Via Email

May 18, 2023

Ms. Phoebe W. Brown
Office of Secretary
Public Company Accounting Oversight Board
1616 K Street, NW
Washington, DC 20006-2803


Dear Secretary Brown:

The Council of Institutional Investors (CII) appreciates the opportunity to share our views and provide input on the Public Company Accounting Oversight Board’s (PCAOB or Board) Release 2023-001, Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards (Proposal).

CII is a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true “Main Street” investors through their pension funds. Our associate members include non-U.S. asset owners with about $4 trillion in assets, and a range of asset managers with more than $40 trillion in assets under management.

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

---

2 Id.
3 For more information about the Council of Institutional Investors (“CII”), including its board and members, please visit CII’s website at http://www.cii.org.
informed decisions, and vital to the overall well-being of our capital markets.\footnote{CII, Policies on Other Issues, Independence of Accounting and Auditing Standard Setters (updated Mar. 1, 2017), \url{http://www.cii.org/policies_other_issues#indep_acct_audit_standards}.} That belief is reflected in the following CII membership-approved policy on the \textbf{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 \ldots standards that \ldots auditors use in providing assurance that the preparers’ recognition, measurement and disclosures are free of material misstatements or omissions.\footnote{Id.}

This policy on \textbf{Independence of Accounting and Auditing Standard Setters} also importantly 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.”\footnote{Id.} Our membership reaffirmed that principle in our policy on \textbf{Auditor Independence}.\footnote{CII, Policies on Corporate Governance, § 2.13 Auditor Independence (updated Mar. 6, 2023), \url{https://www.cii.org/corp_gov_policies}.} That policy includes the following additional provisions that we believe may be relevant to issues raised by the Proposal:

\textbf{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 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:

\begin{itemize}
  \item the clarity, utility and insights provided in the auditor’s report and the auditor’s letter to management in relation to the audit
  \item the level of transparency and robustness of the audit firm with the audit committee and investors, including with respect to audit quality indicators, governance practices and underlying principles, and the financial stability of the audit firm
\end{itemize}
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.\(^8\)

CII also has a long-standing membership-approved policy on **Financial Gatekeepers**.\(^9\) That policy explicitly identifies auditors as “financial gatekeepers.”\(^10\) The policy indicates that it is imperative that auditors be subject to “[r]obust oversight and [have] genuine accountability to investors. . . .”\(^11\) The policy also states that “[c]ontinued reforms are needed to ensure that the pillars of transparency, independence, oversight and accountability are solidly in place.”\(^12\)

**The Proposal**

In CII’s September 2022 letter in response to the Request for Public Comment, *Draft 2022-2026 PCAOB Strategic Plan*,\(^13\) we requested that the Board prioritize “as requested by [Securities and Exchange Commission] Chair Gensler, the Board’s standard setting project on ‘Interim Standards’”\(^14\) (September Letter). Our prioritization of the interim standards was based, in part, on our policy on the **Independence of Accounting and Auditing Standard Setters** that reflects the view that auditing standards should be the product of an independent standard setting process that focuses on investors’ information needs.\(^15\)

As described by PCAOB Chair Erica Y. Williams, the Proposal:

> [W]ould replace a group of standards originally developed by the American Institute of Certified Public Accountants (AICPA) and adopted on an interim basis by the PCAOB in 2003. Those standards address reasonable assurance, due professional care, professional skepticism, independence, competence, and

\(^8\) § 2.13a Audit Committee Responsibilities Regarding Independent Auditors.


\(^10\) See id. (“Auditors, financial analysts, credit rating agencies and other financial ‘gatekeepers’ play a vital role in ensuring the integrity and stability of the capital markets.”).

\(^11\) Id.

\(^12\) Id.


\(^15\) Id. at 4 (referencing our policy on Independence of Accounting and Auditing Standard Setters in support for Securities and Exchange Commission Chair Gary Gensler’s statement regarding the need for the Public Company Accounting Oversight Board to update the “interim standards”).
professional judgment—collectively, what we refer to as the “foundational standards.”

We generally agree with Chair Williams that by “[m]erging these foundational standards into one standard, [it] would reaffirm the general principles and responsibilities of the auditor and solidify the foundation of every audit; leading to investor protection and informative, accurate, and independent audit reports.” And by issuing the Proposal, we believe the Board is appropriately continuing to prioritize standard setting that replaces the interim standards and thereby is responsive to the recommendation in the September Letter.

**Responses to Select Questions**

The following includes CII’s responses to select questions raised in the Proposal.

1. **Are the general principles and responsibilities described in the proposal appropriate for audits performed under PCAOB standards? Are there additional principles or responsibilities that are fundamental to the conduct of an audit under PCAOB standards that merit inclusion in the proposed standard and amendments? If so, what are they and how should they be addressed?**

CII generally believes the general principles and responsibilities described in the Proposal are appropriate for audits performed under PCAOB standards. And, generally consistent with language in our policies on Independence of Accounting and Auditing Standard Setters regarding the importance of the quality and credibility of audited financial information, we strongly agree with Board Member Kara M. Stein that those principles and responsibilities should be “anchor[ed] [on the auditor’s] obligation to protect investors.” In that regard, we would support the inclusion of additional language to the “INTRODUCTION” and “CONDUCTING AN AUDIT” provisions of Proposed Auditing Standard AS 1000, General

---

17 Id.
18 Cf. Letter from Jeffrey P. Mahoney, General Counsel, CII to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board 3 (Feb. 15, 2023), https://www.cii.org/files/issues_and_advocacy/correspondence/2023/Feb%202023%20CII%20Letter%20PCAOB%201025.pdf (“We applaud the Board for issuing the Proposal because it would replace interim standard AS 2310, The Auditor’s Use of Confirmation (AS 2310) [and] [b]y replacing AS 2310, we believe the Proposal would generally be responsive to the recommendation in our September Letter.”).
22 Id. at A1-5.
Responsibilities of the Auditor in Conducting an Audit (AS 1000)\textsuperscript{23} designed to further clarify the obligation to, and role of, auditors to their key customer—investors.

More specifically, we would generally support revisions to paragraphs .01\textsuperscript{24} and .15\textsuperscript{25} of AS 1000 to reflect the auditor’s obligation to, and role in, protecting investors as described in the seminal U.S. Supreme Court decision of United States v. Arthur Young & Co.\textsuperscript{26} The opinion, delivered for a unanimous court by Chief Justice Warren E. Burger states:

By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a public responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public. This "public watchdog" function demands that the accountant maintain total independence from the client at all times, and requires complete fidelity to the public trust. To insulate from disclosure a certified public accountant's interpretations of the client's financial statements would be to ignore the significance of the accountant's role as a disinterested analyst charged with public obligations.\textsuperscript{27}

We agree with Members of the Investor Advisory Group (MIAG) that: “Given the significance of this opinion to the responsibilities and obligations of independent auditors, inserting it into a final standard would certainly enhance the standard.”\textsuperscript{28}

For similar reasons, and consistent with the investor as customer language in our policies on Independence of Accounting and Auditing Standard Setters and Auditor Independence we generally support the inclusion of additional language to the “PROFESSIONAL QUALIFICATIONS OF THE AUDITOR” provisions of AS 1000.\textsuperscript{29} We generally agree with the MIAG “that the training of auditors should be required to include a focus on users of financial information, including investors, as the primary beneficiary of the audit process.”\textsuperscript{30}

\textsuperscript{23} PCAOB Release No. 2023-001 at A1-1.
\textsuperscript{24} Id. (“.01 Auditors have a fundamental obligation to protect investors through the preparation and issuance of informative, accurate, and independent auditor’s reports, and that obligation governs the auditor’s work under the standards of the PCAOB.”).
\textsuperscript{25} Id. at A1-6 (“.15 The auditor must comply with applicable professional and legal requirements in conducting an audit. In fulfilling these requirements, the auditor should keep in mind their role in protecting investors.”).
\textsuperscript{27} Id.
\textsuperscript{28} Letter from Members of the IAG to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board 2 (May 16, 2023) (on file with CII).
\textsuperscript{29} PCAOB Release No. 2023-001 at Page A1-1.
\textsuperscript{30} Letter from Members of the IAG to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board at 6.
More specifically, we would generally support amending paragraph .08(c) of AS 1000 as follows:

08. The auditor should develop and maintain competence through an appropriate combination of:

\[
\text{c. Training, including a focus on investors as the key customer of the audit, and how audits can more responsive to investor needs, as well as accounting, auditing, independence, ethics, and other relevant continuing professional education.}\]

We note that the Board proposes a number of amendments to AS 3101: *The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion (AS 3101).* Generally consistent with the audit report language in our *Auditor Independence* policy, we respectfully recommend the Board consider additional amendments to AS 3101 as part of this Proposal. In our view, two additional amendments are necessary to address (1) the declining number of critical audit matters (CAMs) disclosed and (2) the failure of the disclosure to include the permitted information requested by CII and many investors regarding the outcomes and key observations of the related audit procedures performed.

\[31\] See PCAOB Release No. 2023-001 at A1-3; cf. Letter from Members of the IAG to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board at 6 (“We would suggest that paragraph .08(c) be revised along these lines: “Training, including a focus on investors as the primary beneficiary of the audit process, and how audits can be made more transparent and responsive to investor needs, as well as accounting, auditing, independence, ethics, materiality and other relevant continuing professional education.”).
\[33\] See Interim Analysis Report, Further Evidence on the Initial Impact of Critical Audit Matter Requirements, PCAOB Release No. 2022-007 at 3 (Dec. 7, 2022), https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/economicandriskanalysis/pir/documents/cam-interim-analysis-report.pdf?sfvrsn=1c9f4f13_2&utm_source=PCAOB+Email+Subscriptions&utm_campaign=bec22ed4ac-EMAIL_CAMPAIGN_2019--forums2019_COPY_01&utm_medium=email&utm_term=0_c97e2ba223-bec22ed4ac (“The average number of CAMs per audit report has declined over time, and the proportion of audit reports that communicate a single CAM has increased”); Jian Zhang, PhD and Kurt Pany, PhD, Critical Audit Matter Reporting, A Comparison of Years 1 through 3 (Mar. 2023), https://www.cpa journal.com/2023/03/22/critical-audit-matter-reporting/ (“The average number of CAMs included in audit reports was 1.64 and 1.45 for 2020 and 2021, respectively.”); Kate Suslava et al., Disappearing Audit Disclosure: Changes in the Reporting of Critical Audit Matters 25 (2023) (on file with CII) (“Our tests show that auditors are decreasing not only the number of CAMs, but also the number of procedures mentioned in the audit report . . . .”); see also Jean Eaglesham, Auditors Didn’t Flag Risks Building Up In Banks, Wall St. J., Apr. 10, 2023, https://www.wsj.com/articles/auditors-didnt-flag-risks-building-up-in-banks-6506585 (quoting Martin Baumann, a former chief auditor at the PCAOB: “I’m not the auditor of the bank and I don’t know if this [bonds issue] should have been included in the auditor’s report,” . . . “[b]ut as the lead author of the standard, this certainly is the kind of item that we had in mind for critical audit matters.”).
\[34\] See Jian Zhang, PhD & Kurt Pany, PhD, Critical Audit Matter Reporting, A Comparison of Years 1 through 3 (“As was the case in 2019, none of the CAMs analyzed in the latter two years included an explicit description of the outcomes of the related audit procedures performed”); see also Karla M. Zehms et al., Old Institutions, New Report:
More specifically, our proposed amendments to paragraphs .11 and .14 follow:

_Determination of Critical Audit Matters_

.11 The auditor must determine whether there are any critical audit matters in the audit of the current period's financial statements. A critical audit matter is any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex auditor judgment. Critical audit matters are not a substitute for the auditor's departure from an unqualified opinion (i.e., a qualified opinion, adverse opinion, or disclaimer of opinion on the financial statements as described in AS 3105).

. . . .

.14 For each critical audit matter communicated in the auditor's report the auditor must:

. . . .

c. Describe how the critical audit matter was addressed in the audit; and,

including:

Note: In describing how the critical audit matter was addressed in the audit, the auditor may describe: (1) the auditor's response or approach that was most relevant to the matter; (2) a brief overview of the audit procedures performed; (3) an indication of the outcome of the audit procedures; and (4) key observations with respect to the matter, or some combination of these elements; and

. . . .

We generally agree with the MIAG that the amendment to paragraph .11 to delete the word “especially” addresses “a concern this term is being used to avoid reporting of a critical audit matter.” The amendment to paragraph .14 requires disclosure of how the critical audit matter

---

Auditors’ Experiences Implementing Critical Audit Matter Reporting 36 (2023) (on file with CII) (“Our results illustrate the real-world effects of the political nature of audit standard setting by showing how the PCAOB’s narrowing of the circumstances under which auditors would report original information in CAMs translated in practice into a prohibition against doing so.”).

35 Letter from Members of the IAG to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board 6 (May 16, 2023) (on file with CII); see Karla M. Zehms et al., When Auditors Provide Both Key Audit Matter and Critical Audit Matter Disclosures for the Same Client 22 (May 2023) (on file with CII) (Finding that Key Audit Matters seem to cover a wider array of topics and thus tend to be greater in number than Critical Audit Matters, in part, because CAMs are limited by definition to matters “that involve especially challenging, subjective, or complex auditor judgment.”); see also Soyoung Ho, PCAOB Advisers Say Auditors May not be Fully Complying with Expanded Reporting Rule, Thomson Reuters (Apr. 7, 2023),
was addressed in a manner that many investors believe would provide more useful information for decision making.  

10. Are the proposed amendments to clarify the meaning of “present fairly” appropriate? If not, why not?

CII generally supports the proposed amendments to clarify the meaning of “present fairly.” The meaning of present fairly in the Proposal is generally consistent with the quality and reliability language in our policy on Independence of Accounting and Auditing Standard Setters because it provides that the auditor’s obligation to investors “extends beyond compliance with the applicable financial reporting framework.”

We strongly agree with the MIAG that “[a]udit firms should ensure that auditors focus on whether the financials are a fair presentation of the company's position rather than narrowly focusing on whether the company is following U.S. GAAP.”

The proposed amendments would, in our view, appropriately rescind existing AS 2815, The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting Principles" and incorporate its requirements into proposed AS 2810, Evaluating Audit Results (AS 2810). We generally agree with the Board that the result provides “for a more logical presentation of requirements regarding whether the financial statements are presented fairly in conformity with the applicable financial reporting framework.” We, however, would generally support the Board providing some additional language or guidance in AS 2810 on how auditors would be expected to meet their “present fairly” responsibility.

As one example, the Board might consider including in the Note to paragraph .31 of AS 2810 the following language from paragraph .06 of AS 2815: “Generally accepted accounting principles recognize the importance of reporting transactions and events in accordance with their

https://tax.thomsonreuters.com/news/pcaob-advisers-say-auditors-may-not-be-fully-complying-with-expanded-reporting-rule/ (“Dane Mott, an accounting analyst with Capital Group Companies, believes that analysts should not have to go to two different filings to get information [and] [i]f KAMs have lower threshold, he said the PCAOB should consider lowering the threshold for CAMs because more information is helpful to investors.”).

See, e.g., PCAOB Release No. 2022-007 at 4 (“Several investors said that they would like auditors to use more specific, rather than generic, language in communicating CAMs and to include in CAMs a discussion of the outcome of audit procedures.”).

PCAOB Release No. 2023-001 at 55 (emphasis added).

Id. at 30.

Letter from Members of the IAG to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board at 4 (emphasis omitted).


Id. at 30.

See id. at A2-1 & A2-2.
We agree with the MIAG that “it is important to [include this language] . . . in AS 2810.”

The Board might also consider including in the Note to proposed paragraph .30 of AS 2810 the following additional guidance:

The auditor should also carefully review the significant judgments made by the client that ties to the underlying business model; understand how the crucial elements of the business model interplay with accounting estimates; evaluate the range of estimates the auditor views as appropriate in their assessment of fairly presents; consider incentives/opportunities for management bias in their assessment of fairly presents; and consider uncorrected estimates. The auditor must exercise professional judgment to determine what additional steps should be taken to evaluate the audit evidence in the context of evaluating whether the financial statements are presented fairly.

13. Is the proposed amendment to accelerate the documentation completion date by reducing the maximum period of time to assemble a complete and final set of audit documentation for retention from 45 days to 14 days from the report release date appropriate? If not, why not?

CII generally supports the proposed amendment to accelerate the documentation completion date by reducing the maximum period of time to assemble a complete and final set of audit documentation for retention. We, however, would revise the proposed amendment by replacing 14 days with two days. Generally consistent with the “timely” language in our policy on Independence of Accounting and Auditing Standard Setters, we agree with the Board that:

[A] shorter period of time may provide better protection for investors than a longer period: it could permit acceleration of PCAOB inspections and provide the strongest incentives for firms to implement operating efficiencies. Thus, in principle, the shortest feasible documentation completion date could achieve more benefits than a longer period.

Similarly, we note that Chair Williams stated: “[i]t is critical that the documentation is completed as close in time as possible to the completion of the audit.”

---

44 Id. at A2–4 (language unstruck).
45 Letter from Members of the IAG to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board at 5.
46 PCAOB Release No. 2023-001 at 56 (emphasis added).
47 See id. at A3–5.
48 Id. at 52.
49 Chair Erica Y. Williams, Statement on Proposal to Modernize PCAOB Standards Addressing Core Auditing Principles and Responsibilities, PCAOB Open Board Meeting.
Based on the information provided in the Proposal, we believe the shortest feasible documentation completion date appears to be two days.\textsuperscript{50} We note our view is consistent with the following view of the MIAG:

The Proposal makes a good argument for why the completion period should be shorter in an age of instant documentation and communication but it fails to make convincing argument for why 14 days is better than any other shortened period. . . . We . . . believe that the shorter period would allow the PCAOB to schedule its inspections more efficiently, providing additional benefits to investors.\textsuperscript{51}

24. The Board requests comment generally on the analysis of the impact of the proposal on EGCs. Are there reasons why the proposal should not apply to audits of [Emerging Growth Companies] EGCs? If so, what changes should be made so that the proposal would be appropriate for audits of EGCs? What impact would the proposal likely have on EGCs, and how would this affect efficiency, competition, and capital formation? Please specify.\textsuperscript{52}

CII believes the Proposal should apply to audits of EGCs. Generally consistent with the quality and reliability language in our policy on Independence of Accounting and Auditing Standard Setters and our prior views on EGC and PCAOB proposals,\textsuperscript{53} we generally agree with the following conclusion of the Board:

We expect [the Proposal’s] . . . benefits to be greater on EGC audits than non-EGC audits because EGCs are more likely to be audited by [U.S. non-affiliate firms] NAFs; however, costs of implementation may also be incrementally higher for audits of EGCs. On a net basis, we expect that the overall impact of the proposed amendment on EGC audits would not be disproportionate to the impact on non-EGC audits.

Accordingly, and for the reasons explained . . . , the Board anticipates that, if it adopts the proposed standard and related amendments, it will request that the Commission determine that it is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote

\textsuperscript{50} See PCAOB Release No. 2023-001 at 37 (“Examples observed through the PCAOB’s 2022 inspections include non-U.S. affiliates that have local policies specifying completion of documentation by deadlines such as 2 days, 7 days, 10 days, 14 days, and 30 days after the report release date.”).
\textsuperscript{51} Letter from Members of the IAG to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board at 9.
\textsuperscript{52} PCAOB Release No. 2022-009 at 57 (emphasis added).
\textsuperscript{53} See, e.g., Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Office of the Secretary, PCAOB 2 (Oct. 28, 2021), https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket042/1_cii.pdf?sfvrsn=f15ad4b2_6 (“In response to this question, CII shares the PCAOB’s view that “if [the Board] . . . adopts the proposed amendments, it will request that the [U.S. Securities and Exchange] Commission determine that it is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation, to apply the amendments to audits of EGCs.”).
efficiency, competition, and capital formation, to apply the proposed standard and related amendments to audits of EGCs.\textsuperscript{54}

We note our view is also shared by the MIAG which concluded: “Based on the experience of all our members, we believe the analysis of the impact of the Proposal on EGC’s is reasonably accurate [and] [w]e support the Proposal’s conclusion that the standard should apply equally to audits of EGCs.”\textsuperscript{55}

****

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

Sincerely,

Jeffrey P. Mahoney  
General Counsel

\textsuperscript{54} PCAOB Release No. 2022-009 at 54.  
\textsuperscript{55} Letter from Members of the IAG to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board at 11.