NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

By Electronic Mail

December 9, 2011

Mr. J. Gordon Seymour
General Counsel and Secretary
Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: Solicitation for Public Comment on *Concept Release on Auditor Independence and Audit Firm Rotation and Notice of Roundtable (PCAOB Release No. 2011-006, August 16, 2011, PCAOB Rulemaking Docket Matter No. 37)*

Dear Mr. Seymour:

This letter is submitted in response to the solicitation for public comment by the Public Company Accounting Oversight Board (PCAOB) with respect to its *Concept Release on Auditor Independence and Audit Firm Rotation and Notice of Roundtable (PCAOB Release No. 2011-006, August 16, 2011, PCAOB Rulemaking Docket Matter No. 37) (Concept Release).*

The National Association of Real Estate Investment Trusts® (NAREIT) is the worldwide representative voice for U.S. real estate investment trusts (REITs) and publicly traded real estate companies with an interest in U.S. real estate and capital markets. Members are REITs and other businesses throughout the world that own, operate and finance income-producing real estate, as well as those firms and individuals who advise, study and service these businesses. NAREIT welcomes the opportunity to respond to the Concept Release and is submitting its comments below.

NAREIT appreciates the PCAOB's efforts toward improving audit quality since its inception in 2002. NAREIT believes that auditor independence, objectivity, and professional skepticism are critical elements to achieve high quality audits and commends the PCAOB for continuing to evaluate how these elements could be strengthened. However, NAREIT does *not* believe that mandatory audit firm rotation is a viable option to achieve the desired outcome.

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Lack of Empirical Evidence

NAREIT believes that the Concept Release lacks empirical evidence that would suggest that the current audit structure of public companies requires pervasive reform. The Sarbanes-Oxley Act of 2002 (the Act or Sarbanes-Oxley) instituted a number of measures that were aimed at enhancing auditor independence, objectivity, and professional skepticism. For example, Sarbanes-Oxley requires the periodic rotation of audit partners. Additionally, the Act places limits on the types of non-audit services that audit firms can provide to their audit clients. Finally, the Act has taken the ability to select auditors away from management and placed it with the audit committee. Through all of these measures, NAREIT has observed that confidence in financial reporting has been restored through the decrease of financial scandals and restated financial statements. However, the Concept Release elaborates that despite all of these improvements,

> The Board's inspectors have reviewed portions of more than 2,800 engagements of such firms and discovered and analyzed several hundred cases involving what they determined to be audit failures. In this context, an **audit failure** is a failure to obtain reasonable assurance about whether the financial statements are free of material misstatement. **That does not mean that the financial statements are, in fact, materially misstated.** Rather, it means that the inspection staff has determined that, because of an identified error or omission, the firm failed to fulfill its fundamental responsibility in the audit – to obtain reasonable assurance about whether the financial statements are free of material misstatement. In other words, **investors were relying on an [audit] opinion on the financial statements that, when issued, was not supported by sufficient appropriate evidence.** [Emphasis added]

NAREIT notes that the use of the word “audit failure” has meant something far more severe in the past. Specifically, in the 2003 Government Accountability Office (GAO) Report,

> 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 Generally Accepted Auditing Standards (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 financial statements if appropriate adjustments were not made, or (3) if warranted, the resigning as the public company’s auditor of record and reporting the reason for the resignation to the SEC. [Emphasis added]

If the PCAOB’s inspection findings were truly audit failures, would we not have seen more restatements during the period that the PCAOB conducted its inspections? Additionally, why has the PCAOB not made the portion of its Inspection Reports (*i.e.*, Part II of the Inspection Report) that deals with these "audit failures" public? It appears as though the PCAOB is recommending further regulation as a solution to a problem that simply *does not exist*.

Increased Risk of Audit Failures

The Concept Release was written on the presumption that changing auditors periodically would automatically result in more auditor independence, objectivity, and professional skepticism. However, studies of jurisdictions (*e.g.*, Italy) that require mandatory audit firm rotation have suggested that the requirement does not improve audit quality and could actually be to its detriment.

Others share this view. For example, the Concept Release includes the following quote from James Copeland, former CEO of Deloitte & Touche:

> There is strong evidence that requiring the rotation of entire firms is a prescription for audit failure. It would result in the destruction of vast stores of institutional knowledge and guarantee that auditors would be climbing a steep learning curve on a regular basis. It would expose the public to a greater and more frequent risk of audit failure. It would increase the likelihood of undetected fraud by management. It would make it easier for reckless management to mislead the auditor. And finally, it would allow companies to disguise opinion shopping by enabling them to portray a voluntary change in auditors as obligatory.

Additionally, the Concept Release includes following quote from Barry Melancon, President and CEO of the American Institute of Certified Public Accountants (AICPA): "[m]andatory rotation of audit firms has been proven to increase the potential for fraud".

Additionally, the PCAOB's own inspections process has failed to provide a "correlation between auditor tenure and the number of comments in PCAOB inspection reports."

Costs outweigh Benefits

NAREIT believes that requiring public companies to change audit firms periodically would increase costs with little to no benefit. In 2003, the GAO issued a study that evaluated the merits of mandatory audit firm rotation. The following is an excerpt from the Concept Release:

> The GAO's Report was issued in 2003 and was based, in part, on a survey "of public accounting firms and public company chief financial officers and their audit committee chairs of the issues associated with mandatory audit firm rotation." According to the GAO's survey, 79% of larger audit firms and Fortune 1000 companies that responded believed that changing audit firms **increases the risk of an audit failure in the early years of the audit**, and most believed that mandatory firm rotation "would not have much effect on the pressures faced by the audit engagement partner." Nearly all of the larger firms that responded estimated that **initial year audit costs would increase by more than 20 percent**. [Emphasis added]

NAREIT notes that the estimate for first year audit costs of 20 percent was *prior* to the effective date of Sarbanes-Oxley, which requires audit firms to perform integrated audits of public companies. In integrated audits, audit firms provide audit reports that cover both financial statements and internal control over financial reporting. Thus, the cost could be well in excess of the 20 percent originally estimated in the 2003 GAO study.

Lack of Competitors in the "Big 4" in Smaller Markets

Depending on where a company is located, the choice that audit committees have in selecting a "Big 4" public accounting firm can be limited. This limitation is further complicated when a company uses one of the "Big 4" to provide non-audit services. Thus, a requirement to change audit firms puts companies in smaller markets at a competitive disadvantage in selecting a qualified alternate audit firm. This is further complicated when taking into account industry specializations. Audit firms develop industry specializations depending on the types of clients that they audit. Companies headquartered in smaller markets may be required to reimburse audit firms for the travel expenses of entire engagement teams for the months that the companies are audited and reviewed. Mandatory audit firm rotation would place undue financial burdens on companies headquartered in smaller markets and could lead to a higher risk of audit failure due to lack of qualified alternate audit firms with the requisite level of industry expertise.

NAREIT's Recommendation

The costs that public companies bear to access the capital markets are already expensive without taking into consideration the costs associated with the Concept Release. Given the lack of empirical evidence, increased risk of audit failures, costs that outweigh benefits, and the lack of competitors among the "Big 4" in smaller markets, NAREIT urges the PCAOB to withdraw the requirement for mandatory audit firm rotation from its agenda.

In summary, NAREIT does not believe that mandatory audit firm rotation is a reasonable solution (given the cost and risk) to a problem that remains unsubstantiated.

NAREIT's recommends that the PCAOB should:

- Continue to study the *root cause* of inspection findings.

- Publish data on inspection findings to the filing community in order to provide for a more informed discussion based on empirical data which would focus on root causes behind these perceived audit failures. Also, this approach would allow for perspective as to the size and the scope of the findings which would drive the scope and appropriateness of any contemplated proposed solution.

- Mandate that audit firms discuss with audit committees their complete inspection reports as part of required auditor/client communications. This would provide audit firms with further incentive to address areas that the PCAOB cite as findings in inspection reports and lead to enhanced audit quality.

- Require additional education requirements for all CPAs in the areas of auditor independence, objectivity, and professional skepticism. Currently, educational requirements with respect to independence *vary* depending on the state that a Certified Public Accountant (CPA) is licensed. For example, the Commonwealth of Virginia has an annual ethics requirement; the state of New Jersey has a triennial ethics requirement, and the Commonwealth of Pennsylvania has not yet instituted an ethics requirement. NAREIT believes that there is an opportunity for the PCAOB to establish mandatory ethics and independence training for *all* CPAs *regardless of the state* where the CPAs hold their licenses. This stream-lined approach would ensure that CPAs in public practice have a sufficient understanding of independence, objectivity, and professional skepticism on an annual basis.

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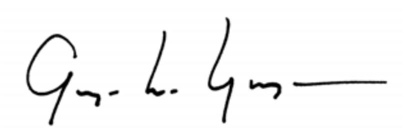
NAREIT thanks the PCAOB for this opportunity to comment on the Concept Release. Please do not hesitate to contact George Yungmann, NAREIT's Senior Vice President, Financial Standards, at (202) 739-9432, or Christopher Drula, NAREIT's Senior Director, Financial Standards at (202) 739-9442 if you would like to discuss our comments on the Concept Release.

Respectfully submitted,



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