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It is an honor for the Council of Institutional Investors to participate on the Investor Advisory Group, and we commend the Public Company Accounting Oversight Board (PCAOB) for its leadership establishing this group.

As an introduction, the Council is a nonprofit association of public, labor and corporate employee benefit plans with assets exceeding $3 trillion. Council members are responsible for safeguarding assets used to fund the retirement benefits of millions of individuals throughout the United States. They have a significant commitment to the U.S. capital markets, with the average member investing about 60 percent of its portfolio in the stocks and bonds of U.S. public companies. Our members are also long-term, patient investors due to their far investment horizons and their heavy commitment to passive investment strategies.

Given Council members' significant long-term financial stake in U.S. markets and the fact that audited annual financial statements are critical sources of information used to guide their investment decisions, the Council has long been engaged in issues involving the strength, independence, and oversight of the audit profession and the quality of the audit process.

The Council believes investor confidence in our financial markets and the markets' general well-being depends on the quality of the information provided by audited financials. The quality of that information, in turn, depends on the quality of the audits and the audit process in providing investors assurance about the accuracy, completeness, reliability, and credibility of financial statements.

The audit profession plays a unique role in our capital markets. It has a ready made marketplace because it is the only profession that must be engaged by a company selling securities in the U.S. However, the U.S. audit profession ultimately derives its strength from the public trust it earns by serving as an effective independent gatekeeper responsible for high quality audits of companies seeking capital from individual and institutional investors.

Unfortunately, public trust in the audit profession and the integrity of the financial reporting process was severely shaken in recent years. The establishment of the PCAOB was a critical first step in restoring confidence in the profession and ensuring that auditors of public companies are protecting the interests of investors and furthering the public interest in the preparation of informative, fair, and independent audit reports.

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The Council strongly supports the PCAOB's mission and the Board's efforts, including the establishment of the Investor Advisory Group, to enhance the effectiveness of its efforts.
Nearly three years ago, the U.S. Department of the Treasury appointed an Advisory Committee on the Auditing Profession (ACAP) charged with providing "informed advice and recommendations to the Department on the sustainability of a strong and vibrant public company auditing profession." I was a member of the ACAP, and a number of recommendations contained in the ACAP's final report, completed after a year of research and discussions, involved the PCAOB. I know that the PCAOB is actively considering a number of those recommendations. I, however, continue to believe these recommendations—detailed below and organized into several broad categories—should remain among those issues to be prioritized by the PCAOB in the coming months.

Improving Auditor Communications

The auditor's report is the primary communication from the audit firm to financial statement users. Aside from reporting an unqualified opinion, a qualified opinion, an adverse opinion or a disclaimer of opinion and, where required, an opinion about management's assessment of the company's internal controls over financial reporting, outside auditors provide little additional information to statement users.

The quality of the auditor's report has been discussed and debated for at least three decades. Highly-respected groups such as the Commission on Auditors' Responsibilities (Cohen Commission, 1978) and the National Commission on Fraudulent Financial Reporting (Treadway Commission, 1987) have recommended expanding the breadth and depth of the auditor's report. Such reforms would clearly be valued by investors, as evidenced by March 2010 and February 2008 CFA Institute surveys. The 2010 survey found that 94 percent of respondents would like to see additional information in the auditor's report. Similarly, the 2008 survey found that 80 percent of the respondents believed the auditor's report should provide specific information about how the auditor reached its opinion.

Enhanced auditor reports could provide investors with information about the scope and processes underlying the audit, as well as key findings and limitations of the audit. All of this information would be useful, but the Council believes more details about the key findings would be of particular benefit to the investing public by providing valuable information about a company's "tone at the top" and the quality of the company's application of accounting standards and practices.

Recommendations from the ACAP report regarding the auditor's report include:

- The PCAOB should "undertake a standard-setting initiative to consider improvements to the auditor's standard reporting model." Further, the SEC and the PCAOB should "clarify in the auditor's report the auditor's role in detecting fraud under current auditing standards and further that the PCAOB periodically review and update these standards."

- The PCAOB should "undertake a standard-setting initiative to consider mandating the engagement partner's signature on the auditor's report." Signatures are required in other jurisdictions, and the ACAP agreed that "the engagement partner's signature on the auditor's report would increase transparency and accountability."

In addition to enhancing auditor communications with financial statement end users, the Council recommends that the PCAOB continue its efforts to enhance auditor communications with company audit committees. The PCAOB's Release No. 2010-001, Proposed Auditing Standards Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards, is a good first step. The Council recommends that the PCAOB consider whether some, or all, of these communications would be beneficial to end users of financial statements and whether these communications should be publicly disclosed.

Improving Auditor Disclosures and Governance

Audit firms are generally structured as private partnerships, and as a result, they are not subject to any of the governance or disclosure requirements mandated of public companies. Given the special role of audit firms in the capital markets, however, the Council believes the firms should be subject to higher governance and disclosure standards than other private companies.

Specifically, the Council believes the firms could benefit from the appointment of more independent directors, and/or from the establishment of advisory boards with meaningful governance responsibilities. These changes could enhance the firms' "tone at the top" and enhance management oversight—which ultimately could lead to higher quality audits.

Enhanced transparency from the firms—particularly regarding the firms' finances and their analysis of audit quality indicators—could also benefit the investing public by enabling them to better assess the performance and strength of the firms.

Regarding audit firm disclosures and governance, the ACAP recommended the following:

- The PCAOB and the SEC, in consultation with other federal and state regulators, auditing firms, investors, other financial statement users, and public companies, should "analyze, explore, and enable, as appropriate, the possibility and feasibility of firms appointing independent members with full voting power to firm boards and/or advisory boards with meaningful governance responsibilities to improve governance and transparency of auditing firms."

- The PCAOB should "require that, beginning in 2010, larger auditing firms produce a public annual report incorporating (a) information required by the EU's Eighth Directive, Article 40 Transparency Report deemed appropriate by the PCAOB, and (b) such key indicators of audit quality and effectiveness as determined by the PCAOB in accordance with Recommendation 3 in Chapter VIII of this Report. Further, urge the PCAOB to require that, beginning in 2011, the larger auditing firms file with the PCAOB on a confidential basis audited financial statements." Such audited financial statements would assist the PCAOB in accomplishing another ACAP recommendation: "as part of its current oversight over registered auditing firms, the PCAOB should monitor potential sources of catastrophic risk which would threaten audit quality."

- The PCAOB should "in consultation with auditors, investors, public companies, audit committees, boards of directors, academics, and others, determine the feasibility of developing key indicators of audit quality and effectiveness and requiring auditing firms to publicly disclose these indicators. Assuming development and disclosure of indicators of audit quality are feasible, require the PCAOB to monitor these indicators."

Enhancing PCAOB Oversight

The Sarbanes-Oxley Act of 2002 provided the PCAOB with registration, reporting, inspection, standard-setting and enforcement authority over public company auditing firms. To ensure that the PCAOB has the tools to most effectively carry out its important mission, the PCAOB should lead ongoing initiatives to enhance its oversight efforts.

Toward that end the ACAP recommended:

- Regulators and other governmental enforcement bodies should meet on a regular basis "in a cooperative effort to improve regulatory effectiveness and reduce the incidence of duplicative and potentially inconsistent enforcement regimes. The ACAP recommended "mandating regulator and formal roundtables of the PCAOB, the SEC, the DOJ, the state boards of accountancy, and the state attorneys general, to periodically review the overall enforcement regimes applicable to the public company auditing profession."

- Regulatory collaboration and coordination between the PCAOB and its foreign counterparts, consistent with the PCAOB mission of promoting quality audits of public companies in the United States, should be enhanced.

The PCAOB has statutory responsibility for inspecting registered audit firms, including registered non-U.S. firms. Unfortunately, for a variety of reasons, the PCAOB has not been able to fully satisfy this requirement. Firms in some jurisdictions including China, Finland, France, Germany, Greece, Ireland, the Netherlands, Norway, Portugal, Sweden, Switzerland and the United Kingdom have never been inspected.

Given the growth of global auditing networks and reports of alleged "outsourcing" of audits of non-U.S. enterprises to audit firms not registered with the PCAOB, this failure may put investors of U.S.-listed companies at risk. While the Council strongly supports enhanced cooperation and coordination with foreign auditing firm regulators, the Council is concerned that any approach permitting the PCAOB to simply rely on the work on non-U.S. regulators is premature and perhaps not in the best interests of investors.

The Council urges the PCAOB to continue its efforts—either on its own or jointly with non-U.S. regulators—to inspect registered non-U.S. firms. However, if the PCAOB continues to face roadblocks to these inspections, the Council recommends that the Board consider alternatives. At a minimum the auditor's report should provide full disclosure of the extent to which auditing work was performed by non-inspected entities, the relationship of these entities to the audit firm and the percentage of the company's operations that have been audited by non-inspected registered firms. In addition, the PCAOB website should prominently display a list of all non-inspected, registered firms and all countries where sole inspections have not yet been performed. The Board may also determine that other blunter tools, such as de-registering a firm, may be appropriate.

Enhancing PCAOB Performance

Currently no centralized, unbiased entity is responsible for serving as a clearinghouse, researcher and investigator of accounting fraud. The Council believes the PCAOB is the ideal entity to lead such an effort. The ACAP agreed that "a collection sharing of fraud prevention and detection experiences among auditors and other market participants will provide a broad view of auditor practices and ultimately improve fraud prevention and detection capabilities and enable the development of best practices."

The ACAP recommended:

- The SEC and Congress, as appropriate, should "provide for the creation by the Public Company Accounting Oversight Board (PCAOB) of a national center to facilitate auditing firms' and other market participants' sharing of fraud prevention and detection experiences, practices, and data and innovation in fraud prevention and detection methodologies and technologies, and commission research and other fact-finding regarding fraud prevention and detection, and further, the development of best practices regarding fraud prevention and detection."

The Council commends the PCAOB for its April 6, 2010, announcement regarding its establishment of a Financial Reporting Fraud Resource Center. To further enhance the Center's efforts and stature, the Council recommends that the Center go beyond the ACAP recommendation by also investigating and providing public reports analyzing significant accounting frauds. Such reports would provide valuable information to auditors, companies, financial statement users and the marketplace at large. They would also assist the PCAOB in its work drafting auditing standards and enhance the public's understanding of the Board's important mission of protecting the interests of investors and furthering the public interest in the preparation of informative, fair and independent audit reports.

Updating Auditing Standards

The Sarbanes-Oxley Act of 2002 directed the PCAOB to establish auditing and related professional practice standards for registered public accounting firms to follow in the preparation and issuance of audit reports. In general the PCAOB adopted as interim standards the existing auditing standards, as described in the AICPA's Auditing Standards Board's Statement of Auditing Standards No. 95.

The Council recommends that the PCAOB devote additional resources to standard setting. The interim standards adopted by the Board should systematically be reviewed to determine whether each of those standards serves the needs of investors and other consumers of audited financial reports. To the extent standards are found deficient, they should be improved, replaced, or discarded after a public due process in which the views of investors are actively solicited and carefully considered.

In addition, the Board should actively monitor current auditing issues and consider providing timely staff guidance on the application of auditing standards to topical issues, such as, for example, repurchase agreements. Again, such guidance should only be provided when the Board concludes that its issuance would benefit investors and other consumers of audited financial reports.