



AFL-CIO

AMERICA'S UNIONS

**American Federation
of Labor and
Congress of Industrial
Organizations**

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Sent by email to comments@pcaobus.org

Phoebe W. Brown
Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006

**Re: PCAOB Rulemaking Docket Matter No. 034 –
The Auditor's Report on an Audit of Financial Statements
when the Auditor Expresses an Unqualified Opinion**

Dear Ms. Brown:

On behalf of the American Federation of Labor and Congress of Industrial Organizations (the "AFL-CIO"), I am writing to express our strong support for the Public Company Accounting Oversight Board's (the "PCAOB") proposed auditing standard "The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion." The AFL-CIO is the umbrella federation for U.S. labor unions, including 56 unions representing 12.5 million members. Union-sponsored and Taft-Hartley pension and employee benefit plans hold more than \$646 billion in assets. Union members also participate directly in the capital markets as individual investors and as participants in single-employer and public pension plans.

Investors are the intended beneficiaries of public company audits, and yet today's auditor's reports on U.S. public company financial statements are almost entirely devoid of useful information. They contain nearly identical boilerplate and can be summarized as a single binary data point of whether the opinion was qualified or unqualified. Accordingly, auditor's reports are often skimmed or ignored by investors. In contrast to archaic nature of auditor's reports in the U.S., other jurisdictions outside the U.S. now require enhanced transparency. The International Auditing and Assurance Standards Board, the European Union, and the U.K. Financial Reporting Council have all adopted expanded auditor reporting requirements in recent years.

Critical Audit Matters

Overall, we support the PCAOB's proposed rule requiring auditors to disclose critical audit matters ("CAM") in the auditor's report. Mandatory CAM disclosure will help investors better understand audited financial statements. For example, CAM disclosure will provide new information that investors can evaluate to gauge the possibility of an audit failure or the risk of an earnings restatement. Investors will be able to incorporate this information into their trading decisions, and thereby CAM disclosure will facilitate price discovery for securities and enhance overall efficiency of the capital markets. Moreover, we believe that investors should be entitled to receive information about CAMs in the auditor's report as a matter of good corporate governance.

In our view, mandatory CAM disclosure will also lead to more informed proxy voting by investors. Shareholders routinely vote to ratify the audit committee's selection of the auditor at company annual meetings. Yet today, shareholders are not provided with substantive information about the audit to take into consideration when voting. Accordingly, proxy voting decisions on auditors are based on limited information such as the ratio of audit fees to non-audit fees. Requiring auditor's reports to include a discussion of CAMs will help proxy voters to better evaluate the quality of the audit. Auditors rather than audit committees are best positioned to communicate CAMs to investors because they are the ones who are responsible for conducting the audit.

The PCAOB's proposed rule defines a CAM as a matter that was communicated or required to be communicated to the audit committee, relates to accounts or disclosures that are material to the financial statements, and involved especially challenging, subjective, or complex auditor judgment. While this definition encompasses audit issues that are of greatest relevance to investors, we are concerned that including a materiality threshold for the identification of CAMs may unduly limit the flow of useful information to investors. As a legal concept, materiality defines the floor for disclosure below which financial reporting becomes fraudulent. However, reasonable investors can differ in whether they consider information to be material to financial statements.

Instead of including a materiality threshold in the definition of CAMs, we urge the PCAOB to look to the IAASB's definition of key audit matters that requires auditors to select the most significant matters in the audit for discussion in the auditor's report. The IAASB's standard also avoids reliance on the auditor's determination of whether a matter involved especially challenging, subjective, or complex auditor judgment. Such a determination gives auditors too much discretion to decide whether a matter needs to be communicated to investors. In other words, investors deserve a discussion of the significant issues presented in the audit regardless of whether the auditor believes that they are material to investors or especially challenging to the auditor.

We also believe that auditors should be required to provide a graded assessment of management's significant accounting estimates and judgements. For example, auditors could communicate whether management's accounting estimates

and judgements are conservative, average, or aggressive rather than simply stating that they conform with GAAP. Such a differentiation would be useful to investors in making a determination as to the overall quality of a company's financial reporting. Moreover, a more gradated approach to the auditor's opinion would help investors better understand the nature of the audit and narrow the "expectations gap" between what investors expect from auditors and what auditors are actually responsible for.

Additional Improvements

We support the PCAOB's proposed additional improvements to the auditor's report. Regarding auditor independence, we support requiring auditors to state that they are required to be independent with respect to the audited company, and further believe that audit firms should be required to state if they are in fact independent and in compliance with the applicable independence rules. We also favor requiring that auditor's reports be addressed to investors in addition to company boards of directors. Investors are the intended third party beneficiaries of the audit, and therefore it makes sense that the auditor's report be addressed to them.

Finally, we strongly favor requiring disclosure of auditor tenure in auditor's reports. Many investors believe that an audit firm's independence can become compromised when a company employs the same audit firm for a substantial period of time. For example, the AFL-CIO's proxy voting guidelines recommend that voting fiduciaries consider voting against ratifying an auditor when a company has had the same audit firm for more than seven years. While long tenure is just one factor that can compromise objectivity, investors should be provided with this data point. Many companies have begun to voluntarily disclose their audit firm's length of tenure, but investors need to be able to access this information in a standardized location.

Conclusion

We commend the PCAOB for taking steps to make auditor's reports more meaningful to investors. The auditor's report is the primary means through which auditors communicate to investors regarding the audit of a company's financial statements. Updating the substantive content of the auditor's report is long overdue, and we hope the PCOAB will take into consideration our suggestions on how the proposed rulemaking may be further improved. If you need any additional information regarding our views, please contact me at (202) 637-5152 or brees@aficio.org.

Sincerely,



Brandon J. Rees
Deputy Director
Office of Investment