



Via Email

March 17, 2014

Phoebe W. Brown
Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

Re: Improving the Transparency of Audits: Proposing Amendments to PCAOB Auditing Standards to Provide Disclosure in the Auditor's Report of Certain Participants in the Audit (PCAOB Rulemaking Docket Matter No. 029)¹

Dear Madam Secretary:

The Council of Institutional Investors (“CII”) appreciates the opportunity to provide comments on the Public Company Accounting Oversight Board’s (“PCAOB” or “Board”) reproposal to amend its standards to improve the transparency of public company audits (“Amendments”).² CII is a non-profit, non-partisan, association of pension funds, other employee benefit funds, endowments and foundations with combined assets that exceed \$3 trillion.³

As the leading voice for effective corporate governance and strong shareowner rights, CII believes that accurate and reliable audited financial statements are critical to investors in making informed investment decisions, and vital to the overall well-being of our capital markets.⁴ That strong belief is reflected in the following CII membership approved policy on “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.⁵

¹ PCAOB Release No. 2013-009 (Dec. 4, 2013), available at <http://pcaobus.org/Rules/Rulemaking/Docket029/PCAOB%20Release%20No%20%202013-009%20-%20Transparency.pdf>.

² *Id.* at 1.

³ For more information about the Council of Institutional Investors (“CII”), please visit CII’s website at <http://www.cii.org/>.

⁴ Council of Institutional Investors, Policies on Other Issues, Independence of Accounting and Auditing Standard Setters (Adopted Oct. 7, 2008), http://www.cii.org/policies_other_issues#indep_acct_audit_standards.

⁵ *Id.*

Our policy on Independence of Accounting and Auditing Standard Setters also 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.”⁶ Our membership reaffirmed that principle last spring when approving substantial revisions to our policy on “Auditor Independence.”⁷ That policy includes the following provisions that we believe are relevant to issues raised by the Amendments:

2.13 Auditor Independence

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 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 track record of the lead partners and the extent of their professional commitments, as provided upon request or observable through disclosure or signature of the lead partner on the auditor’s report

....

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. Such provisions should state that if the board’s selection fails to achieve the support of a majority of the for-and-against votes cast, the audit committee should: (1) take the shareowners’ views into consideration and reconsider its choice of auditor and (2) solicit the views of major shareowners to determine why broad levels of shareowner support were not achieved.⁸

⁶ *Id.*

⁷ Council of Institutional Investors, Corporate Governance Policies § 2.13 Auditor Independence, available at http://www.cii.org/corp_gov_policies#BOD.

⁸ *Id.*

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In applying the language, background, and intent of the above referenced membership approved policies to the issues raised by the Amendments, we have reached the following conclusions:

Disclosure of the Name of the Engagement Partner

CII, consistent with our long-standing views on this topic,⁹ strongly supports the Amendments requiring the disclosure in the auditor's report of the name of the engagement partner for the most recent period. Our support is based, in part, on our membership approved policy on Auditor Independence.

The language, background, and intent of our policy on Auditor Independence indicates that our members' believe that an efficient tool for collecting information about the engagement partner would be through disclosure of the engagement partner's name in the auditor's report. We believe such disclosure would result in databases or compilations of information about the engagement partner that would be useful to investors. More specifically, our policy indicates that information about the engagement partners' track record and the extent of their professional commitments would be relevant to our members as long-term shareowners in determining how to cast votes on the more than two thousand proposals that are presented annually to shareowners on whether to ratify the board's choice of outside auditor.¹⁰

Our support for the disclosure requirement is also based on the related recommendation and conclusions of the U.S. Department of Treasury's Advisory Committee on the Auditing Profession ("ACAP").¹¹ In what was certainly one of the most comprehensive studies of the auditing profession in U.S. history, the ACAP concluded that "the engagement partner's signature on the auditor's report would increase transparency and accountability."¹²

⁹ See, e.g., Letter from Jeff Mahoney, General Counsel, to Office of the Secretary 3 (Jan. 5, 2012) [hereinafter Jan Letter], http://pcaobus.org/Rules/Rulemaking/Docket029/022b_CII.pdf.

¹⁰ ISS Voting Data (last visited March 13, 2014) (on file with CII) (Last year 2,696 companies in the Russell 3000 held a vote to ratify the board's choice of outside auditor.).

¹¹ U.S. Department of the Treasury's Advisory Committee on the Auditing Profession, *Final Report of the Advisory Committee on the Auditing Profession to the U.S. Department of the Treasury* VII:19-20 (Oct. 6, 2008), available at <http://www.treasury.gov/about/organizational-structure/offices/Documents/final-report.pdf>.

¹² *Id.* at VII:20. We note that the Department of the Treasury's Advisory Committee on the Auditing Profession's ("ACAP") recommendation to mandate the engagement partner's signature on the auditor's report originated with ACAP's Subcommittee on Firm Structure and Finances ("Subcommittee"). *Id.* at II:5. The Subcommittee was chaired by Robert R. Glauber, Board Member, Moody's Corporation, XL Capital Ltd., and Quadra Realty Trust, and included Timothy Flynn, Chairman and Chief Executive Officer, KPMG LLP, Gaylen R. Hansen, National Association of State Boards of Accountancy, and Principal, Director of Accounting and Auditing Quality Assurance, Ehrhardt Keefe Steiner & Hottman PC, Richard H. Murray, Managing Director and Chief Claims Strategist, Swiss Re, William D. Travis, Director and Former Managing Partner, McGladrey & Pullen LLP, Lynn E. Turner, Former Chief Accountant, Securities and Exchange Commission, and Senior Advisor, Kroll Zolfo LLC, and Ann Yerger, Executive Director, CII. *Id.* at III:1-2. We also note that the recommendation was explicitly endorsed by, among others, Don T. Nicolaisen, ACAP Co-Chair, former Chief Accountant, and Board Member, Morgan Stanley, Paul G. Haaga, Jr., Vice Chairman, Capital Research and Management, Mary K. Bush, ACAP Member, Board Member, Discover Financial Services, Dennis Johnson, Senior Portfolio Manager, Corporate Governance, California Public Employees' Retirement System, and Paul Lee, Director, Hermes Equity Ownership Services Limited. *Id.* at VII:19.

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As we indicated in our January 2012 letter to the Board, we would have preferred that the PCAOB require the signature of the engagement partner as recommended by ACAP.¹³ Consistent with our policy on Auditor Independence, however, we continue to believe the required disclosure of the name of the engagement partner has most of the potential benefits as the signature requirement.¹⁴ We note that either requirement would result in information about the engagement partner that would be relevant to our members in determining how to cast votes on proposals to ratify the board's choice of outside auditor.

Finally, our support for the disclosure requirement is also based on what appears to be a growing body of empirical research indicating that the engagement partner's name in the auditor's report would enhance investor protection and, consistent with our policy, would be useful information to some investors.¹⁵

Disclosure About Certain Other Participants in the Audit

We also support the Amendments requiring information about certain other participants in the audit. We agree with the Board that investors, including some of our members, have called for greater disclosure in the auditor's report of the names and locations of other participants in the audit.¹⁶

It should not be surprising to anyone that investors are demanding more transparency about off-shoring and similar arrangements by audit firms. Information about those arrangements may be particularly relevant to investors when a significant portion of the audit work is being performed by a firm other than the one that signs the auditor's report and the other firm:

- Is not subject to inspections by the PCAOB or other regulators;
- Has a disciplinary history with the PCAOB or other regulators; or
- Is subject to different, and potentially conflicting, legal and regulatory requirements than the firm issuing the opinion.¹⁷

¹³ Jan Letter, *supra* note 9, at 3 (“We, therefore, would not object to a final standard requiring disclosure of the engagement partner's name, rather than signature, in the audit report.”).

¹⁴ *Id.* (“While our strong support for requiring the signature of the engagement partner in the audit report has not wavered, we acknowledge that the Release's proposed approach of disclosing the name of the engagement partner ‘has most of the same potential benefits as a signature requirement.’”).

¹⁵ See Letter from Auditing Standards Committee, Auditing Section—American Accounting Association, to Office of Secretary, Public Company Accounting Oversight Board 2 (Jan. 9, 2012) (“disclosure of the engagement partner's name in the audit report would enhance investor protection . . . [and] investors may find this information useful”), available at http://pcaobus.org/Rules/Rulemaking/Docket029/024b_AAA.pdf; see also Joseph V. Carcello & Chan Li, *Costs and Benefits of Requiring an Engagement Partner Signature: Recent Experience in the United Kingdom*, 88 *Acct. Rev.* 1511, 1515 (2013) (“Our results are consistent with the argument that requiring an individual audit partner to sign a report improves audit quality by increasing the partner's accountability and transparency of audit reporting.”), available at http://pcaobus.org/Rules/Rulemaking/Docket029/024b_AAA.pdf.

¹⁶ PCAOB Release No. 2013-009 at 9 (“a task force of the Board's IAG conducted a survey of investors affiliated with investment banks, mutual funds, pension funds, and hedge funds . . . [and] [s]eventy percent of the investors surveyed who responded to a question about the desirability of disclosure of work on the audit performed by other firms said that they would like to know the degree of involvement in the audit of the firms that are not signing the auditor's report”).

¹⁷ See *id.* at 19.

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In that regard, we also agree with the Board that:

As with the disclosure of the name of the engagement partner, over time, information sources likely would develop about the firms that participate in public company audits, such as lists of their public company accounts, size of the accounting firms, disciplinary proceedings and litigation in which they have been involved, and similar matters. Such information likely would be useful to . . . investors”¹⁸

As indicated, we believe that investors need more information about certain other participants in the audit and, consistent with our policy on Independence of Accounting and Auditing Standard Setters, the Board should use the Amendments to satisfy those needs.

We thank you for considering our views in response to the Amendments. Please do not hesitate to contact me if you have any questions or would like any additional information about the contents of this letter.

Sincerely,

A handwritten signature in cursive script that reads "Jeff Mahoney".

Jeff Mahoney
General Counsel

¹⁸ *Id.* at 20.