

PCAOB Issues Concept Release Aimed at Enhancing Auditor Independence, Objectivity and Professional Skepticism

On August 16, 2011, the Public Company Accounting Oversight Board (“PCAOB”) issued a concept release to solicit public comments on ways to enhance auditor independence, objectivity and professional skepticism.¹ The concept release focuses on one possible approach to accomplish this goal—mandatory audit firm rotation. Mandatory audit firm rotation would entail a regulatory limitation on auditor tenure and is intended as a means by which to address the fundamental conflict that can result from the fact that auditors are paid by the companies they audit and may therefore put their clients’ interests ahead of investors’ interests.

Mandatory audit firm rotation has been considered at various times since the 1970s. The PCAOB is now considering the idea in response to both the financial crisis and PCAOB inspection data which indicates that auditors still sometimes fail to obtain reasonable assurances from client companies about whether their financial statements are free of material misstatements. The PCAOB is concerned that many such audit failures may be attributable to a lack of auditor independence, objectivity or professional skepticism. Proponents of mandatory auditor rotation believe that term limits would free auditors from the effects of client pressure and offer an opportunity for a fresh look at a given company’s financial reporting, resulting in higher-quality audits and more protection for investors. Opponents, however, argue that mandatory audit firm rotation would result in higher costs and disruptions for companies, as well as lower-quality audits, especially in the early years of an engagement, due to the steep learning curve required for auditors to gain familiarity with a company and its operations.

The concept release aims to solicit comments regarding whether more can and should be done to enhance auditor independence, objectivity and professional skepticism generally and, in particular, whether mandatory audit firm rotation is a viable means by which to accomplish this goal. In addition, the concept release seeks input on any other approaches that could meaningfully enhance auditor independence. Comments are also requested on a number of specific questions, including, for example, whether the PCAOB should consider a rotation requirement only for audit tenures of more than ten years, and only for the largest issuer audits.

Comments on the concept release are due by December 14, 2011. The PCAOB also intends to convene a public roundtable on auditor independence and mandatory audit firm rotation in March 2012.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com; or Abigail Darwin at 212.701.3240 or adarwin@cahill.com.

¹ See PCAOB Release No. 2011-006, *Concept Release on Auditor Independence and Audit Firm Rotation* (August 16, 2011), available at http://pcaobus.org/Rules/Rulemaking/Docket037/Release_2011-006.pdf.