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in Business

August 29, 2018

Public Company Accounting Oversight Board
1666 K Street NW
Washington, DC 20006-2803

Re: File No. 2018-001, *PCAOB Draft Strategic Plan 2018 - 2022*

Dear Board Members:

The Financial Reporting Committee (FRC or Committee) of the Institute of Management Accountants (IMA) is pleased to comment on the Public Company Accounting Oversight Board (PCAOB or Board) *Draft Strategic Plan 2018 - 2022* (Plan). The Institute of Management Accountants (IMA) is a global association representing over 100,000 accountants and finance team professionals. Our members work inside organizations of various sizes, industries and types, including manufacturing and services, public and private enterprises, not-for-profit organizations, academic institutions, government entities, and multinational corporations. The FRC is the financial reporting technical committee of the IMA. The Committee includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics, and analysts. The FRC reviews and responds to research studies, proposed standards and other documents issued by standards-setters and regulators. The FRC proactively brings relevant issues to the attention of these organizations and suggests solutions on behalf of IMA's members and the profession at large. Additional information on the FRC can be found at www.imanet.org (About IMA, Advocacy, Financial Reporting Committee).

To begin, we agree with the statement in the Plan that "the quality of audit services has improved substantially since the formation of the PCAOB but more remains to be done." In particular, the technological innovations altering the timing, nature, and amount of information available are having profound effects on the auditing profession and the PCAOB must ensure that its standards, inspections, and other activities not only stay up with but encourage these continuing innovations. Identifying and addressing these innovations at the earliest possible date are perhaps the most important aspects of the Plan.

We particularly commend the Board for seeking input on its Plan before finalization, both through comments on this draft and in its earlier work using a survey to solicit the views of interested parties as well as interviews with selected external parties conducted by a consultant. In the past we believe that the Board tended to develop its thinking on issues internally and then asked for public reaction. This new approach of listen first and only then begin to develop a position appears to signal an important change in Board thinking that we hope will lead to a more collaborative and improved process.

In addition to what we perceive as an improved listen first approach, we have observed in the actions to date of the new Board members an improved attitude toward public company auditors and corporate financial executives than we believe existed previously. While we fully recognize the legal mandate of the PCAOB to oversee public company audits, too often in the past the actions and words of Board members and staff have indicated an overly cynical attitude toward the professionalism of auditors and preparers. A reasonable and perhaps even high amount of skepticism is necessary in the PCAOB's work but the public is not well served by an adversarial relationship. We are delighted that new Board members are expressing a learning approach in their initial outreach efforts.

This letter begins with a few overall comments on the PCAOB's strategic planning process and then offers a number of recommendations for improvements to the specifics of the Plan.

Include All of the Board's Constituents

We note that the Plan describes the Board's primary constituents in various ways: (1) investors, (2) investors and other stakeholders, (3) investors, audit committees, and other stakeholders, and (4) investors and the public interest. While "other stakeholders" may be intended to include a number of interested parties, curiously missing from any mention in the Plan are those who prepare financial statements. The word "preparers" does not appear in the Plan. While of course important, investors cannot and do not invest directly in auditors. Investors use audit reports as tools to help evaluate the financial statements and other information of the companies in which they do invest. Thus, the PCAOB's role in the investment process is only indirect, albeit very important. We believe that the Plan must recognize one of the most important parties in the investment process – the public company preparers of the reports. Public companies are clearly invested in the PCAOB through the fees they pay to fund the Board's activities.

Auditing standards, inspection activities, and many other PCAOB actions clearly and directly impact the preparation of financial statements. As just one example from the early days of the Board, Auditing Standard No. 2 was issued in March 2004 to cover the new requirements under the Sarbanes-Oxley Act of 2002 (SOX) for auditors to express an opinion on internal controls over financial reporting. With help from the PCAOB, auditing firms interpreted that Standard in a manner that required affected public companies to make many more systems and other costly changes than were reasonable given the objectives of Section 404 of SOX. Only after most of this unnecessary cost was incurred and following pushback from preparers did the Board go back to revise the requirements through Auditing Standard No. 5 issued in June 2007.

The standard on auditing of internal controls is an example of regulating without sufficient input and outreach. Nearly all new auditing standards will have some impact on company record keeping, auditor/company communications, or other matters that necessitate a change not just for the auditor but for the company being audited. That is why the FRC comments on many of the PCAOB's proposals and other exposure drafts. Accordingly, we believe it is imperative that the Plan be explicit in recognizing that public company preparers are as an important constituency as investors, audit committees, and other stakeholders. In addition to simply naming preparers in a final version of the Plan, we strongly urge that the document note that the costs of new standards, inspection activities, etc. must be considered and that those costs are often incurred by parties other than the auditors or investors – namely the public companies.

To summarize this important point, it is critically important that the preparer community not only be explicitly identified as one of the Board's key constituents in the Plan but that preparers also be considered in all that is done in the future.

The Devil is in the Details

While we have specific comments later in this letter on certain of the five strategic goals set out in the Plan and the objectives under those goals, overall they seem reasonable to us. However, they also are quite general and probably subject to a range of interpretation in many cases. We acknowledge this was likely purposeful at this stage in the development of the Plan. Nonetheless, we strongly recommend that the Board develop and share more details to supplement a final Plan to indicate how the goals and objectives are intended to be achieved. Further, metrics should be developed in as many cases as possible to determine whether the goals and objectives are being achieved. In its initial stages the Board may wish to keep some of these details and metrics private but greater transparency will almost certainly lead to greater credibility.

Engaging More Often and Directly

We agree that the PCAOB "must improve [its] engagement and communication with [its] stakeholders." Certainly, "engaging in consistent dialogue and publishing responsive and timely information regarding [y]our oversight activities" will help. In that regard, we offer the general suggestion that you can never communicate too much and sooner is better than later.

The FRC regularly comments on proposals from the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB). We are well informed about the activities of both of those organizations because all of their standards-setting deliberations are held in meetings open to public observation. This makes it possible for all interested parties to be up to date on the status of projects. It also allows auditors, preparers, and investors to weigh in formally or informally as the process develops rather than having to wait until a matter is exposed for public comment. Hearing the debates also helps stakeholders better understand the underlying meaning of some of the matters later covered in written proposals that might otherwise be difficult to interpret. Ideally, we would like to see the PCAOB hold <u>deliberative</u> meetings open to the public (for example, similar to the FASB's approach).

The Board also can take other steps to improve its process by including field testing of, and outreach for, proposals. For example, we refer to the very recent FASB call for companies to experiment with the application of possible new segment reporting rules. Further, field testing and outreach allow the Board and staff to engage directly with auditors and preparers to discuss how existing systems would have to change to accommodate a proposed new standard. These are just a couple of ways in which the PCAOB could engage more often and more directly. The FASB has used these and many other approaches through its 45 years of standards-setting and the Board should look at all of those. Our Committee or individual members would be happy to participate in outreach – please contact us at any time.

Building the Staff Management Team

Goal Five and particularly Objective One thereunder notes that people are the Board's most important asset. The Board plans to strengthen human capital by developing, training, and empowering the next generation of leaders within the organization. These are worthy goals that we fully support.

However, at present this objective is a critical need more than a strategic planning issue for the PCAOB. The Securities and Exchange Commission (SEC) has appointed an entirely new set of Board members to bring a fresh approach to the organization and most, if not all, senior staff managers have left the PCAOB in recent months. Replacing those experienced individuals with the right people will be critical to the achievement of the Plan and more immediately critical for successful operations to carry out the PCAOB's mission. A commitment to the PCAOB's mission is an important hiring criterion but it will also be important to bring in a good cross-section of people who fully understand how auditing impacts corporate accounting and reporting, and who are not biased with a negative attitude toward auditors or preparers.

We have observed negative bias expressed in Board proposals in certain instances. For example, in our comment letter dated August 9, 2017 regarding the proposed rulemaking for auditing estimates and the auditor's use of specialist, we expressed concern that the tone of the proposals asserted a strong predisposition by management to present its financial statements in a biased manner. We noted the following:

> [T]he word "bias" or a form thereof is used 124 times in the Estimates Proposal and five times in the Specialists Proposal. Further, "moral hazard" is a prominent justification given for the positions taken in the Specialists Proposal and is also mentioned in the Estimates Proposal. Together, these words and notions suggest a strong prejudice that management will not act in the best interests of investors and other users of their financial statements.

The negative bias also was noted by us in the proposals to require the disclosure of the name of the audit partner. In our final letter on the matter dated August 5, 2015, under the heading of accountability we stated the following:

> We did reject the notion that naming the engagement partner would improve audit quality [in our January 21, 2014 letter]. As we said then, "We cannot fathom that there is another level of quality to which accounting firms can somehow rise as a result of the engagement partner having his or her name included in the report and feeling more 'accountable'".
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> …In our discussions in preparing this letter, the words "cannot fathom" in our last letter actually did not seem strong enough. Several members stated that requiring the naming of engagement partners to promote a higher level of accountability is a professional insult to the dedication that most engagement partners demonstrate today and an insult to the accounting profession.

It may be difficult to evaluate bias in potential employees but we hope the Board endeavors to avoid the negative bias that we have observed and keeps that in mind in the hiring process.

Further, as part of the Plan we suggest the Board start a practice fellow program. Such programs have worked exceptionally well for the FASB and SEC for many years (some FRC members are former fellows). A fellowship program can bring in an experienced auditor or preparer for a two-year assignment to work on auditing standards projects or other PCAOB activities. These fellows are highly capable and bring very recent practice experience to the organization.

Comments on Specific Goals/Objectives

Goal One, Objective One – Inspection Activities
We certainly agree that the PCAOB should provide more relevant and especially more timely feedback on inspections. We have observed that the interpretation of the Board's standards and requirements resulting from inspection findings have shifted the focus of the auditing profession dramatically toward documentation and we believe it has become a distraction to the overall goal of addressing audit risk. While documentation is essential, the emphasis should be on quality not quantity and we are concerned that the current mindset leads to greater inefficiencies rather than improved mitigation of audit risk.

We also suggest that the Plan be modified to note that the Board will endeavor to include comments of a positive nature as well as criticism in its feedback. Through the inspections process the staff must observe many examples of best practices that could and should be shared with the profession at large. The sharing of best practices also furthers the important objective of prevention. This should be a formal part of planning and execution.

Goal One, Objective Two – Economic and Risk Analysis
We agree that the Board should utilize "robust economic and risk analysis" to more effectively set standards, rules, and guidance. However, what we have seen of the PCAOB's work in these areas to date has been less than impressive. Little in the way of true PCAOB staff economic analysis has found its way into auditing standards-setting, at least as indicated by the relative lack of references thereto in proposed and final auditing standards.

For example, in our July 18, 2016 comment letter on the auditor's report exposure draft we noted, "The Economic Considerations section of the ED does not, in our view, provide a true economic analysis of the pros and cons of mandating presentation of CAMs in auditor's reports. Rather, it consists largely of references to academic studies on the purported benefits of such presentation." In a similar vein, our July 15, 2015 comment letter on *The Auditor's Use of the Work of Specialists* said, "we were somewhat surprised to see two academic papers (Boritz et al and Griffith – one apparently unpublished) referenced no fewer than a dozen times in footnotes. Given that the staff had analyzed data from 50 large audits and 318 smaller audits …, we would have expected more reference to the staff's analysis of actual audits … vs. what seemed to us as selective quoting from the two academic papers."

In short, the PCAOB can substantially improve its performance in the area of economic and risk analysis. Rather than simply better leveraging these tools as Goal One, Objective Two states, the Board needs to take a hard look at this aspect of its operations and reassess its basic effectiveness and cost of the analysis.

Goal Three, Objective Two – Effective Dialogue with Stakeholders
In addition to our earlier comments about engaging earlier and more frequently, we specifically endorse the reassessment of the use of advisory groups. Some of our members have served on such groups or have observed their activities. While some improvements have been made over time, we believe that these groups are still not as effective as they could and should be.

The Association of Accountants and Financial Professionals in Business

The Standing Advisory Group (SAG) is too large and meets too seldom to provide the most effective input. We suggest reducing the SAG to about twenty-four members with meetings scheduled at least three times a year if not four. Two-year terms seem appropriate with one renewal allowed for those who have attended regularly and thoughtfully contributed. We particularly agree with the action taken a few years ago to limit the terms of certain members who had served for many years and tended to dominate the discussion in too many cases.

A separate Investor Advisory Group may be appropriate should the Board believe that investors are not sufficiently heard as part of the SAG. We think that membership should be limited to financial analysts and other professionals who are actively involved in investment decision making versus those professionals primarily concerned with governance issues.

Assuming the Board continues its Investor Advisory Group, we urge appointment of a separate Audit Committee Advisory Group. Audit Committees oversee the independent audit process and their views would hopefully be seen as very valuable to the Board in setting new standards.

One Matter Not Addressed

On page 3 of the Plan, the Board notes that one of its primary duties is to "[e]stablish or adopt auditing and related attestation, quality control, ethics, and independence standards." To date, most of the standards-setting activity has related to attestation with some focus on quality control. Little PCAOB standards-setting has occurred in the other two areas mentioned: ethics and independence. Ethics and independence, of course, are critical to the external audit function. Both the accounting firms as well as their clients (audit committees, in particular) spend a great deal of time trying to make sure there are no ethics or independence issues. In fact, the major accounting firms each have dozens of partners and other senior staff assigned full time to these topics.

We suggest the Board consider including more explicit references to ethics and independence matters in a final Plan. Today's rules have not been updated in decades, seem overly complicated and may not serve the public interest in all cases. Obviously, any such effort should be coordinated with the SEC staff but we feel that this is an area where the professional literature could stand a fresh look.

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In summary, we support the PCOAB Plan overall and offer the above suggestions for your consideration. We appreciate the opportunity to comment and would be pleased to meet with Board members or staff to elaborate on any of the above matters or answer any other questions you may have.

Sincerely,

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