62%**
4. Existing incentives will be somewhat increased	**2%**
5. Existing incentives will be significantly increased	**0%**
6. No answer	

For the following four statements, please indicate the extent to which you agree or disagree.

36. The risk of an audit failure is higher in the early years of an audit tenure period as the new public accounting firm is more likely to have **not fully developed and applied an in depth understanding of the new client's operations and financial reporting practices**.
N=71

1. Strongly agree	**34%**
2. Generally agree	**45%**
3. Neither agree nor disagree	**10%**
4. Generally disagree	**10%**
5. Strongly disagree	**1%**
6. No answer	

37. The risk of an audit failure is higher in the early years of an audit tenure period because the new public accounting firm is more likely to **place heavy reliance on information provided by client management**.
N=72

1. Strongly agree	**11%**
2. Generally agree	**17%**
3. Neither agree nor disagree	**23%**
4. Generally disagree	**39%**
5. Strongly disagree	**10%**
6. No answer	

20

38. The risk of an audit failure is likely to increase as the audit tenure period increases due to the **"comfort level"** (familiarity with client management and the desire to retain the client over many years) provided by the public accounting firm's long-term relationship with client management.
N=71

1. Strongly agree	**1%**
2. Generally agree	**13%**
3. Neither agree nor disagree	**17%**
4. Generally disagree	**39%**
5. Strongly disagree	**30%**
6. No answer	

39. The risk of an audit failure is likely to increase as the audit tenure period increases due to **client management becoming too familiar with the auditor's approach and procedures**.
N=72

1. Strongly agree	**3%**
2. Generally agree	**18%**
3. Neither agree nor disagree	**29%**
4. Generally disagree	**31%**
5. Strongly disagree	**19%**
6. No answer	

40. Do you have any additional comments on the issues covered in this section or comments concerning mandatory audit firm rotation as related to audit quality and audit failures (including any other issues not covered)?

____
____
____

Audit-Related Costs and Audit Fees

The following questions involve audit costs and fees of public accounting firms, and costs incurred by public companies in selecting new firms and supporting the firms selected in performing the initial audit.

Audit cost is the cost incurred by a public accounting firm to perform the public company's financial statement audit. In addition to the firm's actual audit cost, public accounting firms also incur **marketing costs** associated with their efforts to acquire or retain audit clients. **Audit fee** is the amount the public accounting firm charges the public company to perform the financial statement audit.

21

A public company incurs internal costs associated with the company's efforts to select and support the new public accounting firm's efforts to understand the public company's operations and financial reporting practices. The internal **selection costs** and **support costs** incurred by a public company are in addition to the audit fees paid to the public accounting firm for the financial statement audit.

41. To overcome the learning curve associated with understanding the public company's operations and financial reporting practices, **a public accounting firm's initial-year audit costs are likely to exceed the firm's subsequent annual audit costs**?
N=73

1. Yes	**96%**
2. No	**4%**
3. No answer	

If you answered no to question 41, please skip to question 45.

42. On average, how would the additional **audit costs** a firm is likely to incur in an initial year audit of a new public company client **compare to the annual audit costs in subsequent years for the same client**? Additional audit costs are likely to be:
N=69

1. More than 50 percent of subsequent years' audit costs	**10%**
2. More than 40 percent but less than 50 percent of subsequent years' audit costs	**10%**
3. More than 30 percent but less than 40 percent of subsequent years' audit costs	**19%**
4. More than 20 percent but less than 30 percent of subsequent years' audit costs	**49%**
5. More than 10 percent but less than 20 percent of subsequent years' audit costs	**10%**
6. Less than 10 percent of subsequent years' audit costs	**2%**
7. No answer	

For the following two statements, please indicate the extent to which you agree or disagree.

22

43. When a change in public accounting firm is voluntary, the new firm's **additional initial year audit costs are more likely to be absorbed by the firm** and not passed on to the public company in the form of higher audit fees because of the firm's interest in retaining the audit client.
N=68

1. Strongly agree	**28%**
2. Generally agree	**57%**
3. Neither agree nor disagree	**5%**
4. Generally disagree	**7%**
5. Strongly disagree	**3%**
6. No answer	

44. A likely consequence of limiting a public accounting firm's tenure as the auditor of record under mandatory audit firm rotation is that firms will be more likely to **increase audit fees during the now limited audit tenure period to increase the likelihood of recovering any additional initial year audit costs** incurred to fully understand the public company's operations and financial reporting practices.
N=68

1. Strongly agree	**49%**
2. Generally agree	**41%**
3. Neither agree nor disagree	**4%**
4. Generally disagree	**6%**
5. Strongly disagree	**0%**
6. No answer	

45. Under mandatory audit firm rotation, will your public accounting firm likely incur **additional marketing costs** associated with the increased opportunities to compete for new audit clients?
N=72

1. Yes	**79%**
2. No	**15%**
3. Uncertain	**6%**
4. No answer	

If you answered 2 or 3 to question 45, please skip to question 48.

23

46. How will **additional marketing costs** to compete for a new audit client **under mandatory audit firm rotation** compare to the likely initial-year audit fee? Additional marketing costs are likely to be:
N=57

1. More than 10 percent	**37%**
2. More than 5 percent but less than 10 percent	**30%**
3. More than 1 percent but less than 5 percent	**12%**
4. Less than 1 percent	**2%**
5. No basis or experience on which to estimate	**19%**
6. No answer	

For the following statement, please indicate the extent to which you agree or disagree.

47. The **additional marketing costs** that are likely to occur under mandatory audit firm rotation **will be passed on to public companies through higher audit fees**.
N=56

1. Strongly agree	**32%**
2. Agree	**46%**
3. Neither agree nor disagree	**11%**
4. Disagree	**7%**
5. Strongly disagree	**0%**
6. No basis or experience on which to base a response	**4%**
7. No answer	

48. Under mandatory audit firm rotation, assuming new public accounting firms are selected to replace incumbent firms through the increased opportunities to compete by firms willing and able to perform the audit, what are your views on the **likely affect on audit fees over the long-term**?
N=73

1. Likely lead to lower audit fees over time.	**6%**
2. Likely lead to higher audit fees over time.	**81%**
3. No affect on audit fees over time.	**8%**
4. Uncertain.	**5%**
5. No answer	

If you answered 2 in response to question 48, skip to question 53. If you selected 3 or 4 as your response to question 48, please skip to question 55.

24

49. If you believe that **increased opportunities to compete under mandatory audit firm rotation will lead to lower audit fees over the long-term**, do you believe that **audit fees will decrease** by:
N=4

☐ 1-5 percent	**0%**
☐ 6-10 percent	**75%**
☐ 11-15 percent	**0%**
☐ 16-20 percent	**0%**
☐ Greater than 20 percent	**25%**
☐ No basis to estimate	**0%**
☐ No answer	

For the following two statements, please indicate the extent to which you agree or disagree.

50. The lower audit fees likely to occur from increased opportunities to compete under mandatory audit firm rotation **will likely result from increased audit efficiencies and related lower audit costs**.
N=4

1. Strongly agree	**0%**
2. Agree	**25%**
3. Neither agree nor disagree	**0%**
4. Disagree	**25%**
5. Strongly disagree	**50%**
6. No answer	

51. The lower audit fees likely to occur from increased opportunities to compete under mandatory audit firm rotation **will likely be achieved through reduced firm profitability**.
N=4

1. Strongly agree	**25%**
2. Agree	**50%**
3. Neither agree nor disagree	**25%**
4. Disagree	**0%**
5. Strongly disagree	**0%**
6. No answer	

25

52. If you believe that the **lower audit fees** that may result from increased opportunities to compete are likely to occur **for reasons other than increased audit efficiencies/related lower audit costs or reduced firm profitability,** please describe why you think audit fees would be lower?

____

____

____

If you answered the questions above about lower audit fees, please skip the next two questions.

53. If you believe that increased opportunities for audit firms to compete likely to occur under mandatory audit firm rotation will lead to higher audit fees, by what percentage do you believe that **over the long-term audit fees will increase** by?
N=58

☐ 1-5 percent	**0%**
☐ 6-10 percent	**14%**
☐ 11-15 percent	**10%**
☐ 16-20 percent	**33%**
☐ Greater than 20 percent	**34%**
☐ No basis to estimate	**9%**
☐ No answer	

54. If you believe that the increased competition likely to occur under mandatory audit firm rotation will lead to **higher audit fees** over the long-term, please indicate why you think audit fees would be higher?

____

____

____

55. Under mandatory audit firm rotation, assuming the incumbent public accounting firm is replaced through a competition among interested firms, do you believe that **public companies will incur selection costs associated with holding the competition**?
N=72

1. Yes	**90%**
2. No	**3%**
3. No basis to estimate	**7%**
4. No answer	

If you answered 2 or 3 to question 55, please skip to question 57.

26

56. In your opinion, what is the likely level of **selection costs** that public companies are likely to incur as a result of changing their audit firms as compared to the cost of the initial year audit fee for the financial statement audit. Selection costs are likely to be:
N=64

1. 20 percent or more	**5%**
2. More than 15 percent but less than 20 percent	**8%**
3. More than 10 percent but less than 15 percent	**20%**
4. More than 5 percent but less than 10 percent	**20%**
5. Less than 5 percent	**17%**
6. No basis to estimate	**30%**
7. No answer	

57. Following a change in public accounting firms (whether voluntary or under a mandatory audit firm rotation), do you believe the **public company** will likely incur **additional initial year support costs** associated with supporting the new public accounting firm in its efforts to gain an understanding of the public company's operations and financial reporting practices?
N=70

1. Yes	**94%**
2. No	**3%**
3. No basis to estimate	**3%**
4. No answer	

If you answered 2 or 3 to question 57, please skip to question 59.

58. What is the **level of the additional initial year support costs** (internal costs that exceed level needed to support the previous auditor of record) public companies are likely to incur following a change in audit firm as compared to initial year audit fee for the financial statement audit? Additional initial year support costs are likely to be:
N=66

1. 50 percent or more	**8%**
2. More than 40 percent but less than 50 percent	**0%**
3. More than 30 percent but less than 40 percent	**12%**
4. More than 20 percent but less than 30 percent	**27%**
5. More than 10 percent but less than 20 percent	**21%**
6. Less than 10 percent	**11%**
7. No basis or experience on which to estimate.	**21%**
8. No answer	

27

59. Some have argued that mandatory audit firm rotation would benefit auditor independence and audit quality by providing a new auditor focus ("fresh look") on the public company's operations and financial reporting practices. Others have argued that under mandatory audit firm rotation (1) the new auditor's lower level of client-specific knowledge and experience may negatively affect audit quality, and it (2) would increase the cost that public companies pay for financial statement audits because of higher initial audit fees and/or additional costs associated with selecting and supporting a new audit firm.

With respect to audits of public companies performed by your firm, which of the following statements best expresses your firm's views on the **potential costs and benefits that may result under mandatory audit firm rotation**.
N=72

1. Costs are likely to significantly exceed the benefits. **61%**
2. Costs are likely to moderately exceed the benefits. **24%**
3. Costs and benefits are likely to be about equal. **4%**
4. Benefits are likely to moderately exceed costs. **3%**
5. Benefits are likely to significantly exceed the costs. **4%**
6. No basis to judge **4%**
7. No answer

60. With respect to the costs and benefits that may result from mandatory audit firm rotation, to what extent do you believe the likely costs and benefits of mandatory audit firm rotation varies based on the nature and size of the public company being audited?

	Costs are Likely To Significantly Exceed Benefits	Costs are Likely To Moderately Exceed Benefits	Costs And Benefits Are Likely To Be About Equal	Benefits Are Likely To Moderately Exceed Costs	Benefits Are Likely To Significantly Exceed Costs	No Basis To Judge

28

Multinational or Foreign Public Company with revenue of $5 billion or more **N=69**	**25%**	**10%**	**3%**	**0%**	**6%**	**56%**
Domestic Public Company with revenue of $5 billion or more **N=69**	**23%**	**12%**	**3%**	**0%**	**6%**	**56%**
Multinational or Foreign Public Company with revenue of $100 million but less than $5 billion **N=69**	**32%**	**13%**	**3%**	**0%**	**6%**	**46%**
Domestic Public Company with revenue of $100 million but less than $5 billion **N=69**	**35%**	**23%**	**4%**	**2%**	**3%**	**33%**
Multinational or Foreign Public Company with revenue of less than $100 million **N=70**	**43%**	**23%**	**1%**	**4%**	**3%**	**26%**
Domestic Public Company with revenue of less than $100 million **N=70**	**57%**	**32%**	**4%**	**4%**	**3%**	**0%**

29

61. Do you have any additional comments on the issues covered in this section or comments concerning mandatory audit firm rotation as it relates to audit costs and audit fees (including any other issues not covered)?

____

Competition

The following questions are intended to obtain the views of survey respondents on various competition-related issues associated with the acquisition and performance of financial audit services for public companies and how those views might be affected by mandatory audit firm rotation.

62. To what extent do you believe that **the spin-off of consulting services by three of the Big 4 firms** is likely to affect your public accounting firm's opportunities to provide financial audit services to potential public company clients?
N=71

1. Significantly increase the opportunities	**2%**
2. Somewhat increase the opportunities	**14%**
3. Neither increase nor decrease the opportunities	**63%**
4. Somewhat decrease the opportunities	**11%**
5. Significantly decrease the opportunities	**0%**
6. No basis to estimate	**10%**
7. No answer	

63. To what extent do you believe that **the recent additional consolidation of the major public accounting firms (e.g. Big 5 to Big 4)** is likely to affect your public accounting firm's opportunities to provide financial audit services to public companies?
N=72

1. Significantly increase the opportunities	**4%**
2. Somewhat increase the opportunities	**49%**
3. Neither increase nor decrease the opportunities	**36%**
4. Somewhat decrease the opportunities	**8%**
5. Significantly decrease the opportunities	**0%**
6. No basis to estimate	**3%**
7. No answer	

30

64. To what extent do you believe that **the new auditor independence rules prohibiting the auditor of record from also providing certain nonaudit services** as stated by the Sarbanes-Oxley Act of 2002 and related SEC regulations are likely to affect your public accounting firm's future opportunities to provide financial audit services to new public company clients?
N=72

1. Significantly increase the opportunities	**0%**
2. Somewhat increase the opportunities	**45%**
3. Neither increase nor decrease the opportunities	**39%**
4. Somewhat decrease the opportunities	**11%**
5. Significantly decrease the opportunities	**1%**
6. No basis to estimate	**4%**
7. No answer	

65. What are your views on how mandatory audit firm rotation would likely affect the **opportunities public accounting firms have to provide** financial audit services to public companies?
N=73

1. Significantly increase the number of opportunities to compete	**4%**
2. Somewhat increase the number of opportunities to compete	**48%**
3. Neither increase nor decrease the number of opportunities to compete	**30%**
4. Somewhat decrease the number of opportunities to compete	**3%**
5. Significantly decrease the number of opportunities to compete	**4%**
6. No basis to estimate	**11%**
7. No answer	

66. What are your views on how mandatory audit firm rotation would likely affect **the number of public accounting firms willing and able to compete** for audits of public companies?
N=72

1. Significantly increase the number of firms	**1%**
2. Somewhat increase the number of firms	**13%**
3. Neither increase nor decrease the number of firms	**22%**
4. Somewhat decrease the number of firms	**33%**
5. Significantly decrease the number of firms	**21%**
6. No basis to estimate	**10%**
7. No answer	

If you answered 3 or 6 to question 66, please skip to question 69.

31

67. If you believe that mandatory audit firm rotation would likely change the number of public accounting firms willing and able to compete for audits of public companies, what affect would the likely change in the number of firms have on audit fees?
N=49

1. Increase the number of firms willing and able to compete and contribute to lower audit fees.	**4%**
2. Increase the number of firms willing and able to compete and contribute to higher audit fees.	**12%**
3. The likely change in the number of firms would neither increase nor decrease audit fees.	**6%**
4. Decrease the number of firms willing and able to compete and contribute to lower audit fees.	**4%**
5. Decrease the number of firms willing and able to compete and contribute to higher audit fees.	**72%**
6. No basis to estimate.	**2%**
7. No answer	

If you answered 3 or 6 to question 67, please skip to question 69.

68. Please provide a brief explanation for why the likely change in the number of firms would impact audit fees as noted in your response to the above question.
____
____
____

69. What are your views on how mandatory audit firm rotation would affect **the number of firms willing and able to provide financial audit services for public companies in specialized industries**?
N=73

1. Significantly increase the number of firms willing and able to compete.	**1%**
2. Somewhat increase the number of firms willing and able to compete.	**10%**
3. Neither increase nor decrease the number of firms willing and able to compete.	**29%**
4. Somewhat decrease the number of firms willing and able to compete.	**29%**
5. Significantly decrease the number of firms willing and able to compete.	**19%**
6. No basis to estimate.	**12%**
7. No answer	

32

70. How would mandatory audit firm rotation likely affect **the distribution of audits of public companies among the relatively small number (90 to 100) of larger public accounting firms**?
N=71

1. Market share of public company audits will be more concentrated in the relatively small number of larger public accounting firms	**41%**
2. Market share of public company audits concentrated in the relatively small number of larger public accounting firms will remain approximately the same	**43%**
3. Market share of public company audits will be less concentrated in the relatively small number of larger public accounting firms	**8%**
4. No basis to estimate	**8%**
5. No answer	

71. What are your views on how mandatory audit firm rotation would affect **the incentives to create and/or maintain large accounting firms**?
N=73

1. Significantly increase the incentives	**15%**
2. Somewhat increase the incentives	**29%**
3. Neither increase nor decrease the incentives	**31%**
4. Somewhat reduce the incentives	**14%**
5. Significantly reduce the incentives	**3%**
6. No basis to estimate.	**8%**
7. No answer	

72. Do you have any additional comments on the issues covered in this section or comments concerning mandatory audit firm rotation as it relates to competition for audit services (including any other issues not covered)?
____
____
____

33

Impact of the Sarbanes-Oxley Act

The Sarbanes-Oxley Act contains various reform provisions intended to enhance auditor independence and audit quality, strengthen corporate responsibility, and improve the oversight of audits of public companies that are subject to the securities laws of the United States. Many of these reforms will directly or indirectly affect audit firms and the performance and oversight of the public company audits they perform. The Act also created the PCAOB to oversee the audits of public companies in order to protect investors and further public interest in the preparation of audit reports of public companies.

73. Section 203 of the Sarbanes-Oxley Act of 2002 as implemented by SEC regulations requires the mandatory rotation of both lead and reviewing engagement partners after 5 years and after 7 years for other partners with a significant involvement in the audit engagement. Some have argued that these new and enhanced audit partner requirements sufficiently provide the "fresh look" and related benefits to auditor independence and audit quality without the costs of changing the public accounting firm associated with mandatory audit firm rotation. Others have argued that a new public accounting firm is necessary to effectively achieve the benefits associated with the "fresh look" because changing lead and reviewing partners continues the existing auditing practices and working relationship of the incumbent public accounting firm.

    Please select one of the following statements that best describes your belief as to whether mandatory rotation of lead and reviewing partners achieves the benefits to auditor independence and audit quality of the "fresh look" or mandatory audit firm rotation is necessary to achieve those benefits.
    N=71

1. Mandatory rotation of lead and reviewing partners sufficiently achieves the intended benefits of the "fresh look" and is less costly than mandatory audit firm rotation	**66%**
2. Mandatory rotation of lead and reviewing partners may not be as effective as mandatory audit firm rotation in achieving the intended benefits of the "fresh look," but is a better choice given the higher cost of mandatory audit firm rotation	**27%**
3. Mandatory audit firm rotation is necessary to effectively achieve the benefits of the "fresh look," although it is more costly than mandatory rotation of lead and reviewing partners	**6%**
4. Mandatory audit firm rotation is necessary to effectively achieve the benefits of the "fresh look," and the added costs would not outweigh the benefits	**1%**
5. No answer	

34

Please state any other response you may have.

____

____

____

If you answered 1 in response to question 73, please skip to question 75.

74. Considering (1) the audit partner rotation requirements of Section 203 of the Sarbanes-Oxley Act of 2002 as implemented by SEC regulations, (2) the Act's other auditor independence requirements (Section 201), prohibiting certain nonaudit services; Section 202, audit committee pre-approval of audit and non-audit services not otherwise prohibited and related public disclosures; Section 204, certain auditor reporting requirements to the audit committee; Section 206, time restrictions before certain auditors could be employed by the client, (3) the Act's Section 301 audit committee responsibilities, and (4) the Act's Section 101, establishing the PCAOB as an independent agency overseeing registered public accounting firms, **which of the following statements best describes your belief as to whether the specific provisions of the Act noted above, would likely achieve the intended benefits, both with respect to audit quality and auditor independence, that might otherwise be expected to result from implementing a mandatory audit firm rotation requirement.**

The Act's above requirements, **when fully implemented**, can be expected to
N=24

1. Fully achieve the intended benefits of mandatory audit firm rotation	**8%**
2. Substantially achieve the intended benefits of mandatory audit firm rotation	**17%**
3. Somewhat achieve the intended benefits of mandatory audit firm rotation	**42%**
4. Minimally achieve the intended benefits of mandatory audit firm rotation	**21%**
5. Not achieve the intended benefits of mandatory audit firm rotation	**12%**
6. No answer	

35

Other Practices for Enhancing Audit Quality

Authors of studies concerned with audit quality, regulators of the public accounting profession, or other parties who are knowledgeable of the accounting profession have identified various other practices intended to enhance auditor independence and audit quality. For each of the following practices, please provide your belief as to the likely benefit on auditor independence and audit quality in the absence of a requirement for audit firm rotation.

75. **Practice One:** The audit committee would be required to periodically hold an open competition for audit services in which the incumbent public accounting firm could also submit a bid for audit services.
N=73

1. Significant benefit	**1%**
2. Less than significant but a very positive benefit	**10%**
3. Limited benefit	**29%**
4. Little benefit	**15%**
5. No benefit	**45%**
6. No answer	

76. **Practice Two:** Supplement the Sarbanes-Oxley Act of 2002 mandatory audit partner rotation requirement with a requirement to periodically require rotation of audit managers after some specified period as audit manager on the audit engagement.
N=73

1. Significant benefit	**3%**
2. Less than significant but a very positive benefit	**11%**
3. Limited benefit	**27%**
4. Little benefit	**30%**
5. No benefit	**29%**
6. No answer	

77. **Practice Three:** Require another public accounting firm at the direction of the audit committee to periodically assist the audit committee in its responsibilities of overseeing the financial statement audit.
N=70

1. Significant benefit	**7%**
2. Less than significant but a very positive benefit	**13%**
3. Limited benefit	**30%**
4. Little benefit	**23%**
5. No benefit	**27%**
6. No answer	

36

78. **Practice Four:** Require another public accounting firm at the direction of the audit committee to periodically conduct a forensic audit in areas of the public company's financial reporting process that present a risk of fraudulent financial reporting that could result in materially misstated financial statements.
N=72

1. Significant benefit	**7%**
2. Less than significant but a very positive benefit	**23%**
3. Limited benefit	**28%**
4. Little benefit	**18%**
5. No benefit	**24%**
6. No answer	

79. **Practice Five:** Require that public companies hire their auditor of record on a non-cancelable multi-year basis (for example 3, 5, or 7 years). The incumbent firm could terminate the relationship for cause during the contract period. In addition, the incumbent firm would be eligible to compete for the subsequent audit contract period.
N=71

1. Significant benefit	**7%**
2. Less than significant but very positive benefit	**15%**
3. Limited benefit	**33%**
4. Little benefit	**15%**
5. No benefit	**30%**
6. No answer	

37

Views on Implementing Mandatory Audit Firm Rotation

The following questions address several fundamental factors that would have to be decided in structuring mandatory rotation of public accounting firms, if such a practice were to be required. **Regardless of whether or not you would support mandatory rotation of public accounting firms, please select one choice for each of the following questions.**

80. If mandatory rotation of public accounting firms were required, what should be the limit on the incumbent firm's audit tenure period?
N=70

1. Three or four years.	**1%**
2. Five to seven years.	**33%**
3. Eight to ten years.	**47%**
4. Greater than 10 years.	**19%**
5. No answer	

81. If mandatory rotation of public accounting firms were required, after what period of time should the incumbent firm be permitted to once again compete for audit services?
N=69

1. Three or four years.	**86%**
2. Five to seven years.	**13%**
3. Eight to ten years.	**1%**
4. Greater than 10 years.	**0%**
5. No answer	

82. If mandatory rotation of public accounting firms were required, under what circumstances, if any, should the audit committee be permitted to terminate (fire) the firm providing audit services?
N=72

1. The audit committee should be permitted to terminate the firm at any time if it is dissatisfied with the firm's performance or working relationship.	**82%**
2. The audit committee could not terminate the firm except for failure to follow professional standards set by the PCAOB, violations of securities laws, or similar unprofessional actions that may adversely affect audit quality.	**17%**
3. The audit committee could not terminate the firm unless the PCAOB deregistered the firm.	**1%**
4. Other (please specify below)	**0%**
5. No answer	

38

83. If mandatory rotation of public accounting firms were required, under what circumstances should the firm be able to terminate its relationship with the audit committee/public company as the auditor of record?
N=73

1. The firm should be able to terminate its relationship with the audit committee/public company at any time if the firm is dissatisfied with the working relationship.	**82%**
2. The firm should be able to terminate its relationship if it is dissatisfied with the audit committee or management's handling of matters involving fraud or matters that materially effect the fair presentation of the financial statements.	**18%**
3. Other (please specify below)	**0%**
4. No answer	

84. If mandatory rotation of public accounting firms were required, it should be implemented over a period of years (staggered) on a reasonable basis to avoid a significant number of public companies changing auditors simultaneously.
N=73

1. Strongly agree	**70%**
2. Agree	**23%**
3. Neither agree nor disagree	**3%**
4. Disagree	**4%**
5. Strongly disagree	**0%**
6. No opinion	**0%**
7. No answer	

85. If mandatory rotation of public accounting firms were required, do you believe such a requirement should be applied uniformly for audits of all public companies regardless of the nature or size of the public company?
N=72

1. Yes	**28%**
2. No	**72%**
3. No answer	

39

86. Please explain why you believe such a requirement should, or should not, be applied uniformly to all public companies:

____
____
____

If you believe that such a requirement should be applied uniformly, please skip the next question.

87. If you do not believe the requirement should be applied uniformly, please select from the following categories of public companies to which you believe such a requirement should apply?
N=74

1. Multinational or foreign public company with revenue of $5 billion or more	**N=36**
2. Domestic public company with revenue of $5 billion or more	**N=34**
3. Multinational or foreign public company with revenue of $100 million but less than $5 billion	**N=23**
4. Domestic public company with revenue of $100 million but less than $5 billion	**N=16**
5. Multinational or foreign public company with revenue of less than $100 million	**N=4**
6. Domestic public company with revenue of less than $100 million	**N=11**

40

Overall Opinion on Requiring Mandatory Audit Firm Rotation

This final section of the questionnaire asks for your current overall opinion on whether or not you would support requiring mandatory rotation of registered public accounting firms and whether your firm's interest in being a public accounting firm that audits public companies would change if rotation of such firms were required.

88. Regarding your firm's current overall opinion on whether or not the firm supports requiring mandatory rotation of registered public accounting firms, please select one of the following choices.
N=72

1. The firm supports requiring mandatory rotation of public accounting firms at this time provided that the period of time for rotation is reasonable.	**7%**
2. The firm supports the concept of requiring mandatory rotation of public accounting firms, but believes more time is needed to evaluate the effectiveness of the various requirements of the Sarbanes-Oxley Act for enhancing auditor independence and audit quality.	**17%**
3. The firm does not support requiring mandatory rotation of public accounting firms.	**76%**
4. No answer	

89. If you answered 3 to the question above please tell us your primary reasons.
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____
____
____

41

90. Assuming that **mandatory rotation of public accounting firms is not required**, what is your firm's interest in providing future audit services to public companies required to file reports with the SEC (please select one of the following choices)? **N=73**

1. The firm currently provides audit services to public companies required to file reports with the SEC and plans to continue such services by registering with the PCAOB.	**95%**
2. The firm currently provides audit services to public companies required to file with the SEC but is in the process of considering whether to continue to provide such audit services in the future.	**3%**
3. The firm currently provides audit services to public companies required to file reports with the SEC but plans to discontinue such services.	**1%**
4. The firm currently does not provide audit services to public companies required to file reports with the SEC, and the firm would likely continue not to provide such audit services.	**1%**
5. The firm currently does not provide audit services to public companies required to file reports with the SEC, but the firm would likely register with the PCAOB and compete to provide such audit services.	**0%**
6. No answer	

42

91. Regarding your firm's interest in providing future audit services to public companies as a public accounting firm (as noted in the preceding question), would your firm's interest in providing future audit services change **if mandatory audit firm rotation were required**? Please select one of the following choices.
N=72

1. The firm currently provides audit services to public companies required to file reports with the SEC and plans to continue such services by registering with the PCAOB.	**74%**
2. The firm currently provides audit services to public companies required to file with the SEC but is in the process of considering whether to continue to provide such audit services in the future.	**24%**
3. The firm currently provides audit services to public companies required to file reports with the SEC but plans to discontinue such services.	**1%**
4. The firm currently does not provide audit services to public companies required to file reports with the SEC, and the firm would likely continue not to provide such audit services.	**1%**
5. The firm currently does not provide audit services to public companies required to file reports with the SEC, but the firm would likely register with the PCAOB and compete to provide such audit services.	**0%**
6. No answer	

92. Please provide any additional comments or observations you may have on the potential effects of mandatory audit firm rotation of public accounting firms registered with the PCAOB.

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Public Company Survey on Mandatory Audit Firm Rotation

UNITED STATES GENERAL ACCOUNTING OFFICE
PUBLIC COMPANY SURVEY
ON MANDATORY AUDIT FIRM ROTATION

I. INTRODUCTION

To provide a thorough, fair and balanced report to Congress on the potential effects of mandatory audit firm rotation, it is essential that we obtain the experiences and views on this subject from the senior financial executive and the Audit Committee Chair (or head of an equivalent body) of a representative sample of public companies. Your company has been selected from the universe of public companies identified as issuers registered with the SEC.

To obtain the views of your company's senior financial executive and Audit Committee Chair, we are providing two separate surveys.

- The survey for the senior financial executive may be completed on-line at GAO's Website or completed by hand using this survey instrument and returned to GAO via the enclosed pre-addressed, postage-paid envelope. However, we encourage the use of the on-line version, as it will significantly reduce the effort needed to tabulate and summarize your public company's responses.

- The survey for your company's Audit Committee Chair (or head of an equivalent body or group), which is contained in a separately addressed envelope, has been included in the survey materials sent to your public company's senior financial executive. We are asking the senior financial executive to ensure that the survey for the Audit Committee Chair is delivered to the Audit Committee Chair because the names and addresses of the Chairs of public company Audit Committees were not readily available in a form that would facilitate a separate mailing directly to them.

In addition to providing responses to the questions in each survey, respondents will have the opportunity to provide any additional comments they may have on the subject of mandatory audit firm rotation at the end of each survey.

The results of the survey will be compiled and presented in summary form only as part of our report, and GAO will not release individually identifiable data from this survey, unless compelled by law or required to do so by Congress. Proprietary business information is protected by a federal law (18 U.S.C. 1905, the "Trade Secrets Act") that makes unauthorized disclosure a crime.

1

II. SURVEY GLOSSARY

For the purpose of this survey,

- **"public company"** refers to issuers of securities subject to the financial reporting requirements of the Securities Exchange Act of 1934, the Investment Company Act of 1940, and registered with the SEC. For purposes of this survey, mutual funds and investment trusts that meet the statutory definition of issuer of securities are considered public companies.
    - **"multinational or foreign public company"** is a public company with significant operations (10 percent or more of total revenue) in one or more countries outside the United States.
    - **"domestic public company"** is a public company with no significant operations (10 percent or more of total revenue) from outside the United States.
- **"auditor," "auditor of record," or "public accounting firm"** refers to an independent public accounting firm registered with the SEC that performs audits and reviews of public company financial statements and prepares attestation reports filed with the SEC. In the future, these public accounting firms must be registered with the Public Company Accounting Oversight Board (PCAOB) as required by the Sarbanes-Oxley Act of 2002.
- **"mandatory audit firm rotation"** refers to the imposition of a limit on the number of consecutive years in which a particular registered public accounting firm may be the auditor of record for a public company (an "issuer").
- **"audit quality"** refers to the auditor conducting the audit in accordance with *Generally Accepted Auditing Standards* (GAAS) to provide reasonable assurance that the audited financial statements and related disclosures are (1) presented in accordance with *Generally Accepted Accounting Principles* (GAAP) and (2) are not materially misstated whether due to errors or fraud. This definition assumes that reasonable third parties with knowledge of the relevant facts and circumstances would have concluded that the audit was conducted in accordance with GAAS and, that within the requirements of GAAS, the auditor appropriately detected and then dealt with known material misstatements by (1) ensuring that appropriate adjustments, related disclosures, and other changes were made to the financial statements to prevent them from being materially misstated, (2) modifying the auditor's opinion on the financial statements if appropriate changes or other adjustments were not made, or (3) if warranted, resigning as the public company's auditor of record and reporting the reason for the resignation to the SEC.

2

- **"audit failure"** refers to audits for which audited financial statements filed with the SEC contained material misstatements whether due to errors or fraud, and reasonable third parties with knowledge of the relevant facts and circumstances would have concluded that the audit was not conducted in accordance with GAAS, and therefore, the auditor failed to appropriately detect and/or deal with known material misstatements by (1) ensuring that appropriate adjustments, related disclosures, and other changes were made to the financial statements to prevent them from being materially misstated, (2) modifying the auditor's opinion on the financial statements if appropriate changes were not made, or (3) if warranted, resigning as the public company's auditor of record and reporting the reason for the resignation to the SEC.

- **"nonaudit services"** refers to any professional services provided to an issuer by a public accounting firm registered with the PCAOB that serves as auditor of record for the issuer, other than those provided to the issuer in connection with an audit, review, and/or attestation report of the financial statements of an issuer.

- **"audit committee"** refers to a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audit, review, and attestation engagements associated with the financial statements of the issuer performed by public accounting firms.

3

III. PUBLIC COMPANY BACKGROUND INFORMATION

1. Based on your company's last fiscal year, **please select one** of the following categories that best reflects the size and nature of your public company's business activity.

Multinational or foreign public company
N=101

1.	Revenue of $5 billion or more	**38%**
2.	Revenue of more than $1 billion but less than $5 billion	**58%**
3.	Revenue of $100 million but less than $1 billion	**4%**
4.	Revenue of less than $100 million	**0%**
5.	Not Applicable	

Domestic public company
N=100

1.	Revenue of $5 billion or more	**25%**
2.	Revenue of more than $1 billion but less than $5 billion	**70%**
3.	Revenue of $100 million but less than $1 billion	**3%**
4.	Revenue of less than $100 million	**2%**
5.	Not Applicable	

4

2. From the listing of industry sectors and sub-sectors listed below, **please select the one that best reflects your public company's primary business activity.** The listing is based on the North American Industry Classification System (NAICS). We have included industry classifications covering each NAICS industry sector and, with respect to the manufacturing sector, selected sub-sectors.

- ☐ Accommodations and Food Services **N=4**
- ☐ Administrative and Support Services and Waste Management Remediation Services **N=1**
- ☐ Agricultural, Forestry, Fishing, and Hunting **N=3**
- ☐ Ambulatory Health Care Services **N=2**
- ☐ Arts, Entertainment, and Recreation **N=3**
- ☐ Construction **N=3**
- ☐ Educational Services **N=0**
- ☐ Finance and Insurance **N=22**
- ☐ Information Services **N=3**
- ☐ Management of Companies and Enterprises **N=0**
- ☐ Manufacturing—Chemical **N=6**
- ☐ Manufacturing—Computer and Electronic Products **N=14**
- ☐ Manufacturing—Food **N=6**
- ☐ Manufacturing—Paper **N=2**
- ☐ Manufacturing—Primary Metal **N=2**
- ☐ Manufacturing—Transportation Equipment **N=5**
- ☐ Manufacturing—Other **N=24**
- ☐ Mining **N=2**
- ☐ Professional, Scientific, and Technical Services **N=3**
- ☐ Public Administration **N=0**
- ☐ Real Estate, Rental, and Leasing **N=1**
- ☐ Trade—Retail **N=23**
- ☐ Trade—Wholesale **N=9**
- ☐ Transportation and Warehousing **N=5**
- ☐ Utilities **N=10**
- ☐ Other—please specify in box below **N=39**

Other – please specify:
____
____
____

5

Auditor of Record

The following series of questions concern your company's auditor of record including changes in your auditor of record during the last 5 years. In this regard, please do not consider a change in the name of your auditor of record's firm, which resulted from merger and/or consolidation activity within the public accounting profession, to be a change in your company's auditor of record. However, if as a result of merger and/or consolidation activity involving your auditor of record's firm, your company selected a new public accounting firm as your auditor of record, it should be treated as a change in auditor.

3. Please provide the name of your company's current auditor of record and the number of years the firm has served continuously as your company's auditor of record.

(Survey responses to this question are not being provided)
Name of Current Audit Firm

Continuous years as your company's auditor of record (Please round to the nearest whole number.)
N=198

Range of responses=0-5	**N=62**	**31%**
Range of responses=6-10	**N=18**	**9%**
Range of responses=10+	**N=118**	**60%**

If your company's current auditor has served for more than 5 continuous years as auditor of record, please skip to question 5.

4. If your company's current auditor has not served as your auditor of record for at least 5 continuous years, please provide the name of your company's previous auditor of record and the number of years the previous public accounting firm served continuously as auditor of record.

(Survey responses to this question are not being provided)
Name of Previous Audit Firm

Continuous years as your company's auditor of record (Please round to the nearest whole number.)
N=50

Range of responses=0-5	**N=9**	**18%**
Range of responses=6-10	**N=5**	**10%**
Range of responses=10+	**N=36**	**72%**

6

5. Since December 31, 2001, has your public company selected a new public accounting firm to replace Arthur Andersen, as your company's auditor of record?
N=200

1. Yes	**17%**
2. No - Skip to question 11.	**83%**

Replacing Arthur Andersen as Auditor of Record

Questions 6-10 relate to your public company's experience, since December 31, 2001, in replacing Arthur Andersen, as your public company's auditor of record.

6. What process did your public company use to select another public accounting firm to replace Arthur Andersen, as your public company's new auditor of record?
N=31

1. Screened capable firms interested in serving as your new auditor of record.	**16%**
2. Held a structured competition (including submission and review of formal bids and proposals) among capable firms interested in serving as your company's new auditor of record.	**81%**
3. Selected a new capable public accounting firm without either screening or holding a structured competition from other firms interested in serving as your company's new auditor of record.	**3%**
4. Other - please specify in the box below	**0%**
5. No Answer	

Other (please specify)

____

____

7

7. Recognizing that the circumstances surrounding former Arthur Andersen clients' need to find a new auditor of record were somewhat unusual, how satisfied was your public company with the number of capable public accounting firms interested in serving as your company's new auditor of record?
N=33

1. Very satisfied	**40%**
2. Somewhat satisfied	**30%**
3. Neither satisfied nor dissatisfied	**9%**
4. Somewhat dissatisfied	**21%**
5. Very dissatisfied	**0%**
6. No Answer	

8. Did any member of Arthur Andersen's engagement team, which audited your public company's prior year financial statements, join your new auditor of record's engagement team for the first financial statement audit following the change in auditor of record?
N=32

1. No	**44%**
2. Yes	**56%**
3. No Answer	

If yes, please indicate below the number (both in total and by type of position) of former Andersen staff that moved to the new auditor of record's engagement team for the first financial statement audit following the change.

Total number of respondents that said one or more former Andersen staff moved	**N=17**
Total number of respondents that said one or more of the following type of former Andersen staff moved	
Engagement Partner	**N=8**
Other Partners	**N=7**
Audit Managers	**N=14**
Other Professional staff	**N=12**

8

9. As a percentage of the new auditor of record's initial year audit fee, how significant were **your company's estimated costs** (including any internal or external costs) associated with **selecting a new public accounting firm** to replace Andersen as your company's auditor of record?

   Our company's **estimated costs to select a new auditor to replace Andersen were:**
   N=33

1. 20 percent or more of the new firm's initial year audit fee.	**21%**
2. Greater than 15 percent but less than 20 percent of the new firm's initial year audit fee.	**6%**
3. Greater than 10 percent but less that 15 percent of the new firm's initial year audit fee.	**9%**
4. Greater than 5 percent but less than 10 percent of the new firm's initial year audit fee.	**21%**
5. Less than 5 percent of the new firm's initial year audit fee.	**37%**
6. Zero.	**6%**
7. No Answer	

10. As a percentage of the new auditor of record's initial year audit fee, how significant were your public company's **estimated additional initial year costs to support** (internal costs that exceeded the level needed to support the previous auditor of record) the efforts by the public accounting firm that replaced Andersen to understand your company's operations and financial reporting practices?

   Our public company's **estimated additional initial year costs to support a new audit firm were:**
   N=31

1. 50 percent or more of the new firm's initial year audit fee.	**13%**
2. Greater than 40 percent but less than 50 percent of the new firm's initial year audit fee.	**0%**
3. Greater than 30 percent but less than 40 percent of the new firm's initial year audit fee.	**10%**
4. Greater than 20 percent but less than 30 percent of the new firm's initial year audit fee.	**29%**
5. Greater than 10 percent but less that 20 percent of the new firm's initial year audit fee.	**29%**
6. Less than 10 percent of the new firm's initial year audit fee.	**16%**
7. Zero.	**3%**
8. No Answer	

9

Services Provided by Your Auditor of Record

11. With regard to the services provided by your auditor of record to your company during your last fiscal year, please identify **each category of services provided** by your auditor of record.

    1. Audit, review and attestation **N=199**
    2. Financial systems design and implementation **N=17**
    3. All other services **N=166**
    4. None of the above services **N=0**

    Please indicate the **approximate percentage of the total fees** your company paid to your auditor of record for each category of service provided. (Please round all numbers to the nearest whole number.)

	N	Mean	Median	Range
Audit, review and attestation	**192**	**63%**	**63%**	**9-100%**
Financial systems design and implementation	**18**	**31%**	**31%**	**1-76%**
All other services	**180**	**37%**	**35%**	**1-86%**

Total (The means report the average answer for those citing each function. Therefore the means across categories do not equal 100%.)

12. What is the title of the management official in your company that has been principally responsible for coordinating the various services provided to your company by your auditor of record?

    Title (Survey responses to this question are not being provided.)

    How long has that official been responsible for coordinating auditor of record's services? (Please round to the nearest whole number of years.)
    N=196

Range of responses=0-5	**N=144**	**74%**
Range of responses=6-10	**N=34**	**17%**
Range of responses=11+	**N=18**	**9%**

10

Audit Committee

13. Does your company currently have an audit committee and, if it does, how many years has it been in existence?
N=180

1.	No	**0%**
2.	Yes – Please specify number of years below	**100%**
3.	No Answer	

If you answered yes above, how many years has the audit committee been in existence? (Please round to the nearest whole number.)
N=167 **Mean=21** **Median=20** **Range=2-180**

If you answered 2 to question 13, please skip to question 16.

14. Does your company currently have a body or group that carries out the equivalent duties and responsibilities (equivalent body or group) commonly ascribed to an audit committee and, if so, how many years has it been in existence?
N=0

1. No - Skip to question 17.
2. Yes - If yes, please specify length of existence below
3. No Answer

If you answered yes above, how many years has the body been in existence? (Please round to the nearest whole number.)
____

15. Does a member of your company's Board of Directors serve as the lead person on audit committee-type issues that are considered by your company as a body or group equivalent to an audit committee?
N=0

1. No
2. Yes
3. No Answer

11

16. How long has the Chair of your company's Audit Committee (or the lead person on audit committee-related issues considered by an equivalent body or group) served in that capacity?
N=192

1. Less than 1 year	**16%**
2. One year	**9%**
3. Two years	**17%**
4. Three years	**15%**
5. Four years	**5%**
6. Five years	**8%**
7. More than five years	**30%**
8. No Answer	

<u>Audit Firm Rotation Policy</u>

17. Does your company (including your company's audit committee or equivalent body or group) currently have a policy that requires the periodic rotation of your company's auditor of record?
N=200

1. No	**99%**
2. Yes - If yes, please briefly describe below	**1%**
3. No Answer	

If you answered yes above, please briefly describe the audit firm rotation policy (including when established and the maximum audit tenure period permitted).

____
____
____

If you answered 2 to question 17, please skip to question 19.

18. If you answered 1 to question 17, is your public company (including your audit committee or equivalent body or group) currently considering a policy that would require some form of periodic rotation of your auditor of record?
N=193

1. No	**96%**
2. Yes	**4%**
3. No Answer	

12

IV. POTENTIAL EFFECTS OF MANDATORY AUDIT FIRM ROTATION

A. Selection and Availability of Firms

The following questions are intended to obtain the views of your public company on various competition-related issues related to changing audit firms that provide financial audit, review, and attestation services as auditors of record to public companies and how those views might be affected by mandatory audit firm rotation.

Selection of New Firms

19. If your public company needed to change your auditor of record, what method or process would your company likely use to select a new auditor of record? Would your public company likely use the same method or process to select a new public accounting firm to serve as auditor of record if rotation of audit firms were required?

	Without Mandatory Audit Firm Rotation	With Mandatory Audit Firm Rotation	With and Without Mandatory Audit Firm Rotation	No Answer
Screening interested and capable firms **N=116**	**5%**	**6%**	**89%**	
Holding a competition among interested and capable firms **N=154**	**10%**	**2%**	**88%**	
Selecting a capable firm without screening or holding a competition **N=5**	**N=0**	**N=2**	**N=3**	
Other - please describe below **N=4**	**N=1**	**N=0**	**N=3**	
Don't know **N=4**	**N=0**	**N=3**	**N=1**	

Other for which you answered above:
___
___
___

13

<u>Availability of Firms</u>

If your public company's auditor of record is currently **not one of the Big 4 public accounting firms** (PricewaterhouseCoopers**,** Deloitte & Touche, KPMG, or Ernst & Young) **please skip to question 22.**

20. Would your public company realistically consider **using a non-Big 4 public accounting firm** as your public company's auditor of record?
N=179

1. No	**96%**
2. Yes - Skip to question 22.	**4%**
3. Uncertain - Skip to question 22.	
4. No Answer	

14

21. To what extent are the following reasons important in explaining why your public company would **not realistically consider using a non-Big 4 public accounting firm**? Please check one box in each row.

	Very Great Importance	Great Importance	Moderate Importance	Some Importance	Little or No Importance	Don't Know
Expectations of the Capital Markets **N=171**	**57%**	**35%**	**6%**	**2%**	**0%**	**0%**
Public Company geographic/global operations **N=170**	**51%**	**19%**	**15%**	**4%**	**11%**	**0%**
Public Company operations require specialized industry skills/knowledge **N=171**	**38%**	**32%**	**22%**	**5%**	**3%**	**0%**
Public Company contractual obligations (e.g. with banks or lenders) **N=170**	**16%**	**32%**	**24%**	**14%**	**13%**	**1%**
Requirement of the Public Company's Board of Directors **N=166**	**24%**	**40%**	**14%**	**5%**	**10%**	**7%**
Sufficiency of audit firm resources **N=171**	**64%**	**29%**	**5%**	**2%**	**0%**	**0%**
Audit Firm's name and reputation **N=171**	**43%**	**40%**	**12%**	**5%**	**0%**	**0%**
Other Reason: Please describe below **N=8**	**N=5**	**N=3**	**N=0**	**N=0**	**N=0**	**N=0**

If you selected "Other Reason" above—Please describe:

____
____

15

22. **In the absence of mandatory audit firm rotation,** how concerned are you that **the spin-off of consulting services by three of the Big 4 firms has significantly limited the realistic options your public company has in selecting capable public accounting firms** interested in serving your public company as auditor of record? **How would your level of concern likely change under mandatory audit firm rotation?**

	Very Concerned	Somewhat Concerned	Minimally Concerned	Not Concerned	No Basis to Evaluate
Without Mandatory Audit Firm Rotation **N=197**	**1%**	**16%**	**26%**	**53%**	**4%**
With Mandatory Audit Firm Rotation **N=196**	**11%**	**19%**	**22%**	**43%**	**5%**

23. **In the absence of mandatory audit firm rotation,** how concerned are you that **the recent consolidation from the Big 5 to the Big 4 public accounting firms will significantly limit the realistic options your public company has in selecting capable public accounting firms** interested in serving your public company as auditor of record? **How would your level of concern change under mandatory audit firm rotation?**

	Very Concerned	Somewhat Concerned	Minimally Concerned	Not Concerned	No Basis to Evaluate
Without Mandatory Audit Firm Rotation **N=199**	**10%**	**42%**	**30%**	**18%**	**0%**
With Mandatory Audit Firm Rotation **N=198**	**44%**	**35%**	**11%**	**9%**	**1%**

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24. **In the absence of mandatory audit firm rotation,** how concerned are you that **the auditor independence rules** prohibiting the auditor of record from also providing certain nonaudit services as required by the Sarbanes-Oxley Act of 2002 and related SEC regulations will significantly limit the realistic options your public company has in selecting capable public accounting firms interested in serving your public company as auditor of record? **How would your level of concern likely change under mandatory audit firm rotation?**

	Very Concerned	Somewhat Concerned	Minimally Concerned	Not Concerned	No Basis to Evaluate
Without Mandatory Audit Firm Rotation **N=197**	**4%**	**30%**	**31%**	**34%**	**1%**
With Mandatory Audit Firm Rotation **N=199**	**28%**	**25%**	**23%**	**22%**	**2%**

25. **In the absence of mandatory audit firm rotation,** if your public company were to consider changing its auditor of record, **how many capable public accounting firms would likely be interested in serving as** your company's auditor of record? **Would the likely number of interested and capable public accounting firms change under mandatory audit firm rotation?**

	One Firm	Two Firms	Three Firms	Four Firms	Five Firms	If More: Please Specify Below	No Basis to Evaluate
Without Mandatory Audit Firm Rotation **N=200**	**1%**	**12%**	**48%**	**27%**	**5%**	**4%**	**3%**
With Mandatory Audit Firm Rotation N=**199**	**2%**	**16%**	**47%**	**18%**	**5%**	**4%**	**8%**

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If you answered “more” above, please specify:

If, in your answer to question 25, you noted no change in the number of capable firms likely to be interested in competing if mandatory audit firm rotation were required, please skip to question 28.

26. If you believe mandatory audit firm rotation would likely change the number of capable public accounting firms interested in serving as your company’s auditor of record, how do you believe the likely change would impact audit fees?

Mandatory audit firm rotation will likely:
N=43

1. Increase the number of interested and capable firms and contribute to lower audit fees.	**7%**
2. Increase the number of interested and capable firms and contribute to higher audit fees.	**14%**
3. Result in neither higher nor lower audit fees.	**5%**
4. Decrease the number of interested and capable firms and contribute to lower audit fees	**0%**
5. Decrease the number of interested and capable firms and contribute to higher audit fees	**67%**
6. No basis to estimate	**7%**
7. No Answer	

If you answered 3 or 6 to question 26, please skip to question 28.

27. Please provide a brief explanation for why the likely change in the number of interested and capable firms would affect audit fees in the manner noted in your response to question 26.

18

28. How would mandatory audit firm rotation likely affect the distribution of public company audits among the relatively small number (90 to 100) of larger public accounting firms?
N=198

1. Market share of public company audits will be more concentrated in the relatively small number of larger public accounting firms.	**18%**
2. Market share of public company audits concentrated in the relatively small number of larger public accounting firms will remain approximately the same.	**48%**
3. Market share of public company audits will be less concentrated in the relatively small number of larger public accounting firms.	**3%**
4. No basis to estimate.	**31%**
5. No Answer	

B. Costs and Fees

The following questions involve audit-related costs and fees of public accounting firms, and costs incurred by public companies in selecting new firms and supporting the firms selected in performing the initial audit.

- **"marketing costs"** are the actual costs incurred by public accounting firms related to their efforts to acquire or retain financial statement audit clients.
- **"audit costs"** are the actual cost incurred by the public accounting firm to perform an audit of a public company's financial statements.
- **"audit fee"** is the amount the public accounting firm actually charges the public company to perform the financial statement audit.
- **"selection costs"** are the internal costs incurred by a public company in selecting a new public accounting firm as a public company's auditor of record.
- **"support costs"** are the internal costs incurred by a public company in supporting the public accounting firm's efforts to understand the public company's operations and financial reporting practices. Such support costs are in addition to the audit fee that the public company pays to the public accounting firm for the financial statement audit.

19

Audit Fee Impact of Mandatory Audit Firm Rotation

29. Assuming new public accounting firms are selected to replace incumbent firms through the increased opportunities to compete by firms willing and able to perform the audit, how would mandatory audit firm rotation likely affect **audit fees over time**?

Mandatory audit firm rotation would likely:
N=199

1. Lead to lower audit fees over time.	**4%**
2. Lead to higher audit fees over time.	**89%**
3. Have no affect on audit fees over time.	**2%**
4. No basis to evaluate – Skip to question 31.	**5%**
5. No Answer	

30. Please explain your reasons for believing that over time **audit fees would be lower, higher or remain the same** under mandatory audit firm rotation that is accomplished through increased opportunities to compete.
____
____
____
____

Public Accounting Firm Costs and Fees

31. Do you believe that, following a change in a public company's auditor of record (whether as a result of a voluntary or mandatory audit firm rotation), **a public accounting firm's initial-year audit costs are likely to exceed the firm's subsequent year audit costs** because of the new firm's need to quickly develop a "sufficient understanding of the public company's operations and financial reporting practices" in order to perform the audit?
N=200

1. Yes	**92%**
2. No - Skip to question 35.	**4%**
3. Uncertain - Skip to question 35.	**4%**
4. No Answer	

20

32. What is your opinion on the level of **additional audit costs** (as compared to the annual audit costs in subsequent years for the same public company client) that a public accounting firm will likely incur **in an initial year audit of a public company client**?

    A public accounting firm's additional initial year audit costs are likely to exceed subsequent year annual audit costs by:
    N=184

1.	50 percent or more.	**20%**
2.	More than 40 percent but less than 50 percent.	**11%**
3.	More than 30 percent but less than 40 percent.	**23%**
4.	More than 20 percent but less than 30 percent.	**24%**
5.	More than 10 percent but less than 20 percent.	**7%**
6.	Less than 10 percent.	**1%**
7.	No basis or experience on which to respond.	**14%**
8.	No Answer	

Please indicate the extent to which you agree or disagree with the following two statements.

33. When a change in public accounting firm is voluntary, the new firm's additional initial year **audit costs** incurred by the new firm are likely to be absorbed by the audit firm and not passed on to the public company in **higher audit fees**.
    N=184

1.	Strongly agree	**29%**
2.	Generally agree	**48%**
3.	Neither agree nor disagree	**6%**
4.	Generally disagree	**11%**
5.	Strongly disagree	**6%**
6.	No Answer	

34. **Under mandatory audit firm rotation,** the new public accounting firm selected as auditor of record as part of a **scheduled change in auditor** would be more likely to increase its audit fees over its limited audit tenure period to help ensure that the firm fully recovered its additional initial year **audit costs.**
    N=184

1.	Strongly agree	**76%**
2.	Generally agree	**21%**
3.	Neither agree nor disagree	**2%**
4.	Generally disagree	**0%**
5.	Strongly disagree	**1%**
6.	No Answer	

21

35. A likely consequence of mandatory audit firm rotation will be that public companies will need to change their auditor of record more frequently. **Do you believe that those public accounting firms involved in increased opportunities to compete will, regardless of whether they are selected, likely incur additional marketing costs**?
N=198

1.	Yes	**85%**
2.	No - Skip to question 37.	**5%**
3.	Uncertain - Skip to question 37.	**10%**
4.	No Answer	

Please indicate the extent to which you agree or disagree with the next statement.

36. The **additional marketing costs** that are likely to occur under mandatory audit firm rotation **will be passed on to public companies** through higher financial audit fees.
N=168

1.	Strongly agree	**58%**
2.	Agree	**33%**
3.	Neither agree nor disagree	**6%**
4.	Disagree	**2%**
5.	Strongly disagree	**0%**
6.	No basis or experience on which to respond	**1%**
7.	No Answer	

<u>Public Company Costs</u>

37. To the extent that your public company would select a new public accounting firm more frequently under mandatory audit firm rotation, do you believe that your public company will **incur (internal) selection costs?**

As a percentage of initial year audit fees, estimated selection costs are likely to be:
N=198

1.	20 percent or more.	**14%**
2.	More than 15 percent but less than 20 percent.	**8%**
3.	More than 10 percent but less than 15 percent.	**20%**
4.	More than 5 percent but less than 10 percent.	**23%**
5.	Less than 5 percent.	**23%**
6.	Zero.	**1%**
7.	No basis to know	**11%**
8.	No Answer	

22

38. Following a change in public accounting firm (whether as a result of a voluntary or mandatory change in auditor), the new public accounting firm must gain an understanding of a new public company audit client's operations and financial reporting practices. What is the likely level of **additional initial year support costs (internal costs that exceed level needed to support the previous auditor of record) that your public company would incur** following a change in auditor of record as compared to the new auditor of record's initial year audit fees?

As a percentage of new auditor's initial year audit fees, our company's additional support costs are likely to be:
N=196

1.	50 percent or more.	**11%**
2.	More than 40 percent but less than 50 percent.	**8%**
3.	More than 30 percent but less than 40 percent.	**17%**
4.	More than 20 percent but less than 30 percent.	**28%**
5.	More than 10 percent but less than 20 percent.	**23%**
6.	Less than 10 percent.	**5%**
7.	Zero.	**0%**
8.	No basis to estimate.	**8%**
9.	No Answer	

C. Auditor Knowledge and Experience

The following questions address issues concerning how mandatory audit firm rotation may affect the auditor's **ability to detect** financial reporting issues that may indicate material misstatements in a public company's financial statements.

39. In your opinion, how many years do you think it would likely take a new auditor of record to become **sufficiently familiar with your company's operations and financial reporting practices** to no longer require the additional audit resources often associated with conducting an initial year audit of a new public company client?
N=200

1.	1 year	**7%**
2.	2-3 years	**79%**
3.	4-5 years	**11%**
4.	More than 5 years	**0%**
5.	No basis to know – Skip to question 42.	**3%**
6.	No Answer	

23

40. To what extent was your answer to the previous question influenced by the nature and complexity of your company's operations and financial reporting practices?
N=195

1.	A significant extent	**46%**
2.	A moderate extent	**44%**
3.	A minor extent	**8%**
4.	No extent	**2%**
5.	No Answer	

41. Are there factors other than the nature and complexity of your company's operations and financial reporting practices that influenced your answer to the preceding question?
N=190

1.	No	**67%**
2.	If yes, please explain the other factors below.	**33%**
3.	No Answer	

If you answered yes above, briefly explain the other factors:
____
____
____

42. Under mandatory audit firm rotation, new audit firms provide a "fresh look" at the public company's operations and financial reporting practices. In general, how does the fresh look a new auditor provides affect the likelihood that the **new auditor will detect financial reporting issues that may materially affect a public company's financial statements,** which the previous auditor may not have detected?
N=199

1.	Significantly increased likelihood	**1%**
2.	Somewhat increased likelihood	**21%**
3.	No effect on likelihood	**50%**
4.	Somewhat decreased likelihood	**17%**
5.	Significantly decreased likelihood	**7%**
6.	No basis to know	**4%**
7.	No Answer	

24

43. Under mandatory audit firm rotation, in your opinion how would you compare the new public accounting firm's likely initial level of knowledge of the client's specific operations and financial reporting practices to the previous auditor of record's level of knowledge of the client's operations and financial reporting processes?

The new public accounting firm is likely to have
N=200

1.	Significantly less knowledge of the client	**82%**
2.	Somewhat less knowledge of the client	**17%**
3.	About the same knowledge of the client	**0%**
4.	Somewhat more knowledge of the client	**0%**
5.	Significantly more knowledge of the client	**0%**
6.	No basis to know	**1%**
7.	No Answer	

If you answered 3, 4, 5, or 6 to question 43 please skip to question 46.

44. If, under mandatory audit firm rotation, the new public accounting firm is likely to have initially less specific knowledge of the client's operations and financial reporting practices, how would this less specific knowledge likely affect the risk that the new auditor would not detect material misstatements in the financial statements during the first year of the auditor's tenure?
N=196

1.	Significantly increase the risk	**20%**
2.	Somewhat increase the risk	**65%**
3.	Neither increase nor decrease the risk	**12%**
4.	Somewhat decrease the risk	**0%**
5.	Significantly decrease the risk	**1%**
6.	No basis to know	**2%**
7.	No Answer	

45. Under mandatory audit firm rotation, how would **requiring the new auditor of record to perform additional and/or enhanced audit procedures** (including giving the new auditor of record expanded access to the predecessor audit firm's workpapers and key personnel) to increase the auditor's knowledge of your company's operations and financial reporting practices **likely affect the risk of not detecting material misstatements?**
N=196

25

1. Significantly increase the risk	**2%**
2. Somewhat increase the risk	**5%**
3. Neither increase or decrease the risk	**24%**
4. Somewhat decrease the risk	**61%**
5. Significantly decrease the risk	**5%**
6. No basis to evaluate	**3%**
7. No Answer	

<u>D. Auditor Independence</u>

Some say a public accounting firm's independence may be adversely affected by economic pressures to retain the audit client as well as by developing too close a relationship with the public company and its management. These pressures may cause a public accounting firm and/or its partners to not appropriately challenge the client's accounting and financial reporting practices. Concern about auditor independence relates to the public accounting firm's and its partners' ability and willingness to **appropriately deal** with known financial reporting issues that may indicate materially misstated financial statements. An auditor **appropriately deals** with financial reporting issues that arise during an audit by (1) ensuring that appropriate adjustments, related disclosures, and other changes are made to the financial statements to ensure that the financial statements are fairly stated in accordance with generally accepted accounting principles, (2) modifying the auditor's report on the client's financial statements if appropriate changes are not made, or (3), if warranted, resigning as the client's auditor of record and reporting the reason for the resignation to the SEC.

46. In your opinion, under mandatory audit firm rotation, what is the likely impact that the new auditor's focus ("fresh look") on a client's operations and financial reporting practices would have on the auditor's **potential for dealing more appropriately** with financial reporting issues that may indicate material misstatements in a public company's financial statements?
N=198

1. Significantly increase the potential	**1%**
2. Somewhat increase the potential	**18%**
3. Neither increase nor decrease the potential	**71%**
4. Somewhat decrease the potential	**7%**
5. Significantly decrease the potential	**0%**
6. No basis to evaluate	**3%**
7. No Answer	

26

47. **In the absence of mandatory audit firm rotation, how would you rate the pressure on a public accounting firm and its engagement partner(s) to retain clients** as a factor in whether or not they appropriately deal with financial reporting issues that may materially affect a public company's financial statements? **How would that pressure likely change under mandatory audit firm rotation?**

	Significant Factor	Strong Factor	Moderate Factor	Small Factor	No Factor	No Response
Pressure on the firm **in the absence of mandatory audit firm rotation N=189**	**0%**	**5%**	**19%**	**31%**	**45%**	**0%**
Pressure on the firm **with mandatory audit firm rotation N=189**	**0%**	**4%**	**8%**	**35%**	**53%**	**0%**
Pressure on the engagement partner(s) **in the absence of mandatory audit firm rotation N=189**	**3%**	**7%**	**23%**	**27%**	**40%**	**0%**
Pressure on the engagement partner(s) **with mandatory audit firm rotation N=189**	**0%**	**4%**	**14%**	**35%**	**47%**	**0%**

27

48. **In the absence of mandatory audit firm rotation, how would you rate the pressure on a public accounting firm and its engagement partner(s) to retain clients** as a factor in whether or not they appropriately challenge overly aggressive and/or optimistic financial reporting positions taken by public company management in interpreting and applying generally accepted accounting principles? **How would that pressure likely change under mandatory audit firm rotation?**

	Significant Factor	Strong Factor	Moderate Factor	Small Factor	No Factor	No Response
Pressure on the firm **in the absence of mandatory audit firm rotation N=190**	**0%**	**3%**	**17%**	**36%**	**44%**	**0%**
Pressure on the firm **with mandatory audit firm rotation N=190**	**0%**	**2%**	**7%**	**41%**	**50%**	**0%**
Pressure on the engagement partner(s) **in the absence of mandatory audit firm rotation N=190**	**1%**	**6%**	**21%**	**34%**	**38%**	**0%**
Pressure on the engagement partner(s) **with mandatory audit firm rotation N=190**	**0%**	**3%**	**11%**	**43%**	**43%**	**0%**

28

49. **In the absence of mandatory audit firm rotation, how would you rate the potential of a subsequent lawsuit and/or regulatory action against a public accounting firm and its engagement partner(s)** as a factor in whether or not the public accounting firm and engagement partner(s) appropriately deal with financial reporting issues that may materially affect a public company client's financial statements? **How would that pressure likely change under mandatory audit firm rotation?**

	Significant Factor	Strong Factor	Moderate Factor	Small Factor	No Factor	No Response
Pressure on the firm **in the absence of mandatory audit firm rotation N=186**	**30%**	**20%**	**13%**	**12%**	**25%**	**0%**
Pressure on the firm **with mandatory audit firm rotation N=184**	**30%**	**20%**	**13%**	**12%**	**25%**	**0%**
Pressure on the engagement partner(s) **in the absence of mandatory audit firm rotation N=184**	**27%**	**23%**	**14%**	**13%**	**23%**	**0%**
Pressure on the engagement partner(s) **with mandatory audit firm rotation N=185**	**28%**	**23%**	**12%**	**13%**	**24%**	**0%**

29

50. **In the absence of mandatory audit firm rotation**, to what extent do you believe that **the possibility of being replaced by another firm as auditor of record** is a factor in whether or not the incumbent audit firm appropriately deals with financial reporting issues that may materially affect the client's financial statements?
N=199

1. A significant factor	**0%**
2. A strong factor	**3%**
3. A moderate factor	**11%**
4. A small factor	**35%**
5. No factor	**51%**
6. No Answer	

51. **Under mandatory audit firm rotation**, to what extent do you believe **the incumbent audit firm's knowledge that a new firm will replace the incumbent firm as auditor of record at the end of a specified audit tenure period** would be a factor in whether or not the incumbent firm appropriately deals with financial reporting issues that may materially affect the public company client's financial statements?
N=198

1. A significant factor	**3%**
2. A strong factor	**7%**
3. A moderate factor	**11%**
4. A small factor	**29%**
5. No factor	**50%**
6. No Answer	

30

52. How would **establishing a limit on a public accounting firm's tenure** as a public company's auditor of record **affect the perception of the auditor's independence** held by the following:

	Significantly Increase	Somewhat Increase	Neither Increase nor Decrease	Somewhat Decrease	Significantly Decrease	No Response
Perception of auditor independence held by **capital markets** (including analysts, banks, brokers, exchanges, and rating agencies) **N=188**	**1%**	**36%**	**63%**	**0%**	**0%**	**0%**
Perception of auditor independence held by **institutional investors N=189**	**2%**	**37%**	**61%**	**0%**	**0%**	**0%**
Perception of auditor independence held by **individual investors N=188**	**13%**	**53%**	**34%**	**0%**	**0%**	**0%**

31

53. Traditionally, a change in the auditor of record for a public company has been viewed as a "red flag" signal to the capital markets and the public to inquire into the underlying reason for the change in auditor. What impact would **the scheduled change in auditors required under mandatory audit firm rotation** have on the "red flag" signal otherwise associated with a change in auditor? (A scheduled change would be one that occurs as a direct result of an audit firm rotation requirement.)
N=196

1. Significant likelihood of retaining the "red flag" signal	**0%**
2. Some likelihood of retaining the "red flag" signal	**4%**
3. No change in the "red flag" signal	**8%**
4. Some likelihood of eliminating the "red flag" signal	**36%**
5. Significant likelihood of eliminating the "red flag" signal	**52%**
6. No Answer	

54. **Assuming that under mandatory audit firm rotation** either public companies or public accounting firms can terminate their relationship, what is the likelihood that **the traditional "red flag" signal to the capital markets and the public would be retained for any unscheduled change in auditor**? (An unscheduled change would be one that **does not occur** as a direct result of an audit firm rotation requirement.)
N=198

1. Significant likelihood of retaining the "red flag" signal	**60%**
2. Some likelihood of retaining the "red flag" signal	**18%**
3. No change in the "red flag" signal	**14%**
4. Some likelihood of eliminating the "red flag" signal	**8%**
5. Significant likelihood of eliminating the "red flag" signal	**0%**
6. No Answer	

32

E. Audit Tenure and The Risk of Audit Failure

The following questions concern issues related to audit tenure and audit failure. **Audit tenure** refers to the number of continuous years a particular public accounting firm serves as a public company's auditor of record. An **audit failure** occurs when audited financial statements filed with the SEC contained material misstatements whether due to errors or fraud and reasonable third parties with knowledge of the relevant facts and circumstances would have concluded that the audit was not conducted in accordance with GAAS.

Audit Tenure

55. In light of your public company's past experience with changes in your auditor of record, **how would mandatory audit firm rotation likely change the average tenure** for firms that serve as your company's auditor of record in the future?
N=196

1. Average audit tenure would likely increase - Skip to question 62	**1%**
2. Average audit tenure would likely stay the same – Skip to question 62	**2%**
3. Average audit tenure would likely decrease	**97%**
4. No Answer	

56. If you believe that the average audit tenure period is likely to decrease under mandatory audit firm rotation, do you have any concern that a **reduced audit tenure period may negatively affect the public accounting firm's existing incentives to invest the resources needed to understand the client's operations and financial reporting practices** in order to devise effective audit tools and procedures?
N=189

1. Very concerned	**25%**
2. Somewhat concerned	**42%**
3. Neither concerned nor unconcerned	**15%**
4. Somewhat unconcerned	**3%**
5. Not concerned	**14%**
6. No basis to evaluate	**1%**
7. No Answer	

33

57. Do you have any **concern that mandatory audit firm rotation may lead public accounting firms, as the end of a set audit tenure approaches, to move its most knowledgeable and experienced audit personnel** from the current audit engagement to other efforts or engagements to enhance the firm's ability to attract and retain other clients?
N=190

1.	Very concerned	**27%**
2.	Somewhat concerned	**50%**
3.	Neither concerned nor unconcerned	**12%**
4.	Somewhat unconcerned	**3%**
5.	Not concerned	**5%**
6.	No basis to evaluate	**3%**
7.	No Answer	

Risk of Audit Failure

58. If, under mandatory audit firm rotation, **public accounting firms move their most knowledgeable and experienced audit personnel from the current audit engagement** to other efforts to enhance the public accounting firm's ability to attract and/or retain clients in the future, **how do you think this would affect the risk of audit failure on the current audit engagement**?
N=190

1.	Significant increased risk	**22%**
2.	Somewhat increased risk	**70%**
3.	No change in risk	**6%**
4.	Somewhat decreased risk	**0%**
5.	Significant decreased risk	**0%**
6.	No basis to evaluate	**2%**
7.	No Answer	

34

For the following four statements, please indicate the extent to which you agree or disagree.

59. The risk of an audit failure is higher in the early years of an audit tenure period as the new public accounting firm is more likely to have **not fully developed and applied an in depth understanding of the new client's operations and financial reporting practices**.
N=190

1.	Strongly agree	**24%**
2.	Generally agree	**55%**
3.	Neither agree nor disagree	**16%**
4.	Generally disagree	**4%**
5.	Strongly disagree	**1%**
6.	No Answer	

60. The risk of an audit failure is higher in the early years of an audit tenure period because the new public accounting firm is more likely to **place heavy reliance on information provided by client management**.
N=190

1.	Strongly agree	**6%**
2.	Generally agree	**29%**
3.	Neither agree nor disagree	**35%**
4.	Generally disagree	**26%**
5.	Strongly disagree	**4%**
6.	No Answer	

61. The risk of an audit failure is likely to increase as the audit tenure period increases due to the **"comfort level" (familiarity with client management and the desire to retain the client over many years)** provided by the public accounting firm's long-term relationship with client management.
N=189

1.	Strongly agree	**2%**
2.	Generally agree	**7%**
3.	Neither agree nor disagree	**18%**
4.	Generally disagree	**53%**
5.	Strongly disagree	**20%**
6.	No Answer	

62. The risk of an audit failure is likely to increase as the audit tenure period increases due to **the management of public company clients becoming too familiar with the auditor's approach and procedures**.
N=199

35

1. Strongly agree	**0%**
2. Generally agree	**3%**
3. Neither agree nor disagree	**21%**
4. Generally disagree	**46%**
5. Strongly disagree	**30%**
6. No Answer	

F. Costs and Benefits of Mandatory Audit Firm Rotation

63. Some have argued that mandatory audit firm rotation would benefit auditor independence and audit quality by providing a new auditor focus ("fresh look") on the public company's operations and financial reporting practices. Others have argued that under mandatory audit firm rotation (1) the new auditor's lower level of client-specific knowledge and experience may negatively affect audit quality, and (2) would increase the cost that public companies pay for financial statement audits because of higher initial audit fees and/or additional costs associated with selecting and supporting a new audit firm. **Which of the following statements best expresses your public company's views on the potential costs and benefits that may result under mandatory audit firm rotation**.
N=198

1. Costs are likely to significantly exceed the benefits.	**70%**
2. Costs are likely to moderately exceed the benefits.	**22%**
3. Costs and benefits are likely to be about equal.	**3%**
4. Benefits are likely to moderately exceed the costs.	**3%**
5. Benefits are likely to significantly exceed the costs.	**1%**
6. No basis to evaluate.	**1%**
7. No Answer	

64. With respect to the costs and benefits that may result from mandatory audit firm rotation, do you believe the likely costs and benefits of mandatory audit firm rotation will vary based on the nature and size of the public company being audited?
N=198

1. Yes	**66%**
2. No - Skip to question 66	**20%**
3. No basis to evaluate - Skip to question 66	**14%**
4. No Answer	

36

65. **For each of the following categories of public companies**, please provide your opinion on the potential costs and benefits that may result if mandatory audit firm rotation were to be required.

	Costs Are Likely To Significantly Exceed Benefits	Costs Are Likely To Moderately Exceed Benefits	Costs and Benefits Are Likely To Be About Equal	Benefits Are Likely To Moderately Exceed Costs	Benefits Are Likely To Significantly Exceed Costs	No Basis To Judge
Multinational or Foreign Company with Revenue of $5 billion or more **N=124**	**70%**	**16%**	**1%**	**4%**	**1%**	**8%**
Domestic Company with Revenue of $5 billion or more **N=123**	**56%**	**31%**	**4%**	**4%**	**1%**	**4%**
Multinational or Foreign Company with Revenue of $100 million but less than $5 billion **N=126**	**52%**	**32%**	**3%**	**4%**	**0%**	**9%**
Domestic Company with Revenue of $100 million but less than $5 billion **N=123**	**48%**	**39%**	**6%**	**1%**	**1%**	**5%**
Multinational or Foreign Company with Revenue of less than $100 million **N=122**	**31%**	**43%**	**12%**	**2%**	**1%**	**11%**
Domestic Company with Revenue of less than $100 million **N=122**	**23%**	**45%**	**22%**	**2%**	**1%**	**7%**

37

V. IMPACT OF THE SARBANES-OXLEY ACT

The Act contains various reform provisions intended to enhance auditor independence and audit quality, strengthen corporate responsibility, and improve the oversight of audits of public companies that are subject to the securities laws of the United States. Many of these reforms will directly or indirectly affect audit firms and the performance and oversight of the company audits they perform. The Act also created the PCAOB to oversee the audits of public companies in order to protect investors and further public interest in the preparation of public company audit reports.

66. Section 203 of the Sarbanes-Oxley Act of 2002 as implemented by SEC regulations requires the mandatory rotation of both lead and reviewing engagement partners after 5 years and after 7 years for other partners with a significant involvement in the audit engagement. Some have argued that these new and enhanced audit partner requirements sufficiently provide the "fresh look" and related benefits to auditor independence and audit quality without the costs of changing the public accounting firm associated with mandatory audit firm rotation. Others have argued that a new public accounting firm is necessary to effectively achieve the benefits associated with the "fresh look" because changing lead and reviewing partners continues the existing auditing practices and working relationship of the incumbent public accounting firm. Please select one of the following statements that best describes your belief as to **whether mandatory rotation of lead and reviewing partners achieves the benefits to auditor independence and audit quality of the "fresh look" or mandatory audit firm rotation is necessary to achieve those benefits**.
N=200

1. Mandatory rotation of lead and reviewing partners sufficiently achieves the intended benefits of the " fresh look" and is less costly than mandatory audit firm rotation. (Skip to question 68.)	**77%**
2. Mandatory rotation of lead and reviewing partners may not be as effective as mandatory audit firm rotation in achieving the intended benefits of the "fresh look," but is a better choice given the higher cost of mandatory audit firm rotation.	**18%**
3. Mandatory audit firm rotation is necessary to effectively achieve the benefits of the "fresh look," although it is more costly than mandatory rotation of lead and reviewing partners.	**3%**
4. Mandatory audit firm rotation is necessary to effectively achieve the benefits of the "fresh look," and the added costs would not outweigh the benefits.	**1%**
5. Other - Please specify any other belief below.	**1%**
6. No Answer	

38

Other (please state any other belief you may have)

____
____
____
____

67. Considering (1) the audit partner rotation requirements of Section 203 of the Sarbanes-Oxley Act of 2002 as implemented by SEC regulations, (2) the Act's other auditor independence requirements (Section 201) prohibiting certain nonaudit services; Section 202, audit committee pre-approval of audit and non-audit services not otherwise prohibited and related public disclosures; Section 204, certain auditor reporting requirements to the audit committee; Section 206, time restrictions before certain auditors could be employed by the client, (3) the Act's Section 301 audit committee responsibilities, and (4) the Act's Section 101 establishing the PCAOB as an independent entity overseeing registered public accounting firms, which of the following statements best describes your belief as to **whether the specific provisions of the Act noted above, would likely achieve the intended benefits, both with respect to audit quality and auditor independence, that might otherwise be expected to result from implementing a mandatory audit firm rotation requirement.**

    The Act's above requirements, **when fully implemented**, can be expected to:
    N=46

1. Fully achieve the intended benefits of mandatory audit firm rotation.	**11%**
2. Substantially achieve the intended benefits of mandatory audit firm rotation.	**65%**
3. Somewhat achieve the intended benefits of mandatory audit firm rotation.	**20%**
4. Minimally achieve the intended benefits of mandatory audit firm rotation.	**0%**
5. Not achieve the intended benefits of mandatory audit firm rotation.	**4%**
6. No Answer	

39

VI. OTHER PRACTICES FOR ENHANCING AUDIT QUALITY

Authors of studies concerned with audit quality, regulators of the public accounting profession, or other parties who are knowledgeable of the accounting profession have identified various other practices that are intended to enhance audit quality. For each of the following practices, please provide your belief as to the likely benefit on auditor independence and audit quality **in the absence of a requirement for audit firm rotation.**

68. Practice One: The audit committee would be required to periodically hold an open competition for audit services in which the incumbent public accounting firm could also submit a bid for audit services.
N=200

1. Significant benefit	**1%**
2. Less than significant but a very positive benefit	**10%**
3. Limited benefit	**26%**
4. Little benefit	**27%**
5. No benefit	**36%**
6. No Answer	

69. Practice Two: Supplement the Sarbanes-Oxley Act of 2002 mandatory audit partner rotation requirement with a requirement to periodically require rotation of audit managers after some specified period as audit manager on the audit engagement.
N=201

1. Significant benefit	**4%**
2. Less than significant but a very positive benefit	**21%**
3. Limited benefit	**25%**
4. Little benefit	**22%**
5. No benefit	**28%**
6. No Answer	

70. Practice Three: Require another public accounting firm at the direction of the audit committee to periodically assist the audit committee in its responsibilities of overseeing the financial statement audit.
N=200

1. Significant benefit	**1%**
2. Less than significant but a very positive benefit	**9%**
3. Limited benefit	**17%**
4. Little benefit	**25%**
5. No benefit	**48%**
6. No Answer	

40

71. Practice Four: Require another public accounting firm at the direction of the audit committee to periodically conduct a forensic audit in areas of the public company's financial reporting process that present a risk of fraudulent financial reporting that could result in materially misstated financial statements.
N=201

1.	Significant benefit	**2%**
2.	Less than significant but a very positive benefit	**12%**
3.	Limited benefit	**21%**
4.	Little benefit	**28%**
5.	No benefit	**37%**
6.	No Answer	

72. Practice Five: Require that the public company's audit committee hire the auditor of record on a non-cancelable multi-year basis (for example 3, 5, or 7 years). The incumbent firm could terminate the relationship for cause during the contract period. In addition, the incumbent firm would be eligible to compete for the subsequent audit contract period.
N=200

1.	Significant benefit	**2%**
2.	Less than significant but very positive benefit	**2%**
3.	Moderate benefit	**9%**
4.	Little benefit	**26%**
5.	No benefit	**61%**
6.	No Answer	

41

VII. VIEWS ON IMPLEMENTING MANDATORY AUDIT FIRM ROTATION

The following questions address several fundamental factors that would have to be decided in structuring mandatory rotation of public accounting firms, if such a practice were to be required. **Regardless of whether or not you would support mandatory rotation of public accounting firms, please select one choice for each of the following questions.**

73. If mandatory rotation of public accounting firms were required, what should be the limit on the incumbent firm's audit tenure period?
N=199

1.	Three or four years.	**3%**
2.	Five to seven years.	**36%**
3.	Eight to ten years.	**42%**
4.	Greater than ten years.	**19%**
5.	No Answer	

74. If mandatory rotation of public accounting firms were required, after what period of time should the incumbent firm be permitted to once again compete for audit services?
N=197

1.	Three or four years.	**62%**
2.	Five to seven years.	**25%**
3.	Eight to ten years.	**11%**
4.	Greater than ten years.	**2%**
5.	No Answer	

75. If mandatory rotation of public accounting firms were required, under what circumstances, if any, should **the audit committee** be permitted to terminate (fire) the firm providing audit services?
N=200

1.	The audit committee should be permitted to terminate the firm at any time if it is dissatisfied with the firm's performance or working relationship.	**96%**
2.	The audit committee could not terminate the firm except for failure to follow professional standards set by the PCAOB, violations of securities laws, or similar unprofessional actions that may adversely affect auditor independence and/or audit quality.	**3%**
3.	The audit committee could not terminate the firm unless the PCAOB deregistered the firm.	**0%**
4.	Other - Please specify other circumstances below.	**1%**
5.	No Answer	

42

Other (please specify).
____
____
____

76. If mandatory rotation of public accounting firms were required, under what circumstances should **the firm** be able to terminate its relationship with the audit committee/public company as the auditor of record?
N=194

1.	The firm should be able to terminate its relationship with the audit committee/public company at any time if the firm is dissatisfied with the working relationship.	**77%**
2.	A firm should be able to terminate its relationship with a company if dissatisfied with audit committee, directors, or management efforts to address matters likely to involve fraud or materially affect financial statements.	**21%**
3.	Other - please specify other circumstances below.	**2%**
4.	No Answer	

Other (please specify).
____
____
____

77. If mandatory rotation of public accounting firms were required, it should be implemented over a period of years (staggered) on a reasonable basis to avoid a significant number of public companies changing auditors simultaneously.
N=200

1.	Strongly agree	**73%**
2.	Agree	**19%**
3.	Neither agree nor disagree	**5%**
4.	Disagree	**1%**
5.	Strongly disagree	**1%**
6.	No opinion	**1%**
7.	No Answer	

78. If mandatory rotation of public accounting firms were required, do you believe such a requirement should be applied uniformly for audits of all public companies regardless of the nature or size of the public company?
N=198

1.	Yes	**81%**
2.	No	**19%**
3.	No Answer	

43

79. Please explain why you believe such a requirement **should, or should not,** be applied uniformly to all public companies:
____
____
____
____.

If you believe that such a requirement should be applied uniformly, please skip to question 81.

80. If you answered 2 to question 78, please select from the following categories of public companies those to which you believe **such a requirement should apply?** Please select all that apply.
N=38

1. Multinational or foreign public company with revenue of $5 billion or more	**N=14**
2. Domestic public company with revenue of $5 billion or more	**N=15**
3. Multinational or foreign public company with revenue of $100 million but less than $5 billion	**N=8**
4. Domestic public company with revenue of $100 million but less than $5 billion	**N=10**
5. Multinational or foreign public company with revenue of less than $100 million	**N=8**
6. Domestic public company with revenue of less than $100 million	**N=12**
7. None of the above	

44

VIII. OVERALL OPINION ON REQUIRING MANDATORY AUDIT FIRM ROTATION

This final section of the questionnaire asks for your current overall opinion on whether or not you would support requiring mandatory rotation of registered public accounting firms.

81. Regarding your public company's overall current opinion on whether or not your company supports requiring mandatory rotation of registered public accounting firms, please select one of the following choices.
N=187

1.	The company supports requiring mandatory rotation of public accounting firms at this time provided that the period of time for rotation is reasonable. (Please provide the principal reason for supporting mandatory rotation below.)	**4%**
2.	The company supports the concept of requiring mandatory rotation, but believes more time is needed to evaluate the effectiveness of the various requirements of the Sarbanes-Oxley Act of 2002 for enhancing audit quality.	**8%**
3.	The company does not support requiring mandatory rotation of public accounting firms. (Please provide the principal reason for not supporting mandatory rotation below.)	**88%**
4.	No Answer	

(If you answered either 1 or 3 above, please provide the principal reason for either supporting or not supporting mandatory firm rotation below.)

82. Please provide any additional comments you may have on the effects of mandatory rotation of public accounting firms.

45

Survey of Public Companies' Audit Committees on the Effects of Mandatory Audit Firm Rotation

UNITED STATES GENERAL ACCOUNTING OFFICE
SURVEY OF PUBLIC COMPANIES' AUDIT COMMITTEES
EFFECTS OF MANDATORY AUDIT FIRM ROTATION

INTRODUCTION

To provide a thorough, fair and balanced report to Congress on the potential effects of mandatory audit firm rotation, it is essential that we obtain the experiences and views on this subject from the senior financial executive and the Audit Committee Chair (or head of an equivalent body) of a representative sample of public companies. Your company has been selected from the universe of public companies identified as issuers registered with the SEC.

To obtain the views of your company's senior financial executive and Audit Committee Chair, we are providing two separate surveys.

- The survey for the senior financial executive may be completed on-line at GAO's Website or completed by hand using this survey instrument and returned to GAO via the enclosed pre-addressed, postage-paid envelope. However, we encourage the use of the on-line version, as it will significantly reduce the effort needed to tabulate and summarize your public company's responses.

- The survey for your company's Audit Committee Chair (or head of an equivalent body or group), which is contained in a separately addressed envelope, has been included in the survey materials sent to your public company's senior financial executive. We are asking the senior financial executive to ensure that the survey for the Audit Committee Chair is delivered to the Audit Committee Chair because the names and addresses of the Chairs of public company Audit Committees were not readily available in a form that would facilitate a separate mailing directly to them.

In addition to providing responses to the questions in each survey, respondents will have the opportunity to provide any additional comments they may have on the subject of mandatory audit firm rotation at the end of each survey.

The results of the survey will be compiled and presented in summary form only as part of our report, and GAO will not release individually identifiable data from this survey, unless compelled by law or required to do so by Congress. Proprietary business information is protected by a federal law (18 U.S.C. 1905, the "Trade Secrets Act") that makes unauthorized disclosure a crime.

1

SURVEY GLOSSARY

For the purpose of this survey,

- **"public company"** refers to issuers of securities subject to the financial reporting requirements of the Securities Exchange Act of 1934, the Investment Company Act of 1940, and registered with the SEC. For purposes of this survey, mutual funds and investment trusts that meet the statutory definition of issuer of securities are considered public companies.
  - **"multinational or foreign public company"** is a public company with significant operations (10 percent or more of total revenue) in one or more countries outside the United States.
  - **"domestic public company"** is a public company with no significant operations (10 percent or more of total revenue) from outside the United States.
- **"auditor," "auditor of record," or "public accounting firm"** refers to an independent public accounting firm registered with the SEC that performs audits and reviews of public company financial statements and prepares attestation reports filed with the SEC. In the future, these public accounting firms must be registered with the Public Company Accounting Oversight Board (PCAOB) as required by the Sarbanes-Oxley Act of 2002.
- **"mandatory audit firm rotation"** refers to the imposition of a limit on the number of consecutive years in which a particular registered public accounting firm may be the auditor of record for a public company (an "issuer").
- **"audit quality"** refers to the auditor conducting the audit in accordance with *Generally Accepted Auditing Standards* (GAAS) to provide reasonable assurance that the audited financial statements and related disclosures are (1) presented in accordance with *Generally Accepted Accounting Principles* (GAAP) and (2) are not materially misstated whether due to errors or fraud. This definition assumes that reasonable third parties with knowledge of the relevant facts and circumstances would have concluded that the audit was conducted in accordance with GAAS and, that within the requirements of GAAS, the auditor appropriately detected and then dealt with known material misstatements by (1) ensuring that appropriate adjustments, related disclosures, and other changes were made to the financial statements to prevent them from being materially misstated, (2) modifying the auditor's opinion on the financial statements if appropriate changes or other adjustments were not made, or (3) if warranted, resigning as the public company's auditor of record and reporting the reason for the resignation to the SEC.

2

- **"audit failure"** refers to audits for which audited financial statements filed with the SEC contained material misstatements whether due to errors or fraud, and reasonable third parties with knowledge of the relevant facts and circumstances would have concluded that the audit was not conducted in accordance with GAAS, and therefore, the auditor failed to appropriately detect and/or deal with known material misstatements by (1) ensuring that appropriate adjustments, related disclosures, and other changes were made to the financial statements to prevent them from being materially misstated, (2) modifying the auditor's opinion on the financial statements if appropriate changes were not made, or (3) if warranted, resigning as the public company's auditor of record and reporting the reason for the resignation to the SEC.

- **"nonaudit services"** refers to any professional services provided to an issuer by a public accounting firm registered with the PCAOB that serves as auditor of record for the issuer, other than those provided to the issuer in connection with an audit, review, and/or attestation report of the financial statements of an issuer.

- **"audit committee"** refers to a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audit, review, and attestation engagements associated with the financial statements of the issuer performed by public accounting firms.

BACKGROUND ON RESPONDING AUDIT COMMITTEE

1. Please provide the number of years you have served as the Chair of the Audit Committee or head of an equivalent body.

   Number of years serving as Chair______________

   N=177

Range of responses=0-1	**N=32**	**18%**
Range of responses=2-3	**N=67**	**38%**
Range of response=4-5	**N=31**	**17%**
Range of responses=5+	**N=47**	**27%**

2. Does your audit committee or your company have a policy that requires the periodic rotation of your company's auditor of record?
   N=191

   No_____________ **100%**
   Yes_____________ If yes, **0%**
   Year established?__________________
   Maximum audit tenure period permitted___________________

3

If you answered Yes to question 2, please go to question 4.

3. Is your company's audit committee or the company currently considering a policy that would require some form of periodic rotation of your auditor of record?
N=183

Yes **6%** No **94%**

MANDATORY AUDIT FIRM ROTATION COSTS AND BENEFITS

Some have argued that mandatory audit firm rotation would benefit auditor independence and audit quality by providing a new auditor focus ("fresh look") on the public company's operations and financial reporting practices. Others have argued that under mandatory audit firm rotation (1) the new auditor's lower level of client-specific knowledge and experience may negatively affect audit quality and increase the risk of audit failure, and (2) would increase the cost that public companies pay for financial statement audits because of high initial audit fees and/or additional costs associated with selecting and supporting a new audit firm.

4. Which of the following statements best expresses your view on the **potential costs and benefits that may result under mandatory audit firm rotation**.
N=189

1. Costs are likely to significantly exceed the benefits.	**65%**
2. Costs are likely to moderately exceed the benefits.	**24%**
3. Costs and benefits are likely to be about equal.	**4%**
4. Benefits are likely to moderately exceed costs.	**1%**
5. Benefits are likely to significantly exceed the costs.	**1%**
6. No basis to evaluate.	**5%**

5. Please tell us the primary reasons for your view on the potential costs and benefits that may result under mandatory audit firm rotation.

4

AVAILABILITY OF PUBLIC ACCOUNTING FIRMS

If your public company's auditor of record is currently **not one of the Big 4 public accounting firms** (PricewaterhouseCoopers, Deloitte & Touche, KPMG, or Ernst & Young), please skip to question 9.

6. Would your audit committee realistically consider using a non-Big 4 firm as the public company's auditor of record?
   N=175

1.	Yes	**6%**
2.	No	**94%**

If you answered yes to question 6, please go to question 9.

5

7. Please check one box in each row. To what extent are the following reasons important in explaining why your audit committee would only consider using one of the Big-4 public accounting firms? *Please check one box in each row.*

Reasons for limiting consideration to only Big 4 firms	Very Great Importance	Great Importance	Moderate Importance	Some Importance	Little or No Importance	Don't Know
Expectations of the Capital Markets **N=163**	**48%**	**34%**	**14%**	**1%**	**3%**	**0%**
Public Company geographic/global operations **N=164**	**53%**	**27%**	**10%**	**4%**	**6%**	**0%**
Public Company operations require specialized industry skills/knowledge **N=164**	**39%**	**36%**	**18%**	**6%**	**1%**	**0%**
Public Company contractual obligation (e.g. with banks or lenders) **N=163**	**15%**	**28%**	**24%**	**6%**	**20%**	**7%**
Requirement of the Public Company's Board of Directors **N=162**	**23%**	**35%**	**19%**	**7%**	**13%**	**3%**
Sufficiency of audit firm resources **N=164**	**68%**	**26%**	**4%**	**2%**	**0%**	**0%**
Audit Firm's name and reputation **N=164**	**35%**	**41%**	**18%**	**4%**	**2%**	**0%**
Other—Please describe **N=6**	**N=3**	**N=3**	**N=0**	**N=0**	**N=0**	**N=0**

6

8. If your audit committee would only consider using one of the Big 4 public accounting firms, to what extent does the limited number of acceptable firms affect your views on mandatory audit firm rotation.
N=160

1. Support mandatory audit firm rotation and the limited number of acceptable firms would not affect my view	**4%**
2. Support mandatory audit firm rotation but the limited number of acceptable firms would likely result in costs exceeding benefits	**8%**
3. Would not support mandatory audit firm rotation due to the limited number of acceptable firms	**20%**
4. Do not support mandatory audit firm rotation regardless of the number of acceptable firms	**68%**

7

IMPACT OF THE SARBANES-OXLEY ACT OF 2002

Section 203 of the Sarbanes-Oxley Act of 2002 (the Act) as implemented by Securities and Exchange Commission (SEC) regulations requires the mandatory rotation of both lead and reviewing engagement partners after 5 years and after 7 years for other partners with a significant involvement in the audit engagement. Some have argued that these new and enhanced audit partner requirements sufficiently provide the "fresh look" and related benefits to auditor independence and audit quality without the costs of changing the public accounting firm associated with mandatory audit firm rotation (e.g. selection costs, additional support costs). Others have argued that a new public accounting firm is necessary to effectively achieve the benefits associated with the "fresh look" because changing lead and reviewing partners continues the existing auditing practices and working relationship of the incumbent public accounting firm.

9. Considering the above arguments, please select one of the following statements that best describes your belief.
N=185

1. Mandatory rotation of lead and reviewing partners sufficiently achieves the intended benefits of the "fresh look" and is less costly than mandatory audit firm rotation.	**76%**
2. Mandatory rotation of lead and reviewing partners may not be as effective as mandatory audit firm rotation in achieving the intended benefits of the "fresh look," but is a better choice given the higher cost of mandatory audit firm rotation.	**20%**
3. Mandatory audit firm rotation is necessary to effectively achieve the benefits of the "fresh look," although it is more costly than mandatory rotation of lead and reviewing partners.	**1%**
4. Mandatory audit firm rotation is necessary to effectively achieve the benefits of the "fresh look," and the added costs would not outweigh the benefits.	**2%**
5. Other (please state any other belief you may have).	**1%**

____
____
____
____
____
____

If you answered 1 to question 9, please go to question 11.

8

10. Considering the Act's requirements concerning audit partner rotation as implemented by SEC regulations, prohibited nonaudit services, audit committee pre-approval of audit and nonaudit services not otherwise prohibited and related public disclosures, auditor reporting requirements to the audit committee, time restrictions before auditors could become client employees, audit committee responsibilities for hiring, compensating, and overseeing the external auditors, and establishing the Public Company Accounting Oversight Board (PCAOB) as an independent agency overseeing registered public accounting firms, which of the following statements best describes your belief as to **whether the provisions of the Act noted above, would likely achieve the intended benefits, both with respect to audit quality and auditor independence, that might otherwise be expected to result from implementing a mandatory audit firm rotation requirement**.

The Act's above requirements, **when fully implemented**, can be expected to
N=43

1. Fully achieve the intended benefits of mandatory audit firm rotation.	**14%**
2. Substantially achieve the intended benefits of mandatory audit firm rotation.	**58%**
3. Somewhat achieve the intended benefits of mandatory audit firm rotation.	**18%**
4. Minimally achieve the intended benefits of mandatory audit firm rotation.	**5%**
5. Not achieve the intended benefits of mandatory audit firm rotation.	**5%**

9

OTHER PRACTICES FOR ENHANCING AUDIT QUALITY

Authors of studies concerned with audit quality, regulators of the public accounting profession, or other parties who are knowledgeable of the accounting profession have identified various practices other than mandatory audit firm rotation intended to enhance audit quality. For each of the following practices, please provide your belief as to the likely benefit on auditor independence and audit quality **in the absence of a requirement for audit firm rotation.**

11. Practice One: The audit committee would be required to periodically hold an open competition for audit services in which the incumbent public accounting firm could also submit a bid for audit services.
N=189

1. Significant benefit	**6%**
2. Less than significant but a very positive benefit	**17%**
3. Limited benefit	**28%**
4. Little benefit	**25%**
5. No benefit	**24%**

12. Practice Two: Supplement the Sarbanes-Oxley Act of 2002 mandatory audit partner rotation requirement with a requirement to periodically require rotation of audit managers after some specified period as audit manager on the audit engagement.
N=189

1. Significant benefit	**13%**
2. Less than significant but a very positive benefit	**28%**
3. Limited benefit	**34%**
4. Little benefit	**13%**
5. No benefit	**12%**

13. Practice Three: Require another public accounting firm at the direction of the audit committee to periodically assist the audit committee in its responsibilities of overseeing the financial statement audit.
N=189

1. Significant benefit	**4%**
2. Less than significant but a very positive benefit	**9%**
3. Limited benefit	**30%**
4. Little benefit	**29%**
5. No benefit	**28%**

10

14. Practice Four: Require another public accounting firm at the direction of the audit committee to periodically conduct a forensic audit in areas of the public company's financial reporting process that present a risk of fraudulent financial reporting that could result in materially misstated financial statements.
N=188

1. Significant benefit	**3%**
2. Less than significant but a very positive benefit	**16%**
3. Limited benefit	**30%**
4. Little benefit	**31%**
5. No benefit	**20%**

15. Practice Five: Require that the audit committee hire the auditor of record on a non-cancelable multi-year basis (for example 3, 5, or 7 years). The incumbent firm could terminate the relationship for cause during the contract period. In addition, the incumbent firm would be eligible to compete for the subsequent audit contract period.
N=187

1. Significant benefit	**1%**
2. Less than significant but a very positive benefit	**5%**
3. Limited benefit	**13%**
4. Little benefit	**24%**
5. No benefit	**57%**

VIEWS ON IMPLEMENTING MANDATORY AUDIT FIRM ROTATION

The following questions address several fundamental factors that would have to be decided in structuring mandatory rotation of public accounting firms, if such a practice were to be required. **Regardless of whether or not you would support mandatory rotation of public accounting firms**, please select one choice for each of the following questions.

16. If mandatory rotation of public accounting firms were required, what should be the limit on the incumbent firm's audit tenure period?
N=187

1. Three or four years	**3%**
2. Five to seven years	**37%**
3. Eight to ten years	**38%**
4. Greater than ten years	**22%**

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17. If mandatory rotation of public accounting firms were required, after what period of time should the incumbent firm be permitted to once again compete for audit services?
N=190

1. Three or four years	**58%**
2. Five to seven years	**28%**
3. Eight to ten years	**11%**
4. Greater than ten years	**3%**

18. If mandatory rotation of public accounting firms were required, under what circumstances, if any, should the audit committee be permitted to terminate (fire) the firm providing audit services?
N=188

1. The audit committee should be permitted to terminate the firm at any time if it is dissatisfied with the firm's performance or working relationship.	**98%**
2. The audit committee could not terminate the firm except for failure to follow professional standards set by the PCAOB, violations of securities laws, or similar unprofessional actions that may adversely affect auditor independence and/or audit quality.	**2%**
3. The audit committee could not terminate the firm unless the PCAOB deregistered the firm.	**0%**
4. Other (Please specify.)	**0%**

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19. If mandatory rotation of public accounting firms were required, under what circumstances should the firm be able to terminate its relationship with the audit committee/public company as the auditor of record?
N=190

1. The firm should be able to terminate its relationship with the audit committee/public company at any time if the firm is dissatisfied with the working relationship.	**74%**
2. The firm should be able to terminate its relationship with the audit committee/public company if the firm is dissatisfied with the public company's management and/or board of directors and/or the audit committee's performance in addressing matters involving likely fraud and/or matters that may likely materially affect the fair presentation of the financial statements in accordance with generally accepted accounting principles.	**25%**
3. Other (Please specify.)	**1%**

____
____
____
____
____

20. If mandatory rotation of public accounting firms were required, it should be implemented over a period of years (staggered) on a reasonable basis to avoid a significant number of public companies changing auditors simultaneously.
N=189

1. Strongly agree	**72%**
2. Agree	**18%**
3. Neither agree nor disagree	**2%**
4. Disagree	**2%**
5. Strongly disagree	**1%**
6. No opinion	**5%**

21. If mandatory rotation of public accounting firms were required, do you believe such a requirement should be applied uniformly for audits of all public companies regardless of the nature or size of the public company?
N=188

Yes________**65%**________ No________**35%**________

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22. Please explain why you believe such a requirement should, or should not, be applied uniformly to all public companies:
____
____
____
____
____
____

If you answered yes to question 21, please go to question 24.

23. If you answered no to question 21, please select from the following categories of public companies to which you believe such a requirement should apply? Please select all that apply.
N=65

1. Multinational or foreign public company (a public company with significant operations [10 percent or more of total revenue] in one or more countries outside the United States) with revenue of $5 billion or more	**N=43**
2. Domestic public company (a public company with no significant operations [10 percent or more of total revenue] outside the United States) with revenue of $5 billion or more.	**N=40**
3. Multinational or foreign public company with revenue of $100 million but less than $5 billion	**N=21**
4. Domestic public company with revenue of $100 million but less than $5 billion	**N=16**
5. Multinational or foreign public company with revenue of less than $100 million	**N=8**
6. Domestic public company with revenue of less than $100 million	**N=7**

YOUR OVERALL OPINION ON REQUIRING MANDATORY AUDIT FIRM ROTATION

This final section of the questionnaire asks for your current overall opinion on whether or not you would support requiring mandatory rotation of registered public accounting firms. Please select one of the following choices.

24. Regarding your overall current opinion on whether or not you support requiring mandatory rotation of registered public accounting firms, please select one of the following choices.
N=166

1. I support requiring mandatory rotation of public accounting firms at this time provided that the period of time for rotation is reasonable. (Please provide the principal reason supporting your view.)	**2%**
2. I support the concept of requiring mandatory rotation of public accounting firms, but believe more time is needed to evaluate the effectiveness of the various requirements of the Sarbanes-Oxley Act of 2002 for enhancing audit quality.	**7%**
3. I do not support requiring mandatory rotation of public accounting firms. (Please generally state your overall reasons.)	**90%**
4. Other (Please describe.)	**1%**

SPACE FOR ADDITIONAL COMMENTS

25. Please provide any additional comments you may have on whether mandatory rotation of public accounting firms should or should not be required and the related costs and benefits.

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Selected Written Comments from Tier I Public Accounting Firms

Public accounting firms surveyed were invited to add written comments to a number of questions to further explain their answers or to add additional answers. The survey of public accounting firms, annotated with summary responses for each question, is in appendix I. Of the 74 Tier I respondents that responded to the survey, 55 volunteered written answers to at least one of the 17 open-ended comment questions in our survey, which we have summarized into the following subject areas:

- auditor's ability to detect financial reporting issues,
- additional audit procedures for new auditor of record,
- client-specific knowledge and experience,
- auditor independence,
- audit quality and audit failure,
- audit-related costs and audit fees,
- audit procedures for PCAOB consideration,
- competition for audit services,
- implementing mandatory audit firm rotation, and
- overall views on requiring mandatory audit firm rotation.

The following tables display selected comments from respondents to these questions to reflect the range of views that were provided by respondents. Some of the quotes illustrate typical comments made by several public accounting firms, while others represent a unique viewpoint of only that public accounting firm. While these specific comments provide valuable insights, the number of comments of a particular type reproduced here is not necessarily proportional to the number of other similar responses, and, therefore, the comments are not meant to be representative of the views that might be found in the population of Tier I public accounting firms as a whole.

Auditor's Ability to Detect Financial Reporting Issues

We asked respondents to describe factors other than those already listed in the survey that would likely affect the auditor's ability to detect financial reporting issues that may indicate material misstatements in a public company's financial statements. A number of respondents mentioned the importance of an active oversight role of the audit committee, management's attributes, auditor assessments and independence, fee and time pressures placed on auditors, and other factors such as the frequency of auditor contact with key client management affecting the auditor's ability to detect financial reporting issues.

Table 1 shows selected responses to question 10 – "Please describe any relevant factors not listed above [in question 9][1] that you believe would likely affect the auditor's ability to detect financial reporting issues that may indicate material misstatements in a public company's financial statements and, in your response, please specify the level of its importance using the same categories as above."

Table 1: Other Factors Affecting the Auditor's Ability to Detect Financial Reporting Issues

General category of factors	Comment
Role of audit committee	"Very Great Importance–Active oversight role of the audit committee and its understanding of the company's financial reporting."
	". . . willingness of audit committees . . . to fund activities beyond audit requirements, such as forensic efforts and deeper internal controls work."
Management attributes	"Very Great Importance–Quality of the internal control environment -Management's ethical behavior and tone at the top-Strength of the internal audit function."

[1] Factors listed in question 9 include: appropriate staff education, training, and experience; appropriate knowledge of Generally Accepted Accounting Principles; appropriate knowledge of Generally Accepted Auditing Standards; appropriate audit team staffing level; appropriate access to the firm's technical resources (whether locally or nationally); appropriate firm experience within the public company's industry; appropriate risk assessment process for the client acceptance process; and appropriate knowledge of the client's operations, systems, and financial reporting practices.

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General category of factors	Comment
	"... integrity, honesty, and cooperation of management is [are] of very great importance in the auditor's ability to detect financial reporting issues. Also, accuracy and completeness of the information provided to the auditor is of very great importance."
	"... willingness of ... management to fund activities beyond audit requirements, such as forensic efforts and deeper internal controls work."
	"Management attitude-very great importance."
	"Open lines of communication with all client personnel."
Auditor assessments and independence	"Appropriate assessment of management's competence and integrity."
	"Appropriate level of [auditor] skepticism."
	"Appropriate independence of personnel on the [audit] engagement."
Pressures on auditors	"Fee pressure or time pressure, resulting in application of less than appropriate audit procedures. (Great Importance.)"
	"Economic pressures from clients to keep fees to a minimum and pressure from other firms whose fees are lower, but provide substandard levels of service and technical ability."
Auditor-client contact	"Frequency of [auditor] contact (telephonically and physical presence) with key management of the client - great importance."

Source: GAO analysis of survey data.

Additional Audit Procedures for New Auditor of Record

We asked respondents to describe additional and/or enhanced audit procedures other than those already listed in the survey that would be of added value to the new auditor of record in reducing the risk of not detecting material misstatements in a public company's financial statements. Respondents mentioned the importance of an additional level of review of audit work by qualified individuals; participating in the last examination of, or performing a joint audit with, the outgoing auditor; performing comparisons of the company's operating results with industry standards; performing additional procedures to gain more knowledge of the client and its industry; having more contact with management; and continuous auditing as procedures that would be of added value to the new auditor of record. Respondents also offered suggestions such as extending the various SEC filing deadlines in the year of audit firm change to reduce the risk of not detecting material misstatements.

Table 2 shows selected responses to question 16 -- "Please describe other additional and/or enhanced audit procedures not listed above [in question

15][2] that you believe would be of added value to the new auditor of record in reducing the risk of not detecting material misstatements in a public company's financial statements and, in your response, please indicate the level of its value using the same categories as above [question 15]."

Table 2: Other Audit Procedures of Value to New Auditor of Record in Reducing the Risk of Not Detecting Material Misstatements

General category of audit procedure	Comment
Additional level of review	"Our firm performs procedures in addition to those required by generally accepted auditing standards on first-year audits. The chief purpose of these procedures is to lower the risk of an incorrect opinion. The procedures are directed at the audit work performed, not at obtaining additional familiarity with the client and its systems and procedures. We require an additional level of review of audit work by professionals who are recognized within the firm for their technical accomplishments and highly qualified by virtue of their experience. A tax partner reviews and signs off the tax review memorandum, and a highly experienced and technically prepared partner (an 'SEC Reviewing Partner') performs an 'in depth' review of . . . audit work papers. These procedures are also required on our second-year audits."
Perform joint audit	"Require the successor and predecessor auditor to perform a joint audit in the final year of the mandatory rotation period. Great Value."
More client and industry knowledge	"Analysis of company operating results compared to industry standard would be of value as additional procedure."
	"Additional procedures in orientation of new firm to client's business and if necessary, to client's industry."
	"Additional time spent learning about the client's systems, risks, controls, etc. in great depth."
More contact with management	"More frequent contact with key members of management - moderate value."
Continuous auditing	"[Perform] a continuous audit engagement."

[2] Question 15 provides the following additional or enhanced audit procedures: additional procedures in areas material to the financial statements over what would likely be applied if the firm was more client experienced; additional verification of client-supplied statements and data likely to be material to the financial statements; enhanced access to key members of the previous firm's audit engagement team; and enhanced access to audit documentation of the previous firm's audit engagement team.

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General category of audit procedure	Comment
Other	"Allowing issuers to revert to the 90 day Form 10-K filing deadline in the year of audit firm change may be of value to the new auditor and reduce the risk of not detecting material misstatements. Extending the Form 10-K filing deadline would provide the audit firm with additional time to complete the audit."

Source: GAO analysis of survey data.

Client-Specific Knowledge and Experience

We asked respondents to volunteer any additional comments on the issues concerning mandatory audit firm rotation as related to the auditor's client-specific knowledge. A number of respondents raised concerns that mandatory audit firm rotation would decrease the cumulative and specialized knowledge of an audit firm and therefore reduce audit effectiveness, create monopolies or dominance in the market by a few large firms, and substantially increase costs for both public companies and audit firms.

Table 3 shows selected responses to question 19 – "Do you have any additional comments on the issues covered in this section or comments concerning mandatory audit firm rotation as related to the auditor's client-specific knowledge and experience (including any other issues not covered)?"

Table 3: Comments on Auditor's Client-Specific Knowledge and Mandatory Audit Firm Rotation

General category of comment	Comment
Audit effectiveness	"Effective auditing in today's complex business environment requires industry experience and depends on an auditor's ability to develop a detailed understanding of the client's operations. Knowledge is cumulative and is built up over a number of years. [Our firm] believes mandatory audit firm rotation would decrease the cumulative knowledge of an audit firm and reduce audit effectiveness. [Our firm] is supportive of the new requirements on audit partner rotation and agrees with the SEC's statement that 'the final rules balance the need for a fresh look with the need to always have a competent team of auditors.' We believe that mandatory audit firm rotation, on the other hand, would not strike an appropriate balance and thus would be detrimental to audit quality."

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General category of comment	Comment
	"We believe mandatory firm rotation will erode depth of knowledge. Today's business environment is complex (e.g., derivatives, mark to market valuations, and related party transactions). Depth of knowledge about the client's systems, as well as the inherent business and audit risks, is essential to performing an effective audit and making sound judgment calls regarding difficult accounting and reporting issues. Each time an audit firm is rotated, that depth of knowledge with respect to each client is lost and must be rebuilt by the new firm. An auditor's ability to detect issues is often impeded by the lack of integrity of management. Unfortunately, integrity cannot be legislated. Mandatory firm rotation will not stop unscrupulous management, especially when members of management receive compensation incentives based on earnings results. Requiring mandatory rotation will not change the values of management. In fact, mandatory rotation would allow unscrupulous management to use required mandatory rotation to its advantage. In the first year of an audit relationship, it is difficult for auditors to have fully developed and applied an in-depth knowledge of a client; as a result, it would be easier for unscrupulous management to perpetrate fraud without it being discovered by the auditors."
	". . . there is a risk of less effective audits in the first and second years of an auditor's tenure. The question of auditor knowledge and experience under mandatory rotation cannot be separated from its effect on audit quality. It is not lack of diligence or information gathering or any failure to comply with generally accepted auditing standards that creates the potential weaknesses in familiarity with the client in first-and second-year audits. In given circumstances, knowledge can be less effective and apprehension less immediate because related experience has not been acquired. Thus, on-the-job experience with the client can lower the risk of audit failure, and there is no direct equivalent to that experience. This point is put in perspective by examining the notion that more work is performed in the first and second years of the audit to understand the client. What really takes place is that procedures performed in the first year to develop and document an understanding of the client's operations and systems need only be updated in succeeding years. Thus in an important sense, fewer procedures to develop an understanding are performed in succeeding years, but greater knowledge is brought to bear and the risk of an incorrect audit opinion declines. This can be explained only

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General category of comment	Comment
	by the greater context in which the same knowledge is applied, context obtained from direct experience with the client. Our firm does perform procedures on first- and second-year audits that are in addition to those required to obtain an understanding of the client and the client's systems. Other firms presumably do as well. Nevertheless, there is an apparent paradox. Familiarity appears weakest in the year most of the work to obtain it is performed. The missing ingredient is direct experience with the client and its systems and controls, which can be obtained only over time."
	"Most 'audit failures' in my opinion are caused by one or a combination of the following which aren't going to be corrected by mandatory firm rotation: management integrity, experience level of staff by audit firm on specific client, fee pressures from clients due to competition, complexity of accounting rules and ability to interpret them which can be challenged in hindsight (versus principles based approach)."
	"A large drawback in any auditor rotation scenario is the time it takes the new auditor to understand the company's business and, more specifically, what motivates management. Any additional procedures proposed should enhance the new auditor's understanding of these areas versus prescribing specific audit tests."
Industry specialization and dominance	"Mandatory rotation would kill firms that have industry specialization, as they would be faced with a loss of all their clients in the industry they handle. Thus they would lose their specialized knowledge and would have a very difficult time re-establishing a presence in that industry ('who else do you audit in our industry?' 'no one, we had to rotate off all of them')."
	"I would be concerned about the Federal Trade Commission issues when only 2 or 3 of the large international accounting firms represent 90% of the market value in some industries. The profession needs to be concerned about monopoly issues."
	"In the mutual fund industry there are only a few existing CPA firms other than the Big 4 that have this area of expertise."
	"Some other form of regulation should be imposed in order to ensure compensation to the losing firm. For example, each firm that gives up a client should 'receive' a client from another firm. Otherwise, a few firms could dominate and 'corner' the market."
Cost	"Based on past experience with smaller clients, the first year time incurred in an audit is normally 40 to 50 percent more than the second and subsequent years. For most small clients, this investment on an ongoing basis is cost prohibitive."
	"Start-up with new clients requires investments of time and dollars. Rotation every 5 years would seem to (1) cause increases in overall audit services costs and fees to registrants and (2) potentially limit the ability for the auditor to reasonably recoup the investment time over a multi-year engagement."

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General category of comment	Comment
	"Mandatory firm rotation simply fails the cost-benefit model. It does provide a fresh look and interpretation of accounting policies, but it makes it much more difficult to find a concealed fraud at a much higher cost."
	"The problem is not that new audit firms can't do sufficient procedures. The problem is the fee caps set by the client. If clients understand that an audit by a new firm will cost an additional 50% in year 1, 30% in year 2 and 10% in year 3, the new auditors could do sufficient procedures to reduce the risk."
	"Mandatory rotation will not be effective (or possible) in this [mutual fund] industry without involvement of the Big 4. This will cause substantial increases in audit cost for the over 2,000 small funds in the industry."

Source: GAO analysis of survey data.

Auditor Independence

We asked respondents to volunteer any additional comments concerning mandatory audit firm rotation related to auditor independence. The comments addressed several issues including the limited supply of firms, red flag signal, inability to legislate ethics, attracting talent to the profession, large versus small firms, and opinion shopping. In addition, several respondents commented that mandatory audit firm rotation would have little or no benefit to auditor independence.

Table 4 shows selected responses to question 29 – "Do you have any additional comments on the issues covered in this section or comments concerning mandatory audit firm rotation as related to the auditor's independence (including any other issues not covered)?"

Table 4: Comments Concerning Auditor Independence and Mandatory Audit Firm Rotation

General category of comment	Comment
Limited supply of firms	"As a result of the independence standards, it would be difficult for many issuers to implement mandatory firm rotation due to the limitations imposed on the services audit firms can provide. For example, of the top tier firms, if Firm A provides internal audit services, Firm B provides another prohibited nonaudit service, and Firm C is the audit firm – the only other firm that could serve as the auditor of the issuer would be Firm D. So an issuer, rather than choosing among the three other top tier firms to rotate, would have only one realistic firm to rotate in as its audit firm, unless it considered next tier firms. To further highlight this potential issue – it is possible that Firm D may not have the industry expertise desired by the issuer. As a result, the issuer - in order to comply with mandatory firm rotation - could be forced to choose an audit firm that does not have the optimum level of industry expertise."
Red flag signal	"We feel that the red-flag signal has been a good signal for the capital markets to investigate potential accounting related issues. Mandatory rotation would reduce the current concern raised by the markets when a change in auditor occurs."
	"Any time there is a change in auditor not related to the year end audit there is certainly the possibility that the 'RED FLAG' signal would be retained."
	"Changes in auditors for public companies, both large and small, have become common occurrences over the past several years due to firm mergers, company mergers, the demise of Andersen, fee disputes and the desire to minimize fees paid, need for more specific industry-focused resources, etc. In this day and age, a company changing auditors may not be raising a red flag at all."
Cannot legislate ethics	"I do not believe you can legislate or regulate the 'ethics' that are required to evaluate one's independence. Generally, I believe firms, especially ours, does a very good job evaluating independence and, just as important, doing what is right in the circumstances."
	"I believe that the issues that result in audit failures and the drive for auditor rotation are caused by individuals or firm cultures. No amount of regulation is going to control human behavior or address unethical acts."
	"The pressure to do a professional job and maintain or enhance our reputation would be a factor in whether or not we appropriately deal with financial reporting issues that may materially affect the public company client's financial statements."

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General category of comment	Comment
Attracting talent to the profession	"Professionals would have to sell holdings incompatible with the independence rules more frequently, because their respective firm's portfolio of clients would change more frequently. Those considering a career in auditing are likely to be influenced by the prospect of being inconvenienced more consistently, always with a loss of time and on occasions with economic sacrifice, by the rules intended to ensure independence. The added burden would likely affect the supply of talent, and thereby the quality of auditing."
Large versus small firms	"Government should not be taking this role to put small firms out of business. Mandatory rotation will put small firms out of business, but it will have no effect on independence."
	"Unfortunately, for small firms (under $75,000,000 in revenue) the concept ignores the efficiency involved in changing firms from both the client and firm prospective. The difference and bigger issue relates to the fact that for large firms, the audit client is most likely the only client the engagement partner has."
	"Clearly, in a large firm, where annual fees exceed $1,000,000, mandatory rotation would improve the independence of the auditor where that audit partner has so much at stake with a single client."
	"The significance of auditor rotation is directly related to the size of client as it impacts an office or a firm. We do not have a client large enough to influence a decision. I believe a firm or office with a large client that makes up a significant portion of that firm's or office's revenues has a different risk profile."
Opinion shopping	"Mandatory firm rotation would increase the likelihood that a client would be 'opinion shopping' when selecting an auditor."
Little or no benefit to independence	"Independence should not be impacted by rotation. An independent mindset from day 1 is necessary to perform a quality audit."
	"Where rotation has occurred in governmental type audits at the direction or encouragement of agencies, I have not seen any benefit to the independence of firms or partners."
	"I believe the mandatory rotation would be very dangerous and risky with little upside benefit. In addition we have experienced no difference in how we handle difficult accounting issues in the first year of a new engagement or the last year we will perform the audit in the contract period. What we also find is that we spend considerable hours on the front end and during the first year engagement trying to understand the competencies of the client staff, organization and operation. I do not see any positive impact from mandatory rotation of auditors on independence."

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General category of comment	Comment
	"Disadvantages of mandatory audit firm rotation (lack of knowledge and experience with the client, which reduced the likelihood of detecting material misstatements) outweigh the perceived advantage of improved independence. There are other more effective and less radical ways of reducing the familiarity, intimidation and self-interest threats to independence than requiring audit firm rotation (for example, independent consultation on significant issues, and independent review of significant issues)."
	"If the auditors do the job as expected and required, mandatory rotation of firms seems unnecessary."

Source: GAO analysis of survey data.

Audit Quality and Audit Failure

We asked respondents to volunteer any additional comments concerning mandatory audit firm rotation related to audit quality and audit failures. Several comments were offered regarding the effect of this requirement on audit tenure, audit risk and quality, industry specialization, audit resources, and independence rules.

Table 5 shows selected responses to question 40 – "Do you have any additional comments on the issues covered in this section or comments concerning mandatory audit firm rotation as related to audit quality and audit failures (including any other issues not covered)?"

Table 5: Comments Related to Audit Quality and Audit Failure

General category of comment	Comment
Audit tenure	"We know of no correlation between audit failings and significant tenure at a client. Partner rotation, concurring partner reviews and other quality measures mitigate the risk of becoming too cozy."

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General category of comment	Comment
Increased audit risk/lower audit quality	"Increasing the frequency of rotation may adversely impact the quality of audits. While it is not unusual to have rotation of firms in the current environment, implementing mandatory audit firm rotation would likely increase the frequency of rotation. . . . there is the potential for increased risk and decreased audit quality. With regard to question #37 which asks whether the risk of an audit failure is higher in the early years of an audit tenure period because the new public accounting firm is more likely to place heavy reliance on information provided by client management – it is important to point out that to some extent all accounting firms (new and seasoned) place reliance on information provided by management. Still, professional standards require that auditors obtain sufficient, competent evidential matter. Therefore, to suggest that a new accounting firm is more likely to place 'heavy reliance' on information provided by management and, therefore, the risk of audit failure is higher is not consistent with the professional standards auditors are required to follow."
	"The more you understand a client, its pressures from both an industry and operational standpoint, tendencies, prior reaction to events, weaknesses, and numerous other characteristics, the risk of audit failure reduces for small companies. Small registrant audits don't have the audit issues that larger audits do which allow management to predict where audit procedures will be performed such as auditing divisions every three years, inventory observation rotation, etc."
	"I would agree that the risk of audit failure might increase, but only in cases where management is fraudulent, not in all cases."
Industry specialization	". . . it would be difficult for companies operating in very specialized industries to meet mandatory rotation requirements thus potentially impeding audit quality. In some industries, major audit firms may possess differing levels of expertise to effectively serve a particular company. If one of those firms provides internal audit services and another provides prohibited non-audit services, the only way for the company to meet the rotation requirement would be to choose a firm that lacks the depth of industry expertise, which could increase risks and potentially harm the company as well as its shareholders."

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General category of comment	Comment
Strain on firms' resources	"If mandatory rotation were adopted in the U.S., the frequency of auditor changes would increase, putting a strain on firm's resources of expertise. It would be harder to keep a pool of experienced, expert auditors that matched the portfolio of audit clients, because the portfolio would be in far greater flux. Thus the findings above about audit quality in the U.S. are a conservative indicator of what would take place under mandatory rotation in this way: They do not reflect the added difficulty in matching personnel to engagements and its effect on audit quality. The likely strain on resources of expertise and its effect on audit quality is particularly obvious in the case of smaller offices, with fewer professionals and therefore fewer professionals highly experienced and knowledgeable about accounting and auditing needs specific to individual industries. The strain is even greater in the case of firms in foreign countries. Personnel in foreign locations must have sufficient facility with U.S. GAAS and GAAP as well as the language skills and cultural awareness to work with the rest of the audit team. Relocations of suitable personnel for engagement purposes would be expensive and might not be possible due to local licensing and similar requirements. For these reasons, mandatory rotation of audit firms, by increasing the frequency that new teams must be assembled for new audits, would make it harder to align expertise in overseas offices to the needs of audits of multinational U.S. companies."
Independence rules	"The new SEC auditor independence rules, particularly the audit partner rotation rules, address many of the issues above in terms of having a new partner give the audit a fresh look, including changes in auditing procedures, while maintaining that firm's overall knowledge of the company's business."

Source: GAO analysis of survey data.

Audit-Related Costs and Audit Fees

A large majority (81 percent) of survey respondents indicated that mandatory audit firm rotation would likely lead to higher audit fees over time largely because of the audit firms' need or desire to recoup their costs over a shorter period.

Table 6 shows selected responses to question 54 – "If you believe that the increased competition likely to occur under mandatory audit firm rotation will lead to higher audit fees over the long-term, please indicate why you think audit fees would be higher?"

Table 6: Comments on Why Audit Fees Would Be Higher under Mandatory Audit Firm Rotation

General category of reason	Comment
Recoup investment	"The need to recover start-up costs over shorter period and the tendency not to reduce the initial year base amount."
	"Less time to recoup first year audit and proposal costs."
	"More work will be required with a shorter time to absorb start-up costs."
	"The primary reasons for higher audit fees would be coverage of first year familiarization costs and coverage of additional bidding and marketing costs, knowing that the client would only be around for the short term."
	"The fact that rotation will occur will cause 'first year' costs to be allocated to the engagement period vs. absorbed as an investment which will cause fees to increase."
	"Firms will be more sensitive to make certain they get their investment returned more promptly, the result of a heightened awareness of costs."
	"A shorter period over which to amortize the initial investment, means higher cost per year. I would expect firms to charge more for first-year audits rather than eat and amortize the cost."
	"The increase [in fees] will result from the inability of accounting firms to recover the high early year costs associated with learning the business and financial reporting systems of new clients over an extended period of service to those clients."
	". . . firms will cease absorbing initial year orientation costs."
	"All firms will be more likely to pass on additional first year costs to prospective audit clients. Therefore, all firms will likely propose higher fees to prospective new clients resulting in overall higher fees."
Increased audit effort	"Less use of analytical procedures, increased sample sizes to compensate for greater risk in the early years."
	"Learning curve in understanding business and systems."
	"Need to spend time understanding the client's business. Building a permanent file of contracts, etc."
	"Increased expense resulting from higher level staff required to become familiar with the client and to gain sufficient understanding of client systems and operations."
	"Increased hours to document new client systems, controls, risk factors, etc."
Increase in firms' costs	"Mandatory rotation of firms would increase costs for marketing and for relocations and training, because it would be harder to match personnel to engagements with a less predictable group of clients."

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General category of reason	Comment
	"In addition to recovering initial year costs associated with becoming familiar with a client and recovering increased marketing costs associated with the lower tenure of clients, firms would have to build into their fees the costs of the volatility associated with managing an accounting practice knowing that the average tenure of public clients would be substantially reduced under mandatory rotation."
	"Marketing costs will increase, cost of audit personnel will increase due to specialized area, audit procedures will be greatly expanded."
	"The increased work required in the early years of an audit will create an increased demand for audit personnel, therefore higher rates."
	"Marginal profit on jobs will decrease due to lack of efficiencies gained over time and will have to be replaced by higher fees."
Less competition	"Fewer firms will be competing at the appropriate levels of competition. Fees will naturally rise because of the scarcity of competing firms."
	"Requiring rotation will by definition decrease the number of competitors who would propose on the audit since the incumbent would have to decline to propose. Also, other firms (especially at the Big 4 level) may have conflicts of interest due to providing prohibited services, auditing competitors, financial relationships, etc. As the number of audit firms competing declines, audit fees would be expected to increase."
	"Because there are so few firms that have the national and international resources to provide audit services to large public companies, I believe there will be an increase in fees by those firms."
	"Increased competition will only occur at the large firms. Mandatory rotation will likely force the smaller firms out."
	"I don't believe that there will be enough qualified auditors willing to do public company audit work, due to the new regulations, restrictions, etc."

Source: GAO analysis of survey data.

Only 6 percent of survey respondents indicated that mandatory audit firm rotation would likely lead to lower audit fees over time, citing increased opportunities and competition and possibly the performance of less audit work. Table 7 shows selected responses to question 52 – "If you believe that the lower audit fees that may result from increased opportunities to compete are likely to occur for reasons other than increased audit efficiencies/related lower audit costs or reduced firm profitability, please describe why you think audit fees would be lower?"

Table 7: Comments on Why Audit Fees Would Be Lower under Mandatory Audit Firm Rotation

General category of reason	Comment
Increased opportunities and competition	“Mandatory rotation will provide opportunities for certain firms other than the Big 4 to grow their public company practice especially for larger public companies. This increased level of service to the public company market segment will enhance competition for talent and for the opportunity to serve these larger entities requiring services throughout the year.”
Less audit work	“Less work may be done, due to clients demanding lower fees rather than a thorough audit.”
	“Once competition is ‘increased’ there will be market pressures as to cost of services - basic ‘supply and demand’ theory. The increased competition in the industry over the last 15-20 years has caused numerous opportunities for ‘low balling’ of fees, resulting in the firms trying to find a more ‘efficient’ way to audit. I believe this situation could actually lead to continued audit failures in the future, especially since the environment has and will continue to become more demanding.”

Source: GAO analysis of survey data.

Table 8 shows selected responses to question 61 – “Do you have any additional comments on the issues covered in this section or comments concerning mandatory audit firm rotation as it relates to audit costs and audit fees (including any other issues not covered)?”

Table 8: Comments Concerning Audit Costs and Audit Fees

General category of comment	Comment
Costs to auditors	"Mandatory audit firm rotation would have a significant impact on accounting firms not only in terms of costs associated with rotation, but also in terms of personnel related costs. (1) Mandatory firm rotation would force accounting firms to place greater attention on proposal opportunities occurring each year. As a result, accounting firms will incur significant additional costs (including opportunity costs) in marketing and selling audit services to potentially new clients and, as a result, may find it necessary to divert resources from performing and completing quality audits. (2) Offices in smaller geographic areas will suffer from the greater volatility in clientele and demand in staff. As a result of this volatility, employees will be forced to become more mobile; employees could routinely be asked to move to other locations, disrupting the lives and careers of the employees, their spouses, and their families. Rather than uprooting their spouses and children, employees may be more likely to become associated with the firm that has won the audit work. So, although the audit firm has rotated, the same people may end up serving the client. (3) With mandatory firm rotation, the costs of maintaining an office in smaller geographic areas will be higher. It may not make economic sense for big firms to have a presence in a geographic area that may only have one or two public companies since, by virtue of regulation, that firm may be forced out of the audit business in that area in a short period of time. (4) It will be more difficult for smaller CPA firms to absorb the costs associated with mandatory audit firm rotation. Such costs include: additional resources associated with actively pursuing new clients, maintaining an audit practice, and inefficiencies as a result of continuously starting up new audits. Indeed, smaller firms will be more likely to experience greater volatility in clients and their own need for staff. This operational volatility may cause small CPA firms to abandon audit services for public companies."
	"Mandatory auditor rotation increases the cost of auditing for individual clients and eventually for the economy, because incoming auditors must incur the start-up and learning time necessary to become familiar with the company and its operations. In addition, more numerous proposal opportunities will pile up new costs. Auditors cannot lose engagements and ignore opportunities to obtain new ones, so proposals will become a bigger and more important part of the business side of auditing. There is no certainty that the increased costs would be recovered by proportional increases in fees. A failure to consistently recover increased costs would undermine the financial viability of some firms, a clear risk under mandatory rotation."

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General category of comment	Comment
	"Any firm specializing in an industry would be especially hard hit from rotation, as their specialized industry knowledge/personnel/forms would quickly become unneeded, and then it would be hard to re-establish oneself in the industry."
Costs to companies	"With regard to issuers, mandatory firm rotation would also impose additional costs and create unintended consequences. (1) Mandatory firm rotation would increase internal costs and distraction. Each time rotation occurs management would be faced with a disruptive, time consuming, and expensive process of selecting and then introducing the new auditors to the company's operations, procedures and controls, systems, and industry environment. The first year of an audit requires an inordinate commitment at all levels of company management and staff as the new audit firm develops and documents its initial understanding of the control environment, accounting systems and the terminology and culture that is unique to each company. (2) For companies in smaller geographic areas where only two or three firms are located, it will be difficult for companies to rotate between firms. For example, if only three firms have a presence in a particular geographic area and one firm provides internal audit services and another provides another non-audit service that prevents the firm from acting as the auditor – there would be only one firm left in the geographic area to act as the audit firm. It would be possible to bring in another firm from outside the geographic area, but doing so would increase costs significantly. (3) Mandatory firm rotation would disproportionately hurt small registrants. Small registrants may not be able to absorb the costs associated with rotating auditors. They may not have the resources necessary to both effectively manage their business and perform the additional work involved with rotating auditors. In addition, small registrants typically depend more on their auditors for expertise in dealing with the intricacies of GAAP and SEC requirements, as they are more likely not to have the requisite in-house expertise; as a result, the rotation process would be even more disruptive. (4) Mandatory firm rotation could be disruptive to mergers and acquisitions and to raising capital. Example 1: Company A and Company B sign a letter of intent to merge in November. Company A is required to rotate auditors in January; however, the merger will not be finalized until May. Company A would be required to hire new auditors to perform the last audit which would be problematic or at least very disruptive to the merger process. Further, firms may not choose to be considered for appointment if the anticipated merger would quickly cause loss of the new client. Example 2: If a company is required to switch auditors in the middle of a financing, at a minimum it will slow down the company's ability to get to the market; the new auditors will need additional time to gain the necessary knowledge about the client and to perform the required procedures. At worst, it may

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General category of comment	Comment
	cause a black out period in which the company will simply be unable to get to the market; the new auditors may be unwilling to be involved with such financing until an audit has been completed, which could cause a black out period anywhere from three months to a year. Further, it may be more difficult to obtain the requisite involvement from the predecessor accountants. Additionally, it is during a financing that company's management has the greatest incentive to look its best financially. Unscrupulous management may purposely plan a financing just after hiring new auditors and intentionally create fraudulent financial statements in order to raise money in the market."

Source: GAO analysis of survey data.

Audit Procedures for PCAOB Consideration

Under existing generally accepted auditing standards, 95 percent of respondents indicated that their firm had sufficient flexibility to implement additional audit procedures without the PCAOB requiring the procedures. However, respondents identified the need for enhanced access to the previous auditor, extending the filing deadline, and requiring the predecessor and successor auditor to perform a joint audit as items the PCAOB should consider requiring under mandatory audit firm rotation to further reduce their firm's risk of not detecting material misstatements.

Table 9 shows selected responses to question 18 – "Please identify which audit procedures listed above [in question 15][3] the PCAOB should consider requiring under mandatory audit firm rotation to further reduce your firm's risk of not detecting material misstatements to an acceptable level."

[3] Question 15 provides the following additional or enhanced audit procedures: additional procedures in areas material to the financial statements over what would likely be applied if the firm was more client experienced; additional verification of client-supplied statements and data likely to be material to the financial statements; enhanced access to key members of the previous firm's audit engagement team; and enhanced access to audit documentation of the previous firm's audit engagement team.

Table 9: Audit Procedures the PCAOB Should Consider under Mandatory Audit Firm Rotation

General category of audit procedure	Comment
Enhanced access to previous auditor	"Enhanced access to key members of previous firm's audit engagement team."
	". . . it still would help to have more access to [workpapers] of 4 largest firms. They often do not share with smaller firms, although they do share with each other."
	"Enhanced access to personnel and audit files."
Extend filing deadline	"Allowing issuers to revert to the 90 day Form 10-K filing deadline in the year of audit firm change . . ."
Require joint audit	"Require joint audit in final year of mandatory rotation period."

Source: GAO analysis of survey data.

Competition for Audit Services

The majority of respondents (72 percent) indicated that mandatory audit firm rotation would likely decrease the number of firms willing and able to compete and would contribute to higher audit fees. For those respondents who indicated that mandatory audit firm rotation would likely change the number of public accounting firms willing and able to compete for audits of public companies, we requested explanatory comments. Table 10 shows selected responses to question 68 – "Please provide a brief explanation for why the likely change in the number of firms would impact audit fees as noted in your responses to the above question [question 67]."

Table 10: Comments on Why the Likely Change in the Number of Firms Would Impact Audit Fees

Range of options	Comment
Decrease number of firms/higher audit fees	"The decrease in SEC practicing firms will allow those firms continuing to practice in this area to charge higher fees to recover increased insurance, training and preparation costs."
	"The remaining fewer firms that are still willing to stay in the market will tend to be the larger firms only. Smaller, specialty firms who provide services to smaller and start-up SEC companies will tend to not be willing to spend the additional time and dollars on clients who will be short lived without an increase in price."
	"Less competition will allow prices to be driven upwards."

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Range of options	Comment
	"Fewer firms would be willing to audit small companies. Remaining firms would charge higher fees."
	"Public companies will have less choices and firms will likely increase fees due to reduced competition."
	"If small firms realize that they would be required to rotate off of engagements after a period of time, they will be less likely to serve those clients and put time and effort in to them. As a result, fewer firms will be interested in serving these firms unless they see an increased opportunity to obtain replacement clients in the future. However, the ability of smaller firms to attract public companies is difficult. As a result of fewer firms providing these services, costs are likely to increase, particularly for the smaller public company (under $100 million)."
	"In a competitive market, it will be difficult for a non Big 4 firm to pass on additional cost to a client and still provide quality service."
	". . . many small public accounting firms audit only one or two public companies in their market area. If rotation were mandatory, it is likely that such firms would complete their rotation on the one or two public companies they audited, then cease auditing public companies altogether due to the costs associated with auditing public companies, such as PCAOB compliance."
	"The costs of investing resources in a possibly short-term client relationship will be a deterrent to many firms, and the willing firms will require increased revenues to perform the services at a realistic profit."
	"Public company auditing is becoming less attractive to mid-size firms in general. This will be one more step in convincing audit firms to get out of the business."
Decrease number of firms/lower audit fees	"Price would become a greater factor in the auditor selection decision, not quality."
Increase number of firms/higher audit fees	"Audit costs will increase because there will be more audit time spent per year on average with mandatory auditor rotation. Higher fees will invite more firms to participate. More firms won't lower fees because of the high cost of entry into this market niche."
	"More firms would have the ability to propose on engagements because of the need for change. These firms would most likely have to spend additional hours in preparation for a new engagement and in additional start up expenses."
	"I think more smaller firms may compete for audits of public companies. The charge-out rates in smaller firms is lower than in larger firms but this will be offset by increased time for the smaller firms to do the audits."
Increase number of firms/lower audit fees	"Presently a large segment of the public company universe never comes up for new auditor consideration. More opportunities to get new work will lead to increased competition and to fees lower than they would otherwise be if the opportunities were reduced."

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Range of options	Comment
	"I think the competition will cause the bigger firms to be more competitive with their audit fees, thus driving them down."

Source: GAO analysis of survey data.

Table 11 shows selected responses to question 72 – "Do you have any additional comments on the issues covered in this section or comments concerning mandatory audit firm rotation as it relates to competition for audit services (including any other issues not covered)?"

Table 11: Comments Related to Competition for Audit Services

General category of comments	Comment
Additional barrier to entry	". . . mandatory firm rotation would not solve the significant barriers to entry, such as high litigation risks, that exist for entering the practice of serving issuers and would actually create an additional barrier to entry."
Increase in consolidation	"Strong competition currently exists among the top tier firms and among each of the different tiers of firms. As such, to implement measures such as mandatory firm rotation as a way to increase competition among audit firms is not needed."
	"Advantages of concentration in an industry would become greater for the 4 largest firms, to the detriment of the other firms."
	"Small firms who do public work frequently have as a source of referral a relatively few sources. As those sources are forced to rotate auditors, some of the small auditors will go out of business. The large firms will simply rotate the large clients with relatively low impact to overall client base."

Source: GAO analysis of survey data.

Implementing Mandatory Audit Firm Rotation

The majority of respondents (72 percent) indicated that a requirement for audit firm rotation should not be applied uniformly for audits of all public companies. Table 12 presents responses to question 86 — "Please explain why you believe such a requirement should, or should not, be applied uniformly to all public companies."

Table 12: Comments on Whether Mandatory Audit Firm Rotation Should Be Applied Uniformly for Audits of All Public Companies

Apply requirement uniformly	Comment
Yes	"If mandatory rotation of public accounting firms is deemed necessary to protect investors, then it should be implemented consistently across all public companies regardless of the nature or size of the public company."
	". . . we believe that if the policy is required, it should be applied uniformly to all public companies. Any other policy would be in conflict with the motive that would undoubtedly be put forward for the requirement, namely, to improve the quality of audits. There is no evidence we are aware of that fraudulent financial reporting is less frequent among smaller companies, and they are the likely candidates for a less stringent version of the requirement. In addition, the audit report of an independent CPA should mean the same thing to those who rely on it. If different requirements are set for audits of different companies, unqualified audit reports would not have the same meaning to those aware that the requirements differed by the size or nature of the audited company."
	"There should be no difference in applying the mandatory rotation requirement if the perceived benefit is a better audit."
No	". . . large multinational issuers should have a longer rotation period for audit firms, while perhaps small issuers should be exempt from rotating audit firms."
	"Smaller companies rely more on the expertise of the auditor. They would find it more difficult to transition to a new auditor. Also, large multinational companies would have greater difficulty in ensuring service coverage in all areas of the world."
	"Smaller public companies have less resources to deal with the incremental costs and staffing requirements."
	"A different set of rules should apply to the very small start-up companies with revenues of less than $10-20 million. The vast majority of our SEC audits have revenues of less than one million dollars. These companies cannot afford the very large CPA firms yet the proposed rules would take the small CPA firms out of the market."
	"Smaller public companies (< $50 million) would have minimal benefits of mandatory auditor rotation, but more costs because total audit time would increase over the long term. So this provision is detrimental to smaller public companies and should not apply to them."
	"Smaller companies (for example S-B filers or non-accelerated filers) don't present the same risk of loss to the marketplace (in terms of dollars or confidence), and the cost of the change is, on a relative basis, much more significant."

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Apply requirement uniformly	Comment
	"Generally, the burden placed on small companies is significantly higher on a relative basis, when having to follow the same rules as large companies that have the infrastructure and financial ability to implement the requirements."
	"Small specialized public companies have few qualified firms willing to perform their attest function within their budget."
	"Smaller companies generally have limited internal financial skills and rely on the expertise of their outside auditor to assure compliance. Rotating firms would add a complexity to their operations with little benefit to the shareholders. It would also discourage smaller CPA firms from making the necessary investment to maintain a high skill level if they could not maintain clients for long periods of time."
	"Smaller domestic companies are generally in a geographic area where there may only be one accounting firm."
	"The risk associated with small public companies is different than large public companies. Large companies like Enron impact many more people, and are significantly more complex than many small public companies. From a risk-based perspective, small public firms and their auditors are bearing the same costs without the benefits. The corrective action necessary to the market place from large public company audit failures should not be unduly placed at the door of small public companies and their auditors."

Source: GAO analysis of survey data.

Overall Views on Requiring Mandatory Audit Firm Rotation

The majority of respondents (76 percent) indicated that their firms do not support requiring mandatory rotation of public accounting firms. The nature of comments received from many of these respondents as to why their firm does not support requiring mandatory audit firm rotation include: new regulations; lower audit quality/risk of audit failure; increased costs; and new role of audit committees. Table 13 shows selected comments explaining why the respondent's firm does not support requiring mandatory rotation of public accounting firms (question 89).

Table 13: Reasons for Not Supporting Mandatory Audit Firm Rotation

General category of explanation	Comment
New regulations	"The Sarbanes Oxley Act of 2002 ("the Act") and the recently issued SEC rules on Strengthening Auditor Independence, along with vigilant audit committees, are major steps in restoring the investor's trust and confidence in the capital markets. These positive actions must be given time to work and rebuild investors' confidence."
	"New rules have been adopted by the SEC which require the lead and concurring review partner to rotate after five years, and other audit partners (for example - lead audit partners on significant subsidiaries) to rotate after seven years. These rules should be given a chance to work."
Lower audit quality/risk of audit failure	"The auditor must understand the client's business to audit effectively. Given the complexity of today's global business environment in various industries, it is imperative that the auditor be very knowledgeable of the client's business and industry. Knowledge is cumulative and is built up over a number of years and must be leveraged for the benefit of the investor."
	"We believe mandatory audit firm rotation increases the risk of audit failure, and, as a result, may further erode public confidence in our capital markets. Studies demonstrate that there are increased risks of failure during the first and second years of an audit relationship. . . . increasing the frequency of rotation will erode depth of knowledge about clients and may adversely impact the quality of audits."
	"The primary reason we oppose requiring mandatory rotation of auditing firms is that it would lower audit quality and thereby injure the public interest. Research has shown, and various authorities have accepted, that first- and second-year engagements entail higher risks of audit failure. The benefits of a 'fresh look' often cited in favor of mandatory rotation of audit firms would be more than offset by the risk of lower audit quality and its effect on the public interest. Moreover, the benefits of a 'fresh look' are available without the risk to audit quality from intra-firm rotation that already takes place. The risks to audit quality in first- and second-year audits cannot be wholly offset by additional auditing procedures, because the risk is caused by lack of experience with the client. Gaining familiarity with a client's business means more than gaining knowledge of its operations, systems, procedures, and controls. It also means gaining familiarity with how designed procedures and organizational arrangements operate in different circumstances. There is no direct substitute for this kind of experience."
	"Mandatory rotation would result in increased audit failures because it takes many years for an audit firm to build the knowledge base of the clients' system, particularly in complex multinational companies."

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General category of explanation	Comment
	"The elimination of auditors' carry-forward knowledge of public companies is a substantial risk factor."
Increased costs	"Mandatory rotation of audit firms increases the company's costs, disrupts its operations, and is overall inefficient which in turn costs the investors money."
	"Mandatory firm rotation would have a significant impact on accounting firms not only in terms of costs associated with rotation, but also in terms of personnel related costs. First, mandatory firm rotation would force accounting firms to place greater attention on proposal opportunities occurring each year rather than focusing on quality audits. Second, employees who work at firms with offices in smaller geographic areas may be forced to become more mobile uprooting their families or rotate employment between firms in the area. Third, mandatory firm rotation may actually force big firms to close offices in smaller geographic areas due to the high costs. Lastly, smaller audit firms could potentially suffer disproportionately as it will be more difficult to absorb costs associated with rotation and may actually cause them to exit the practice of auditing issuers."
	". . . it increases the risk of audit failures and makes auditing a less desirable career option for new students thus increasing the cost of performing audits and the overall profitability of auditing."
New role of audit committees	"Strengthened role of audit committees should mitigate risk."
	"Audit committees and firms should decide in the open market when it is appropriate to change auditors."

Source: GAO analysis of survey data.

Table 14 shows selected responses to question 92 – "Please provide any additional comments or observations you may have on the potential effects of mandatory audit firm rotation of public accounting firms registered with the PCAOB."

Table 14: Additional Comments on the Potential Effects of Mandatory Audit Firm Rotation

General category of comment	Comment
Financial institutions	"Many of our public clients are financial institutions. Faced with the loss of these due to rotation, we may very well decide it is no longer worthwhile to audit the public companies we would have remaining or to try to 'build back up' the financial institution clients in 5 years (only to lose them all 5 years after that). Thus, the effect on firms auditing a special industry might be to drive them out of the public company audit sphere."
Overall	"Every year approximately 3,000 firms would be changing firms causing staffing problems."
	"Mandatory rotation has never been proved to improve audit quality and will not solve the issues related to audit failure. Limitation on other services is a greater benefit with little or no cost to the public company and little or no cost to small firms who have never provided these types of services to public companies."

Source: GAO analysis of survey data.

Selected Written Comments from Fortune 1000 Public Company Chief Financial Officers

Chief financial officers surveyed were invited to add written comments to a number of questions to further explain their answers or to add additional answers. The survey of public company chief financial officers, annotated with summary responses for each question, is in appendix II. Of the 201 chief financial officers who responded to the survey, 199 provided written answers to at least one of the following open-ended comment questions in our survey:

- competition for audit services,
- audit-related costs and audit fees,
- auditor's ability to detect financial reporting issues,
- impact of the Sarbanes-Oxley Act on achieving the benefits of a "fresh look,"
- implementing mandatory audit firm rotation,
- overall views on requiring mandatory audit firm rotation, and
- additional comments on the effects of mandatory audit firm rotation.

The following tables display selected comments from respondents to these questions to reflect the range of views that were provided by respondents. Some of the quotes illustrate typical comments made by several other companies, while others represent a unique viewpoint of only that company. While these specific comments provide valuable insights, the number of comments of a particular type reproduced here is not necessarily proportional to the number of other similar responses, and, therefore, the comments are not meant to be representative of the views that might be found in the population of Fortune 1000 public company chief financial officers as a whole.

Competition for Audit Services

A majority (88 percent) of respondents indicated that they believe mandatory audit firm rotation would likely change the number of capable public accounting firms interested in serving as their auditor of record and would impact audit fees. The largest number of respondents said mandatory audit firm rotation would likely result in higher audit fees and a decrease in the number of capable firms. Table 15 shows selected responses to question 27—"Please provide a brief explanation for why the likely change in the number of interested and capable firms would affect audit fees in the manner noted in your response to question 26.”

Table 15: Impact on Audit Fees from Potential Change in Number of Audit Firms Available

Direction of audit fees and number of firms available	Comment
Higher fees and less competition	“Incumbent would be disqualified [by mandatory audit firm rotation] - very limited competition would result in higher fees.”
	“Only 3-4 have global capability and one [the incumbent firm] would be taken out of the mix. Also, with only 3 eligible and with the education required for a new auditor, fees would likely go up.”
	“Less competition implies higher fees [and] firms would begin to pass the cost of their learning curve to client.”
	“Shorter duration to recover initial costs and increased marketing costs - increased risk of audit failure because firm does not know our business.”
	“Mandatory rotation would reduce a company's ability to negotiate lower ‘start-up’ costs as well as result in higher fees due to reduced competition – all firms will get their share. Also, the company's expenses and personnel demands will increase due to the constant change and training of firms.”
Higher fees and more competition	“Second tier firms would compete but with shorter time to serve as auditor, costs [would be] higher due to learning curve to familiarize to company and industry.”
	“Mandatory rotation would mean that all of the Big 4 would rotate off clients equally so firms that we would not use today, due to competitive reasons, would be free to bid on our account. The process will cause costs to increase. It is unavoidable.”
Lower fees and more competition	“Increased competition would lead to overall lower fees. Fees are a primary attribute in the auditor selection process.”
	“I believe capable regional firms would be more likely to compete with the Big 4. I would hope that increased competition would decrease fees.”

Source: GAO analysis of survey data.

Audit-Related Costs and Audit Fees

Most respondents (89 percent) said that mandatory audit firm rotation would lead to higher audit fees over time. Table 16 shows selected responses to question 30—“Please explain your reasons for believing that over time audit fees would be lower, higher, or remain the same under mandatory audit firm rotation due to increased opportunities to compete.”

Table 16: Potential Audit Fee Impact under Mandatory Audit Firm Rotation

Direction of audit fees and reasons	Comment
Lower fees -- competition issues	"Increasing the number of competitive bids and consideration of firms that might have previously been excluded from the selection process meets the criteria that have historically brought about reduction in fees."
	"It seems to me that if we could use more than 4 big firms, the competition would lower overall fees."
Higher fees -- learning curve and start-up costs	"Mandatory audit firm rotation would lead to higher fees because (i) public accounting firms could seek to recover higher first year audit costs over the period in which the firm is auditor of record and (ii) public accounting firms would be less likely to discount audit fees from standard rates since the firm's relationship with the public company will be of limited duration rather than long-term."
	"More hours associated with learning curve and re-audit of prior auditor's work."
	"Mandatory rotation will force the firms to charge higher fees due to extra time needed on new engagements in order to become familiar with the company's structure and processes."
	"The cost of marketing would skyrocket as would the cost of audits due to learning curve requirements."
	"Mandatory rotation would require significantly greater auditor time to understand fundamentals of the engagement. This would result in higher billings depending upon the frequency of rotation."
	"Learning curve costs not recovered before forced rotation."
	"Rotation leads to higher costs for the CPA firm. Every rotation creates the high startup cost scenario for at least one to two years."
	"Firm rotations are inefficient. Accounting firms have to be paid to cover their significant start-up costs. Transition costs related to discussions with prior auditors also have to be recovered by both accounting firms."
Higher fees -- competition issues	"This has created a monopoly. The public market will only accept certain size audit firms. Right now our fees have doubled."
	"We believe that only one of the Big 4 would be 'capable' and 'appropriate' to audit our company; therefore, no real increase in competition would come as a result of mandatory rotation."
	"It does not increase opportunities to compete; but mandates change for the sake of change, moving the negotiating leverage and ultimately higher fees to the auditing firms."

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Direction of audit fees and reasons	Comment
No change in fees	"Increased costs of audit firms in preparing to audit would be bargained away in the bidding process every five years."
	"Assuming the number of auditing firms remains the same, as well as public companies, fees should remain relatively the same - no increased competition."

Source: GAO analysis of survey data.

Auditor's Ability to Detect Financial Reporting Issues

Most respondents indicated that it takes a new auditor of record 2 to 5 years to become sufficiently familiar with a company's operations and financial reporting practices to no longer require the additional audit resources often associated with conducting an initial year audit of a new public company client. In addition, while most respondents (90 percent) indicated the complexity of their company's operations and financial reporting practices influences the amount of time it would likely take a new auditor of record to become familiar with their company's operations and financial reporting practices, 33 percent of the respondents in a follow-up question said that there are other factors that influenced their response regarding the number of years it takes an auditor to become familiar with their company's operations and financial reporting practices. In the follow-up question, many respondents identified the learning curve to the new auditor and industry expertise as the main reasons for their response. Table 17 shows selected responses to question 41—"Are there factors other than the nature and complexity of your company's operations and financial reporting practices that influenced your answer to the preceding question [on the number of years it takes for an auditor to become familiar with your company's operations and financial reporting practices]."

Table 17: Auditor Knowledge and Experience with a Company's Operations and Financial Reporting Practices

Factor impacting audit risk	Comment
Industry expertise and learning curve	"Industry expertise - we have six segments, all in specialized industries, headquartered in four different cities, doing business worldwide, making it very difficult to find or retrain new auditors."
	"Understanding of the industry. Familiarity with who to contact to follow up on issues. Experienced based understanding of key issues and competence of personnel."

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Factor impacting audit risk	Comment
	"Audit staff turnover, prior years work papers, and knowledge transfer impacts the auditor's efficiency in periods beyond the first year."
	"It takes time for an auditor to understand even the simplest company's operation and financial reporting structure."
	"With the accelerated reporting dates recently established, it will be very difficult for a public accounting firm to gain a complete understanding of a client's business during one audit cycle."
	"The evolving nature of GAAP as well as changes in the economic environment often have implications for areas within the organization that were not previously considered overly important."
	"Changes due to acquisitions, divestitures, and restructurings. As well as new management and changes to information systems. New SEC and FASB regulations that require interpretation by accounting firms and the Company."
Geographic locations	"As a multi-national company, we have operations in 27 countries. Each would require a change."
	"Number of geographic locations and statutory requirements."

Source: GAO analysis of survey data.

Impact of the Sarbanes-Oxley Act on Achieving the Benefits of a "Fresh Look"

While 77 percent of the respondents indicated that mandatory rotation of lead and reviewing partners sufficiently achieves the intended benefits of the "fresh look" and is less costly than mandatory audit firm rotation, another 18 percent of the respondents said the mandatory rotation of lead and reviewing partners may not be as effective as mandatory audit firm rotation in achieving the intended benefits of the "fresh look" but is a better choice given the high cost of mandatory audit firm rotation, and 4 percent answered that mandatory audit firm rotation is necessary to effectively achieve the intended benefits of a "fresh look." The remaining 1 percent indicated that checks and balances are already in place. One respondent provided comments to question 66 about the checks and balances already in place. See table 18.

Table 18: Comment Received: Checks and Balances Are Already in Place for the Auditors to Achieve the Benefits of a "Fresh Look"

General category of comment	Comment
Checks and balances already in place	"I also believe that in the current environment, everyone is fully aware of the need for independent evaluation and it is highly unlikely that audit failures will occur as a result of 'too' much familiarity with a client. The firms have put in the necessary checks and balances to ensure against this and chief financial officers and chief executive officers are signing-off quarterly on the accuracy of their financial statements."

Source: GAO analysis of survey data.

Implementing Mandatory Audit Firm Rotation

More than 80 percent of our respondents said that, if mandatory rotation of public accounting firms were required, it should be applied uniformly for audits of all public companies regardless of the nature or size of the public company. Most respondents (135 out of 173) indicated that the requirement should be applied uniformly because all public companies should be treated equally and size does not matter. However, the remaining respondents (38 out of 173) indicated that the requirement should not be applied uniformly primarily because of issues relating to complexity, size, risk, or cost. Table 19 shows selected responses to question 79—"Please explain why you believe such a requirement should, or should not, be applied uniformly to all public companies."

Table 19: Comments on the Uniform Application of Mandatory Audit Firm Rotation to All Public Companies

Position	Comment
In favor of uniform application	"Shareholders invest in public companies of all sizes. If mandatory rotation is aimed at improving financial statement integrity, size should not matter. Investors are still susceptible to losses if financial statements are misstated at any company."
	"It should be applied uniformly to ensure that all public companies are treated equally and that the investors are protected with the same level of controls/review applied to any public company."

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Position	Comment
	"Mandatory rotation would be implemented only after the SEC determined that it would unquestionably improve auditor independence and the quality of audit practices. If this were to occur, the perceived benefits should be applicable to all public companies for the protection of all investors and stakeholders."
	"If you believe rotation provides benefits that outweigh the cost, the rule should be applied to everyone so that every investor enjoys the benefits."
	"I don't believe that mandatory rotation will improve audit quality. In fact, I believe it will increase audit risk and significantly increase costs. If it were required, all companies, regardless of size, should have to comply."
	"We believe audit risk is inherent in all companies including privately held. Assuming auditor rotation reduces audit risk, applying the requirement to only a subset of all public companies implies audit risk occurs only within that particular subset."
	"Any non-uniform application would be arbitrary and potentially confusing to the capital markets."
	"One set of standards is easier to administer and companies competing in the same public markets should be subject to the same standards."
	"Inequities in laws or regulations lead to unfair competitive advantages."
	"All are public with shareholders money at risk. Size does not matter."
Vary application	"The entire concept is a well intentioned but misguided overreaction to the misdeeds of a few. A 'one size fits all' answer fails to recognize real variations in industry risk, cultural issues and other factors which have much more influence on the accuracy of the financial statements than changing auditors. The costs of implementing these and other changes is staggering and is another 'tax' on doing business in the United States."
	"Cost to small companies may make it prohibitive."
	"I believe mandatory rotation does not by itself result in better audits or less audit failures. If there is evidence that mandatory rotation yields better results in companies with certain characteristics, it should be applied to those companies and not every company as it is disruptive and, I believe, can result in greater risk of audit failure."

Source: GAO analysis of survey data.

Overall Views on Requiring Mandatory Audit Firm Rotation

Most (88 percent) respondents said their overall current view was that they do not support requiring mandatory rotation of public accounting firms because of the higher costs, risk of audit failure, and audit inefficiencies associated with rotating the auditor of record, among other issues. While 4 percent of respondents supported mandatory audit firm rotation at this time and 8 percent believed that more time was needed to evaluate the effectiveness of the various requirements of the Sarbanes-Oxley Act, table 20 shows selected responses to the follow-up portion of question 81—

which asked respondents to provide the principal reasons for either supporting or not supporting mandatory firm rotation.

Table 20: Explanations of Overall Current Views

View	Comment
Supports mandatory audit firm rotation	"Mandatory rotation would provide a 'fresh look' and all its corresponding benefits and overall would outweigh related costs."
	"It seems like it would positively impact the independence of auditors, if handled correctly. It will certainly be costly to implement, particularly on the company side."
	"The principal reason for supporting mandatory firm rotation at this time is to ensure that public accounting firms perform their responsibilities with full diligence, knowing that another firm in the future, will replace them and will review their work papers, possibly questioning certain positions and financial reporting."
Does not support mandatory audit firm rotation	"Mandatory rotation of external auditors might force a company to select an audit firm whose performance and value proposition is less than that which is provided by the preferred audit firm. This issue will be further exacerbated by the initial increase in costs, fees, and disruption to operations and financial reporting. More importantly, there will likely be an initial drop in audit performance and reduced ability to provide assurance that there are no material misstatements in the financial reporting. This drop in performance is in perfect contradiction to the intended result."
	"The key requirement for adequate audits is to make sure competent personnel are on the engagement. Changing firms just increases costs with no benefits."
	"Loss of expertise is a far more significant risk than the theoretical benefit of a 'fresh look'."
	"We are a complex organization, with operations around the globe. Mandatory rotation would result in a less capable audit team, at a higher cost."
	"The cost of implementation does not provide additional benefits to investors and may in fact increase the risk of audit failures in large complex companies."
	"Rotation of auditors could hinder the quality of audit opinions and attestations due to the inexperience of the auditor with the company or the industry."
	"Auditor rotation will not reduce audit failures but will add costs and increase risks."
	"It will reduce reliability, increase auditor training costs and send the entire industry into a marketing frenzy while dramatically increasing costs."

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View	Comment
	"We, like all companies I've known, attempt to hire the most capable firm to audit our company, in our industry and geographic footprint. We demand strong SEC and GAAP expertise and have changed audit firms when we didn't receive that expertise. This plan would force us to accept inadequate counsel. That's a bad idea."
	"We believe that the 'fresh look' benefit is, in fact, assured via partner rotation and that the costs of mandatory rotation are not justified."
	"The incremental costs will exceed the benefits. Additionally, more time is necessary to evaluate the effectiveness of the numerous requirements of the Sarbanes-Oxley Act of 2002 on enhancing audit quality."
	"'Fresh look' and independence can be achieved while not rotating the audit firm."
	"Mandatory firm rotation should not be required. The accuracy of the financial statements is the responsibility of management. As such, management should be entrusted with the decision on whether to continue with the use of a firm or not. Due to legality reasons, firms and management have an incentive to ensure that the financial statements are as accurate as possible."

Source: GAO analysis of survey data.

Additional Comments on the Effects of Mandatory Audit Firm Rotation

We asked respondents to volunteer any additional comments on the effects of mandatory rotation of public accounting firms. A number of the respondents mentioned concerns about mandatory rotation being too expensive, not being the solution, providing no benefit, and other issues. Table 21 shows selected responses to question 82—"Please provide any additional comments you may have on the effects of mandatory rotation of public accounting firms."

Table 21: Additional Comments

Type of Comment	Comment
Too costly	“The benefits of mandatory rotation are likely minor in comparison to the costs.”
	“Clearly a confidence crisis has developed in the area of independent accountants. Public trust must be restored. The Sarbanes-Oxley Act is designed to accomplish this restoration. I believe we need to let it work, mandatory rotation punishes companies with increased costs and we question the benefits to the investing public. We support the restrictions on ‘services’ provided by the external auditors. We believe this will significantly insure independence.”
	“There are numerous new deterrents to improper accounting behavior on the part of public companies and their audit firms. The cost to implement and comply with these new procedures is very high. Adding another requirement such as audit firm rotation will likely compromise the other requirements already enacted. Our audit firm already has a high degree of independence in their audit, adding rotation requirements will add cost and risk (due to inexperience) and do very little in terms of improving audits.”
Not the solution	“I am concerned that this will be the first step in moving towards government audits of public companies. That would be a mistake with a few notable exceptions, the current system has been effective for a long time and will remain effective. Neither the Sarbanes-Oxley actions nor the mandatory rotation of auditors will make dishonest people become honest. More importantly, these actions will not make honest people more honest.”
No benefit	“We have seen over the past three years the effect of what rotation of auditor personnel on the engagement can have on the quality and internal costs. Our audit team (external) has turned over completely in the past 2-3 years without a rotation of audit firm. The new members of the audit team do not know our company nor our industry. The questions asked are shallow and demonstrate a lack of understanding. It has taken a tremendous amount of internal time to educate the auditors. Clearly if one lacked integrity, this would be the time to try to get away with something to enhance financial reporting. In our case, that would never happen due to the integrity of management, but if one wanted to do something irresponsible we could see how it could occur without being detected.”
	“Any such change would be entirely cosmetic and political - industry and shareholders would pay a net price.”
	“Aside from the cost/benefit scenario, additional rules re: mandatory rotation of public accounting firms, to govern the process will only serve to further dilute the public's trust in the value of an audit and make matters even more complex.”

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Type of Comment	Comment
Other concerns	"It is certainly a judgment call on whether to have mandatory rotation of accounting firms. A 'fresh look' is more likely to find an intentional error, but less likely to find an unintentional error."
	"The mandatory rotation is a response to a failure in a select group of large cap companies and lack of audit committee involvement in these companies. Just to change auditors does not necessarily mean a 'bad' company will be good. The large 'cap' companies have more room to maneuver then a small cap company because our size allows the audit firm to push as usual."
	"I believe that the audit model is broken. I believe that audit firms are conducting audits to protect themselves, not primarily to reach a conclusion about the fairness of the financial statements. I also believe that the 'expectation GAP' between the auditor and the general public has grown as a result of the recent audit failures. The auditing profession has NOT adequately addressed this GAP, only increased the GAP through comments they have made. I do believe that there must be more audit procedures performed to the detection of fraud, as, from those instances that are currently in the public, there appears to have eluded detection from the auditors in a rather rudimentary manner. The FASB is also currently considering going from a 'Rules-based' to a 'Principles-based' approach, which in my opinion, will potentially lead to more opportunity for incorrect financial reporting."
	"We do not believe that mandatory rotation is necessary or effective. The cost to implement a mandatory program will be greater than today's already higher levels. The burden in added out-of-pocket costs and inefficiency due to training the new auditors in the policies and practices of the company will not outweigh the benefit, if any, that will come from a mandatory rotation. We believe that the proposal to rotate the engagement partners periodically is the most effective approach. Also, the PCAOB should establish mandatory rotation requirements for lower level audit engagement personnel in addition to the audit engagement partners."

Source: GAO analysis of survey data.

Selected Written Comments from Fortune 1000 Public Company Audit Committee Chairs

Audit committee chairs surveyed were invited to add written comments to a number of questions to further explain their answers that were provided in the questionnaire or to add additional answers. The survey of public company audit committee chairs, annotated with summary responses for each question, is in appendix III. Of the 191 audit committee chairs who responded to the survey, 183 provided written answers to at least one of the following open-ended comment questions in our survey:

- potential costs and benefits under mandatory audit firm rotation,
- implementing mandatory audit firm rotation,
- overall views on requiring mandatory audit firm rotation, and
- additional overall comments on mandatory audit firm rotation.

The following tables display selected comments from respondents to these questions to reflect the range of views that were provided by respondents. Some of the quotes illustrate typical comments made by several other audit committee chairs, while others represent a unique viewpoint of only that audit committee chair. While these specific comments provide valuable insights, the number of comments of a particular type reproduced here is not necessarily proportional to the number of other similar responses, and, therefore, the comments are not meant to be representative of the views that might be found in the population of Fortune 1000 public company audit committee chairs as a whole.

Potential Costs and Benefits under Mandatory Audit Firm Rotation

Under mandatory audit firm rotation, 89 percent of Fortune 1000 public company audit committee chairs stated that costs are likely to exceed benefits, 4 percent stated that costs and benefits would likely be about equal, 2 percent stated that benefits would likely exceed costs, and 5 percent stated they had no basis to answer the question. Table 22 shows selected responses to question 5—“Please tell us the primary reasons for your view on the potential costs and benefits that may result under mandatory audit firm rotation.”

Table 22: Views on Costs and Benefits

Costs likely to exceed benefits	Comment
Increased costs / increased audit risk	“Conducting a periodic competitive bid and evaluation process to select a new audit firm is a time-consuming and costly process. The benefits of an arbitrary change in audit firms are unknown and questionable. An auditor who is familiar with the firm’s operations and management can be expected to do a more thorough and informed job as auditor.”
	“[Our company] went through the audit firm rotation in 2002 by necessity, moving from Arthur Anderson to [another Big 4 firm]. While clearly getting a fresh set of eyes, it took a full year for [the Big 4 firm] to ‘get up to speed’ and give the audit committee definitive responses to our questions and concerns. The transition has clearly required more company resources in educating [the Big 4 firm] and increased out of pocket costs for the first annual audit by more than $1 million. I am also concerned about the lame duck effect in the final year of a relationship.”
	“Monetary costs of changing auditors is significant, but other costs are more important still. In addition to disruption of financial management of operations, quality of audits during transition is likely to be lower until new auditors become familiar with the new client's operations and the details of its control systems and reporting functions.”
	“The learning curve on a new engagement is very steep and time consuming. Risk of audit failure is highest in the early years of a relationship.”
	“Company effort involved in selection process leads to higher costs. Time and effort of both audit firm and client staff invested during start-up period lead to higher audit fees and overhead costs. Time required by audit engagement team to become familiar with company structure and industry may lead to lower-quality audits.”
	“Mandatory audit firm rotation doesn't make sense. Once the audit firm had figured out the intricacies of the company it is auditing, it would have to quit and the learning process started all over again with a new firm.”
	“Knowledge of business and familiarity with employees (strength/weaknesses) are important components of audit quality. Rotation implies less in-depth business knowledge and superficial relationships that could, in fact, reduce audit quality and increase the risk of overlooking an issue or being ‘manipulated’ by management.”

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Costs likely to exceed benefits	Comment
	"Start-up costs are likely to be significant, and audit firms are likely to take a shorter-term view of their potential engagement. Thus, they will want to recapture these costs in higher fees more quickly. Benefits are highly uncertain. Firms will have less incentive to specialize their practices, perhaps [with] the result that quality declines."
	"The perceived benefits of a 'fresh look' would be more than offset by the loss of continuity of the team. For example, many issues impact a company's financial statements over a period of years and are event based; therefore, continued knowledge of the transactions history is needed. Mandatory rotation would eliminate relationship pricing from the firms, thereby increasing costs. Additionally, the time and efforts on the part of management would increase to get the new firm up to speed on issues as well as the relationship with the audit committee."
	"We had a set rotation policy between [a public accounting firm] and [a Big 4 firm] (switched every 5 years). We found that for the first 2 years of the audit the new firm was learning and had little in the way of suggestions for improvement. They got better after 2 years, so we had a poor audit for the first 2 years. Thus, we stopped the rotation."
Benefits hard to see	"There is no assurance that rotation will eliminate potential conflicts; it could potentially reduce competition among the Big 4 and make it worse."
	"I think the benefits are imaginary and the costs, especially the disruption costs, are significant."
Existing requirements	"The current policy of rotating lead audit and reviewing partners every five years is a good, balanced approach in that it provides for continuity of certain members of audit team and a fresh look."
	"Most of the intended benefit of accounting firm rotation will be achieved through other requirements of the Sarbanes-Oxley Act and related corporate governance initiatives (such as rotation of audit partners involved in the engagement, the increased responsibilities of the independent audit committee, pre-approval requirements, etc.) without the significant costs of firm rotation."
	"Until the accounting profession stabilizes post-Sarbanes-Oxley, I would strongly oppose any mandatory rotation of auditing firms."

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Costs likely to exceed benefits	Comment
	"The primary areas of concern—absence of a 'fresh look' potential for making the same mistake repeatedly—are well addressed by partner rotation and the strengthened oversight process within the firms themselves. The loss of continuity, or institutional memory, would be a negative aspect of firm rotation that could be damaging to audit quality."
	"The Sarbanes-Oxley Act, and increased awareness generally, have produced many positive changes at audit firms and in the management practices and audit committees of public companies. It is not clear that mandatory rotation would add significant additional benefit. Public companies would bear the additional internal cost of transitioning to a new firm and absorb, through fees, the audit firm start-up costs."
Few qualified firms	"With only 3 other firms qualified to do our audit, mandating a change would only reduce the quality and drive up the costs of the audit."
	"If we rotated within Big 4 [firms], we would quickly run out of preferred firms."
	"With only 4 large audit firms, more use of other firms for non-audit services will reduce our flexibility in choosing a new firm. Industry-specific specialization is also important."
	"Continuity and broad familiarity and knowledge of the company's highly complex worldwide operations are extremely valuable and necessary to conducting effective independent audits. Few independent audit firms possess the worldwide capabilities to audit large U.S. operations as well as operations in 28 countries outside the USA. Nevertheless, individual lead auditors within the audit firm must be rotated every 4 to 5 years."
Counterproductive timing of change	"Mandatory audit rotation could result in a change of auditors at a time that would be counterproductive for the audit firm and the company."
	"Financial/economic cost to change auditors; mandatory change of auditors in midst of strategic shifts/mergers or acquisitions could impair business; overly burdensome to smaller public companies."
	"Since the timing of the change would not be under the control of the audit committee, it could come at a time when the expense of a change would be inordinately high, such as during a major acquisition, recapitalization, or restructuring."

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Costs likely to exceed benefits	Comment
Responsibility of the audit committee	“The audit committee should rigorously evaluate the work of the independent auditors on an on-going basis. Changes should be made to strengthen the independent audit team, as needed, or to change audit firms based on the performance of the independent auditors and the needs of the company —not on a mandatory rotation schedule.”
	“Rotation for the pure purpose of regulating change does not substitute for watchful review by audit committees. The committee can decide if auditors are complacent, [are] too close to management, or are no longer effective.”
	“I do not believe that mandatory actions and legislation can substitute for honesty, integrity, judgement, and quality work. Mandatory changes would take something away from responsibility that should be on directors and management’s shoulders to bring judgement to bear on when change might be called for. In my experience, companies with good governance periodically open the audit up for bid anyway and evaluate who will do the best job for the company and shareholders.”
Costs and benefits likely to be about equal	
Increased cost offset by increased benefits	“Costs are likely to moderate slightly because there would be more turnover and more competition. Quality would benefit from a fresh set of eyes and suffer from lack of familiarity. Overall no significant change in quality.”
	“The increase in costs would be offset by increased benefits. Increased costs would be moderate due to auditing firms’ competitive nature and desire to be associated with a prestigious client; benefits would include unique or different perspective, suggestions for improvements, and additional resources within our industry available to us.”
	“Costs will be competitive, and the benefit of a fresh look at financials would not be expensive.”
Few qualified firms	“In a smaller community there is probably only one large firm who knows the industry well. A change means going out of town entailing start-up costs and additional travel.”
Benefits likely to exceed costs	
Enhanced audit committee responsibilities	“A fresh look at company procedures would enhance and improve audit committee responsibilities.”
Reduced pressure	“Pressure to ‘go along’ would be significantly reduced if audit had a finite period.”

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Costs likely to exceed benefits	Comment
Multiple firm use mitigates costs	"Mandatory audit firm rotation represents the only truly effective way to achieve the 'fresh look' contemplated by the Sarbanes-Oxley Act. While additional costs would be incurred, I feel that these can be substantially mitigated in today's environment where most registrants are using multiple firms to provide important non-audit services. In my opinion, this involvement would reduce the start-up time traditionally associated with auditor changes."
No basis to answer question	
Lower audit quality	"While rotation of audit firms would increase probability of arms-length relationships, it would decrease significantly the understanding of the audited companies' circumstances and thus the quality of the audit."
	"Benefits are likely to reduce because of loss of continuity and familiarity with operations. Costs may reduce because of the bidding process to obtain a new client. This in turn may cause corner cutting with resultant lower quality audit."
Costs/benefits not clear	"Not enough sound information to know the costs, benefits, and risks."
	"I expect an increase in costs but until there is more experience with such rotation, the cost/benefit is difficult to assess."

Source: GAO analysis of survey data.

Implementing Mandatory Audit Firm Rotation

About 65 percent of Fortune 1000 public company audit committee chairs indicated that mandatory audit firm rotation, if required, should be applied uniformly for audits of all public companies regardless of the nature or size of the company and 35 percent stated mandatory audit firm rotation should not be applied uniformly to all audits of public companies. Many of the audit committee chairs provided an explanation for their response to question 22, as shown in table 23.

Table 23: Comments on Whether Mandatory Audit Firm Rotation Should Be Applied Uniformly for Audits of All Public Companies

	Comment
Should be uniformly applied	
Size is not a determining criterion	"If a practice/policy change is sufficiently valuable, important to apply to some, it should apply to all. Applying the rule to some rather than all would seriously undermine the premise that the change to the new policy is appreciably adding to the quality of audits."
	"The requirement should be uniform since size of company does not guarantee that problems that may arise in large companies may not arise in small companies and vice versa."
	"If there is any point to rotation, it should apply to all public companies, small or large. In fact, a smaller company might be in more need for rotation than a large company, particularly if it is not audited by the Big 4 CPA firms."
	"Size is not the issue—integrity is. Companies change size or profile rapidly. Whatever criteria are set, a company may move in or out of the requirements over time. While I do not support mandatory rotation, if implemented, it should be implemented for all public companies. Otherwise some firms will be at a cost disadvantage."
	"All reporting companies should be subject to the same requirements and rules. Large companies should not have an advantage or be disadvantaged. Small companies, if regulated and not able to comply with requirements, can elect a number of remedies to become non-regulated and non-public."
	"A uniform application of mandatory rotation would result in a more uniform cost structure as it relates to audit fees. That is, I would expect a two-tier fee schedule to develop, otherwise, whereby those companies facing mandatory rotation requirements would pay higher fees than a potential competitor might pay if the competitor were not required to engage in mandatory rotation."
	"If mandatory rotation increases audit quality, it makes sense to do it for all companies. All companies should be treated equally."
	"If someone wants to try to bend or break the rules, the size or nature of the company won't be a deterrent. As much as I dislike a 'one size fits all' approach, in this case the requirement should be universal."
	"Why would one class of public company be considered more or less honest?"
	"Risks are not correlated to the size of a company. Early start-up/growth companies often have complex systems and relatively inexperienced management."

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	Comment
	"As long as there is market risk and reward, size should not be the determining factor."
	"Rotation cost is relative to size and would not put a greater relative burden on small companies than large."
	"If the concept were adopted, the requirement should be uniformly applied. Not to do so would create a tiered structure which might suggest that smaller companies were not subjected to the same high standards as larger companies."
	"All public companies should be held to identical requirements. Shareholders are the same for big and small and should be entitled to the same safeguards."
All security holders should be protected	"If one believes that mandatory rotation would give better protection to public (investors, lenders, employees, etc.), then all parties should be protected regardless of size."
	"The objective of financial statement integrity is absolute. If a company wants the capital market benefits associated with being a SEC registrant, it needs to meet a common standard. It is not apparent why the risk of problems is not the same across all companies, and all securities holders should be equally protected."
	"The primary purpose of the new process would be to protect investors in public companies. The standards of protection should be the same for all investors; accordingly, such processes should be applicable to all public companies."
Should not be uniformly applied	
Too few qualified firms	"There would not be enough firms to go around."
	"…(1) For some industries there are only a limited number of public accounting firms with the skill set to audit a particular firm. (2) The cost to smaller public companies will be high, thus affecting shareholder value. (3) Location of firms (physically) may increase unique problems due to where the skill set on the part of the service provider is inconvenient to timely meet the needs of the company."
	"Some industries have very specialized issues with limited qualified firms, such as registered investment companies."
Public company diversity	"Such diversity exists among public companies in terms of line of business, size, etc., that I believe that a uniform standard will work to the detriment of many companies."
	"The size and complexity of public companies varies greatly. Therefore, the disruption associated with initial implementation of mandatory rotation should be mitigated by 'rolling out' the initiative in an orderly manner."
	"There are too many variations in companies to provide a blanket policy. Small companies should be treated differently than large companies with multiple operations. Those operating abroad should be treated differently than those that are domestic only."

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	Comment
Too costly for small companies	"The process is far too expensive for smaller firms and, therefore, should be applied according to some sales and/or asset figures."
	"Smaller companies could have a longer rotation cycle because the costs to change auditors is more significant and the risks to investors and capital markets is less."
	"The cost to smaller companies could be prohibitively expensive relative to their sales or earnings and would be more likely to result in a detriment to the interests of stockholders rather than a benefit. The disruption of financial management of operations would likely be disproportionately greater for smaller firms."
	"In smaller companies, costs will outweigh the benefit to the company and investors. Mandatory rotation for all companies should include such factors as size, nature of industry, and location. Mandatory rotation should be required for companies retaining the same audit firm for 15 years or more."
	"Some threshold of annual revenues should be set for imposing mandatory rotation. Often such companies have simpler business models and fewer business segments."
Difficulties for large complex companies	"Mandatory accounting firm rotation will involve significant costs, particularly for large multinational companies … that have complex and geographically dispersed operations. These significant costs, as well as the increased risk of audit failure, do not justify the minimal, if any, benefit of such mandatory rotation."
	"Mandatory rotation poses a substantially greater difficulty for very large complex international companies than it does for smaller companies with limited product lines in very few countries."
	"Issues related to staffing audit work on large global companies will be more complex and difficult."
Apply to large, complex, or multinational companies	"[Mandatory rotation] should apply initially to large, complex national or multinational companies."
	"Start with largest companies first and those who have had qualified opinions in the past."
	"If there were mandatory rotation, I believe there should be a size hurdle on the companies to which it applies. Two reasons: first, the financial and administrative burden of rehiring and retraining auditors would weigh more heavily on smaller companies than on larger ones. Also, the global impact of an Enron type problem is much more serious when it involves a very large company as opposed to a very small one. An accounting mishap or even fraud at a small company would impact a much smaller universe than would the same event at a large company."

Source: GAO analysis of survey data.

Overall Views on Requiring Mandatory Audit Firm Rotation

About 90 percent of Fortune 1000 public company audit committee chairs stated they do not support requiring mandatory rotation of public accounting firms registered with the PCAOB, 2 percent stated they did support such mandatory rotation, about 7 percent of Fortune 1000 public company audit committee chairs supported the concept of requiring mandatory audit firm rotation of registered public accounting firms but believed that more time was needed to evaluate the effectiveness of the various requirements of the Sarbanes-Oxley Act of 2002, and 1 percent stated other opinions. These respondents were also given the opportunity to provide an explanation for their opinions expressed in question 24, which are summarized in table 24.

Table 24: Explanation for Overall Opinion on Requiring Mandatory Audit Firm Rotation

Does not support mandatory audit firm rotation	Comment
Increased risk not outweighed by benefits	"Expensive both externally and internally and does not guarantee a quality audit. Actually risk in quality occurs in the early years of a new firm performing an audit before totally understanding the company being audited."
	"I do not believe the 'fresh look' benefits outweigh the loss of company-specific knowledge and knowledge of the quality and integrity of the key financial and control personnel."
	"Not enough benefit would result from the costs incurred. Strong and consistent accounting standards should provide the same effect. The limited (and shrinking) number of large accounting firms provides minimal benefit to rotation, as does the learning curve that is necessarily present for a new audit."
	"Effective audits of large, diverse, and worldwide organizations require significant knowledge and experience of the individual company...not just the industry. This knowledge can only be obtained through direct and hands-on experience. It takes 2-3 years working directly with the company to obtain the knowledge. [Knowledge] accumulated over many years that is extremely valuable to an audit firm responsible for a financially complex multinational corporation. Mandatory rotation of audit firms is contrary to this belief and, therefore, is not supportable. Audit effectiveness and audit reliability would be negative."

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Does not support mandatory audit firm rotation	Comment
	"Using a five year model, the new auditor would require as much as two years to become familiar with the 'rhythm' of a new client as well as its risks and vulnerabilities. The years following would likely produce a sound auditing service. The final year would take on the stigma of a 'lame duck' assignment."
	"It has not been determined that mandatory rotation will result in better, more efficient independent and more valuable audits."
	"Not enough work has been done to properly evaluate the costs and benefits associated with mandatory rotation. We also need to understand potential risks with this concept."
Few qualified firms	"The Big 4 [firms] provide too little choice for companies that need them; I think partner rotation provides most of the benefits."
Audit committee/board responsibilities	"The audit committee and board should be able to continually monitor the audit process and retain the proper firm for the company."
	"Our audit committee takes its role very seriously in protecting the shareholders and other stakeholders. We feel comfortable with our current public accounting firm. We are in the best position to judge if a change is needed."
	"The audit committee of the firms should be exercising strong attentiveness and responsibility in conjunction with the rotation of partners and managers of a new accounting firm."
	"The audit committee is ultimately responsible for audit quality. I do not think mandatory rotations changes that. The audit committee needs to do its job and have complete flexibility with respect to hiring or firing the auditors."
	"Selection and retention of the independent auditors should be conscious decisions of the audit committee based on facts relating to the independent auditors and the company and should not be based on a predetermined rotation schedule."
	"The issue is not about auditor rotation but corporate values and auditor effectiveness. Rotation doesn't solve or address the issues. Boards and audit committees need to determine corporate values and auditor effectiveness, not some arbitrary rule."
	"A public company should periodically assess the suitability of the incumbent public accounting firm relative to all facts and circumstances including the consideration of the qualifications of other firms. Regulation of requirements substituting for judgment is not appropriate."

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Does not support mandatory audit firm rotation	Comment
	"Although rotation is beneficial, the decision is one that should be made by the board and not by law."
Cost/benefit	"The increase in audit fees to public companies will be significant with benefits that would likely be achieved through other means (i.e., partner rotation)."
	"The costs far outweigh the benefits. Any gain in confidence that might occur is offset by the increase in audit costs. You need honest people to oversee the audit and changing auditors will not make honest people out of people that are not trustworthy."
	"I do not believe mandatory rotation would add significantly to the reliability and accuracy of financial statements. I believe the cost would be exorbitant, and there would likely be other unintended consequences of such a dramatic change that have not been thought through."
Existing requirements	"Problems have arisen because of cozy relationships among persons (coupled with personal compensation considerations determined by the engagement relationship), not among institutions. Hence, rotation of appropriate personnel, coupled with a strong audit committee, should suffice."
	"Partner rotation accomplishes benefit with less cost and disruption."
	"With Sarbanes-Oxley, etc., I believe companies will apply good business judgment to change audit firms when appropriate—sometimes even for public appearance sake."
	"Rotation is an incredible overreach which penalizes honest companies, those in the vast majority. The Justice Department, the SEC, and quality board members are the appropriate remedy."
Integrity	"It's about integrity—of audit committee members, of financial officers, of chief executive officers, and of audit firm that makes the difference. Rotation of audit firms will never replace integrity."
More time is needed to evaluate the effectiveness of the Sarbanes-Oxley Act	
	"Various requirements of the Sarbanes-Oxley Act of 2002 are designed to enhance audit quality. More time is needed to evaluate the effectiveness of these requirements."
	"The costs and risks are significant, and I would prefer to see the effects of the Sarbanes-Oxley Act and other governance initiatives first before moving to mandatory rotation."

Source: GAO analysis of survey data.

Additional Overall Comments on Mandatory Audit Firm Rotation

We asked Fortune 1000 public company audit committee chairs to volunteer any additional comments on the issues in the survey. A number of the audit committee chairs mentioned that existing requirements would likely achieve the intended benefits of mandatory audit firm rotation or the requirements should be given time to determine their effectiveness; mandatory audit firm rotation was a bad idea, not cost-effective, and could adversely affect audit quality; and Fortune 1000 public company management, boards of directors, and their audit committee chairs should be held accountable. Table 25 provides selected additional comments of audit committee chairs to question 25.

Table 25: Additional Overall Comments

General category of comment	Comment
Existing requirements/ Sarbanes-Oxley Act experience	"If audit committees and public accounting firms follow already existing regulatory and other guides to professional performance, rotation is not necessary. In addition, I believe that less rather than more restrictions on the degrees of freedom of boards and management are desirable, despite the abuses of the last few years."
	"The impact on the auditing firm economies should be studied. The Sarbanes-Oxley Act has done a good job in repositioning the importance of the auditor in our capital markets system. It also empowered and clarified responsibilities of board and audit committees in a way that impacts auditor performance in a positive way. These initiatives should be allowed to work."
	"The restrictions placed on auditors under the Sarbanes-Oxley Act sufficiently protect the public and all users of financial statements and provide for auditor independence. This, together with officer certifications and the renewed reliance and responsibilities of the audit committee and directors in general sufficiently meet the desired objectives. Rotating the auditor potentially creates a window in the early years of engagement, that could expose the public to the easier perpetration of fraud."
Accountability	"Our company has been run with the utmost scrutiny and respect for proper and truthful accounting procedures. Those companies that have reported untruthfully and illegally and unethically should be prosecuted to the full extent of the law. The rest of us should not be considered 'guilty until proven innocent'."

(Continued From Previous Page)

General category of comment	Comment
	"Well-run companies with good boards do not need anything being suggested here and my answers come from that perspective. For those pushing the limits, or worse, perhaps there is a case for rotation and new conditions which go with it. I think, in the 'new world of corporate governance,' there is a big positive change overall and now is not the time to 'over' regulate. Everybody who 'pushed the envelope' certainly should now have the message they had better get it 'right'."
	"Accounting and reporting abuses are best minimized by investors, regulators, and other authorities holding managements, audit committees, and accounting firms to high professional standards and codes of conduct. In the absence of such standards and codes, mandatory rotation of accounting firms will not help."
	"Most of the Sarbanes-Oxley Act requirements solidify the assured integrity of the entire financial reporting process. The proposed rotation is a reactionary action that is unfounded and without logic. Any further attention should be directed toward improving our criminal justice system to increase probability of successfully prosecuting wrongdoers!"
Cost effectiveness / increased risk	"The costs in effectiveness of audits cannot be over emphasized, in addition to the monetary costs. Even an experienced and effective audit team will likely take one to two years to become fully 'up to speed' in even a moderately complex large corporation. The ability to know what to look for, where to look, and whom to talk to definitely improves with time. "
	"Mandatory rotation will impose a higher burden (cost) on shareholders and will not result in a better work product. A focus on better auditing standards and training (including ethics) is of greater importance."
	"It seems difficult to justify the costs, disruptions, and learning-time consequences of mandatory rotation for all corporations. But it does seem that it would be beneficial for some. It seems worth serious consideration about criteria and approaches that might strike a better balance than blanket rotation."
	"One negative of changing auditors is that the new firm, usually in an effort to impress the new client, has become overly aggressive in some of its advise. This is a risk which must be guarded against."
	"Companies with operations in smaller cities would probably find considerable difficulties in switching audit firms as would companies with operations in non-U.S. parts of the world. Applying this approach to foreign firms with operations here would provide another unneeded point of argument with foreign countries."

Source: GAO analysis of survey data.

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