

Via Email

April 18, 2019

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

*Re: File Number PCAOB-2019-02/<sup>1</sup>File Number PCAOB-2019-03<sup>2</sup>*

Dear Mr. Secretary:

This letter is in response to the Securities and Exchange Commission (SEC) notice to solicit comments on the Public Company Accounting Oversight Board's (PCAOB or Board) Proposed Rules on Auditing Accounting Estimates, Including Fair Value Measurements, and Amendments to PCAOB Auditing Standards (Estimates Standard),<sup>3</sup> and the related Proposed Rules on Amendments to Auditing Standards for Auditor's Use of the Work of Specialists (Specialists Standard) (Estimates Standard and Specialists Standard, collectively the Standards).<sup>4</sup>

The Council of Institutional Investors (CII or Council) continues to support the Standards.<sup>5</sup> CII is a nonprofit, nonpartisan association of 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. Our associate members include a range of asset managers with more than \$35 trillion in assets under management.<sup>6</sup>

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<sup>1</sup> Public Company Accounting Oversight Board; Notice of Filing of Proposed Rules on Auditing Accounting Estimates, Including Fair Value Measurements, and Amendments to PCAOB Auditing Standards, Exchange Act Release No. 85,434, 84 Fed. Reg. 13,396 (Apr. 4, 2019), <https://www.govinfo.gov/content/pkg/FR-2019-04-04/pdf/2019-06426.pdf>.

<sup>2</sup> Public Company Accounting Oversight Board; Notice of Filing of Proposed Rules on Amendments to Auditing Standards for Auditor's Use of the Work of Specialists, Exchange Act Release No. 85,435, 84 Fed. Reg. 13,442 (Apr. 4, 2019), <https://www.govinfo.gov/content/pkg/FR-2019-04-04/pdf/2019-06425.pdf>.

<sup>3</sup> 84 Fed. Reg. at 13,396.

<sup>4</sup> 84 Fed. Reg. 13,442.

<sup>5</sup> See, e.g., Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Office of Secretary, PCAOB 1 (Aug. 28, 2017) [hereinafter August Letter], [https://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2017/August%2028,%202017%20PCAOB\(letterhead\).pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2017/August%2028,%202017%20PCAOB(letterhead).pdf).

<sup>6</sup> For more information about the Council of Institutional Investors (CII), including its board and members, please visit CII's website at [https://www.cii.org/about\\_us](https://www.cii.org/about_us).

## **CII Policies**

CII membership approved policies relevant to the Standards include our policies on Financial Gatekeepers,<sup>7</sup> Independence of Accounting and Auditing Standard Setters,<sup>8</sup> and Auditor Independence.<sup>9</sup>

### Financial Gatekeepers

Adopted in April 2000, our policy on financial gatekeepers identifies audit firms as “financial gatekeepers” and encourages the regulators of those firms to remain “vigilant” in their oversight.<sup>10</sup> That policy states in relevant part:

The Council of Institutional Investors believes financial gatekeepers should be transparent in their methodology and avoid or tightly manage conflicts of interest. Robust oversight and genuine accountability to investors are also imperative. Regulators should remain vigilant and work to close gaps in oversight. Continued reforms are needed to ensure that the pillars of transparency, independence, oversight and accountability are solidly in place.

Auditors . . . and other financial “gatekeepers” play a vital role in ensuring the integrity and stability of the capital markets. They provide investors with timely, critical information they need, but often cannot verify, to make informed investment decisions. With vast access to management and material non-public information, financial gatekeepers have an inordinate impact on public confidence in the markets. They also exert great influence over the ability of corporations to raise capital and the investment options of many institutional investors.

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CII welcomes further examination of financial gatekeepers by regulators, lawmakers, academics and others, to determine what changes, including new rules and stronger oversight, are needed.<sup>11</sup>

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<sup>7</sup> Council of Institutional Investors, Policies on Other Issues, Financial Gatekeepers (adopted Apr. 3, 2010), [https://www.cii.org/policies\\_other\\_issues#fin\\_gatekeepers](https://www.cii.org/policies_other_issues#fin_gatekeepers).

<sup>8</sup> Council of Institutional Investors, 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>9</sup> Council of Institutional Investors, Corporate Governance Policies § 2.13 Auditor Independence (last updated Oct. 24, 2018), [https://www.cii.org/files/10\\_24\\_18\\_corp\\_gov\\_policies.pdf](https://www.cii.org/files/10_24_18_corp_gov_policies.pdf).

<sup>10</sup> Council of Institutional Investors, Policies on Other Issues, Financial Gatekeepers.

<sup>11</sup> *Id.*

## Independence of Accounting and Auditing Standard Setters

Our long-standing policy on independence of accounting and auditing standard setters was updated in 2017, in part, to clarify the attributes of an effective accounting *or* auditing standard setter.<sup>12</sup> That policy states in relevant part:

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. The result should be timely, transparent and understandable financial reports.

. . . .

In order to be high quality, accounting and auditing standards must be seen as meeting the needs of the investing public, and the standard setting process must be independent and free from undue influence.<sup>13</sup>

## Auditor Independence

Our long-standing policy on auditor independence was updated in 2013, in part, because of investor concerns about the audit committee's role in overseeing the external audit, including the decision to rotate the external auditor.<sup>14</sup> The policy states in part:

### **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 quality and frequency of communication from the auditor to the audit committee

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<sup>12</sup> Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Office of the Secretary, PCAOB 3 (Sept. 6, 2018) [Hereinafter September Letter], [https://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2018/September%206,%202018%20PCAOB%20Strategic%20Plan.pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2018/September%206,%202018%20PCAOB%20Strategic%20Plan.pdf).

<sup>13</sup> Council of Institutional Investors, Policies on Other Issues, Independence of Accounting and Auditing Standard Setters.

<sup>14</sup> September Letter, *supra* note 12, at 4.

- the experience, expertise and professional skepticism of the audit partner, manager and senior personnel assigned to the audit, and the extent of their involvement in performing the audit . . .
- the clarity, utility and insights provided in the auditor’s report and the auditor’s letter to management in relation to the audit . . .

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.<sup>15</sup>

. . . .

**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.<sup>16</sup>

In light of these and other membership approved policies and related CII public positions, we offer the following views on the Standards.

## **CII Views on Standards**

### Estimates Standard

We continue to support the Estimates Standard.<sup>17</sup> 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>18</sup> Further, we believe investors assign a high value to the auditor’s evaluation of fair value estimates and other accounting estimates reported by issuers.<sup>19</sup> This is not surprising, since

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<sup>15</sup> Council of Institutional Investors, Corporate Governance Policies § 2.13a Audit Committee Responsibilities Regarding Independent Auditors.

<sup>16</sup> *Id.* § 2.13f Shareowner Votes on the Board’s Choice of Outside Auditor.

<sup>17</sup> *See, e.g.*, August Letter, *supra* note 5, at 3.

<sup>18</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>19</sup> *See* 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 Oversight Board” 2 (Oct. 2, 2014),

[http://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2014/10\\_02\\_14\\_JMahoney%20PCAOB%20SAG\\_%](http://www.cii.org/files/issues_and_advocacy/correspondence/2014/10_02_14_JMahoney%20PCAOB%20SAG_%)

academic research and empirical evidence confirms that “financial reporting has continued to require more accounting estimates that involve complex processes and have a significant impact on companies operating results and financial positions.”<sup>20</sup>

We believe the need for the Estimates Standard is particularly compelling given that “the PCAOB has historically observed numerous deficiencies in auditing accounting estimates [and] . . . [i]nspection observations continue to raise concerns about auditors’ application of professional skepticism, including addressing potential management bias, in auditing accounting estimates.”<sup>21</sup>

We share the view of other investor groups that asserted in comment letters to the Board that the Estimates Standard “will strengthen auditor responsibilities, improve audit quality, and further investor protection.”<sup>22</sup>

We believe the Estimates Standard provides benefits to investors in at least two ways. First, the Estimates Standard provides “uniformity of the standards” for auditing accounting estimates.<sup>23</sup> We agree with the Board that creating greater uniformity in the auditing standards in this area should: (1) “increase . . . the quality of the information presented in the financial statements;”<sup>24</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>25</sup>

Second and more broadly, the Estimates Standard “strengthens auditor responsibilities for auditing accounting estimates.”<sup>26</sup> For example, the Estimates Standard would “[r]equire that the auditor obtain an understanding of management’s analysis of critical accounting estimates and take that understanding into account when evaluating the reasonableness of significant assumptions and potential management bias.”<sup>27</sup> This new requirement is particularly important for investors given the “disclosure and reporting responsibilities [for] . . . these matters” currently owed by auditors to an issuer’s audit committee and investors.<sup>28</sup> We agree with the Board that the new requirements “can reduce the non-diversifiable risk to investors and generally should result in investment decisions by investors that more accurately reflect the financial

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[20Investor%20Perspectives.pdf](#); see also Public Company Accounting Oversight Board; Notice of Filing of Proposed Rules on the Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion, and Departures From Unqualified Opinions and Other Reporting Circumstances, and Related Amendments to Auditing Standards, 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>20</sup> 84 Fed. Reg. at 13,427.

<sup>21</sup> *Id.* at 13,399. We believe the standard may be particularly helpful for estimates made pursuant to the new accounting standard on credit losses—an area of accounting estimates where, in our view, management bias historically has been rampant.

<sup>22</sup> *Id.* at 13,400.

<sup>23</sup> *Id.* at 13,433.

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

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

<sup>26</sup> *Id.* at 13,432.

<sup>27</sup> *Id.* at 13,401.

<sup>28</sup> *Id.* at 13,415 n.76.

position and operating results of each company, increasing the efficiency of capital allocation decisions.”<sup>29</sup>

### Specialists Standard

We also continue to support the related Specialists Standard.<sup>30</sup> We agree with the Board that a number of factors, including recent SEC and PCAOB enforcement actions, “indicate that improvements to PCAOB standards for using the work of a company’s specialists are needed and that increasing auditors’ attention to the work of a company’s specialists with respect to significant accounts and disclosures will enhance investor protection.”<sup>31</sup>

More specifically, we agree with the Board that investors will benefit from the Specialists Standard “because the application of the requirements should result in more consistently rigorous practices among auditors when using the work of a company’s specialist in their audits, as well as a more consistent approach to the supervision of auditor-employed and auditor-engaged specialists.”<sup>32</sup> We also agree that the increase in audit quality that should result from the new requirements “may increase the quality of the information provided in a company’s financial statements and decrease the cost of capital for that company.”<sup>33</sup>

In addition to the prospect of improving audit quality generally, we agree with the Board that the Specialists Standards’ requirement “to evaluate the work of the company’s specialist should result in some auditors developing a better understanding of the company’s accounting estimates in significant financial statement accounts and disclosures.”<sup>34</sup> That better understanding, in turn, “may also result in improved communications between the auditor and the audit committee,”<sup>35</sup> and between the auditor and investors via the auditor’s report.<sup>36</sup> We believe those improved communications have the potential for assisting investors in making more informed proxy voting decisions on the election of the audit committee chair and members and the ratification of the external auditor.<sup>37</sup>

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<sup>29</sup> *Id.* at 13,432.

<sup>30</sup> *See, e.g.*, August Letter, *supra* note 5, at 5.

<sup>31</sup> 84 Fed. Reg. at 13,448.

<sup>32</sup> *Id.* at 13,475.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.* at 13,476.

<sup>35</sup> *Id.*

<sup>36</sup> *See id.* at 13,469 (noting that the required description of critical audit matters in the auditor’s report “might include a discussion of the work or findings of a specialist”).

<sup>37</sup> *See, e.g.*, September Letter, *supra* note 12, at 10 (“for investors that are shareholders, . . . [audit] expectations may include: . . . providing information related to the audit that may assist in oversight of the audit committee’s responsibilities regarding the independent auditor, including proxy voting decisions on the election of directors that may chair or serve on audit committee and the ratification of the . . . the outside auditor”).

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

Sincerely,

A handwritten signature in blue ink that reads "Jeff Mahoney". The signature is written in a cursive style with a long, sweeping underline.

Jeffrey P. Mahoney  
General Counsel