December 11, 2013

Phoebe W. Brown, Secretary
Attention: PCAOB Rulemaking Docket No. 034
Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006

VIA ELECTRONIC MAIL: comments@pcaobus.org


Dear Madam:

The Committee on Capital Markets Regulation (the “Committee”) is grateful for the opportunity to comment on the recently proposed standards issued by the Public Company Accounting Oversight Board (the “PCAOB”), including The Auditor’s Report on an Audit of the Financial Statements When the Auditor Expresses an Unqualified Opinion (the “Proposed Auditor Reporting Standard”) and The Auditor’s Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor’s Report (the “Proposed Other Information Standard,” and together with the Proposed Auditor Reporting Standard, the “Proposed Standards”).

Founded in 2006, the Committee is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. Our membership includes thirty-two leaders drawn from the finance, investment, business, law, accounting, and academic communities. The Committee is chaired jointly by R. Glenn Hubbard (Dean, Columbia Business School) and John L. Thornton (Chairman, The Brookings Institution) and directed by Hal S. Scott (Nomura Professor and Director of the Program on International Financial Systems, Harvard Law School). The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

The Proposed Standards follow an initial concept release issued by the PCAOB in June of 2011, and broadly seek to improve the form of the auditor’s report, which has changed little in the United States since the 1940’s. Specifically, the Proposed Standards aim to address concerns that the current form of auditor’s report provides little specific information about a particular company to financial statement end users.¹ The Committee applauds the PCAOB’s goal of enhancing auditor communications and making financial statements more useful for end users. However, we believe several of the proposed changes may not serve this goal and, in fact, may lead to confusion by investors and unnecessary effort and expense on the part of both auditors and companies in producing financial statements, without recognizable benefit.

First, we believe the discussion of “critical audit matters” should not be included in a final rulemaking. The Proposed Auditor Reporting Standard provides for disclosure of such matters, including “those matters addressed during the audit that (1) involved the most difficult, subjective, or complex auditor judgments; (2) posed the most difficulty to the auditor in obtaining sufficient appropriate evidence; or (3) posed the most difficulty to the auditor in forming the opinion on the financial statements.” Critical audit matters include subjects that under current PCAOB requirements would be documented and/or communicated to the audit committee, although not all such matters would rise to the level of “critical audit matters.” The proposal provides a list of factors auditors should take into account when determining critical audit matters.

Disclosing all “critical audit matters” is problematic for several reasons. Certain investors may misinterpret discussion of these issues as an indication of a problem, even if the audit results in a clean audit opinion – the additional disclosure has the potential to make mountains out of molehills. Inclusion of critical audit matters may be viewed by end users as an implicit qualification of the audit, and could lead users to perceive different levels of assurance on different areas of the financial statements. The mere fact that auditors and a board have spent significant time on an issue does not suggest it should be of particular interest to investors, and conversely, not all issues of interest should be considered “critical audit matters.” What is of concern to investors is what the accounting policies and treatment are, not how they have been devised through discussion between auditors and issuers. The proposed additional information will not permit a more insightful evaluation of the fairness of the accounting reflected in the financials.

In addition, drafting disclosure of critical audit matters will likely require significant additional time and effort on the part of the auditors. Disclosure is likely to be voluminous, in particular as auditors seek to convey “critical audit matters” to investors not familiar with topics that, while complex and difficult to address, may routinely arise during public company audits. Auditors will likely take longer in producing their reports to address items that are not of clear informational value. Finally, and most importantly, a requirement to disclose “critical audit matters” would likely result in less open discussion between auditors and issuers and boards, as issuers and directors constantly will be mindful that any issue they discuss could be subject to disclosure.

Secondly, we believe the Proposed Other Information Standard is too broad and, at the least, should be limited to cover information derived from accounting records and subject to an internal control framework. The Proposed Other Information Standard would require that auditors perform specific procedures in evaluating “other information” taken from a company’s public reporting, and that auditors provide an affirmative statement in their reports that they have not identified material inconsistencies or material misstatements of facts in the other information. “Other information” includes all company information, not just financial-related disclosures. The PCAOB says these inconsistencies could be the result of “unintentional error, managerial biases, or intentional misreporting.” Under existing standards, auditors already have an obligation to read and consider such other information, but there is no obligation to report their findings.

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2 Proposed Standards, p. 15.
3 Proposed Standards, p. 7.
4 Proposed Standards, p. 20.
Requiring an affirmative attestation by auditors will result in auditors taking significant additional time and effort to review “other information” in public company filings, as they seek to protect themselves against potential 10b-5 liability. Particularly where this “other information” is unrelated to financial statements, we do not believe this is an efficient use of auditors’ time and expertise. Much of the disclosure provided outside the financial statements and related notes is subjective and forward-looking, and accordingly, it will be difficult for auditors to evaluate this information or objectively to verify it. To avoid these concerns, registrants may curtail the amount or nature of information in their disclosures.

Furthermore, current law, including the Sarbanes-Oxley Act, requires the CEO and CFO of a public company to make certifications in their annual and quarterly reports, and stock exchange listing rules also require independent audit committee supervision of these reports. Management and the company audit committee are certainly better equipped to certify non-financial information than auditors. The Proposed Other Information Standard will result in significant expense with no clear benefit to investors.

Finally, we encourage the PCAOB to clarify how auditor tenure should be disclosed for registered investment companies. Mutual funds are often legally structured as a series of individual funds under a single legal entity (the “umbrella fund”), and their financial statements are issued at the umbrella fund level. Disclosure of the auditor’s tenure for each individual fund may be voluminous, confusing and less relevant to end users than the auditor’s tenure for the entire family of funds. We hope the PCAOB will consider the unique structure of registered investment companies and clarify an approach that provides maximum benefit to end users.

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Thank you very much for your consideration of the Committee’s opinion. Should you have any questions or concerns, please do not hesitate to contact the Committee’s Director, Prof. Hal S. Scott (hscott@law.harvard.edu), or its Executive Director of Research, C. Wallace DeWitt (cwdewitt@capmktreg.org), at your convenience.

Respectfully submitted,

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