



Public Company Accounting Oversight Board
Public Meeting on the Auditor's Reporting Model Proposal
Panel 1: Improving the Auditor's Report with an Emphasis on the ACAP Recommendation
April 2, 2014
Jeff Mahoney
Opening Remarks

Good morning.

Thank you Chairman Doty and board members and staff for hosting today's public meeting on the Public Company Accounting Oversight Board's ("PCAOB" or "Board") proposal to enhance the auditor's reporting model.

The Council of Institutional investors appreciates your leadership and willingness to pursue this important issue that has long been debated and remains controversial, particularly with some members of the auditing profession.

It was a real honor for me to have had the opportunity to serve on the Department of Treasury's Advisory Committee on the Auditing Profession ("ACAP" or "Committee"), on behalf of our Executive Director Ann Yerger, and to participate on the Committee's Subcommittee on Firm Structure and Finances ("Subcommittee") with my three distinguished fellow panelists.

As you may know, the Subcommittee was ably chaired by Robert Glauber, and in addition to my fellow panelists, the Subcommittee included Timothy Flynn, the then Chairman and CEO of KPMG, and William Travis, Director and Former Managing Partner of McGladrey & Pullen.

Others who devoted countless hours to the activities of the Subcommittee and were instrumental in assisting in the development of the Subcommittee's findings and recommendations included: Donald Nicholaisen, who was Co-Chair of the Committee along with Arthur Levitt; Alan Beller, the Counselor to the Co-Chairs, who I understand will provide his perspectives this afternoon; and last but not least by any measure, Kristen Jaconi, who was the Senior Policy Advisor to the Under Secretary for Domestic Finance at the Department of the Treasury.

After reviewing extensive amounts of data provided to the Subcommittee by the audit firms, the Center for Audit Quality and testimony and comment letters from a broad range of experts, the Subcommittee focused on seven areas in need of improvement in the auditing profession and produced seven recommendations.

In my opinion, perhaps the most significant and compelling of the seven was recommendation number five: To "[u]rge the PCAOB to undertake a standard-setting initiative to consider improvements to the auditor's standard reporting model."

As the Committee's final report indicated, the "auditor's report is the primary means by which the auditor communicates to the users of financial statements regarding its audit of financial statements."

And, despite the numerous instances in which blue ribbon panels of experts, like the Cohen Commission in 1978, recommended that the standard auditor's report be improved to provide more relevant information to the users of financial statements, no significant changes to the auditor's report were ever implemented.

I believe it is also significant that the Committee's final report highlights the testimony of Richard Fleck, Global Relationship Partner, for Herbert Smith. In that testimony, Mr. Fleck stated that institutional investors "believe an expanded auditor's report would enhance investor confidence in financial reporting and recommended exploring a more 'narrative' report in areas, such as 'estimates, judgments, sufficiency of evidence and uncertainties.'"

The substance of Mr. Fleck's testimony has since been corroborated by multiple sources including surveys of the CFA Institute and the PCAOB's Investor Advisory Group ("IAG"), and the PCAOB's own extensive outreach to investors and other users in connection with developing the proposed model.

For example, disclosure of the independent auditor's assessment of management's critical accounting judgments and estimates was supported by 79% of institutional investor respondents to a 2011 IAG survey, and 86% of respondents to a 2011 CFA Institute survey.

On the latter survey, Kurt Schacht, who I understand is on a panel this afternoon, can provide more details and discuss other CFA Institute materials that may be relevant to the proposed model.

Based on those results, the related findings and recommendation of ACAP, as well as the Council's own membership-approved corporate governance policies, we generally support the PCAOB's proposed auditor reporting model.

We would, however, revise the proposed model to provide that the auditor be required to communicate, at a minimum, an assessment of management's critical accounting judgments and estimates based on the audit procedures performed.

In our view, this modest revision to the proposed model would result in an auditor's report that provides the kind of independent auditor "insights" that are reflected in our policies and are more responsive to investors' information needs.

In that regard, we would not support a proposed model that failed to include independent auditor insights and simply repeated or referenced management disclosures that already are provided to investors.

If our modest revision were adopted, we believe the proposed model, as revised, would be more likely to achieve the Board's worthy goal of increasing the relevance and usefulness of the auditor's report to investors—the key customer of the auditor's report.

Thank you again for inviting me to participate at this important meeting, and I look forward to learning from my fellow panelists, the Board, and all of you here today.