

Via Email

August 28, 2017

Office of Secretary  
PCAOB  
1616 K Street, NW  
Washington, DC 20006-2803

*Re: PCAOB Rulemaking Docket Matter No. 043/PCAOB Rulemaking Docket Matter No. 044*

Dear Madam Secretary:

This letter provides comments on the Public Company Accounting Oversight Board's (PCAOB or Board) Proposed Auditing Standard, *Auditing Accounting Estimates, Including Fair Value Measurements* (Estimates Proposal),<sup>1</sup> and the related *Proposed Amendments to Auditing Standards for Auditor's Use of the Work of Specialists* (Specialist Proposal) (Estimates Proposal and Specialist Proposal collectively the Proposals).<sup>2</sup>

The Council of Institutional Investors (CII or Council) supports the Proposals. The Council is a non-profit, nonpartisan association of public, corporate, and union pension funds, and other employee benefit plans, foundations and endowments with combined assets that exceed \$3 trillion. Our member funds are major, long-term investors committed to protecting the retirement savings of millions of American workers. CII also has associate members, including asset managers with more than \$20 trillion in assets under management.<sup>3</sup>

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<sup>1</sup> PCAOB Release No. 2017-002 (June 1, 2017), <https://pcaobus.org/Rulemaking/Docket043/2017-002-auditing-accounting-estimates-proposed-rule.pdf>.

<sup>2</sup> PCAOB Release No. 2017-003 (June 1, 2017), <https://pcaobus.org/Rulemaking/Docket044/2017-003-specialists-proposed-rule.pdf>.

<sup>3</sup> For more information about the Council of Institutional Investors ("CII"), please visit CII's website at [http://www.cii.org/about\\_us](http://www.cii.org/about_us).

## CII Policies

As the leading U.S. voice for effective corporate governance and strong shareholder rights, CII believes that accurate and reliable audited financial statements are critical to investors in making informed decisions, and vital to the overall well-being of our capital markets.<sup>4</sup> That belief is reflected in the following CII membership-approved policy on the “Independence of Accounting and Auditing Standard Setters”:

Audited financial statements including related disclosures are a critical source of information to institutional investors making investment decisions. The efficiency of global markets—and the well-being of the investors who entrust their financial present and future to those markets—depends, in significant part, on the quality, comparability and reliability of the information provided by audited financial statements and disclosures. The quality, comparability and reliability of that information, in turn, depends directly on the quality of the . . . standards that . . . auditors use in providing assurance that the preparers’ recognition, measurement and disclosures are free of material misstatements or omissions.<sup>5</sup>

This policy establishes the principle that “investors are the key customer of audited financial reports and, therefore, the primary role of audited financial reports should be to satisfy in a timely manner investors’ information needs.”<sup>6</sup> Our membership reaffirmed that principle when it approved substantial revisions to our policy on “auditor independence.”<sup>7</sup> That policy, as revised, includes the following additional provisions that we believe may be relevant to issues raised by the Proposals:

**2.13a Audit Committee Responsibilities Regarding Independent Auditors:** The audit committee should fully exercise its authority to hire, compensate, oversee and, if necessary, terminate the company’s

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<sup>4</sup> CII, Policies on Other Issues, Independence of Accounting and Auditing Standard Setters (updated Mar. 1, 2017), [http://www.cii.org/policies\\_other\\_issues#indep\\_acct\\_audit\\_standards](http://www.cii.org/policies_other_issues#indep_acct_audit_standards).

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> CII, Policies on Corporate Governance § 2.13 Auditor Independence (last updated Sept. 30, 2016), [http://www.cii.org/corp\\_gov\\_policies](http://www.cii.org/corp_gov_policies).

independent auditor. In doing so, the committee should take proactive steps to promote auditor independence and audit quality. Even in the absence of egregious reasons, the committee should consider the appropriateness of periodically changing the auditor, bearing in mind factors that include, but are not limited to:

- ....
- the clarity, utility and insights provided in the auditor’s report
- ....
- the quality and frequency of communication from the auditor to the audit committee
- ....

Investors are the “customers” and end users of financial statements and disclosures in the public capital markets. Both the audit committee and the auditor should recognize this principle.

....  
**2.13f Shareowner Votes on the Board’s Choice of Outside Auditor:**  
Audit Committee charters should provide for annual shareowner votes on the board’s choice of independent, external auditor.<sup>8</sup>

## CII Views on Proposals

### *Estimates Proposal*

We support the Estimates Proposal. We have long believed that fair value accounting with robust disclosures provides investors with more useful information than amounts that would be reported under amortized cost or other existing alternative accounting approaches.<sup>9</sup> Further, we believe investors assign a high value to the auditor’s testing and evaluation of fair value estimates and other critical accounting estimates reported by issuers.<sup>10</sup> That view is demonstrated by

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<sup>8</sup> *Id.*

<sup>9</sup> *See, e.g.*, Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors et al., to Mr. Timothy F. Geithner, Secretary, Department of Treasury et al. 2 (Feb. 13, 2009) (“fair value accounting . . . best serves the interests of investors both now and over the long term”), [http://www.aicpa.org/Press/DownloadableDocuments/CAQ\\_CII\\_CFA\\_Admin\\_Fair\\_Value\\_Letter.pdf](http://www.aicpa.org/Press/DownloadableDocuments/CAQ_CII_CFA_Admin_Fair_Value_Letter.pdf); *see generally* Stephen G. Ryan, “Fair Value Accounting: Understanding the Issues Raised by the Credit Crunch” 1 (July 2008) (describing the key reasons why fair value accounting benefits investors), [http://www.cii.org/files/publications/white\\_papers/07\\_11\\_08\\_fair\\_value\\_accounting.pdf](http://www.cii.org/files/publications/white_papers/07_11_08_fair_value_accounting.pdf).

<sup>10</sup> *See, e.g.*, Jeff Mahoney, “Investor Perspectives & Related Considerations on Auditing Estimates and Fair Value Measurements: Remarks at the Meeting of the Standing Advisory Group of the Public Company Accounting

the broad support the PCAOB has received from investors for pursuing improvements to the auditor's report that would include information directly from the auditor about significant management estimates made in the preparation of the financial statements.<sup>11</sup>

We are concerned that the "PCAOB continues to identify high rates of audit deficiencies in this area [of accounting estimates]."<sup>12</sup> We commend the Board's effort's to address those deficiencies, in part, by "strengthen[ing] auditor responsibilities for accounting estimates, including fair value measurements."<sup>13</sup>

We believe the Estimates Proposal provides benefits to investors in at least two ways.

First, the Estimates Proposal provides a "single, consistent set of requirements" for auditing accounting estimates.<sup>14</sup> We agree with the Board that creating greater uniformity in the auditing standards in this important area should: (1) "increase . . . the quality of the information presented in the financial statements;"<sup>15</sup> and (2) "enhance the audit committee's understanding of the auditor's responsibilities, and, therefore, potentially facilitate communications between the audit committee and the auditor."<sup>16</sup>

Second, the Estimates Proposal provides a better alignment between the Board's requirements for auditing accounting estimates and the Board's risk assessment standards.<sup>17</sup> We agree with the Board that by aligning more closely with the risk

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Oversight Board" 2 (Oct. 2, 2014), [http://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2014/10\\_02\\_14\\_JMahoney%20PCAOB%20SAG\\_%20Investor%20Perspectives.pdf](http://www.cii.org/files/issues_and_advocacy/correspondence/2014/10_02_14_JMahoney%20PCAOB%20SAG_%20Investor%20Perspectives.pdf).

<sup>11</sup> PCAOB, Exchange Act Release No. 81,187, 82 Fed. Reg. 35,396, 35,397 (July 28, 2017) ("areas that investors have indicated would be of particular interest to them, [include] . . . significant management estimates . . . made in preparing the financial statements"), <https://www.gpo.gov/fdsys/pkg/FR-2017-07-28/pdf/2017-15718.pdf>.

<sup>12</sup> See, e.g., Steven B. Harris, Board Member, "Statement on Proposed Auditing Standard on Auditing Accounting Estimates, Including Fair Value Measurements, and Proposed Amendments to Auditing Standards for Auditor's Use of the Work of Specialists" 2 (June 1, 2017), <https://pcaobus.org/News/Speech/Pages/Harris-statement-auditing-accounting-estimates-specialists-6-1-17.aspx>.

<sup>13</sup> PCAOB Release No. 2017-002, at 40.

<sup>14</sup> *Id.* at 41.

<sup>15</sup> *Id.* at 42.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

assessment standards the Estimates Proposal “may lead to increased audit quality for harder-to-measure estimates . . . due to enhanced procedures.”<sup>18</sup> On this point, we generally agree with the 2014 comments of then Chief Investment Officer of CII member Colorado PERA:

While we believe auditing estimates is critical and worthy of its own standard, aligning it with risk assessment standards seem prudent. Investors want auditors to spend their time efficiently, and to be efficient, auditors must first know where the biggest risk to material misstatements are located, and then appropriately plan and executive the audit plan around high risk areas. This approach resonates well with us, and we believe it is the framework that should be used to develop standards for accounting estimates.<sup>19</sup>

### *Specialist Proposal*

We also support the related Specialist Proposal. We agree with the Board that as accounting frameworks continue to evolve in response to investor demands for more fair value accounting, “the use of the work of specialists continues to increase in both frequency and significance.”<sup>20</sup> The increasing use of specialists heightens the risk that if the specialist’s work is not properly overseen or evaluated by the auditor, the auditor’s work may not be sufficient to detect a material misstatement in fair value (or other) estimates.<sup>21</sup>

We are concerned that the “PCAOB inspections staff continues to observe deficiencies related to auditors’ use of specialists’ work, such as failures to evaluate the assumptions of company specialists in fair value measurements or failures to consider contradictory evidence or issues raised by an auditor's specialist.”<sup>22</sup> We therefore endorse the Board’s efforts to address those deficiencies, in part, by pursuing the Specialist Proposal designed to direct

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<sup>18</sup> *Id.*

<sup>19</sup> Letter from Jennifer Paquette, Chief Investment Officer, Colorado PERA to Office of the Secretary, Public Company Accounting Oversight Board 1 (Nov. 3. 2014), [https://pcaobus.org/Rulemaking/Docket043/013\\_Colorado\\_PERA.pdf](https://pcaobus.org/Rulemaking/Docket043/013_Colorado_PERA.pdf).

<sup>20</sup> PCAOB Release No. 2017-003, at 1.

<sup>21</sup> *Id.* (“If a specialist's work is not properly overseen or evaluated by the auditor, there may be heightened risk that the auditor's work will not be sufficient to detect a material misstatement in accounting estimates.”)

<sup>22</sup> *Id.* at 2.

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“auditors to devote more attention to the work of specialists and enhance[] the coordination between auditor’s and specialists.”<sup>23</sup>

In addition to the prospect of improving audit quality generally, we agree with the Board that the “proposed requirements to test and evaluate the work of a company’s specialist may result in some auditors developing a better understanding of a company’s critical accounting estimates related to relevant financial statement accounts and disclosures.”<sup>24</sup> The result should be “improved communications between the auditor and the audit committee”<sup>25</sup> and, importantly, improved communications between the auditor and investors upon adoption of the Board’s proposed standard to enhance the standard auditor’s report.<sup>26</sup>

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We appreciate the opportunity to provide the Council’s investor-focused perspective on the Proposals. Please let me know if you have any questions about the contents of this letter.

Sincerely,



Jeffrey P. Mahoney  
General Counsel

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<sup>23</sup> *Id.* at 38.

<sup>24</sup> *Id.* at 40.

<sup>25</sup> *Id.*

<sup>26</sup> 82 Fed. Reg. at 35,397 (proposed standard would require “communication of critical audit matters . . . relevant to investors and other financial statement users by informing them of issues identified in the audit that were significant to the auditor, focusing attention on issues that would be pertinent to understanding the financial statements, and enhancing investor confidence in the financial statements”).