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Brent Fields, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

18 August 2017

RE: Release No. 34-81187; File No. PCAOB-2017-001, *The Auditor's Report On An Audit Of Financial Statements When The Auditor Expresses An Unqualified Opinion*

Dear Mr. Fields:

We thank the Commission for the opportunity to submit these comments to File No. PCAOB-2017-001, regarding the new audit report model, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards* (the Standard), approved by the Public Company Accounting Oversight Board (PCAOB or Board).

As reflected in our comment letters to the Board,¹ EY supports the PCAOB's efforts to increase transparency to shareholders and other stakeholders of relevant and material information communicated between auditors and the companies they audit. EY also appreciates the Board's efforts to address the many comments and questions it received from stakeholders during its standard-setting process.

Many financial statement users have expressed dissatisfaction with the current reporting by auditors, particularly on the heels of the financial crisis. We continue to support the PCAOB's efforts to make the auditor's report more informative and relevant for investors and other users of the financial statements. Enhanced transparency of the audit process benefits all stakeholders and promotes the important role of independent auditors in serving the public interest. As such, we support approval of the Standard by the SEC and, if approved, will seek to foster its effective implementation.

Our prior comment letters have observed the importance of the Standard achieving an appropriate balance between the informational needs and interests of investors and other users of financial statements, the current requirements under the securities laws and existing regulations around disclosure obligations of public companies and their independent auditors, and associated costs.

With that in mind, we appreciate the Board's acknowledgement of the need for close monitoring of the effectiveness of the Standard after implementation.² As discussed below, we believe that monitoring of the Standard should begin with a comprehensive post-implementation review, conducted under the auspices of the Commission, to consider quantitative and qualitative data and the views of all relevant

¹ Comment letters to the Standard as initially proposed on December 18, 2013, and to the Standard as re-proposed on August 15, 2016.

² PCAOB-2017-01, p. 0217.

stakeholders as to the benefits and costs that result, whether the Standard has achieved its objectives, or whether unintended consequences have come to pass. We believe the phased-implementation advocated by the PCAOB, whereby the Standard is initially applicable to large accelerated filers, provides an effective framework for such a review to be undertaken before the Standard is applied to other segments of the issuer community. Such an effort would help inform whether further refinement is warranted to achieve the Standard's objectives.

Post-Implementation Review of Large Accelerated Filers

We believe a post-implementation review should include both a qualitative and quantitative analysis. Qualitatively, the review should consider the views of all stakeholders as to the effects of the Standard and seek their input through comment letters or other means. Specifically, the SEC should seek input as to whether the inclusion of critical audit matters (CAMs) increases the availability of meaningful information to investors and whether investors perceive increased value of the audit report and improved understanding of the audit. Also, we encourage the collection of views of audit committees and audit firms for large accelerated filers about whether the dialogue between the auditors and their clients changes as a result of the Standard.

From a quantitative standpoint, as noted in the Board's adopting release, commenters on the Standard did not submit data on the effect of CAMs and the potential costs and benefits considered by the Board were inherently difficult to quantify.³ Accordingly, we believe as part of the post-implementation review, the Commission should work with the PCAOB and other stakeholders to consider quantitative impacts on auditor and issuer internal and external costs, including whether litigation costs are impacted through increased claims (whether or not meritorious), increased discovery expenses, and use of outside counsel.

After evaluating both qualitative and quantitative evidence, the post-implementation review should examine, in the aggregate, whether the overall benefits to investors from receiving CAMs outweigh the related costs of the Standard, as well as whether any changes to the Standard or to its implementation would further the objectives of the Standard.

Set out below in more detail are specific considerations that we believe should be points of the post-implementation review.

In evaluating whether the Standard results in meaningful information to investors, the analysis could consider whether CAMs meaningfully reduce any level of "information asymmetry" between investors, auditors and management. For example, an investor's ability to monitor management's and the board of directors' stewardship of the company by highlighting the matters that investors wish to emphasize in their engagement with management could be analyzed.⁴

Analyzing whether CAMs achieve the intended beneficial objectives is particularly important given the definition of CAMs is not limited to material information but includes matters related to accounts or disclosures that are material to the financial statements. To the extent that CAMs result in the disclosure of immaterial information, the effect may be to reduce the usefulness of the information provided under the Standard and unduly add to the totality of financial statements.

³ PCAOB-2017-01, p. 0246.

⁴ PCAOB-2017-01, p. 0263.

The Standard will expand auditors' disclosures and may also result in the expansion of issuers' disclosures. We believe the review should consider whether the Standard improves the readability of the financial statements and enhances investors' understanding of them.

We believe an assessment should be made of whether the new Standard promotes audit quality by enabling auditors to engage in more robust conversations in areas arising from the most complex, subjective or challenging issues. The assessment should also consider whether there were any unintended consequences, such as hindering the frequency, nature or candor in communications between audit committees and auditors. We encourage the collection of views of audit committees and audit firms about whether the dialogue between auditors and audit committees changes as a result of the Standard and, if so, how.

We appreciate the Board's careful consideration of the concerns about potential auditor and issuer liability raised in comment letters and the Board's undertaking to monitor the Standard post-implementation for unintended consequences. However, we remain concerned that increased litigation risk and litigation-related costs, both financial cost and the disruption to business, may detract from the benefits of the Standard and upset the overall implementation effort.

The United States is a highly litigious society, with a growing volume of claims under the securities laws.⁵ Even where these claims lack merit, which is frequently the case, the cost of defense can be substantial and can drive issuers and auditors to pay settlements to avoid such costs.⁶

Important legal concepts including protections established by the Private Securities Litigation Reform Act (PSLRA) (such as the Safe Harbor for Forward-Looking Statements), control person liability under *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135 (2011), protections regarding opinion statements under *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, 135 S. Ct. 1318 (2015), and other important screening mechanisms, have served to limit meritless lawsuits against issuers and auditors. Any erosion of these important legal concepts would be an unintended consequence of the Standard and undermine its success.

As part of a post-implementation review, we believe the nature and scope of litigation claims involving CAMs, as well as the cost of litigation and third-party discovery to the extent issuers and audit firms face an increased number of subpoenas and other discovery requests, should be considered.

⁵ A recent study by Cornerstone Research found that "[o]ver the past 18 months, more securities fraud class actions have been initiated in federal court than in any equivalent period since enactment of the [PSLRA]." *Securities Class Action Filing – 2017 Midyear Assessment*, Cornerstone Research, 1, (2017), available at <https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2017-Midyear-Assessment>. Securities fraud class actions not only rose as an absolute value, but also in terms of the percentage of U.S. public companies sued: "[i]n the first half of 2017, 4.7 percent of U.S. exchange-listed companies were sued in federal securities fraud actions. If activity continues at the same pace, 9.5 percent of exchange-listed companies will be the subject of filings in 2017—the highest rate since 1997." *Id.*

⁶ Cornerstone Research's study of accounting class actions indicates that in 2016, "accounting case settlement dollars totaled \$4.8 billion, the highest amount since 2007." *Accounting Class Action Filings and Settlements—2016 Review and Analysis*, Cornerstone Research Group, 10, (2016), available at <https://www.cornerstone.com/Publications/Reports/2016-Accounting-Class-Action-Filings-and-Settlements>.



Beyond the post-implementation review process, we urge the Commission to consider if additional rulemaking is warranted to further mitigate the risk of increased auditor and issuer liability resulting from the Standard's implementation. The potential for such action was discussed and supported by the PCAOB Investor Advisory Group as a means to help facilitate effective implementation of the Standard by minimizing potential unintended consequences and would be consistent with the language and legislative history of the PSLRA. We would be pleased to offer suggestions to the Board and the Commission on ways to preserve the protections of the PSLRA and important precedent like those cited above and believe implementation of the Standard would benefit from such considerations.

We would be pleased to discuss our comments with the Commission at your convenience.

Very truly yours,

Ernst + Young LLP

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