

August 15, 2016

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

**RE: PCAOB No. 2016-003, Rulemaking Docket No. 34 – Proposed Auditing Standard –  
The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an  
Unqualified Opinion and Related Amendments to PCAOB Auditing Standards**

Dear Messrs. Doty, Ferguson, Hanson, and Harris, and Ms. Franzel:

As members of the Auditor’s Report Working Group (Working Group) for the 2016 annual meeting of the PCAOB’s Investor Advisory Group (IAG), we are writing to provide comments on the PCAOB’s May 11, 2016 Proposed Auditing Standard entitled *The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Auditing Standards*. The undersigned members of the PCAOB’s IAG Working Group have collaborated in drafting this comment letter to the Board.<sup>1</sup>

We believe that the Board’s Proposed Auditing Standard (Proposal) represents a meaningful improvement from the current standard audit report. The requirement to discuss critical audit matters (CAMs), if devoid of boilerplate language, will be useful to the investment community. We encourage the Board to emphasize in any final standard, in subsequent outreach efforts and, especially through its inspection program, the need for CAMs to be highly bespoke. In our view, there will be a direct correlation between the extent of CAM company-specificity and the related value of the audit report to the investing public.

Notwithstanding our clear support for the Proposal, we ask the Board to do more. As currently drafted, the Proposal requires that the audit report: (1) identify the CAM, (2) describe why the auditor viewed the issue as a CAM, (3) indicate how the auditor addressed the CAM, and (4) refer to the financial statement line(s) and disclosure(s) that pertain to the CAM. We take no exception to these four requirements. But the Board stopped short of mandating the one item that we believe would provide the greatest value to investors – the discussion of what the auditor *found* when it addressed the CAM (i.e., what were the results of the auditor’s procedures in these

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<sup>1</sup> Hereafter when we refer to a position of the IAG, we are only referring to those IAG members who have chosen to sign this letter. Every member of the Auditor’s Report Working Group of the PCAOB’s IAG has chosen to sign this letter. Their individual views do not necessarily reflect the opinions of the companies or associations with which they are affiliated or any other officers, employees, or members thereof.

areas). We recognize that mandating the disclosure of findings at this late stage in the project may be problematic, particularly since the forthcoming IAASB standard does not mandate the disclosure of findings nor does the existing FRC standard. Given this reality, we ask the PCAOB to consider the more limited step of modifying the existing Proposal to simply add one sentence:

**“We view the inclusion of informative, company-specific findings related to each CAM as a best practice in auditor reporting, and although the inclusion of findings is not required in the Auditing Standard we strongly encourage auditors to include such findings in their audit reports.”**

In the balance of this letter, we justify our position for the inclusion of informative, company-specific findings<sup>2</sup> related to each CAM in the auditor’s report.<sup>3</sup> The PCAOB’s Congressionally-mandated mission is “to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports.” We view including CAM-related findings as unambiguously making audit reports more informative. Therefore, our suggested modification to the Board’s Proposal is clearly consonant with the Board’s mission.

As the Board itself recognizes, accounts and disclosures involving significant management estimates and judgments may often be disclosed as CAMs (PCAOB 2016a, 2), and investors have previously indicated their high level of interest in significant management estimates and judgments (PCAOB 2016a, 2, 93). Moreover, the importance of estimates and judgments has become more pronounced over time as GAAP has evolved, serving to exacerbate the information asymmetry between investors and auditors (PCAOB 2016a, 1). We recognize that disclosing CAMs is useful, but believe that such disclosure will be incomplete without also revealing the related findings.

Most importantly, investors have a clear and strong interest in the disclosure of findings. Approximately 80 percent of investors believe that audit reports should include findings (KPMG 2015). Citi, in its analysis of the new audit reports being issued in the United Kingdom (UK), states, “We would like all auditors to disclose findings” (Deans 2015, 1). Finally, the FRC itself has stated, “Investors clearly valued the additional insight offered by extended auditor reporting, and have since encouraged the adoption of greater transparency, particularly in respect of auditor’s judgments and their findings” (FRC 2016, 6).

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<sup>2</sup> Just as the Proposal contemplates that CAMs will be determined “in the context of the particular audit, with the aim of providing audit-specific information rather than a discussion of generic risks” (PCAOB 2016a, 25), so too should findings provide audit-specific information.

<sup>3</sup> We realize that the Proposal already allows auditors to discuss the outcome of their procedures and/or to include key observations with respect to the CAM (PCAOB 2016a, 31). We fully support this language but simply encourage the Board to go further and more explicitly recognize and encourage, without necessarily mandating, the inclusion of findings.

But, in reporting findings, it is essential that the auditor provide informative and company-specific information, particularly with respect to estimates and judgments. A finding that states that an estimate is reasonable (FRC 2015, 59) or that an estimate falls within an acceptable range is already implied by the issuance of an unmodified audit report (Deans 2015, 16). Such findings lack granularity, and as a result fail to provide meaningful, incremental information. As Tony Cates, the head of audit at KPMG UK states, “Instead what is required is graduated findings that say whereabouts in a range matters sit” (FRC 2015, 25). We agree wholeheartedly with Mr. Cates.

The new audit reports in the UK have been so well received that the Investment Management Association (IMA) sponsors a yearly contest to select and recognize the best audit reports. While we admit that this competition is not quite as glamorous as the Academy Awards, it represents a giant leap from bygone years when investors only skimmed the report to see if any modification existed. In recognizing the Rolls Royce audit report, the IMA commends KPMG for including, “... what they found. The inclusion of findings was a step further than other auditors and *provided a real value add* (our emphasis), giving colour as to whether management’s judgments were balanced, mildly optimistic or mildly pessimistic in the view of the auditor” (FRC 2015, 55).

In addition to the strong investor support for the inclusion of findings in the audit report, auditors in the UK are recognizing investor demand for this information and, at least in some cases, choosing to provide the information, particularly as it relates to the auditor providing his or her own commentary on management judgments (Touche 2014). We view this result as indicating that at least some audit firms view reports with findings as a superior market-responsive service. For example, PwC has committed to including findings in its reports across its entire UK portfolio (FRC 2016, 24). Moreover, to the extent that there are variations among issuers, audit firms, and even individual auditors within firms (Touche 2014), such variation creates a landscape where different parties to the financial reporting process can signal differential quality, or at least market responsiveness. Such differentiation, by definition, is what makes information useful (i.e., to the extent that all information provided is identical the usefulness of reports declines).

There is obviously some opposition to auditors disclosing findings. First, some may argue that disclosing findings would move the auditor toward providing original information and would exceed the auditor’s mandate (PCAOB 2016a, 2). With all due respect, we view the extent of the auditor’s mandate not as permanently engraved on tablets of stone but rather determined and defined by members of the PCAOB based on your collective judgment in fulfilling your investor protection mission.

Second, some critics, particularly in the audit committee community, have questioned what investors would do with the information in expanded auditor reports. Although we could offer many examples, we simply offer one based on TUI Travel plc's 2014 audit report. PwC, TUI's auditor, included the following in its audit report, "Management is forecasting high revenue and profit growth rates in the next five years resulting from the investment in Brazil and Asia. If these growth rates are not achieved, it could lead to impairment of the related goodwill and intangible assets" (PwC 2015, 5). If analysts do not believe that high growth rates are achievable they could quasi-impair now.

Finally, some might argue that including findings in the audit report might expose auditors to incremental legal liability (FRC 2015, 60). A decision to encourage, but not require, the reporting of findings allows each individual audit firm to weigh the benefits associated with issuing a more useful and market-responsive report against the costs of potentially increased legal liability. Notwithstanding that choice would be preserved under our recommendation, the signatories of this letter are supportive of efforts to provide auditors with a narrowly-tailored legal safe harbor. That is, we support a legal safe harbor related *only* to the inclusion of CAM-related findings in the audit report.

We close by highlighting the alignment between our recommendations for improving the Board's Proposal with recent statements by certain Board members. Lewis Ferguson has stated, "The repropoed standard is meant to better arm investors with *insight previously available to and considered by, the auditors, but not ultimately evident in the auditor's report*" (our emphasis) (PCAOB 2016b). Auditors clearly assess and consider the relative gradation in management estimates and judgments, but such knowledge and consideration is not evident in the audit report.

Jay Hanson has stated, "... proposed requirements will impose costs and burdens on auditors, preparers and audit committees ...[o]ur goal, then, cannot be merely to reduce information asymmetry by requiring the disclosure of information, but *making sure that the information to be provided will be valuable to investors such that it justifies the imposition of the related costs*" (our emphasis) (PCAOB 2016b). Most of this comment letter details the investor demand for and value derived from informative, company-specific CAM-related findings.

Finally, with no disrespect intended, we pose a challenge to the Board. Board member Jeanette Franzel has stated, "Although this is *a significant step forward in auditor reporting, it is a small step*" (our emphasis) (PCAOB 2016b). We agree with Ms. Franzel, but in the spirit of vigorous debate on an important public policy matter we challenge what appears to be the implicit conclusion. Why would the Board take a small step when the preferences of the group that the Board was intended to serve, investors, are crystal clear?<sup>4</sup>

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<sup>4</sup> This challenge is to the entire Board and not uniquely to Ms. Franzel. We simply use her quote to frame the issue.

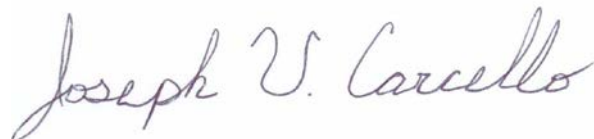
In conclusion, we support the PCAOB's Proposal as a meaningful improvement in auditor reporting. We believe that the Proposal would be substantially strengthened if the Board simply encouraged, but did not require, the inclusion of informative, company-specific findings in the audit report.<sup>5</sup> Regardless of the Board's opinion regarding our recommendation, we encourage the Board to expeditiously adopt a final rule on auditor reporting, preferably no later than the end of 2016.

We, as members of the Auditor's Report Working Group of the PCAOB's Investor Advisory Group, jointly submit this comment letter.

Sincerely,



Mary M. Bersot, CFA  
CEO and Chief Investment Officer  
Bersot Capital Management LLC



Joseph V. Carcello, CPA, CGMA, CIA, CMA  
EY and Business Alumni Professor  
Department Head – Department of Accounting and Information Management  
Executive Director – Neel Corporate Governance Center  
University of Tennessee

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<sup>5</sup> Our letter will serve as the foundation for our presentation at the IAG meeting on October 27, 2016. We will not introduce new ideas, proposals, or data at that meeting.

*Sarah Deans.*

Sarah Deans  
Managing Director – Accounting & Valuation  
Exane BNP Paribas

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Linda de Beer  
Independent Non-Executive Director and Corporate Governance Advisor  
South Africa

A handwritten signature in black ink, appearing to be 'Grant Callery'.

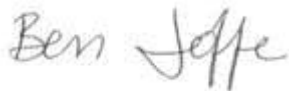
Grant Callery  
Principal  
Oversight and Governance Solutions, LLC



Norman J. Harrison  
Senior Managing Director  
FTI Consulting, Inc.



Michael J. Head, CPA, CIA, CISA, CMA  
Lecturer  
Texas A&M University



Bess Joffe  
Managing Director and Head of Stewardship & Corporate Governance  
TIAA



Anne Simpson  
Investment Director  
California Public Employees Retirement System (CalPERS)

cc: PCAOB  
James R. Doty, Chairman  
Lewis H. Ferguson, Member  
Jeanette M. Franzel, Member  
Jay D. Hanson, Member  
Steven B. Harris, Member

SEC  
The Honorable Mary Jo White, Chairman  
The Honorable Kara M. Stein  
The Honorable Michael S. Piwowar  
Wesley R. Bricker, Interim Chief Accountant



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