

## AUDIT INTEGRITY AND JOB PROTECTION ACT

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JULY 8, 2013.—Committed to the Committee of the Whole House on the State of  
the Union and ordered to be printed  
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Mr. HENSARLING, from the Committee on Financial Services,  
submitted the following

### R E P O R T

[To accompany H.R. 1564]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the bill (H.R. 1564) to amend the Sarbanes-Oxley Act of 2002 to prohibit the Public Company Accounting Oversight Board from requiring public companies to use specific auditors or require the use of different auditors on a rotating basis, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike all after the enacting clause and insert the following:

#### **SECTION 1. SHORT TITLE.**

This Act may be cited as the “Audit Integrity and Job Protection Act”.

#### **SEC. 2. LIMITATION ON AUTHORITY RELATING TO AUDITORS.**

Section 103 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7213) is amended by adding at the end the following:

“(e) **LIMITATION ON AUTHORITY.**—The Board shall have no authority under this title to require that audits conducted for a particular issuer in accordance with the standards set forth under this section be conducted by specific auditors, or that such audits be conducted for an issuer by different auditors on a rotating basis.”.

#### **SEC. 3. STUDY OF MANDATORY ROTATION OF REGISTERED PUBLIC ACCOUNTING FIRMS.**

(a) **STUDY AND REVIEW REQUIRED.**—The Comptroller General of the United States shall update its November 2003 report entitled “Study on the Potential Effects of Mandatory Audit Firm Rotation”, and review the potential effects, including the costs and benefits, of requiring the mandatory rotation of registered public accounting firms. In addition, the update shall include a study of—

(1) whether mandatory rotation of registered public accounting firms would mitigate against potential conflicts of interest between public accounting firms and issuers;

(2) whether mandatory rotation of registered public accounting firms would impair audit quality due to the loss of industry or company-specific

knowledge gained by a public accounting firm through years of experience auditing the issuer; and

(3) what affect the Sarbanes-Oxley Act of 2002 has had on registered public accounting firms' independence and whether additional independence reforms are needed.

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

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

#### PURPOSE AND SUMMARY

H.R. 1564, the “Audit Integrity and Job Protection Act,” amends section 103 of the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”), 18 U.S.C. 1514A *et seq.*, to prohibit the Public Company Accounting Oversight Board (PCAOB) from requiring U.S. public companies to use specific auditors or require the use of different auditors on a rotating basis. H.R. 1564 also requires the Government Accountability Office (GAO) to update its November 2003 “Study on the Potential Effects of Mandatory Audit Firm Rotation,” and report to Congress on the potential effects, including the costs and benefits, of requiring mandatory rotation of audit firms.

#### BACKGROUND AND NEED FOR LEGISLATION

H.R. 1564 responds to an August 16, 2011 PCAOB Concept Release on Auditor Independence and Audit Firm Rotation (“Concept Release”), which sought public comment on “whether mandatory auditor rotation would significantly enhance auditors’ objectivity and ability and willingness to resist management pressure.” The Concept Release sets forth the arguments for and against mandatory audit firm rotation, as well as the history of proposals for audit firm rotation dating back to 1977, when Congress created the Cohen Commission after several corporate scandals. The Cohen Commission ultimately decided against mandating audit firm rotation, and instead recommended that audit committees retain discretion in deciding whether to rotate audit firms or make periodic personnel changes within the audit team of the auditing firm. Mandatory audit firm rotation was raised again in 2002 during congressional debate on what ultimately became Sarbanes-Oxley, but was again rejected. In November 2003, the GAO released its Study on the Potential Effects of Mandatory Audit Firm Rotation, as required under Sarbanes-Oxley, which concluded “that mandatory audit firm rotation may not be the most efficient way to strengthen auditor independence and improve audit quality. . . .”

The original comment period for the PCAOB’s Concept Release ended in December 2011. But after receiving more than 600 comments—with 96 percent of comments opposed to the concept of mandatory audit firm rotation—the PCAOB extended the comment period to the end of April 2012. The PCAOB also hosted two days of roundtables on the issue in March 2012. The PCAOB has yet to issue any rules requiring mandatory audit firm rotation for U.S. public companies.

Rather than promoting auditor independence, objectivity, and professional skepticism, imposing a mandatory audit firm rotation

requirement on U.S. public companies would likely degrade audit quality by hindering the ability of auditors to develop detailed knowledge of their clients' management and operations through long-term audit engagements. On December 14, 2011, BlackRock, Inc., the world's largest asset management firm, wrote to the PCAOB, "We do not support mandatory auditor rotation, principally because we are not aware of any empirical evidence that indicates that mandatory rotation would improve auditor independence and skepticism. While auditor rotation may theoretically reduce certain risks, it also is likely to create other risks, such as auditor loss of institutional knowledge and a reduced incentive for audit firms to invest in the audit relationship by relocating the most qualified personnel or investing in travel and training to learn the business." Similarly, on May 23, 2013, Robert Smith, Corporate Secretary, Vice President & General Counsel of NiSource, Inc., testified on behalf of the Society of Corporate Secretaries and Governance Professionals before the House Committee on Financial Services' Subcommittee on Capital Markets and Government Sponsored Enterprises, "Evidence in the [PCAOB] Release indicates that audit quality in the first years of an engagement tends to be lower, and therefore could lead to a greater risk of audit failure. With a mandatory rotation rule in place, companies will spend more time in a short-tenure audit situation, and overall audit quality will be negatively impacted."

Moreover, any benefits of mandatory audit firm rotation are questionable given that there are often only a limited number of firms available to conduct public company audits, particularly for the largest multi-national corporations. On December 14, 2011, the Walt Disney Company wrote to the PCAOB, "We believe that only four audit firms (the Big 4) currently have the scope of operations and experience that most large, global, multi-segment companies require for an effective audit; the periodic elimination of one of those firms will substantially reduce viable options. . . . Thus, mandatory auditor rotation may force the selection of a sub-optimal firm and, ironically, reduce audit quality." In a December 14, 2011 letter to the PCAOB, The Proctor & Gamble Company voiced similar concerns, stating, "As a large multinational company, we employ all of the 'Big 4' account firms—one as an independent auditor and the other three through various consultative capacities . . . . Requiring us to rotate auditors on a regular basis would have a detrimental impact on our ability to source our non-audit consulting needs. At a minimum, we would need to effectively decide on our auditors one or two rotations out in order to insure the new auditors are independent at the time of rotation. This would effectively lock us into our next auditor and eliminate any fee leverage we have in selecting our auditors. This could dramatically increase the audit costs and be harmful to shareholders."

Mandatory audit firm rotation may also result in significant added costs for public companies. On July 17, 2012, the Business Roundtable informed the PCAOB of a survey it conducted which found that companies "that had changed audit firms within the past ten years estimated that the cost of doing so, including additional management time and company resources, ranged from \$500,000 to over \$5 million." On May 23, 2013, Robert Smith testified before the Subcommittee on Capital Markets and Government

Sponsored Enterprises, “Mandatory auditor rotation will lead to both increased audit costs as well as increased costs for audit-related services. This is supported by the GAO’s 2003 Report, which found that nearly all of the larger audit firms surveyed estimated that initial audit year costs would be more than 20% higher than subsequent year’s costs; the responses from the Fortune 1000 public companies were similar.”

In addition, mandatory audit firm rotation would encroach on important corporate governance responsibilities traditionally exercised by public company audit committees. On December 14, 2011, the National Association of Corporate Directors (NACD) wrote to the PCAOB, “NACD has not seen evidence that supports the proposition that mandatory audit firm rotation improves the auditor’s independence, objectivity, skepticism, or otherwise improves audit quality, and consequently, the quality of financial reporting. Rather, we believe that mandated audit firm rotation could potentially undermine the statutory responsibility and authority of audit committees to select the best auditor for their companies.” On May 23, 2013, Thomas Quaadman, Vice President of the U.S. Chamber of Commerce Center for Capital Markets Competitiveness, testified before the Subcommittee on Capital Markets and Government Sponsored Enterprises, “Mandatory audit firm rotation would reduce the supervision and oversight of the audit committee and management, rolling back strong corporate governance policies. . . . With the continued consideration of the concept release on mandatory audit firm rotation. . . .the PCAOB is leaving the realm of audit regulation and crossing the threshold of regulating corporate governance, a subject area that has been left to state corporate law and the Securities Exchange Commission.

#### HEARINGS

The Committee on Financial Services’s Subcommittee on Capital Markets and Government Sponsored Enterprises held a hearing on H.R. 1564 on May 23, 2013.

#### COMMITTEE CONSIDERATION

The Committee on Financial Services met in open session on June 19, 2013, and ordered H.R. 1564, as amended, to be reported favorably to the House by a recorded vote of 52 yeas to 0 nays (recorded vote no. FC–18), a quorum being present.

#### COMMITTEE VOTES

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto. The sole recorded vote occurred on the chairman’s motion to report H.R. 1564, as amended, favorably to the House. The motion was agreed to by a vote of 52 yeas to 0 nays, as follows:

#### RECORD VOTE NO. FC–18

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Hensarling .....	X	.....	.....	Ms. Waters .....	X	.....	.....
Mr. Gary G. Miller (CA) .....	.....	.....	.....	Mrs. Maloney (NY) .....	X	.....	.....

## RECORD VOTE NO. FC-18—Continued

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Bachus .....	X	.....	.....	Ms. Velázquez .....	X	.....	.....
Mr. King (NY) .....	.....	.....	.....	Mr. Watt .....	X	.....	.....
Mr. Royce .....	X	.....	.....	Mr. Sherman .....	X	.....	.....
Mr. Lucas .....	.....	.....	.....	Mr. Meeks .....	X	.....	.....
Mrs. Capito .....	X	.....	.....	Mr. Capuano .....	.....	.....	.....
Mr. Garrett .....	X	.....	.....	Mr. Hinojosa .....	X	.....	.....
Mr. Neugebauer .....	X	.....	.....	Mr. Clay .....	X	.....	.....
Mr. McHenry .....	X	.....	.....	Mrs. McCarthy (NY) .....	.....	.....	.....
Mr. Campbell .....	X	.....	.....	Mr. Lynch .....	X	.....	.....
Mrs. Bachmann .....	X	.....	.....	Mr. David Scott (GA) .....	X	.....	.....
Mr. McCarthy (CA) .....	X	.....	.....	Mr. Al Green (TX) .....	X	.....	.....
Mr. Pearce .....	X	.....	.....	Mr. Cleaver .....	.....	.....	.....
Mr. Posey .....	X	.....	.....	Ms. Moore .....	X	.....	.....
Mr. Fitzpatrick .....	X	.....	.....	Mr. Ellison .....	X	.....	.....
Mr. Westmoreland .....	.....	.....	.....	Mr. Perlmutter .....	X	.....	.....
Mr. Luetkemeyer .....	X	.....	.....	Mr. Himes .....	X	.....	.....
Mr. Huizenga (MI) .....	X	.....	.....	Mr. Peters (MI) .....	X	.....	.....
Mr. Duffy .....	X	.....	.....	Mr. Carney .....	X	.....	.....
Mr. Hurt .....	X	.....	.....	Ms. Sewell (AL) .....	X	.....	.....
Mr. Grimm .....	X	.....	.....	Mr. Foster .....	.....	.....	.....
Mr. Stivers .....	X	.....	.....	Mr. Kildee .....	X	.....	.....
Mr. Fincher .....	X	.....	.....	Mr. Murphy (FL) .....	X	.....	.....
Mr. Stutzman .....	X	.....	.....	Mr. Delaney .....	X	.....	.....
Mr. Mulvaney .....	X	.....	.....	Ms. Sinema .....	X	.....	.....
Mr. Hultgren .....	X	.....	.....	Mrs. Beatty .....	X	.....	.....
Mr. Ross .....	X	.....	.....	Mr. Heck (WA) .....	X	.....	.....
Mr. Pittenger .....	X	.....	.....				
Mrs. Wagner .....	X	.....	.....				
Mr. Barr .....	X	.....	.....				
Mr. Cotton .....	.....	.....	.....				
Mr. Rothfus .....	X	.....	.....				

## COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the Committee has held hearings and made findings that are reflected in this report.

## PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee states that H.R. 1564 will, among other things, amend Sarbanes-Oxley to prohibit the PCAOB from requiring the rotation of auditors of public companies.

## NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX EXPENDITURES

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee adopts as its own the estimate of new budget authority, entitlement authority, or tax expenditures or revenues contained in the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

## COMMITTEE COST ESTIMATE

The Committee adopts as its own the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

## CONGRESSIONAL BUDGET OFFICE ESTIMATES

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the following is the cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974:

U.S. CONGRESS,  
CONGRESSIONAL BUDGET OFFICE,  
*Washington, DC, July 3, 2013.*

Hon. JEB HENSARLING,  
*Chairman, Committee on Financial Services,  
House of Representatives, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 1564, the Audit Integrity and Job Protection Act.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Susan Willie.

Sincerely,

ROBERT A. SUNSHINE  
(For Douglas W. Elmendorf, Director).

Enclosure.

*H.R. 1564—Audit Integrity and Job Protection Act*

H.R. 1564 would prohibit the Public Company Accounting Oversight Board (PCAOB) from requiring public companies to use a specific auditor or to use different auditors on a rotating basis. The bill also would require the Government Accountability Office (GAO) to update a report completed in 2003 that reviewed the potential effects of mandatory rotation for auditing firms.

Based on information from the PCAOB, CBO estimates that enacting H.R. 1564 would not affect direct spending or revenues; therefore, pay-as-you-go procedures do not apply. The PCAOB has no immediate plans to issue a ruling specifying how public companies should choose a financial auditor; therefore, the prohibition in H.R. 1564 would not change its workload. Based on information about similar reporting efforts, CBO estimates that implementing H.R. 1564 would have a discretionary cost of about \$1 million for the GAO to complete the required study and report.

H.R. 1564 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act and would not affect the budgets of state, local, or tribal governments.

The CBO staff contact for this estimate is Susan Willie. The estimate was approved by Theresa Gullo, Deputy Assistant Director for Budget Analysis.

## FEDERAL MANDATES STATEMENT

The Committee adopts as its own the estimate of Federal mandates prepared by the Director of the Congressional Budget Office pursuant to section 423 of the Unfunded Mandates reform Act.

## ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

#### APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of the section 102(b)(3) of the Congressional Accountability Act.

#### EARMARK IDENTIFICATION

H.R. 1564 does not contain any congressional earmarks, limited tax benefits, or limited tariff benefits as defined in clause 9 of rule XXI.

#### DUPLICATION OF FEDERAL PROGRAMS

Pursuant to section 3(j) of H. Res. 5, 113th Cong. (2013), the Committee states that no provision of H.R. 1564 establishes or reauthorizes a program of the Federal Government known to be duplicative of another Federal program, a program that was included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111–139, or a program related to a program identified in the most recent Catalog of Federal Domestic Assistance.

#### DISCLOSURE OF DIRECTED RULEMAKING

Pursuant to section 3(k) of H. Res. 5, 113th Cong. (2013), the Committee states that H.R. 1564 contains no directed rulemaking.

#### SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

##### *Section 1. Short title*

This Section cites H.R. 1564 as the “Audit Integrity and Job Protection Act.”

##### *Section 2. Limitation on authority relating to auditors*

This section amends Section 103 of Sarbanes-Oxley by removing any authority the PCAOB may have under that title to require that audits conducted for a particular issuer be conducted by specific auditors, or that such audits be conducted for an issuer by different auditors on a rotating basis.

##### *Section 3. Study of mandatory rotation of registered public accounting firms*

This section requires the GAO to update its November 2003 report entitled “Study on the Potential Effects of Mandatory Audit Firm Rotation,” and report to Congress within 1 year of the date of enactment of H.R. 1564 on the potential effects, including the costs and benefits, of requiring mandatory rotation of registered public accounting firms.

#### CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (new matter is printed in italic and existing law in which no change is proposed is shown in roman):

**SARBANES-OXLEY ACT OF 2002**

\* \* \* \* \*

**TITLE I—PUBLIC COMPANY  
ACCOUNTING OVERSIGHT BOARD**

\* \* \* \* \*

**SEC. 103. AUDITING, QUALITY CONTROL, AND INDEPENDENCE STANDARDS AND RULES.**

(a) \* \* \*

\* \* \* \* \*

*(e) LIMITATION ON AUTHORITY.—The Board shall have no authority under this title to require that audits conducted for a particular issuer in accordance with the standards set forth under this section be conducted by specific auditors, or that such audits be conducted for an issuer by different auditors on a rotating basis.*

\* \* \* \* \*