



August 18, 2017

Mr. Brent J. Fields  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Subject: Release No. 34-81187; File No. PCAOB-2017-01

Submitted via <https://www.sec.gov/cgi-bin/ruling-comments>

Dear Mr. Fields:

The Committee on Corporate Reporting (CCR) of Financial Executives International (FEI) appreciates the opportunity to provide its views on the PCAOB's request for Securities and Exchange Commission approval of the new auditor reporting standard, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (the "new standard"). In this letter we have put forward questions that we believe the Commission should consider as it evaluates whether to approve the new standard. As background, we have included other information that we believe is relevant to this decision. Should the Commission decide to approve, we have included recommendations for an orderly and effective transition to the new reporting model.

FEI is a leading international organization of more than 10,000 members that engages with key stakeholders on matters that are important to senior financial executives. CCR is the senior technical committee of FEI. CCR member companies represent approximately \$7.5 trillion in market capitalization.

#### *Capital Market Implications*

There has always been a linkage between financial reporting by public companies and application of auditing standards by the profession, both from a technical and a behavioral perspective. With the creation of the PCAOB, and development and refinement of internal control standards (Auditing Standard No. 2 or "AS 2," and its successor Auditing Standard No. 5 or "AS 5"), there has been a noticeable increase in the degree to which application of auditing standards by auditors and their subsequent regulation by the PCAOB have directly impacted companies. Specifically, companies have been forced to change their internal operations, to incur additional compliance costs and to deploy resources differently than for their business or compliance needs. In addition, the new environment has influenced the decisions management

makes for financial reporting and disclosure. As the regulator for issuers, we believe these consequential effects on issuers are and should continue to be within the purview of the Commission to evaluate – whether the cause is related to the application of existing standards (e.g., AS 5) or the potential effects on issuers of the newly proposed auditor reporting standard. The basis for this is that the SEC has primacy over all matters that affect public companies, including the assessment of the cost of the regulatory burden it imposes. We believe that the new standard has the potential to bring those matters to a head.

To fairly evaluate the auditor reporting standard, the Commission will need to consider the issues auditing standards create for registrants in a broader capital market context. In the United States, we have the largest and deepest capital markets in the world. However, we observe that the long-term trends show a decline in the number of public companies and the number of initial public offerings, which should be an important public policy concern. If these trends continue and the favorable market conditions cease, the Commission will be regulating a steadily shrinking public market, while new offerings find their way into private channels outside the purview of the SEC. The efficiency and cost-effectiveness of private capital-raising effectively provides an upper limit on the costs that can be imposed on public companies before public market fundraising is deemed uneconomic. FEI is of the view that keeping new capital raising within the SEC's jurisdiction is an important public policy issue. Accordingly, we believe the Commission needs to consider not only the impact of this new standard on the auditing profession but also the consequential effects on issuers and prospective registrants.

In the view of the preparer community, the steady increase in the cost of meeting the obligations of a public company in the United States has significantly affected the level of new issuances. Another key factor is a regulatory system fraught with a myriad of risks both to the issuer and the management team personally. It is generally accepted that when offering and compliance costs are too high, companies and their investors will seek alternative opportunities. We believe there is risk that, depending on how this standard is implemented by auditors and enforced by their regulators, this standard could add significant compliance cost and impact audit efficiency. Given the Commission's broader mission to promote efficient capital formation, a thorough consideration of costs and benefits of this new auditing standard, including its potential impact on issuer costs, will be important.

We are quite familiar with the IAASB's equivalent to the PCAOB standard. It is important to recognize that how a new auditor reporting model will function is in large part determined by the regulatory environment in which it is implemented. We have the most developed regulatory system in the world, with the SEC and PCAOB serving as the oldest and best-resourced regulators compared with their counterparts in other jurisdictions. Our thorough and exacting regulatory philosophy will demand absolute compliance from this new standard. Accordingly, as the Commission evaluates the potential impact of this new standard, no comfort should be drawn from experience in other jurisdictions related to this type of reporting. For example, we are aware of the kind of auditor reports included in securities filings in the United Kingdom and wish to clarify that we don't believe that type of reporting will work in the U.S. regulatory environment. One must consider the financial reporting environment holistically, including the authority and power of the securities regulator and actions that are likely to result from such

disclosures. The regulatory environments in which this new IAASB standard is being implemented are not comparable to ours. Accordingly, implementation of the IAASB's standard abroad should not be construed as an appropriate testing ground for how this standard would be implemented in the U.S., nor should it serve as support for whether such additional information will be useful to investors in the U.S.

#### *Key Issues with the New Standard*

During the due process leading up to the release of this new standard, we and other constituents raised significant concerns regarding the impact this new standard could have on public companies, particularly as it relates to the scope of the auditor's responsibility and the influence of audit firm regulation on financial disclosure by registrants. Although some of these concerns were addressed in the version of the standard the Commission is reviewing, we do not believe that those matters have been addressed comprehensively. Two areas that are of particular concern are as follows:

1. Application of professional judgment by the engagement team and/or national office. It is important that judgments of the auditor reflect a fair and balanced application of the new standard. Those judgments should not be influenced by a desire to reduce the risk of an inspection finding or the desire to remediate a finding from a prior inspection of the accounting firm. This could be particularly challenging as auditors seek to determine what matters "relate to accounts or disclosures that are material to the financial statements," and to conclude on which of those "involved especially challenging, subjective, or complex auditor judgment." As part of its review of the new standard, the Commission should consider the consequences on auditors and registrants when judgments are subject to second-guessing in the absence of more prescriptive guidance or when good faith judgments reached by the audit engagement team are overturned.
2. Maintaining the authority and accountability of the SEC for issuer reporting. Management has legal responsibility for an entity's financial reporting and the SEC is responsible for regulating companies and their reporting. There is general agreement among all stakeholders that auditors should not be the original source of information about the registrant, nor should the auditor's report become a means to force companies to report information they would not have otherwise been required to disclose. We believe that the PCAOB has acknowledged those concerns in the course of developing the new standard. However, we have doubts as to whether those concerns were sufficiently addressed in this proposal given that the auditor retains an exception when "it is necessary to describe the principal considerations that led the auditor to determine that a matter is a critical audit matter or how the matter was addressed in the audit." To the extent that auditor behavior in compliance with an auditing standard compels disclosure by the registrant that is not otherwise required to comply with U.S. GAAP, the SEC's authority has been breached. By virtue of its broader view of costs and benefits, we believe that the SEC should not directly (or indirectly by operation of an auditing standard) cede that authority to another body, unless such delegation is specifically and formally recognized as a matter of law.

*Other Considerations and Potential Actions by the Commission*

We understand that the decision on whether to approve this standard hinges on whether doing so would be in the best interest of the public, a very high threshold that requires the Commission to consider the new standard's implications broadly and thoroughly. We have outlined above key issues and concerns that were shared previously with the PCAOB through its due process. In the event that the potential adverse outcomes are deemed to be significant, but not to the level of objecting, we believe that it is incumbent upon the SEC to take appropriate steps to proactively address key risk areas related to effects on issuers/registrants.

We observe that this proposal is coming at a time when registrants are implementing an unprecedented level of changes to major components of U.S. GAAP (e.g., revenue recognition, lease accounting, accounting for credit losses, and financial instrument accounting). Implementation of those standards is consuming an enormous amount of auditor and preparer resources. In judging this new standard, the Commission should explicitly consider whether the effective date selected by the PCAOB is reasonable and appropriate in light of these other resource commitments, which affects both issuers and auditors. Ideally, we should seek to avoid a delay in filings by companies due to the confluence of major changes in both accounting and auditing standards. As the Commission has oversight responsibilities over both, it must broadly consider resource constraints that exist within the system. In the final analysis, all stakeholders will be well-served by an effective date that is appropriate in light of the resources that will be necessary to execute an orderly, high-quality transition to this new reporting model.

We believe it would be helpful and informative to the implementation planning if the Staff of the PCAOB could present their plan to risk-assess potential problem areas and to respond appropriately and in a timely manner if and when issues arise. We believe that it is very important that the PCAOB and the SEC actively monitor and engage directly with audit firms and registrants as part of a robust implementation review process specifically designed to monitor the interpretation, application and effectiveness of the new auditor report, in the best interests of the investing public.

We believe that the review process for this standard should begin upon approval of the standard and proceed for an appropriate period of time in light of the issues that are identified with its application. We further recommend that the Commission should receive regular briefings from affected stakeholders, including registrants, regarding how implementation is progressing and any unintended consequences on auditor behavior or registrant reporting that arise. This should allow the SEC to gather the necessary data and information to make appropriate judgments about the costs, capital market benefits, and usefulness of the revised auditor report to investors and to take appropriate remedial action, if necessary. This review also can also address whether concerns raised by key stakeholders (and outlined in this letter) were addressed through careful implementation planning and execution.

FEI believes that the Commission should engage in a discussion as to whether the initial application should be afforded a form of safe harbor to facilitate implementation of a robust post-implementation evaluation process. We recommend a two-year safe harbor to allow sufficient time for practices to adapt and become consistent.

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*Conclusion*

Given the very high threshold to be met for the Commission to object to issuance of the standard, it is difficult to say whether the full weighting of these issues above would suggest it should not be approved. We believe that the matters we have raised in this letter and in our past comment letters to the PCAOB (e.g., capital market effects, impact on issuer disclosures, direct and indirect compliance costs imposed on issuers, among other considerations) should give the Commission cause for concern and make it a priority area for review in the year ahead. The PCAOB has stated its intention to actively monitor implementation. Given the significance of the potential impact on issuers, we urge the Commission to undertake similar precautions.

We stand ready to assist in any way and welcome an opportunity to discuss our comments further with the Commission.

Sincerely,

*Mick Homan*

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Chairman, Committee on Corporate Reporting  
Financial Executives International

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