August 15, 2016

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Subject: PCAOB Rulemaking Docket Matter No. 34

Submitted via comments@pcaobus.org

Dear Board Members:

Financial Executives International (FEI) is a leading international organization of more than 10,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior-level financial executives. The Committee on Corporate Reporting (CCR) is a technical committee of FEI, which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. CCR member companies represent approximately $5 trillion in market capitalization and actively monitor standard setting activities of the Public Committee Accounting Oversight Board (PCAOB). This document represents the views of CCR and not necessarily the views of FEI or its members individually.

CCR Response

We appreciate the opportunity to respond to PCAOB's reproposal of the auditor reporting standard, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*. Although the revised standard is responsive to certain of the concerns we raised in our December 2013 letter, we have significant concerns over the potential impact of the proposed standard as outlined further below.

As we have discussed with members of the PCAOB in other venues, regulation and inspection of audit firms can have direct and indirect implications for the issuers they audit. This has proven to be the case with the results of inspections of the firms in the area of Internal Control over Financial Reporting (ICFR). In this revised proposed standard we see the potential for reporting of information by the auditor for which management is the original source (original information) including potential disclosure of significant deficiencies, even though existing guidance would not require them to be disclosed. As this could affect public company reporting of matters related to ICFR and other areas, we believe changes in disclosure requirements are within the purview of the Securities and Exchange Commission (SEC) to promulgate.

As outlined further below, the concerns we have over the impact of this proposal are significant, as the standard, if approved, will have a lasting impact on the scope of the auditor's responsibility and the role of the PCAOB and SEC in addressing financial disclosure by registrants. In addition, this new standard could significantly increase the cost of the audit and/or delay or place additional pressure on the timing of key audit procedures. It is also unclear to us what identifiable benefits the additional information provides to investors. There is also potential, if these issues are not properly addressed through additional changes (e.g., introduction of safe harbors), that this proposal could create new avenues for baseless litigation to the detriment of the audit profession and/or issuers.

Original Information

While the revised proposed standard moves a step closer to acknowledging what we consider to be the appropriate roles of management and the auditors, we continue to have concerns around the scope and the definition of a critical audit matters (CAM). We believe that if a final standard is issued, it should make clear that:

> (a) Auditors should not be the original source of information about the registrant, and
>
> (b) Auditors have no obligation to disclose significant deficiencies in their audit report, consistent with the framework for ICFR, as such matters are required to be reported to the audit committee, but not publicly disclosed[1].

Note 2, paragraph 14, of the revised proposed standard states:

> "*When describing critical audit matters in the auditor's report the auditor is not expected to provide information about the company that has not been made publicly available by the company* ***unless such information*** [emphasis added] *is necessary to describe the principal considerations that led the auditor to determine that a matter is a critical audit matter or how the matter was addressed in the audit*."

We believe that the above language has potential to lead the auditor to disclose original information pertaining to the issuer that it has not disclosed and is not required to disclose. We disagree with this outcome and believe that auditors and management should directly resolve any such differences in views as to the adequacy and completeness of a registrant's disclosures. In today's reporting environment, there are substantial interactions between auditors and registrants related to disclosures contained in drafts of quarterly and annual SEC filings and differences are resolved in the normal course of this work. In unusual situations, where there is an unresolved difference on an important matter, the auditors may need to report such a difference to the audit committee for resolution. However, the revised proposed standard should make clear that it is not appropriate for the auditor to be the original source of information unless a matter continues to be unresolved with management and the audit committee. Communication to the audit committee of unresolved differences will be sufficient to drive appropriate resolution and adequately protect investors.

[1] Management is also not required to disclose such information.

A significant consequence of the proposal is that registrants may be compelled to add additional disclosures as a result of this proposal, which is inconsistent with the general disclosure framework for registrants who are governed by SEC guidance when determining what to disclose, rather than PCAOB standards.

Definition of a CAM

If the Board votes to move forward with the revised proposed standard, we recommend the Board consider revisions to the definition of a CAM. As drafted, the definition includes matters that were "*communicated or required to be communicated to the audit committee that: (1) relates to* ***accounts or disclosures*** [emphasis added] *that are material to the financial statements, and (2) involved especially challenging, subjective or complex auditor judgment.*" In order to address the issues discussed above, we believe that the Board should revise the above proposed guidance as follows:

> "*communicated or required to be communicated to the audit committee that: (1)* ***relates to any issue that is material*** [emphasis added] *~~to accounts or disclosures that are material~~ to the financial statements, and (2) involved especially challenging, subjective or complex auditor judgment.*"

In addition to concerns this proposed guidance raises discussed above (i.e., original information and disclosure of significant deficiencies), such language could cause other matters that are immaterial to the financial statements to be brought within scope even though such matters were adequately addressed and resolved by the auditor during its audit. We observe that the terminology used to define a CAM (i.e., "especially challenging, subjective or complex auditor judgment") is extremely broad and subjective, which has the potential to generate inconsistency in application, as it will inevitably depend upon individual judgments and/or biases regarding what matters qualify. For example, the same set of facts and circumstances are likely to be interpreted differently because even qualified and knowledgeable individuals applying reasonable professional judgment may reach different conclusions on the meaning and application of such a broad and subjective set of criteria. While we understand that the Board wishes this to be principles-based, we believe that there needs to be some objective components to the definition that are based on observable facts.

For context, we observe that an audit of a global entity is complex, involving a large number of individual audit and accounting issues. As currently drafted, and depending on the professional judgments applied, many issues that are considered in the normal course for a complex organization may nevertheless fall within the definition of a CAM (e.g., determining fair value measures based on hypothetical market participants, determining fair value of contingent consideration; and judgments and estimates for variable considerations). As such issues are regularly considered as part of the accounting issue resolution process of a global organization, we believe that the potential list of items meeting the overly broad definition of a CAM could indeed be voluminous.

In addition, we recommend that the Board consider, as an alternative, limiting the identification of a CAM to those matters already disclosed by management as critical accounting estimates, which we believe provides a more appropriate anchor for matters that the auditor should consider for inclusion in its audit report. Critical accounting estimates must be discussed with the audit committee, so this would also have a logical tie-in to the recommendation above.

Implementation Learning Period and Value Assessment

We have concerns that, as a natural consequence of the PCAOB's regulatory process, auditors will have a natural tendency to identify more CAMs than is necessary to meet the goals of the proposed standard. For example, auditors may choose to include disclosure of matters that are otherwise immaterial to users of the financial statements in order to avoid PCAOB audit findings from inspection teams. This concern is supported by recent findings from internal surveys conducted within our membership around how audits of ICFR are being conducted by auditors and the effects of PCAOB inspection findings on audits of our member companies. These concerns have also been raised and discussed recently in numerous meetings, conferences, and other discussions with preparers, investors, and regulators and are not unique to CCR member companies.

Application of the new standard will require significant auditor judgment, and therefore it is imperative the PCAOB have a robust plan that allows appropriate time to monitor and understand how auditors are interpreting and applying the new standard, recognizing that there may be differences in professional judgment or interpretation of the standard as written. As evidenced in other situations, auditor behavior is likely to be shaped by inspection findings over the long run which will have a lasting impact on the market overall.

Absent the benefits of adequate field testing on the revised proposed standard, we recommend that the PCAOB consider the first year of implementation as an opportunity for auditors to implement the new standard, and for the PCAOB to monitor implementation with the goal of learning how the standard is being interpreted and applied across audit firms, and to identify issues arising during implementation. This could include a type of "safe harbor" of at least one year, along with a robust post-implementation evaluation process to discuss findings and possible revisions that may need to be made to ensure the standard is achieving its objectives. This post-implementation review should include key stakeholder feedback including, for example, investor feedback to understand how the additional information is being utilized, as well as preparer and auditor feedback to understand the additional costs and time associated with implementation of the new standard. A robust post-implementation review and evaluation, and key stakeholder discussion, would not only allow auditors to develop and possibly make improvements in their process prior to formal PCAOB inspection findings, but would also allow appropriate time for the PCAOB to react to what it learns and to make revisions, where necessary, to improve the application of the new standard.

Filing Deadline Implications

In addition, we have operational concerns that audit procedures to address the new standard are likely to come at a critical time during the audit process, and may distract auditors and management from completing other critical parts of the financial statement preparation and audit process. This may involve partner and manager time, as well as national office resources, including input from the registrant's senior management team including inside and outside legal counsel, and audit committee members. In some cases, this could result in a delay in filing for certain companies and should be appropriately considered during implementation.

Cost / Benefit

We observe that as a general rule, certain investors are always willing to say yes to additional disclosure; however, as evidenced during the original and subsequent drafts of this proposal, investors have not explained how they would use this information to make better investment decisions and thereby improve the overall functioning of our capital markets. We observe that this type of information has potential to skew or mislead investors and, as noted in the revised proposed standard, inclusion of this type of information could result in a decrease in audit quality.[2] It is clear that investors understand and utilize the existing pass/fail model but unclear how the revised proposed standard enhances their understanding.

In addition to identification of a CAM in the audit report, the revised proposed standard will require auditors to "*describe the principal considerations that led the auditor to determine that the matter is a critical audit matter, describe how it was addressed in the audit, and refer to the relevant financial statement accounts and disclosures.*" Given that we are not clear on how reporting of CAMs will realistically assist investors in understanding or analyzing a company's financial position and results, we do not see how a description of related audit procedures will benefit or provide additional value to investors and users of the financial statements. In addition, there is a risk that providing such information could, in some instances, cause an auditor to disclose original information about a registrant. We are also concerned that providing this level of detail could also result in boilerplate language over the long run, or auditors reporting a lengthy list of all procedures performed in order to avoid inspection findings.

As previously mentioned, we believe there will be a significant increase to cost overall as a result of this new standard and it doesn't appear that a compelling case has been made on how the benefits of this change exceed its costs.[3] If the PCAOB proceeds to a final standard based on this proposal, we recommend, as noted above, that a robust post-implementation review be conducted to identify the benefits and understand whether, and to what extent, investors and users of the financial statements are utilizing this additional information, along with an evaluation of the related costs.

As previously communicated to members of the Board, in areas where the work of the PCAOB directly or indirectly affects the reporting of issuers, we believe that all stakeholders (including preparers, investors, and auditors) would benefit from a more open dialogue on these issues or the creation of a mechanism for key stakeholders to come together and discuss proposals and practice issues with the goal of improving application of the standards.

[2] Refer to section VI. Economic Considerations, section D. Costs and Potential Unintended Consequences, FN 178.
[3] Refer to section VI. Economic Considerations, sections C. Benefits and D. Costs and Potential Unintended Consequences.

Documentation

We do not believe that the documentation requirements by the auditor (which are significant and will add substantial cost to an audit) are likely to improve the quality of the audit, as we perceive the benefit to be limited to those involved in the PCAOB inspection. Specifically, this would require a process that enhances the ability of inspectors to determine that every item was considered and definitively adjudicated as a CAM or not. Having to document the “negative” of why something is not challenging, subjective or requires complex auditor judgment is cumbersome and is unlikely to be meaningful to investors. We believe that documenting only the reasons why something is a CAM is a more appropriate and efficient process. Given all that needs to be completed for the audit before meeting with the audit committee, we believe that having an auditor focus on creating contemporaneous documentation related to items that were deemed to be unimportant inevitably takes away time and resources during a critical phase of the audit. We fail to see how this resource intensive process will add to the quality of audits. On the other hand, we can certainly understand concerns that such diversions of resources raises the risk that audit quality will suffer as a result.

Litigation

The litigious nature of the US environment is well documented and requires little in the way of further explanation or support. It is not uncommon for lawsuits, brought by plaintiffs related to matters such as these, to be settled in order to avoid further litigation expenses even in the absence of any wrongdoing. It is important to remember that qualified knowledgeable professionals can disagree, particularly when it relates to assumptions or estimates which are not black and white, or when an issue relates to areas that are so complex that they require multiple discussions between the auditor, preparer and, sometimes, the auditor’s national office in order to fully understand and evaluate the accounting requirements which may be applicable. We believe that the Board and the SEC need to be cognizant of this reality and take care to ensure that requirements of their standards do not inappropriately subject audit firms and issuers to litigation. As discussed above, introducing safe harbor rules during the implementation phase of this proposed standard may be a reasonable way to avoid such outcomes.

Auditor Tenure

We don’t believe that there is any meaningful link between auditor tenure and audit quality (whether that is to say that longer tenure results in better or worse audit quality) and therefore, recommend that this disclosure should not be required in the auditor’s opinion. Including this information in Form AP would be preferable to inclusion in the audit report.

Independence

We support inclusion of a statement that the auditor is required to be independent and the added language clarifying “whether due to error or fraud” when describing the auditor’s responsibilities.

Opinion Paragraph

We support the PCAOB decision to move the opinion paragraph earlier in the auditor's report.

Concluding Remarks

As financial officers of public companies, we recognize the responsibility we have to the financial markets to produce accurate and reliable financial information, along with the importance of an independent audit as a signal to investors about their ability to rely on the information we provide.

While we are supportive of the efforts of the PCAOB to regulate the audit profession and to provide meaningful audit standards, we have significant concerns about the revised proposed standard and would object to a final standard that does not address the issues raised in this letter. If the Board votes to move forward after addressing these concerns, we recommend the PCAOB design a robust review process during implementation to adequately collect the information necessary to learn how the standard is being interpreted and applied in practice. We believe this process should be completed prior to any formal audit findings from PCAOB inspections.

We appreciate the Board's consideration of these matters and would be glad to answer any questions you may have.

Sincerely,

Richard Levy

Richard Levy
Chairman, Committee on Corporate Reporting
Financial Executives International