



Via Email

August 19, 2015

Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC
20549—1090

*Re: Possible Revisions to Audit Committee Disclosures*¹

Dear Mr. Secretary:

The Council of Institutional Investors (CII) appreciates the opportunity to provide comments on the Securities and Exchange Commission's (SEC or Commission) concept release on possible revisions to audit committee disclosures (Release). 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.²

As the leading voice for effective corporate governance and strong shareowner rights, CII generally supports the SEC's initiative to improve the content of audit committee disclosures. CII members as long-term shareowners rely on audit committee members to perform many critical roles and responsibilities. Our members generally believe that audit committees should disclose "meaningful information to investors about how the committee carries out its responsibilities."³

The Release focuses largely on one of the audit committee's many responsibilities—audit committee oversight of the independent auditor.⁴ CII members generally believe that that responsibility should include ensuring that the independent audit is a worthwhile use of company assets.

CII members generally expect the independent audit to serve a greater function than a compliance exercise and to add value to long-term shareowners. Yet some audit committees may not always exert the degree of scrutiny on independent audits that shareowners expect.

¹ Securities Act Release No. 9862, Exchange Act Release No. 75,344, 80 Fed. Reg. 38,995 (July 8, 2015), <http://www.gpo.gov/fdsys/pkg/FR-2015-07-08/pdf/2015-16639.pdf>.

² For more information about the Council of Institutional Investors ("CII"), please visit CII's website at <http://www.cii.org/>.

³ Council of Institutional Investors, Corporate Governance Policies, § 2.13 Auditor Independence (updated Apr. 1, 2015), http://www.cii.org/files/committees/policies/2015/04_01_15_corp_gov_policies.pdf.

⁴ See 80 Fed. Reg. at 39,003.

The following CII membership approved policies, are intended, in part, to narrow the gap between long-term shareowner expectations and audit committee practices with respect to the audit committee and independent auditor relationship:

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

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.

The audit committee report should provide meaningful information to investors about how the committee carries out its responsibilities. The report should include an explanation of how the committee carries out its auditor compensation responsibilities in consideration of audit quality objectives. The report should include a fact specific explanation for not changing the company's auditor if the committee chooses to renew the engagement of an auditor with more than 10 consecutive years of service, or if the auditor is retained despite knowledge of substantive deficiencies during the committee's review of the considerations described above.

2.13b Competitive Bids: The audit committee should seek competitive bids for the external audit engagement at least every five years.

. . . .

2.13d Audit Committee Charters: The proxy statement should include a copy of the audit committee charter and a statement by the audit committee that it has complied with the duties outlined in the charter.

. . . .

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.⁵

Disclosure About Audit Committee Oversight of Auditor

Consistent with our membership approved policies, CII generally believes that there are at least two changes to the current audit committee disclosure requirements that the Commission should consider that would likely better inform investors about the audit committee's oversight of the audit and the independent auditor. More specifically, we would generally support, at a minimum, the following audit committee disclosures:

- (1) Disclosure about how the committee evaluates the amount of audit fees and their connection to audit quality,⁶ and
- (2) Disclosure about how the committee determines renewal of engagement of an audit firm when the firm has more than 10 consecutive years of service, or if the firm has substantive deficiencies identified during the committee's review.⁷

⁵ § 2.13 Auditor Independence.

⁶ See § 2.13a.

⁷ *Id.* CII continues to support the Public Company Accounting Oversight Board's proposed auditor reporting standard that would require the auditor to include in the auditor's report a statement containing the year the auditor began serving consecutively as the company's auditor. See Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to Phoebe Brown, Office of the Secretary, PCAOB 2 (Dec. 16, 2013 Attachment) ("CII generally believes that information regarding auditor tenure in the auditor's report would be useful to investors and other financial statement users."), http://www.cii.org/files/issues_and_advocacy/correspondence/2013/12_16_13_CII_letter_PCAOB_docket_034_proposed_auditing_standards.pdf. If the Securities and Exchange Commission were to issue and implement a rule requiring CII's membership approved disclosure in audit committee reports, we would not oppose eliminating a duplicative requirement to disclose auditor tenure in the auditor's report.

As an initial matter, we note that both of our membership approved audit committee disclosures are generally consistent with disclosures that the Audit Committee Collaboration, referenced in the Release,⁸ has identified as emerging practices that “audit committees should consider [adopting to] improve[] their related disclosures . . .”⁹

We generally agree with the Audit Committee Collaboration that disclosure about auditor compensation:

[C]ould help investors understand the direct and primary role the audit committee played, and the important balance the audit committee struck in ensuring that the auditor is paid a reasonable amount that is consistent with the delivery of a quality audit. Linking this type of contextual information to compensation policies or decisions could be useful to those seeking to better understand the appropriateness of audit firm compensation.¹⁰

Similarly, in commenting on the Release and the related Public Company Accounting Oversight Board (PCAOB or Board) standard setting projects, prominent accountant/analyst Jack Ciesielski wrote that providing investors more information about how auditor compensation relates to audit quality could “engender[] [more] confidence in the financial statements and the capital markets”¹¹

We also generally agree with the Audit Committee Collaboration that disclosure about renewing the engagement of an audit firm “can help build investor confidence by underscoring the thoroughness of the process that led to the audit committee’s decision.”¹² We believe the benefits of such disclosure are heightened in the case of long auditor tenure.¹³

⁸ See, e.g., 80 Fed. Reg. at 38,996 n.5.

⁹ Audit Committee Collaboration, Enhancing the Audit Committee Report, A Call to Action 8 &10-13 (Nov. 20, 2013) (Recommending, among other disclosures, “relevant factors the audit committee considers when . . . reappointing an audit,” and “relevant factors the audit committee considers when determining auditor compensation”), <http://www.thecaq.org/docs/audit-committees/enhancing-the-audit-committee-report-a-call-to-action.pdf?sfvrsn=2>.

¹⁰ *Id.* at 12.

¹¹ Jack T. Ciesielski, Can Regulators Make Audits Matter More? Three Proposals Offer Some Hope, 24 Analyst’s Acct. Observer 1 (July 29, 2015) (on file with CII).

¹² Audit Committee Collaboration at 11.

¹³ See § 2.13a.

August 19, 2015
Page 5 of 9

Our policy on “audit committee responsibilities regarding outside independent auditors” was revised in 2013 to reflect the view of many of our members that lengthy auditor tenure may threaten auditor independence and increase the risk of audit failure.¹⁴ Our proposed disclosure builds upon our long standing policy on competitive bids providing that the “audit committee should seek competitive bids for the external engagement at least every five years.”¹⁵

Our proposed disclosure also builds on, and could incorporate, existing voluntary disclosures about auditor tenure that have been adopted in recent years by a growing number of audit committees of Fortune 500 companies.¹⁶ Those voluntary disclosures reflect the PCAOB’s finding that there is “strong interest in this information” from investors,¹⁷ and the SEC’s acknowledgement that there is “some academic evidence connecting auditor tenure and audit quality”¹⁸

¹⁴ See Rosemary Lally, 21 CII Governance Alert, Carpenters’ Fund Continues to Make Progress on Auditor Disclosure 2 (July 16, 2015) (indicating that CII member United Brotherhood of Carpenters Pension Fund believes that long audit tenure may threaten auditor independence), http://www.cii.org/article_content.asp?edition=4§ion=13&article=603; see generally, Maxwell Murphy, CFO Journal, Most Companies Have Same Auditor for Over a Decade, Wall St. J., Aug. 10, 2015 at 1 (“The Public Company Accounting Oversight Board broached the topic in 2011, but by early 2014 dropped its pursuit of auditor term limits after heavy resistance from companies.”), <http://blogs.wsj.com/cfo/2015/08/10/most-companies-have-same-auditor-for-over-a-decade/>.

¹⁵ § 2.13b

¹⁶ Rosemary Lally at 2 (indicating that in the last two proxy seasons thirty-eight companies have adopted the following audit committee disclosures relating to audit tenure: (1) The tenure of the current audit firm; (2) That the audit committee periodically considers whether there should be a regular rotation of the independent external audit firm; and (3) that the members of the audit committee and the board believe that the continued retention of the audit firm as the company’s independent external auditor is in the best interests of the company and its investors). We note that audit committee disclosure about auditor tenure has long been considered a corporate governance best practice in the United Kingdom. Financial Reporting Council, The UK Corporate Governance Code § C.3.8 (Sept. 2012) (audit committee reports should include an “an explanation of how it has assessed the effectiveness of the external audit process and the approach taken to the appointment or reappointment of the external auditor, and information on the length of tenure of the current audit firm and when a tender was last conducted”), <http://www.slc.co.uk/media/5268/uk-corporate-governance-code-september-2012.pdf>.

¹⁷ PCAOB Release No. 2013-005, Proposed Auditing Standards – The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion; the Auditor’s Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Amendments to PCAOB Standards, PCAOB Rulemaking Docket Matter No. 034, at A5-16 (Aug. 13, 2013), http://pcaobus.org/Rules/Rulemaking/Docket034/Release_2013-005_ARM.pdf.

¹⁸ 80 Fed. Reg. at 39,002 n.74; see generally, Lauren C. Reid, University of Pittsburgh et al., Impact of Auditor and Audit Committee Report Changes on Audit Quality and Costs: Evidence from the United Kingdom 6 (Aug. 17, 2015) (“this paper contributes to the audit quality literature by providing evidence that is consistent with enhanced auditor and audit committee disclosures increasing audit quality without a significant increase in audit costs”) (on file with CII).

August 19, 2015

Page 6 of 9

As indicated, we generally believe that both of our membership approved proposed audit committee disclosures would enhance the ability of shareowners to oversee the audit committee's activities. Moreover, and importantly, the disclosures would provide an additional basis upon which shareowners can cast their votes in connection with the ratification of the audit committee's selection of the external auditor and in connection with the election of the audit committee chair.¹⁹

Disclosure of Certain Individuals on the Engagement Team

CII continues to believe, generally consistent with our membership approved policies,²⁰ that disclosure of the signature or name of the engagement partner in the auditor's report would be useful to investors.²¹ As we have previously explained in a comment letter to the Board:

Our support is based on the Council's membership-approved policies. Those policies indicate that information about engagement partners' track record compiled as the result of requiring disclosure of the partner's name in the auditor's report would be relevant to our members as long-term shareowners in overseeing audit committees and 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.

¹⁹ See Rosemary Lally at 2 (indicating that CII member United Brotherhood of Carpenters Pension Fund plans to "begin to vote against auditor ratification, and if that does not produce results, vote against the audit committee chair" if certain audit committee disclosures including disclosures about the audit fee and tenure are not provided).

²⁰ § 2.13a ("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").

²¹ See Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to Phoebe W. Brown, Office of the Secretary, Public Company Accounting Oversight Board 2 (Aug. 15, 2014), http://www.cii.org/files/issues_and_advocacy/correspondence/2014/08_15_14_PCAOB_letter_audit_transparency.pdf [hereinafter Aug Letter]; see also Francine McKenna, PCAOB's Franzel Speaks to AAA: Are Auditor's ICFR Opinions Just "Busy Work," 3 (Aug. 9, 2015) (supporting disclosure of the name of engagement partners to provide "transparency about whether or not the system is working and incompetents are being flushed out"), <http://retheauditors.com/2015/08/09/pcaobs-franzel-speaks-to-aaa-are-auditors-icfr-opinions-just-busy-work/>; PCAOB Release No. 2015-004, Supplemental Request for Comment: Rules to Require Disclosure of Certain Audit Participants on a New PCAOB Form, PCAOB Rulemaking Docket Matter No. 029, at A2-11 (June 30, 2015) ("empirical evidence suggests that disclosure of the name of the engagement partner could be beneficial . . ."), http://pcaobus.org/Rules/Rulemaking/Docket029/Release_2015_004.pdf.

As we have also indicated in prior letters, we believe that the Council's position in favor of requiring disclosure in the auditor's report of the name of the engagement partner is generally supported by, among other sources, the recommendations and conclusions of the U.S. Department of Treasury's Advisory Committee on the Auditing Profession, the growing body of empirical research indicating that the requirement would enhance investor protection and provide useful information to investors, and the more than eight years of experience with a similar requirement in the European Union.²²

We have also publicly supported and continue to support required disclosure in the auditor's report of certain other participants involved in the audit as proposed by the PCAOB.²³ As we have previously explained in a comment letter to the Board:

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. 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.

²² Aug Letter, *supra* note 21, at 2 (footnotes omitted).

²³ Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to Phoebe W. Brown, Office of the Secretary, Public Company Accounting Oversight Board 4-5 (Mar. 17, 2014), http://www.cii.org/files/issues_and_advocacy/correspondence/2014/03_17_14_CII_letter_to_PCAOB_impoving_audits.pdf.

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”²⁴

CII would not oppose disclosure of the name of the engagement partner or others involved in the audit in the audit committee report. However, as previously explained in our recent comment letter to the PCAOB, in which we did not oppose disclosure in the new PCAOB Form AP, we generally believe disclosure in a location outside of the auditor’s report “is . . . less likely to capture all of the potential benefits of disclosure . . . in the auditor’s report and is also generally inconsistent with the language of CII’s membership approved policy.”²⁵ More specifically, we generally agree with the Board that:

[D]isclosure in the auditor’s report would be more transparent because (1) the “required information would be disclosed in the primary vehicle by which the auditor communicates with investors and where other information about the audit is already found and [(2) the information] would be available immediately upon filing with the SEC of a document containing the auditor’s report.”

In addition, . . . disclosure in the auditor’s report . . . would increase an engagement partner’s sense of accountability because the “engagement partner would be involved in the preparation of the auditor’s report, but may not be involved in the preparation of the . . . [other disclosure document].”²⁶

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²⁴ *Id.* at 4-5 (footnotes omitted).

²⁵ Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to Phoebe W. Brown, Office of the Secretary, Public Company Accounting Oversight Board 3 n.11 (July 30, 2015), http://pcaobus.org/Rules/Rulemaking/Docket029/005d_CII.pdf.

²⁶ *Id.* at 4 (footnotes omitted).

August 19, 2015
Page 9 of 9

We thank you for considering our views in response to the Release. 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". The signature is written in black ink and is positioned above the printed name and title.

Jeff Mahoney
General Counsel