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before the
Advisory Committee on the Auditing Profession
U.S. Department of Treasury

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Chairman Levitt and Chairman Nicolaisen:

Thank you for the opportunity to testify before the Advisory Committee on the Auditing Profession ("Committee") on the subject of concentration and competition in the auditing profession. NYSE Euronext applauds your leadership and the Committee's efforts on the various issues confronting the auditing profession, all of which are enormously important to our capital markets. The role, regulation and oversight of independent auditors are, of course, of fundamental significance to each of the over 2600 leading companies that are listed on the NYSE, as well as to those companies that list on our non-U.S. affiliates around the world. These current auditor issues also play an important part in the decision by non-U.S. companies to list with us here in the U.S, or to choose to list outside our shores.

I. NYSE Standards Relating to Independent Auditors

The NYSE has been a trailblazer in standards relating to the use of audited financial statements, both in requiring its listed companies to provide investors with annual audited financial statements, and later in requiring its listed companies to have audit committees comprised only of independent directors. The U.S. government has since taken over this area of regulation. Since the 1930s all public companies have been required by the Securities Exchange Act and related SEC rules to file annual financial statements audited in accordance with generally accepted accounting principles (GAAP). More recently, pursuant to the Sarbanes Oxley Act, all listed companies have been required to have independent audit committees with specified responsibilities.

At the same time as the Sarbanes Oxley legislation was focusing on the audit process, the NYSE was adopting a set of enhanced corporate governance requirements for its listed companies. These requirements focused mainly on independent directors and board processes, but also contained a set of additional requirements focused on the audit committee: generally, its purpose, duties and responsibilities. In addition to these requirements, the standards also include several recommended best practices, mostly related to how the audit committee would be expected to pursue its responsibilities. Typically, the NYSE chose to utilize a recommendation, rather than a requirement, when to do more would risk micromanaging the audit committee or the board, or would risk robbing the board or audit committee of flexibility to respond appropriately to differing needs or circumstances.

An example of this is found in Section 303A.07(c)(iii)(A), which requires that the audit committee receive an annual report from the auditor on several specified issues relating to its qualifications and independence. The Section goes on to recommend how the audit committee should use that report:*

> After reviewing the foregoing report and the independent auditor's work throughout the year, the audit committee will be in a position to evaluate the auditor's qualifications, performance and independence. This evaluation should include the review and evaluation of the lead partner of the independent auditor. In making its evaluation, the audit committee should take into account the opinions of management and the listed company's internal auditors (or other personnel responsible for the internal audit function). In addition to assuring the regular rotation of the lead audit partner as required by law, the audit committee should further consider whether, in order to assure continuing auditor independence, there should be regular rotation of the audit firm itself. The audit committee should present its conclusions with respect to the independent auditor to the full board.

II. Concentration within the Auditing Profession and SRO Rules/Guidance

In connection with its work examining ways to increase audit market competition, the Committee's Working Discussion Outline includes consideration of whether there is now de facto a "too big to fail" public policy, and whether for this reason or others a change in policy is warranted.

It seems clear that there has been a perception in the market for many years that there is a certain group of auditing firms from amongst which it is appropriate for a substantial public company to choose its auditor. (These firms, known as the "Big 4", are Deloitte & Touche LLP, Ernst & Young LLP, KPMG LLP and PricewaterhouseCoopers LLP.) This is not a dictate of regulation - for example, the NYSE has never required that a listed company have a "Big 4" auditor. It is purely a matter of perception, presumably similar to the perception that at a certain level it is expected that a company going public or raising additional capital will be underwritten by a "bulge bracket" investment bank or represented by a certain kind of law firm. The difference in the auditing sector is mostly that the number of "Big" firms has been steadily reduced, particularly since the late 1980's, to the current Big 4.

We do think that this expectation that a company must use a "Big" auditing firm is beginning to erode – as one would expect given the very constrained number of "Big" firms. At the NYSE, we have noted an increase in the number of next-tier national and regional firms performing company audits, such as BDO Seidman LLP, Grant Thornton LLP, McGladrey & Pullen LLP, Crowe Chizek & Company LLC, Moore Stephens LLP, Hein & Associates LLP and Squar, Milner. All of these firms are, of course, required to register with the Public Company Accounting Oversight Board (PCAOB) and are subject to the PCAOB inspection process. While it is true that approximately 94% of NYSE operating companies are audited by one of the Big 4, that is down from approximately 98% only a few years ago.

* In Section 303A, the use of the word "must" indicates a requirement, while the use of the word "should" indicates a recommendation.

There have been a number of developments in our view over the last few years that have led to this audit firm turnover. These developments include: the dissolution of Arthur Andersen; the passage of Sarbanes Oxley; the creation of the PCAOB; SEC investigations; mandatory partner retirement provisions at the Big 4; changes in the affiliation practices of international member firms and the increase in accounting restatements that we currently seem to be experiencing.

Companies may initiate a change in audit firms on a voluntary basis for many compelling reasons such as performance concerns, cost overruns, restatement delays and resource issues. The audit firms themselves may also end their associations with a public company for a host of reasons including risk assessment, profitability concerns and time constraints. In these instances, it is the audit committee that is the focal point of the evaluation and decision-making process. We believe that the best practices recommendations in our guidelines play an important role in the audit committee's decision-making process.

Along with our own NYSE listed company experiences, there have been two recent studies that we would like to point out to the Committee that address audit firm turnover. The publication “Compliance Week” tracks audit firm turnover and recently reported that 1942 public companies changed auditors in 2007. The reasons noted included dismissal, termination, resignation and even the death of the lead partner on the account.

In its January 2008 issue, the “CPA Journal” also published an article entitled "Auditor Resignations & Dismissals - Their Effect on the Profession". The article examines the trends between 2000 and 2005 involving auditor terminations and resignations, the relocation of SEC-registered issuers after auditor resignations and dismissals and the continued rebalancing of former Arthur Andersen public company clients. One of the interesting trends during this period includes the change in the auditors among Big 4 clients and national clients. The article notes that for Big 4 clients changing firms in 2000, 55% of those changing went with other Big 4 firms, while in 2005 that percentage declined to 28%. The trend for national clients also supports that view with 30% switching to Big 4 in 2000 and then only 17% in 2005. In all cases, the statistics continue to point to the continued emergence of the national and regional firms performing public company audits.

Some have wondered whether stock exchange listing standards might be used to address this concentration in the market for independent accounting firms. It is, of course, difficult to dictate choice to a group of consumers (for example to have required greater numbers of telephone customers to use a supplier other than the predominant telephone company that existed back in the 1970s). But some have suggested that the stock exchanges might require that listed companies review their auditor annually to determine whether it is appropriate given the size and scope of the company’s needs.[*]

[*] We note that this does not appear to us to be an area in which a mandatory standard could play any role at all. As a practical matter, of course, such an approach would require specific coordination by the SEC to insure that all the various exchange standards would be substantially equivalent, to avoid the possibility that companies would choose a listing venue based on the absence or nature of its requirements regarding the choice or rotation of an audit firm. Beyond that, the diversity of listed companies both in terms of size, sophistication and business focus suggests that the board and audit committee require more flexibility than a mandatory standard is likely to allow.

As noted above, our guidance is designed to cause the independent audit committee to do just that. And the statistics mentioned above suggest that companies are in fact looking at these issues and taking action when appropriate.

It is important to note that a choice to change auditors is one that does involve cost and other resources. For one thing, the independence requirements imposed by SEC rules dictate that a firm must eliminate impermissible relationships – including ownership of company stock by any of the auditing firm's personnel. It must be worthwhile for an auditing firm to do that – the potential business has to be significant enough to move the firm to take the steps necessary to take on the assignment. In addition, the audit client may well have to rearrange other advisory arrangements it may have with other auditing firms, so that those firms can be eligible to serve as the independent auditor of the company's financials.

Notwithstanding these hurdles to changing auditors, our experience has shown that auditor rotation is occurring. Public companies do have a choice among audit firms from which to select. The reputation of the Big 4 remains very strong, but many national and regional firms continue to gain market share among public companies.

We support the Committee's goals to foster this trend and promote choice and competition among audit firms for public company work. It is our experience that the best practices highlighted earlier involving audit committee evaluation are helping to encourage behavior by audit committees that is increasing the role of audit firms outside the Big 4 firms. We will continue to monitor this behavior to ensure our guidance continues to achieve the best results for public companies and their investors.

Thank you for giving us the opportunity to testify today. I look forward to answering any questions you may have.