CME Group

August 11, 2016

TO: Office of the Secretary
PCAOB
1666 K Street, NW
Washington, DC 20006-2803

RE: PCAOB Rulemaking Docket Matter No. 034

PCAOB Release No. 2016-03 "The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion"

We appreciate the opportunity to comment on PCAOB Release No. 2016-003 "The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion" (the Proposal), issued by the Public Company Accounting Oversight Board (the PCAOB). We support the PCAOB's objective of addressing the asymmetry between information communicated by auditors to the audit committee as compared to the information communicated by auditors to investors.

Overall, we believe the Proposal would reduce the information asymmetry between investors and management. However, we recommend that the PCAOB consider certain modifications to the Proposal in order to mitigate the impact of unintended consequences and uncertainty in application associated with the scope of those items identified as critical audit matters, as discussed in the Appendix to this letter.

While we support the Proposal, we believe the PCAOB should continue to refine the definition of what it means to be deemed a critical audit matter. As the Proposal is currently written, auditors are being placed in the position to resolve the information gap between investors and management through more expansive disclosures within the audit report. We believe that these disclosures would have the following consequences:

- Draw undue attention to matters that are not material and potentially be a disservice to outside users of financial statements;
- Possibly lead to increased meritless litigation exposure;
- Place the auditor in the position of being the source of the disclosure; and
- Applied in an inconsistent manner.

Our position, however, is that management's financial statements and accompanying disclosures are the primary tool by which to effectively resolve information asymmetry, thereby keeping the onus on management for determining the sufficiency of disclosures to investors.

We would be happy to share our thoughts on possible next steps with the PCAOB staff. The Appendix to this letter contains our thoughts relative to certain aspects of the Proposal.

We would be pleased to discuss our comments with the PCAOB or its staff at your convenience.

Very truly yours,

John Pietrowicz
Chief Financial Officer

Jack Tobin
Chief Accounting Officer

Appendix

The re-proposed standard would include the following significant changes to the existing auditor's report:

- *Critical audit matters (CAM)*—would require communication in the auditor's report of any critical audit matters arising from the audit of the current period's financial statements.

- *Definition of a critical audit matter*—any matter that was communicated or required to be communicated to the audit committee and that:

    - Relates to accounts or disclosures that are material to the financial statements, and

    - Involved especially challenging, subjective, or complex auditor judgment.

We believe that the scope of the revised CAM definition is still expansive and would more effectively accomplish the disclosure objective if it were more narrowly defined. Currently, CAMs must relate to an account or disclosure that is "material" to the financial statements. However, the proposed definition does not require the communication itself to involve a material issue. This can result in the disclosure of immaterial items in the audit report, thereby cluttering the audit report with items that do not have a significant impact to the readers of the financial statements. Disclosing immaterial items in the audit report could confuse and mislead readers to make investor decisions based on such information. Consider the following example:

- A material account on the balance sheet of a bank is Loan Receivables. In connection with the year-end audit, the audit team discovers that there was a change in the method used by management to value the Loan Receivables. The audit team determined that this change in approach was not unreasonable and did not result in a significant change to the valuation. This matter was communicated to the audit committee and is required under the Proposal to be included in the audit report.

We believe that, in this example, disclosure of the change in valuation approach draws undue attention to a matter that is not material to the overall financial statements. Further, additional disclosure within the audit report would cause the audit report to expand beyond just one concise page to multiple pages. This could be counterproductive to readers as they sift through potentially voluminous disclosures. This level of detail within the audit report shifts the auditor responsibility from providing a pass/fail rating on management's financial statements to effectively providing a grade on the financial statements on a relative basis. This grading system, as it is more complex than pass/fail, is less useful and could be a disservice to outside users of financial statements.

Also, inclusion of CAMs in public disclosures will possibly lead to increase meritless litigation exposure. Plaintiffs could use CAMs to allege error or wrongdoing. The identification of specific matters raised to the audit committee may be misconstrued by plaintiffs as acts of negligence or carelessness on the part of the company. Also, as litigation costs are one of the drivers of audit fees, audit fees are expected to increase due to the litigation exposure of audit firms as a result of the expanded disclosure requirements under the Proposal. We expect that, based on CAMs in the audit report, plaintiffs will seek to hold an audit firm liable for certain issues of the company, thereby increasing litigation costs.

We also believe that the Proposal has the potential to place the auditor in the position of being the source of the disclosure, rather than management, which has not previously been the intent of the audit report. The purpose of the audit report is to opine on the completeness and accuracy of the financial information as prepared by management. The financial statements and accompanying disclosures are management's responsibility. The onus is on management to prepare financial statements and disclosures that are not misleading to investors. The role of the auditor, on the other hand, is to opine on management's assertions. However, under the Proposal, the role of the auditor expands to become an actual source of disclosure. The auditor is not merely attesting to the sufficiency of management's financial information, but is also a mechanism for disclosure. The consequence of having the auditor bear responsibility to disclose CAMs is that such disclosure by the auditor would compel management to also disclose the item, which would not have been otherwise disclosed if it were not for the CAM requirement in the audit report. This reactionary circumstance undermines the spirit of our financial reporting model by compelling management to disclose items of an immaterial nature in the financial statements, which could be misleading to readers.

If a CAM is identified by the auditor and not disclosed by management, then readers of the financial statements might conclude that the CAM is a "finding" by the audit team. As a result, the Proposal will drive expanded disclosure both in the audit report and in management's financial statements thereby, diminishing the governance role of the audit committee as well as management's responsibility for the company's disclosure of financial information.

Our final point regarding the unintended consequences of the Proposal centers on the uncertainty in application of the requirements. Audit teams might limit their communications with the audit committee since CAMs include matters that have been voluntarily reported to the audit committee. At the risk of disclosing immaterial items in the audit report, auditors may become hesitant to raise matters to the audit committee, as it would then trigger potential CAM reporting. Alternatively, given the subjectivity in the proposed requirements, auditors may choose to over-disclose the existence of CAMs to avoid the consequences of being second-guessed regarding whether a CAM should have been disclosed.

In closing, while we agree that information asymmetry must be addressed, we believe that the current requirements under the Proposal would more effectively accomplish this objective if the scope of CAM were narrowed.