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

Re: Proposed PCAOB Standard on Changes to Auditor Reporting Model (ARM)

Dear Mr Fields,

CFA Institute[1] appreciates the opportunity to comment on the Public Company Accounting Oversight Board ("PCAOB") Proposed Auditing Standard on *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards, AS 3101* (the "Proposed Standard").

The proposed standard improves the auditor report model (ARM) as it updates contents required within the standard auditor's report. It will require a discussion of critical accounting matters ("CAMS") and this applies to matters involving "especially challenging, subjective, or complex auditor judgment" that are reported to the audit committee and relate to an account or disclosure that is material to the financial statements. The proposed enhanced auditor report will also include the tenure of the auditors and other changes designed to clarify the auditor's role and responsibilities, and make the auditor's report easier to read.

Long Established Case for Change

CFA Institute welcomes and strongly supports the recently announced Public Company Accounting Oversight Board (PCAOB) adoption of an enhanced auditor report model. The case for changing current auditor report has been established through extensive deliberations that have occurred for more than six years.

Changes Fulfil Investor Expectations for Change: Our longstanding support for an enhanced auditor report was discussed in our 2013 response to the PCAOB and International Audit and Assurance Standards Board (IAASB) and is strongly supported by CFA Institute surveys conducted over multiple years (2012, 2011 and 2010). Our survey results have consistently

[1] CFA Institute is a global, not-for-profit professional association of more than 151,000 investment analysts, advisers, portfolio managers, and other investment professionals in 163 countries, of more than 145,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 148 member societies in 73 countries and territories.

highlighted our member/investor support for a change from the current exclusive "pass/fail"[2] form of auditor reporting and for an enhancement in the information content of auditor reporting (i.e. retain "pass/fail" reporting augmented with information on audit findings and the audit process[3]). This support has been affirmed through a recent July 2017-member survey (see Appendix for details), which shows that the quality of information within the auditor report is a critical determinant of the perceived value of audit and it also influences investors' perceptions on audit quality[4].

Overdue Replacement of Antiquated Current Reporting Model: Improvements are needed to the current auditor report, which is a seriously outdated model for the communication of important information to investors and other users regarding the auditor's professional examination of a company's financial statements. The current model last changed in the 1940s and is out of touch with advancements that have occurred within other strands of corporate reporting to reflect the increased complexity of businesses, underlying transactions and accounting standards[5] and a corresponding need for users of financial statements to be abreast of the critical methodology, valuation and estimates' risk associated with companies' reported information. The auditor report ought to be considered as part of the mosaic of necessary, useful corporate reporting information alongside the financial statements and other narrative sections of an entity's financial report (i.e. management commentary, operating and financial review, etc.).

Changes Enable Investor Understanding of Audit Risk & Assessment of Audit Quality: The limited information within the current abbreviated auditor report is inconsistent with the notion of auditor accountability and transparency to shareholders, who incidentally not only approve the retention of the auditor but are the primary client of audit services. The current, bare bones communication also reinforces the "information gap" that exists between auditors and investors and contributes to the "expectations gap"- where many stakeholders are unclear about the level of assurance that is provided on financial statements and information presented within corporate releases and reports, but outside the main financial statements.

Crucially, the current reporting model does not meet the needs of investors who need to assess audit quality (e.g. for purposes of ratifying auditor appointments) and who should be viewed as part of the audit quality oversight process in addition to audit committees and audit regulators. Though audit committees have a primary duty for oversight on audit quality and they are the

[2] The current auditor report has been commonly described as a pass/fail model since the auditor expresses an opinion on whether the financial statements are fairly presented (pass) or not (fail).

[3] Pass/fail reporting is still necessary because it is brief, clear, consistent and comparable. It benefits those investors who want to quickly identify the auditor report for any departures from the unqualified report. However, it has limited utility for those who desire a more thorough and complete understanding of the audit findings and the audit process. For this reason, we believe that the pass/fail element of the model should be augmented with substantive informative enhancements.

[4] In our 2017 survey, the "quality of information within the auditor report" ranks very high among factors that influence investors' perceived value of audit with 73% of respondents considering this factor as very important. It is also influences investors' perceptions of audit quality with 62% of respondents considering this factor as very important.

[5] Over the years, accounting standards have increased in their complexity, judgment and measurement uncertainty (e.g. accounting standards for revenue recognition, financial instruments, post-employment obligations, business combinations).

eyes and ears of investors, investors still need to have an independent assessment of audit risk-particularly as audit committee communication to investors is voluntary and often boilerplate. More importantly, audit committee communication to investors, regardless of its quality, cannot substitute for the required distinctive auditor disclosures. Through increased transparency, an enhanced ARM will facilitate better analysis and increase user confidence in the audited financial statements.

Distinctive Auditor Disclosure Role is Justified: The proposed standard imposes an enhanced disclosure obligation on auditors. This is appropriate because companies' management, auditors and audit committees all have a unique vantage point through which they participate in the financial reporting process. The proposed standard clarifies the important role of each of these key actors in communicating among themselves and to outside users of the financial statements.

For meaningful changes to be effective, the reporting mindset of the audit committee, management, and independent auditors will need to undergo a cultural shift. The historical reporting relationship has tended to be viewed as the auditor reporting to the audit committee and to management, rather than a broader communication exercise to investors. As CFA Institute has argued, communication obligations by any one of these three parties cannot substitute for that of another. Said differently, the auditor report has a distinctive role and can incrementally inform investors regarding both "financial statements information risk" and "audit risk".

Benefits Outweigh any Associated Costs: The proposed standard will not require changes to the audit process and hence should not impose any significant incremental costs. AS 3101 applies only to matters that already must be identified by auditors during audits, documented and resolved as part of the audit procedures and process. Furthermore, the CAMS have been limited to matters that are reported to the audit committee. A concern that is raised is the risk of increased auditor liability but as we argue below this concern is probably overstated and in any event, audit reforms should be primarily focused on improving the reliability of reported information and should not be about protecting the audit firms.

While incremental costs or auditor effort ought to be minimal, there are manifold benefits for investors. In addition, we expect the new ARM requirements to strengthen audit quality oversight where disclosure of CAMS will actually improve the quality of interactions between auditors and audit committees. The proposed standard includes a framework for discussion between auditors and audit committees and the requirement to disclose CAMs should incentivize greater scrutiny by audit committees on any matters that have been elevated to them by the auditor that could be disclosed as CAMs. In effect, the proposed standard will augment the audit committee- related audit quality oversight process.

Finally, in respect of assessing cost-benefit tradeoffs, it will be instructive for the Commission to draw from lessons learnt in the UK, where a different version of enhanced auditor report was adopted with effect from 2014. We comment further below on lessons from outside the US.

Auditor Liability Concerns are Overstated

In the opinion of many stakeholders including legal experts, concerns about increased auditor liability tend to be overstated. It seems more plausible for legitimate claims of auditor culpability for materially, misleading financial statement information to arise if there is limited auditor communication on audit risk than in situations where auditors do provide robust information through the disclosure of CAMs.

Transparency especially regarding the "challenging, subjective, or complex" matters of judgment not only enables investors to fulfill their analytical duties and better identify information risk, but provides observable evidence that auditors have adequately exercised professional skepticism and appropriately identified areas where there is the risk of misstatement within the financial statements. We concur with the view expressed by one of the Big 4 audit firms (Deloitte)[6] to the effect that concerns about potential liability should not stand in the way of moving forward.

Evidence and Experiences from Other Jurisdictions Supports Case for Change in the US
Enhanced auditor reporting has been adopted in other countries such as the UK using a similar approach to enhanced auditor reporting. There is much that can be learned from the UK, which adopted enhanced auditor reporting with effect from 2014. There are relevant lessons on the likely implementation costs, auditors reporting behaviors and usefulness derived by investors. As highlighted by the UK Financial Reporting Council Thematic reviews of the enhanced auditor report, investor feedback has been strongly positive. UK investors highly value auditors' view on management assumptions around key risk areas. Similarly, they value reports that are incrementally informative, company-specific and essentially conform to good communication principles.

We observe that in December 2016, the International Audit and Assurance Standards Board (IAASB) issued its requirements for an enhanced auditor report that will be applicable to multiple jurisdictions. Hence, the PCAOB requirement is an important milestone towards ensuring robust and investor friendly auditor reporting within the US and creates closer alignment with reforms in global markets.

Other Changes within Proposed Standard are Appropriate
In addition to the need for CAMs disclosure, we support other aspects of the proposed standard including information regarding the tenure of the auditors and other changes designed to clarify the auditor's role and responsibilities, and make the auditor's report easier to read. The results of our recent July 2017 survey (see Appendix) show that 50.5% of respondents considered "frequency of change in auditors" as a very important factor influencing their perception of audit quality and only 1.1% think it is not important at all.

In our 2013 comment letter response, we highlighted that auditor tenure is useful information to the investor, in that there could be instances where in the case of a newly appointed auditor, an investor may feel that the audit contains more risk. This may especially be the case where the new auditor may not have developed a complete understanding of the entity. Or in

[6] https://pcaobus.org/Rulemaking/Docket034/041c_Deloitte.pdf

the case of a longstanding audit relationship, an investor may question whether the auditor is adequately objective and skeptical.

Conclusion- Need to Build on Rather than Impede Important First Step towards Enhanced Auditor Transparency

As discussed throughout this letter, the proposed standard is a long overdue update and marks an important step towards improving the relevance of audit and reducing "information gaps" and "expectation gaps" that investors face in respect of the audit process. The changes in auditor report requirements can only strengthen investors' confidence and trust in audited financial statements.

We appreciate that the PCAOB's proposed standard must balance multiple stakeholder perspectives (e.g. by defining and limiting CAMs to material matters that can be elevated to audit committees) in a manner that minimizes the associated incremental costs of implementing the new requirements. Hence, it is necessary for the Commission to approve these changes as the benefits far outweigh the costs. In that regard, the Commission can proceed confidently knowing the benefits outweigh the costs.

Finally, we would note that the PCAOB has acted in a very calibrated and reasoned manner. As our past comment letters and member surveys show, investors desire robust information within the auditor report beyond that required by the PCAOB proposed standard. Hence, they have balanced effectively the varied stakeholder considerations in arriving at this new standard. Furthermore, as the UK experience shows, there is a need to learn from the implementation experiences and there can be an openness on the part of the PCAOB towards examining auditor reporting on a continuous basis. Markets, investors' expectations and the flow of information will continue to change at a rapid rate. Our standards need to keep pace.

Sincerely,

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Appendix- Member Surveys

Past CFA Institute member surveys conducted in 2012, 2011 and 2010 consistently revealed the expectation that the auditor's report should provide more information about the basis for the auditor's opinion. Below are some headline findings from our past surveys:

- A large majority of respondents indicated that more information regarding materiality, the auditor's independence, management's critical accounting judgments and estimates, and key areas of risk is important.
- Respondents (58%) expected the auditor's report to provide more specific information about how the auditor reaches their opinion
- Respondents (75%) believe that risk factors associated with measurement uncertainties in an entity's financial statements should be included in the independent auditor's report.

A recently concluded 2017 CFA Institute member survey (see Appendix) affirms earlier survey results and shows that the quality of information within the auditor ranks very high among factors that influence investors' perceived value of audit with 73% of respondents considering this factor as very important (see **Table 1**). It also influences investors' perceptions of audit quality with 64.5% of respondents considering this factor as very important (see **Table 2**).

Table 1: July 2017 CFA Institute Member Survey-Factors Influencing Investors' Perceived Value of Audit

Value of Audit Factors	Respondents	1=Not imp	4=Very imp	Avg
Quality of information contained within the auditor report	*211*	*2.4%*	*73.0%*	*3.65*
Disclosure to investors of the audit quality indicators that are monitored by audit committees and/or regulators	210	3.3%	57.1%	3.48
Audit firms' communication to investors (e.g. published audit firm transparency reports)	211	4.7%	58.8%	3.40
Expanded use of data analytics and artificial intelligence whilst conducting audits	211	5.2%	29.9%	3.02
An expansion of the current scope of audit and assurance services	211	8.1%	30.3%	2.91
Leveraging technology, network alliances and process efficiency to reduce the costs of conducting audits	211	10.4%	22.7%	2.77
Audit pricing that is either comparable or at a premium relative to the pricing of other advisory or certification, quality assurance services	209	13.9%	16.7%	2.66

1=Respondents who rated factor as "Not important"; 4- Respondent who rated factors as "Very important"; Avg- Average rating of 1-4 score and excluded respondents who had no opinion.

Table 2: July 2017 CFA Institute Member Survey- Factors that Influence Investors' Perception of Audit Quality

Audit Quality Factors	Respondents	1=Not imp	4=Very imp	Avg
Reported episodes of fraud within audited companies	186	0.0%	78.0%	3.84
Quality of financial reporting disclosures	186	1.1%	64.5%	3.67
Restatement of company financials	186	0.5%	64.5%	3.66
Lawsuits or regulator investigations of auditor due to reporting failures	187	1.1%	56.1%	3.63
Quality of information contained within the auditor report	*187*	*1.1%*	*62.0%*	*3.63*
Evidence of inconsistent implementation of accounting standards across similar companies	186	2.2%	64.0%	3.62
Bankruptcy or any evidence of financial distress of audited companies	187	2.7%	59.4%	3.52
Securities regulators' significant concerns on reporting issues	187	2.1%	55.1%	3.52
Frequency of change in auditors	*187*	*1.1%*	*50.8%*	*3.45*
Audit regulatory inspection findings	188	1.1%	39.4%	3.45
Audit regulator sanctions and their size and nature	188	1.6%	44.1%	3.43
Industry expertise of audit personnel	188	1.1%	44.7%	3.42
Issues of ethics in non-audit services	189	3.2%	45.0%	3.37
Extent to which an independent audit regulator has oversight on audit and assurance services	188	1.6%	36.2%	3.33
Training and accreditation of audit personnel	188	2.1%	38.3%	3.27
Quality of audit committee reporting & other communication to investors	187	2.1%	37.4%	3.26
Auditor use of experts such as valuators, tax specialists, actuaries, surveyors	187	2.7%	36.9%	3.25
The quality of auditor oversight on the work of external specialists	188	1.6%	33.5%	3.19
Composition and effectiveness of audit committee	187	2.7%	35.3%	3.16
Tenure of engagement partner	188	5.9%	28.2%	3.04
Extent to which non-audit services are part of audit firm service offerings and have an impact on firm culture	188	5.9%	29.8%	3.02
Extent of use of data analytics and artificial intelligence to determine audit scope, coverage, risk assessment and detailed testing	189	4.2%	23.3%	2.97
Issues arising within the international, multiple country (if applicable) network of the audit firm	189	5.8%	27.0%	2.97
Audit fees relative to fees charged for non-audit services	189	7.4%	24.3%	2.86
Number of audit staff per audit partner	187	5.9%	18.2%	2.80
Size and cross border reach of audit firms	189	8.5%	21.7%	2.80
Audit firm recruitment and retention practices	189	11.1%	23.8%	2.74
Audit fees relative to peers	187	8.0%	14.4%	2.71

1=Respondents who rated factor as "Not important"; 4- Respondent who rated factors as "Very important"; Avg- Average rating of 1-4 score and excluded respondents who had no opinion.