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Office of the Secretary
PCAOB
1666 K Street, NW
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Board Members:

Pfizer Inc. is a research-based, global biopharmaceutical company headquartered in New York. We discover, develop, manufacture and market leading medicines and vaccines, as well as many of the world's best-known consumer healthcare products. In 2015, we reported revenues of $48.9 billion and total assets of $167.5 billion.

We appreciate the opportunity to present our comments on the Board's proposed auditing standard "The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion." and we recognize the Board's efforts in service to financial statement users. We thank the Board for its consideration of comments received on the related concept release and note that the proposed standard has addressed some of the concerns raised previously by us by attempting to narrow the source of critical audit matters (CAMs). We also support the inclusion of a statement that the auditor is required to be independent, the added language clarifying "whether due to error or fraud" when describing the auditor's responsibilities and the PCAOB decision to move the opinion paragraph earlier in the auditor's report. While we agree with those aspects of the reproposal, we continue to have concerns around others as are outlined below.

<u>Critical Audit Matters</u>

We believe that while using communications to audit committees as a source for CAMs appears to be a reasonable approach as those are generally the most important matters it is likely to have numerous unintended consequences including providing a potential disincentive to openness of interactions with the audit committee. As this is contrary to overall best practice and good corporate governance, we cannot support this proposed provision of the standard. Furthermore, there is a real and substantive cost to this proposal for which investors have not yet been able to articulate how they would use the information to make better investing decisions resulting in benefits which are intangible and amorphous. We are concerned that:

1. The language "involved especially challenging, subjective or complex auditor judgment" may, in fact, yield unintended consequences as described below.
    a. The language is dependent upon the audit partner's experience and biases and may result in inconsistent application and presentation of CAMs and communications to investors. For example, within the pharmaceutical industry, the rebate accrual process is complex as accruals are required at the time of sale for a rebate that is provided to an insurer who is neither the customer nor the patient. An audit firm or partner who is experienced in this, will likely not find this particularly challenging because he understands the process and the nuances involved. However, an audit firm or partner who is not experienced in this area may find this to be especially challenging and subjective. The experienced firm or partner will likely not have a CAM while the inexperienced firm or partner is likely to believe it is CAM. Another example which is more general is business combinations where the assets to be valued are intangibles that rely upon forecasted information and assumptions or where goodwill is being tested for impairment which requires forecasted information about the P&L as well as a segmented balance sheet which many companies produce manually. A firm or partner who has dealt with this subjective process may not see it as a CAM because he is comfortable with the process for validating assumptions utilized while another may find such valuations especially challenging and requiring complex auditor judgment. Investors may therefore be misled into thinking that the auditee's have significantly different issues when, in fact, they do not.
    b. The phrase "especially" challenging, subjective or complex auditor judgment" is still too broad and subjective that it will lead to inconsistent application by audit firms, PCAOB inspectors and audit partners. This is because the terms themselves are so highly subjective and dependent on the perspectives, experiences and biases of the individual applying them as to make application inoperable and subject to hindsight and second guessing by PCAOB inspectors, reviewing partners and plaintiff's attorneys. While the factors are helpful, the identification of CAMs, is fundamentally a subjective process which is prone to inconsistent application from the Board's intent. The same set of facts may be interpreted differently because even reasonable people may disagree on the application of a very subjective set of criteria. While we understand that the Board wishes this to be principles-based, we believe that there need to be some objective components to the definition that are based on specific facts, can be measured and are readily observable. We believe that the default when auditors are faced with this issue will be to include everything that is communicated to audit committees and thereby bury the important in the unimportant. An audit of a global entity is complex because a business is dynamic and ever-changing to meet current and future customer needs. Furthermore, based on the CAM definition, we can easily see that there would be many issues that would likely produce a CAM but are simply a part of the current complex accounting rules that preparers must apply, including contingent consideration must be fair valued even though the two parties in the transaction couldn't place a value on it today (hence the reason it is contingent), hypothetical market participants which are used to consider fair values in business combinations, making judgments and estimates for variable consideration in revenue is a regular part of the revenue recording process,

and litigation accruals which are inherently unpredictable and wherein the assessment process relies heavily upon estimates and assumptions that while reasonable, may prove to be incomplete or inaccurate and unanticipated events and circumstances may occur that might cause us to change those estimates and assumptions.

2. We do not believe that the proposed documentation requirements by the auditor, which are significant and will add substantial cost to an audit will improve the quality of the audit or CAMs as it seems to be mainly for the benefit of the PCAOB inspection process and the ability to determine that every item was considered, debated and reasons specifically documented as to why it is a CAM or not. Having to document the "negative" of why something is not challenging, subjective or requires complex auditor judgment is overly burdensome as it sets a presumption that everything is a CAM unless proven otherwise. 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 documenting unimportant items takes away from rather than adds to the audit quality.
3. Unfortunately, we live in a litigious society where lawsuits are brought by plaintiffs and often settled to avoid litigation costs even when there is no wrongdoing. Again, it is important to remember that reasonable people can disagree, particularly when it relates to assumptions or estimates which are not black and white areas, or when it relates to areas that are so complex as to need multiple discussions between the auditor, preparer and, sometimes, the auditor's professional practice group to understand and evaluate the accounting rules which may be applicable. We note that, at times, the Big 4 accounting firms offer differing interpretations or guidance of rules and that these interpretations and guidance have all been made in good faith. We believe the Board and the SEC needs to protect both audit firms and auditees from litigation brought solely in reliance on an audit report description of a CAM by introducing safe harbor rules. Otherwise, we believe that CAMs will be utilized as a source for potential litigation by enterprising plaintiff's bar as auditor workpapers are subject to discovery. We believe the situation will become analogous to securities lawsuits wherein plaintiff's bar begin actions based on negative news. We think that the Board and the SEC need to answer the question as to whether a CAM disclosure could <u>ever</u> result in a change in market price of the auditee's stock. If yes, then the advent of litigation is a virtual certainty.
4. Significant deficiencies are required to be reported to the audit committee; however, public disclosure is not required. The proposed statement still does not address this inconsistency and permits the auditor to disclose this as a CAM. A significant deficiency or deficiency lacks the potential to cause a material error, by definition. We cannot see how it will be helpful to investors to be presented with information about matters that have no potential to be material. As such, we recommend that the Board prohibit an auditor disclosure of significant deficiencies or other deficiencies.
5. Should the Board move forward with CAMs despite our objections, the Board should consider an implementation plan that will address the fact that no field test will be performed for this standard. Based on their experience with other PCAOB standards, auditees are very aware that PCAOB inspections will drive audit practices around the identification of CAMs. We are also aware that the PCAOB's influence on partner's compensation when there are audit failures has caused partners to be extremely cautious and conservative. In fact, we can envision that unless

a plan is enacted to understand <u>both</u> under and over disclosure of CAMs, the Board will not have achieved its purpose which is to provide important information to investors. Instead, taking a hard line immediately will drive auditors to be overly conservative and err on the side of caution by listing all items communicated to the audit committee as CAMs which undermines the purpose of the proposal. It is therefore important that the inspection process on this issue take into account that the evaluation of a CAM is highly subjective and influenced by the perspectives and set of experiences that the evaluator (including an inspector) has relative to an audit. Rather than issuing comments immediately, we suggest that the Board institute a "grace period" of at least two audit cycles during which practice can evolve and issues around the new standard can be better understood by all.

6. We note that the proposed standard allows for communications made to the audit committee that are not required to be a source of CAMs. We suggest that this language be eliminated so as to allow free communication between the auditor and the audit committee. Potential unintended consequences could include auditor's only communicating on required items to eliminate the risk that such an item could be considered a CAM. Because the current required items are quite extensive, we cannot see an event wherein the auditor would not be required to communicate an item which would qualify as a CAM unless process evolves in an inappropriately conservative manner.

<u>**Other**</u>

Auditor Tenure: We continue to view disclosure of auditor tenure as not meaningful as a link to audit quality has not been established. However, should the Board move forward with this proposal, we recommend that this disclosure be included in Form AP rather than required in the auditor's opinion.

Boilerplate language: With respect to the reporting of CAMs within the report, it is not clear to us that standardized language within firms and certainly within the Big 4 can be avoided, given the cost in both time and effort, and the risk of confusion and liability that attends the notion of "custom-tailored" report language. . PCAOB oversight will likely drive the firms to apply the broadest and most inclusive definition to these terms. Moreover, the firms themselves will quickly align with one another on that basis, leading to extensive and potentially confusing over-disclosure. We therefore believe that investors will likely find the first round of auditor's reports interesting, but not very useful in the following years as similar issues are noted by the auditor for each year and the audit report is treated like the financials whereby users will apply software to see what has changed from year to year.

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In summary, as described above, while we support the efforts of the PCAOB to improve audit quality and provide the necessary standards, we continue to have concerns about aspects of the proposal and ask the Board to consider the recommendations provides in this letter

Once again, we appreciate this opportunity to comment on this concept release and encourage the Board to continue to engage its constituents. We would be pleased to discuss our perspective on these issues with you at any time.

Very truly yours,

Loretta V. Cangialosi

Loretta V. Cangialosi
Senior Vice President and Controller

cc: Frank D'Amelio
Executive Vice President and Chief Financial Officer