American Federation of Labor and Congress of Industrial Organizations

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December 9, 2013

Submitted by email to comments@pcaobus.org

Ms. Phoebe W. Brown
Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: Rulemaking Docket Matter No. 034 - Proposed Auditing Standards on the Auditor's Report and the Auditor's Responsibilities Regarding Other Information

Dear Ms. Brown:

On behalf of the American Federation of Labor and Congress of Industrial Organizations ("AFL-CIO"), I appreciate the opportunity to comment on the Public Company Accounting Oversight Board (the "PCAOB") proposed auditor reporting standards as set forth in PCAOB Release No. 2013-005 dated August 13, 2013. The AFL-CIO is the umbrella federation for U.S. labor unions, including 57 unions representing more than 12 million union members. Union-sponsored and Taft-Hartley pension plans hold more than $540 billion in assets. Union members also participate directly in the capital markets as individual investors and as participants in pension plans sponsored by corporate and public-sector employers.

The ability of investors to rely on accurate and reliably audited financial statements is fundamental to ensuring the integrity of the capital markets. We commend the PCAOB for taking steps to improve the audit process, including efforts to make the report by auditors to shareholders on company financial statements more meaningful. The auditor's report is the primary means through which auditors communicate with investors regarding the audit of a company's financial statements. However, auditors' reports that consist of boilerplate are of little value to investors.

We believe that the proposed standards should be further strengthened to provide investors with useful new information. It is noteworthy that even audit firms support the need for audit reports to provide more relevant information to investors. As Dennis Nally, Chairman of PricewaterhouseCoopers, has said: "It's not difficult to imagine a world where the combination of single reporting standards (and) more cohesive global auditing standards…lead one to consider whether it is necessary to change the content of the auditor's report to be more relevant to the capital markets and its various stakeholders."[1]

To reiterate the AFL-CIO's previous comments on the PCAOB's concept release, we believe that four key changes need to be made to the audit report. The report should include a discussion of the auditor's assessment of the estimates and judgments made by management in preparing the financial statements, and how the auditor arrived at the assessment; a discussion of areas of high financial statement and audit risk, and how the auditor addressed those risks; a discussion of unusual transactions, restatements and other significant changes in the financial statements; and a discussion of the quality, not just the acceptability of a company's accounting practices and policies.

While the PCAOB's proposed auditing standards will require auditors to report on what they have identified as "critical audit matters," we believe that reporting needs to be strengthened to address the three other areas addressed by the AFL-CIO's previous comments. Moreover, the proposed auditing standards endorse a subjective standard of critical audit matters, leaving it to the auditor to determine what they are, rather than using an objective assessment. And, although it would be expected that there would be critical audit matters in most audits, the auditors would be free not to report any, so long as their work papers document the reasons.

Financial statements have become increasingly complex and dependent on management's estimates of subjective values. We believe that auditors should be required to disclose their assessment of significant judgments and estimates made by management. Some might argue that by doing so, auditors are taking on the role of management. However, when an auditor has substantial doubt about a company's ability to continue as a going concern, the auditor is required to issue a modified report – and, in so doing, the auditor is providing new information to the market. So it is not inconsistent to require auditors to disclose their assessment of significant judgments and estimates made by management.

We continue to believe that the auditor's report should also include a discussion of unusual transactions, restatements and other significant changes in the financial

[1] Written testimony of Dennis Nally, Chairman and Senior Partner, PricewaterhouseCoopers, LLP before the Federal Advisory Committee on the Auditing Profession, U.S. Department of the Treasury, Dec. 3, 2007.

statements. Investors would benefit from knowing more about accounting misstatements, including failures in internal controls that permitted the misstatement to occur, whether those weaknesses in internal controls had been fixed, and other changes that have occurred as a result. Investors should also be provided more information about unusual transactions such as those made toward the end of a quarter, or at fiscal year-end, in order to meet financial targets. Other unusual transactions that would fall under this category include tax-shelters and related party transactions.

The auditor's report should also discuss the quality, not just the acceptability, of the issuer's accounting practices and policies. For example, auditors should describe those instances in which a management's application of accounting principles, while acceptable under GAAP, was not the preferred practice. Differences in how companies apply GAAP can have a significant impact on their financial statements.

In addition, we believe that the auditor's report should indicate the auditor's responsibility for detecting material fraud. The auditor's report should clearly state that the auditor provides reasonable assurance that the financial statements are free of material misstatement, and indicate in the report that reasonable assurance indicates a high level of assurance.

Although there is some merit to the pass/fail nature of current audit reports, we would prefer that audit reports provide more gradations than simply unmodified and modified – particularly since the large majority of audit reports issued are unmodified. For example, auditors could evaluate the quality of the issuer's accounting policies and practices (including its estimates and judgments) by assigning one of four grades: conservative, above average, average and aggressive. There will not need to be a separate failing grade because such a grade would denote non-GAAP reporting and would require the auditor to issue a modified opinion.

Requiring audit firms to issue reports with such grades could serve to meaningfully differentiate between issuers in the quality of their accounting policies and practices. Such differentiation would be useful to investors in making investment decisions, and could represent an efficient means of communicating the auditor's overall judgment about the issuer's accounting quality. Moreover, expanding the audit report choice to four categories will reduce the risk that auditor reporting devolves into boilerplate language which would provide less information to investors.

The auditor's report should identify the role of any affiliated firms in conducting the audit. We believe this is important because investors currently have no information about the extent to which the audit was performed by a foreign affiliate of a U.S. auditing firm. Investors would also benefit from the development of an information clearinghouse that identified auditors attached to public company audit engagements worldwide, listing any sanctions, suspensions and litigation against them. Investors can already obtain this type of information about brokers and investment advisers.

We are pleased that the PCAOB is also moving toward requiring lead audit engagement partners' names to be disclosed in company annual reports, although we believe it lacks the weight of requiring the engagement partner to sign his or her name on the auditor's report in addition to the audit firm's name. We find the absence of the engagement partner's signature inexplicable given that CEOs and CFOs must personally certify company financial statements.

Investors deserve more information about company audits and the auditors whose job is vital to preventing material misstatement in the financial statements of public companies, whether caused by fraud or error. Thank you again for the opportunity to comment on the proposal. If you need any additional information, please contact me at brees@aflcio.org or (202) 637-5152.

Sincerely,

Brandon Rees
Acting Director, Office of Investment

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