

July 20, 2023

Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street, NW  
Washington, DC 20006-2803

Dear Secretary Brown and Members of the Public Company Accounting Oversight Board (“PCAOB” or the “Board”):

CFA Institute<sup>1</sup>, in consultation with its Corporate Disclosure Policy Council (“CDPC”)<sup>2</sup>, appreciates the opportunity to comment and provide our perspectives on the [PCAOB Rulemaking Docket Matter No. 049: Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards, PCAOB Release no.2023-001](#) (the “Proposal”<sup>3</sup>).

CFA Institute has a long history of promoting fair and transparent global capital markets and advocating for strong investor protections. An integral part of our efforts toward meeting those goals is ensuring that corporate financial reporting and disclosures and the related audits provided to investors and other end users are of high quality. Our advocacy position is informed by our global membership who invest both locally and globally.

We thank the Board for undertaking this project to replace and augment its interim standards. This was something CFA Institute recommended in our commentary to the Board in 2022 as the new Board was seated and we recognize the Board’s efforts in being responsive in this regard.

The interim standards were adopted from the audit profession twenty years ago. The PCAOB is not a self-regulatory organization and the proposed standards are better aligned with the Board’s statutory mandate to: *“oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public*

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<sup>1</sup> With offices in Charlottesville, VA; New York; Washington, DC; Brussels; Hong Kong SAR; Mumbai; Beijing; Abu Dhabi; and London, CFA Institute is a global, not-for-profit professional association of more than 190,000 members, as well as 160 member societies around the world. Members include investment analysts, advisers, portfolio managers, and other investment professionals. CFA Institute administers the Chartered Financial Analyst® (CFA®) Program. For more information, visit [www.cfainstitute.org](http://www.cfainstitute.org) or follow us on [LinkedIn](#) and Twitter at [@CFAInstitute](#).

<sup>2</sup> The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners’ perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

<sup>3</sup> We use the term “Proposal” to refer to the proposed rule as a whole and “proposed standard[s]” to specifically refer to the proposed standards contained in the Appendices to the Proposal.

*interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors.”<sup>4</sup>*

The Proposal combines four interim standards<sup>5</sup> which establish the general principles and responsibilities of the auditor when conducting an audit into a new standard AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*.

Additionally, the Proposal amends several other standards including AS 2810, *Evaluating Audit Results*, AS 1215, *Audit Documentation*, and rescinds AS 2815, *The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting Principles."*

Our comments are organized and presented in two sections which follow. The first is comprised of overarching considerations we noted in reviewing and considering the Proposal more broadly. The second section provides our responses to select questions posed by the Board.

## OVERARCHING CONSIDERATIONS

### 1. Fundamental Obligation to Investors

***Support Acknowledgement of Auditor’s Obligation to Investors*** – We commend the Board for adding Paragraphs .01 and .15 to AS 1000 that acknowledge and sets forth the auditor’s fundamental obligation to protect investors. The new language affirms what is already embodied in the requirement for the auditor’s report to be addressed to shareholders and evidenced by many facets of the relationship between investors and auditors, including<sup>6</sup>:

- Investors bear the risk of material misstatements of the financial statements and weaknesses in internal controls over financial reporting.<sup>7</sup>
- Investors rely on audited financial statements to make investment decisions. Management, apart from making investments in other issuers such as acquisitions, does not. Management has access to a broad range of internal financial information to make decisions.
- Shareholders, as owners of corporations, compensate auditors.
- Shareholders elect the members of the board including the audit committee which, by law, must maintain independence from the issuer and appoint and oversee the auditor.<sup>8</sup>

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<sup>4</sup> Sarbanes-Oxley Act of 2002, Section 101(a).

<sup>5</sup> AS 1001, *Responsibilities and Functions of the Independent Auditor*; AS 1005, *Independence*; AS 1010, *Training and Proficiency of the Independent Auditor*; and AS 1015, *Due Professional Care in the Performance of Work*.

<sup>6</sup> AS 3101, *The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, Paragraph .07.

<sup>7</sup> Karpoff, Jonathan M. and Lee, D. Scott and Martin, Gerald S. (2008); *The Cost to Firms of Cooking the Books*; Journal of Financial and Quantitative Analysis, 43, September 2008, 581-612., pg. 13. The mean and median cumulative abnormal stock returns for firms subject to federal enforcement actions for financial misrepresentation were -51% and -31%, respectively. Shareholders experienced total losses in 34% of the 585 firms subject to enforcement actions from 1978 to 2002.

<sup>8</sup> Sarbanes-Oxley Act of 2002, Section 301.

- Shareholders vote annually on whether to ratify the selection of independent auditors by most issuers' (over 90% of Russell 3000 constituents) audit committees.<sup>9</sup>

***Suggested Revisions:***

***Define “Investors” Consistent with US GAAP, Explain the Auditor’s Obligation and Remove Reference to “Client” When Referring to Entity Under Audit***

*Define Investors* – To strengthen Paragraphs .01 and .15 in AS 1000, we suggest the Board defines “investors,” clarifies and explains what duties the auditor has to investors to fulfill its fundamental obligation and removes the remaining instances of the word “client” from the Proposal when referring to the issuer under audit.

“Investors” include not only existing shareholders, to whom the auditor’s report is addressed, but potential shareholders as well as existing and potential debt investors. To more clearly identify to whom auditors owe their fundamental obligation, we recommend the Board adds a footnote to the first sentence of Paragraph .01 in AS 1000 with the following definition and description of “investors,” drawn from the Financial Accounting Standards Board’s (“FASB”) Concepts Statement No. 8, Conceptual Framework for Financial Reporting – Chapter 1, *The Objective of General Purpose Financial Reporting*.<sup>10</sup>

*Investors are existing and potential shareholders, lenders, and other creditors of an issuer. Investors rely on audited and reviewed financial information reported by issuers, among other sources, in making decisions to provide resources to them. Unlike management and regulators, investors cannot require issuers to provide them with information directly.*

Regardless of the specific language the Board chooses, we urge alignment between the FASB’s definition of primary users and the Board’s definition of investors because they should reflect a responsibility to the same group of individuals and institutions.

*Explain Auditors Obligation* – Paragraphs .01 and .15 of the proposed AS 1000 state and remind auditors of their fundamental obligation to protect investors. Page 16 of the Proposal speaks to the importance of “explicitly remind[ing] auditors of their obligation to protect investors.” While we agree in principle, we recommend the Board clarifies the auditor’s duties to investors by citing to the legal or regulatory requirements that the Board is seeking to remind auditors of in the final standard.

Such clarifications should provide more detail on whether the auditor’s obligation entails activities beyond conducting an audit in accordance with PCAOB standards, which we believe is unclear in the proposed AS 1000. It would also be helpful for the Board to explain how the auditor’s obligation to investors differs from its obligations to the issuer’s board of directors,

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<sup>9</sup> Howard, J.K., Son, M. and Song, H. (2023); *Shareholders’ Perception of Auditor Type and Timing of Auditor Engagement: Evidence from Auditor Ratification*; Australian Accounting Review.

<sup>10</sup> [FASB Concepts Statement No. 8, Conceptual Framework for Financial Reporting - Chapter 1, The Objective of General Purpose Financial Reporting](#). See Paragraph OB5 as well as Paragraphs BC1.15-BC1.24 for why the FASB concluded that the primary users of financial reports are existing and potential investors, lenders, and other creditors.

audit committee, and management. At a minimum, we recommend including Footnote 21<sup>11</sup> from the Proposal that cites to *United States v. Arthur Young & Co.*, 465 U.S. 805, 817-18 (1984) in the final standard.

*Remove Reference to Client* – Finally, we suggest the Board replace the remaining instances of the word “client” with “issuer,” “company,” or “company under audit” in the final standard.<sup>12</sup> We recognize that the existing interim standards use “client”, and the Board has removed several instances of it in the proposed standards, but the task is not yet complete. Identifying the issuer or its management as the “client” of the auditor mischaracterizes their relationship, placing the auditor in a subservient position. The auditor’s fundamental obligation is to investors.

## 2. Present Fairly

*What Changed?* – The text of the Proposal – which precedes and discusses the changes to the standards – states that the amendments to AS 2810, *Evaluating Audit Results*, and rescission of AS 2815, *The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting Principles"*, would “clarify that the auditor’s evaluation of fairness goes beyond the evaluation of whether the financial statements are presented in conformity with the applicable financial reporting framework” and, further, that “present fairly, under extant PCAOB standards, is a parallel concept that goes beyond mere technical compliance with the applicable financial reporting framework.”<sup>13</sup>

We have undertaken to map the changes from AS 2815 to the revised AS 2810 to ascertain if the changes in the standards accomplished this intended objective. We find that most provisions of AS 2815 have been incorporated into AS 2810 as follows with one key addition:

- **Paragraph .01** in AS 2815, which explains the purpose of the standard, maps to Paragraph .30 in AS 2810.
- **Paragraph .03** in AS 2815 explains the concept of fairness needs to be applied within the reporting framework and without it no uniform standard would exist for making a fairness judgement. The reporting framework is mentioned in Paragraph .30 and .30A of AS 2810, but the language “without it no uniform standard would exist for making a fairness judgement” is omitted from AS 2815.
- **Paragraph .04** in AS 2815, which explains the meaning of fairly presents, maps to Paragraph .30 in AS 2810, particularly Paragraphs .30 a, b, and c - though different language is used. It is not clear why different language was deemed necessary.
- **Footnote 1 to Paragraph .04** in AS 2815, which addresses materiality, maps to Footnote 17C of Paragraph .30A in AS 2810.
- **Paragraph .06** in AS 2815 dealing with the substance of a transaction is included in the note to Paragraph .31 in AS 2810.
- **Paragraph .08** in AS 2815 dealing with other regulatory agency reporting requirements does not appear to be carried forward in AS 2810.

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<sup>11</sup> Footnote 21 states: *See United States v. Arthur Young & Co.*, 465 U.S. 805, 817-18 (1984) (also noting that an “independent certified public accountant ... [b]y certifying the public reports that collectively depict a corporation’s financial status, ... assumes a public responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation’s creditors and stockholders, as well as to [the] investing public”) (emphasis in original).

<sup>12</sup> Specifically, we request the Board replaces instances of the word “client” in Paragraphs: .04 of AS 1000; .11 of AS 1215; .12 of AS 1220; .13 of AS 2505; .11 of AS 2610; .05 of AS 2710; and .29 of AT Section 701 which are among the standards amended by the Proposal.

<sup>13</sup> Proposal, Page 30.

- **Paragraphs .02, .05, .07 and .09** in AS 2815 had been deleted previously and were not carried forward to AS 2810.
- **Footnote 17A** of AS 2810 is an addition which references to SEC Rule 12b-20 requiring management to make additional disclosures beyond the required statements if necessary to make the required statements not misleading. This cross reference did not exist in AS 2815.
- **Footnote 17B** of AS 2810 simply cross references to AS 2820, *Evaluating Consistency of Financial Statements* which is not explicitly mentioned in AS 2815.

We see the net result as follows:

- If the language in AS 2815 was copied over word-for-word from AS 2815 to AS 2810, the only significant addition would be that of Footnote 17A which references to SEC Regulation S-K Rule 12b-20.
- The other changes amount to wording changes, the most substantive of which relate to the fairness references in Paragraph .03 and the narrative explanation of fairness in Paragraph .04 in AS 2815. The need to consider the substance of a transaction language in AS 2815 – the language which might likely be interpreted as related to overriding GAAP – carries over to AS 2810. This may likely stem from language on Page 30 of the Proposal.

***Differing Interpretations of Changes*** – We find there are widely different interpretations of these changes by the PCAOB’s stakeholders.

On one end of the spectrum, organizations indicate this is a fundamental change in auditors’ responsibilities and would result in auditors undertaking to override GAAP for public companies if they believe the underlying application of GAAP does not fairly present the substance of transactions.<sup>14</sup> On the other end of the spectrum, you have stakeholders interpreting that the language does not sufficiently explain that the responsibilities of auditors extend beyond mere compliance with GAAP.<sup>15</sup>

We are challenged to see how both interpretations can simultaneously be true. As such, we analyzed the differences which may result in these differing interpretations.

***The Areas Resulting in Varying Interpretations*** – As we analyzed these differing interpretations two items appear central to the differing views. We consider these below:

- ***Reference to the Reporting Framework*** – There is a view by some stakeholders that the reference to the reporting framework makes the interpretation of fairness too confined to the technical application, rather than the substance of GAAP. Those reaching that interpretation could only point to changes in language in Paragraph .03 and .04 of AS 2815 and how they have been incorporated into Paragraphs .30 and .30A of AS 2810 as a basis for their position that something is narrower than what was stated previously.
- ***Reference to SEC Regulation S-K, Rule 12b-20*** – Other stakeholders appear to view the reference to SEC Regulation S-K Rule 12b-20 (requiring management to make additional disclosures beyond the required statements if necessary to make the required statements not misleading) should not be included in an auditing standard because they believe this refers to

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<sup>14</sup> Chamber of Commerce Comment Letter: [https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket-049/24\\_chamber.pdf?sfvrsn=3b71c437\\_4](https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket-049/24_chamber.pdf?sfvrsn=3b71c437_4)

<sup>15</sup> PCAOB Investor Advisory Group Comment Letter: [Microsoft Word - AS1000 MIAG CommentLetter 05 16 2023.docx \(pcaobus.org\)](#)

other information outside of the financial statements. And, they highlight this is an obligation of management not the auditor. They believe this language addition extends the auditors scope significantly beyond the financial statements, as well as beyond present requirements to read the information outside the financial statements for inconsistencies as specified by AS 2710, *Other Information in Documents Containing Audited Financial Statements*. These stakeholders point to the language in the Proposal on Page 30 and to the statement of Board members in making this assertion.

***Our Consideration of the Changes*** – Our take on these interpretative issues is as follows:

- ***Reference to the Reporting Framework (Paragraph 30 of AS 2810)*** – We note the proposed AS 2810 does not explicitly state that the auditor’s evaluation of fairness goes beyond evaluating conformity with the applicable financial reporting framework.

In fact, AS 2810 retains the AS 2815 language “...*in conformity with the applicable financial reporting framework*” in AS 2810 Paragraphs .30, .30A, .30A(b), and .31.

What is unclear is precisely what language within Paragraph .30 are those who believe a narrower interpretation results than currently exists in AS 2815 looking to in reaching that conclusion.

The language in Paragraphs .03 and .04 of AS 2815 (excerpted below) might be interpreted by some as being a bit more helpful (specifically, the language bolded below) in understanding what fairness means than the revised language in Paragraph .30.

- .03 The independent auditor's judgment concerning the “fairness” of the overall presentation of financial statements should be applied within the framework of generally accepted accounting principles. ***Without that framework, the auditor would have no uniform standard for judging the presentation of financial position, results of operations, and cash flows in financial statements.***
- .04 The auditor's opinion that financial statements present fairly an entity's financial position, results of operations, and cash flows in conformity with generally accepted accounting principles should be based on his or her judgment as to whether (a) the accounting principles selected and applied have general acceptance; (b) the accounting principles are appropriate in the circumstances; ***(c) the financial statements, including the related notes, are informative of matters that may affect their use, understanding, and interpretation*** (see paragraph .31 of AS 2810, Evaluating Audit Results); (d) the information presented in the financial statements is classified and summarized in a reasonable manner, that is, neither too detailed nor too condensed (see AS 2810.31); and ***(e) the financial statements reflect the underlying transactions and events in a manner that presents the financial position, results of operations, and cash flows stated within a range of acceptable limits, that is, limits that are reasonable and practicable to attain in financial statements.***

The question is: should this exact language be moved from AS 2815 to AS 2810 to mitigate some of the noise around this change? The language in Paragraph .04 bolded above makes it fairly clear the PCAOB is requiring auditors to urge management to make additional disclosures when necessary to facilitate an understanding of the financial statements and ensuring they are “...*informative of matters that may affect their use, understanding, and interpretation.*”



In our view, the PCAOB needs to add clarifying language to AS 2810 to ensure there is clarity regarding their intent to ensure the auditors' obligation is broader than mere technical compliance with GAAP.

The language in Paragraph .06 of AS 2815 with respect to the need to consider the substance of the transaction is included in AS 2810 Paragraph .31 and makes it clear that the substance of the transaction is to be considered. When combined with Paragraphs .03 and .04 of AS 2815, it is clearer that disclosure – not overriding GAAP – is to be the tool used in ensuring fair presentation.

It is important to note that we have supported the incorporation of a disclosure objective in addition to disclosure requirements within GAAP such that companies and auditors have the flexibility to add clarifying disclosures when the specific disclosure requirements may not suffice to provide investors with a complete understanding or fair presentation of the substance of the transaction.

Additionally, we would add that we disagree with the Proposal's use of the phrase “mere technical compliance with the applicable financial reporting framework” in describing auditor's present responsibilities for evaluating fairness. US GAAP and IFRS afford management a wide degree of discretion; there are many conforming choices management can make in its accounting policies across virtually every financial statement account and the notes to financial statements.<sup>16</sup> It is the auditor's responsibility to judge whether management has made choices within the reporting framework that present the substance and economic reality of transactions, events, and conditions fairly in all material respects. It is also the auditor responsibility to evaluate whether the disclosures reflect and accurately explain those choices.

- Reference to SEC Regulation S-K, Rule 12b-20 (SEC's Requirement of Management) – Footnote 17A in Paragraph .30 of AS 2810 cites SEC Rule 12b-20 17, C.F.R. §240.12b-20 requiring **management** to make additional disclosures if necessary to make the required statements not misleading. We do not believe the PCAOB's proposed rule properly articulates the **auditor's** responsibilities.

Further, we believe the reference to the Regulation S-K rule – which generally deals with disclosures outside the financial statements (which are governed by Regulation S-X) – is creating the perception, but possibly not the intended reality, that the auditors' scope of responsibility is being expanded to disclosures outside the financial statements. SEC Regulation S-K Rule 12b-20 states the following:

*In addition to the information expressly required to be included in a statement or report, there shall be added such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made **not misleading**.*

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<sup>16</sup> Important examples of areas of US GAAP and IFRS with wide management discretion that are material to investors include revenue and expense recognition, segment reporting, accounting for business combinations, computing the provision for income taxes, fair value measurement, contingencies, and the classification and measurement of financial instruments.

We would note that SEC Regulation S-K Rule 12b-20 indicates it requires management to consider additional disclosures – that can be included in financial statements (or reports, which may imply in annual report on Form 10-K and thereby be interpreted as also including information outside the financial statements) that are necessary to prevent the financial statements from being misleading. What lacks clarity is whether such additional information to prevent the financial statements from being misleading needs to be included inside the financial statements. One would presume that management would make these within the financial statements to ensure there is no question regarding them not being misleading, but this is not stated in SEC Regulation S-K Rule 12b-20.

We would note, however, the provisions of SEC Regulation S-X, Rule 4-01(a)(1) which states:

**§ 210.4-01 Form, order, and terminology.**

**(a) *Financial statements* should be filed in such form and order, and should use such generally accepted terminology, as will best indicate their significance and character in the light of the provisions applicable thereto. The information required with respect to any statement shall be furnished as a minimum requirement to which shall be added such further material information as is necessary to make the required statements, in the light of the circumstances under which they are made, not misleading.**

**(1) Financial statements filed with the Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading or inaccurate, despite footnote or other disclosures, unless the Commission has otherwise provided.** This article and other articles of Regulation S-X provide clarification of certain disclosures which must be included in any event, in financial statements filed with the Commission.

This provision of Regulation S-X Rule 4-01(a)(1) makes it clear that management is responsible for filing financial statements with the SEC that are prepared in accordance with generally accepted accounting principles (and noting that footnotes or disclosures do not cure the failure to apply generally accepted accounting principles). Not doing so is presumed to mean the financial statements are misleading. The aforementioned language also makes it clear that additional disclosures are necessary to ensure the financial statements, under the principles they are made, are not misleading.<sup>17</sup> Because this is within Regulation S-X and relates to financial statements upon which the auditors are expressing an opinion, we believe it is clear this would also apply to auditors.

While we believe the Board sought to clarify rather than create a new responsibility, their citation of SEC Regulation S-K Rule 12b-20 appears to have muddled the issue of disclosures inside and outside the financial statements. In doing so, it has enabled those who disagree with this clarification to not only state that the Board is extending the auditors responsibility to include an evaluation of the completeness of an issuer's disclosures in their entirety (not only the financial statements and notes), which includes searching for omitted information.

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<sup>17</sup> SEC Rule S-X § 210.4-01(a)(1) states that “financial statements filed with the Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading or inaccurate, despite footnote or other disclosures, unless the Commission has otherwise provided.”



Further, this cross referencing has allowed those who oppose the changes to extrapolate this belief into a view that they are enabling auditors to override GAAP. We do not believe that this reference to SEC Regulation S-K Rule 12b-20 (i.e., which deals with disclosures not accounting) nor any language which has been transitioned from AS 2815 or added to AS 2810, as we discuss in the previous bullet, would suggest management or the auditors have the ability to override GAAP as some suggest. We believe Regulation S-X Rule 4-01(a) makes this perfectly clear and is a reference the Board should consider as clarifying language.

With respect to information outside the financial statements, we note that AS 2710, *Other Information in Documents Containing Audited Financial Statements*, governs the auditor's responsibilities for other information besides the financial statements and notes included in, for example, an annual report filed on Form 10-K with the SEC. AS 2710 advises auditors (uses the language "should" throughout) to read the report, identify and seek correction of material inconsistencies and misstatements, and communicate or take action on inconsistencies and misstatements that management refuses to correct.<sup>18</sup> AS 2710 is silent on whether the auditor should identify omissions that make the financial statements and notes misleading or, more generally, evaluate the annual report for completeness. We note that AICPA auditing standards, which govern audits of non-public companies, explicitly state that "the auditor is not responsible for searching for omitted information or for the completeness of the other information."<sup>19</sup>

We would support a responsibility for auditors to evaluate the completeness, in all material respects, of an issuer's annual report beyond the financial statement and notes (i.e., an auditor responsibility that complements the responsibility of management required by SEC Rule 12b-20 17, C.F.R. § 240.12b-20). However, we believe such a responsibility should be established by an amendment to AS 2710 and include guidance on materiality, what basis auditors should use to evaluate completeness, and how the auditor should respond if it identifies omissions that make required disclosures misleading. For example, could some omissions in the annual report rise to the level of requiring the auditor to add an explanatory paragraph in their report?

*Our Suggested Revisions: We Support the Spirit of What the PCAOB Wants to Accomplish, But Improved Wording is Necessary to Clarify the Board's Intent and Eliminate Misinterpretations* –

Because the proposed standard does not explicitly state that the auditor's evaluation of fairness goes beyond the evaluation of whether the financial statements are presented in conformity with the applicable financial reporting framework – in contrast to Page 30 of the Proposal which does state this – our suggested changes for the final standard include the following. We suggest the Board:

- Use the language in Paragraphs .03 and Paragraph .04 from AS 2815 in AS 2810 and explain, possibly through examples, how technical compliance with GAAP may require additional disclosures to improve investors' understanding of the financial statements. And

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<sup>18</sup> AS 2710, *Other Information in Documents Containing Audited Financial Statements*, Paragraphs .04-.06.

<sup>19</sup> AU-C Section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, Paragraph .18.

including further language explaining that such additional disclosures do not result in an override of GAAP but are meant to simply ensure that, as per AS 2815: “...*the financial statements, including the related notes, are informative of matters that may affect their use, understanding, and interpretation.....and the financial statements reflect the underlying transactions and events in a manner that presents the financial position, results of operations, and cash flows stated within a range of acceptable limits, that is, limits that are reasonable and practicable to attain in financial statements.*

- Remove the existing language on Page 30 in the Proposal and replace with language which mirrors the language in AS 2810 such that it is clear how the words in AS 2810 accomplish the PCAOB’s intent to ensure the financial statements are informative with respect to the matters that affect their use, understanding, and interpretation.
- Reference Rule 4-01(a)(1) which clarifies the Board recognizes that neither management nor auditors may override generally accepted accounting principles, and which highlights that additional disclosures may be necessary to ensure that the financial statements prepared and presented in accordance with generally accepted accounting principles are not misleading – a responsibility of both management and the auditor.
- Remove Footnote 17A to Paragraph .30 of AS 2815 that cites SEC Rule 12b-20 17, C.F.R. §240.12b-20 and add language – if they believe necessary in light of any addition of Rule 4-01(a)(1) – that provides greater clarity that this rule within Regulation S-K – which may result in additional disclosures by management inside the financial statements because it is meant to ensure that financial statements are not misleading is consistent with the spirit and intent of AS 2810’s requirement that auditors make a fair presentation assessment as financial statements cannot be considered fairly presented without a consideration of the need for disclosures that prevent the financial statements from being misleading.
- As it relates to the inclusion of other information outside of financial statements under SEC Rule 12b-20 17, C.F.R. §240.12b-20, commence a research project on AS 2710, *Other Information in Documents Containing Audited Financial Statements*. In addition to considering an auditor’s responsibility for evaluating the completeness of other information, we note that this standard is worthy of the Board’s attention because of investors’ regular use of other information in making investment decisions.

We believe the changes above would ensure the language in AS 2810 accomplishes the PCAOB’s intent with respect to the fair presentation of information within financial statements; ensures the discussion in the Proposal which supplements AS 2810 appropriately expresses the PCAOB’s intent and the actual wording in AS 2810 and provides a distinction between managements and the auditors responsibilities within and outside the financials. This should also quell any mistaken interpretation that the PCAOB supports overriding GAAP.

### 3. Critical Audit Matters

We are troubled by the lack and decreasing number of critical audit matters (CAMs) in audit reports as addressed at a [recent PCAOB Investor Advisory Group Meeting](#).<sup>20</sup>

A large number, and rising proportion, of audit reports contain only one CAM, including those for 7 of the 10 largest issuers on US stock exchanges by market capitalization and the financial institutions that failed or liquidated in the spring of 2023.<sup>21</sup>

This is especially troubling in comparison to audit reports in other jurisdictions like the UK, which tend to contain twice the number of KAMs and significantly more tailored disclosures.<sup>22</sup>

CAMs are an important communication by the auditor to investors. CAMs are an opportunity for auditors to “show their work,” and increase investors’ confidence in the quality of the audit and conclusions of the audit report. We are afraid that unless the Board acts, the audit profession will successfully achieve its desire not to communicate to investors via CAMs. We worry that this will perpetuate the belief amongst investors that audits are not fit for purpose or relevant.

As an initial step in preventing the lack of usefulness of CAMs’, we respectfully urge the Board to elevate CAMs (which are only mentioned in footnote 30 in the proposed standard) by moving Paragraph .11 from AS 3101, *The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* to Paragraph .03 in AS 1000.

Additionally, we agree with the suggestion by the members of the PCAOB’s Investor Advisory Group to delete the term “especially,” given concerns that this term is used by auditors to avoid communicating critical audit matters.

Our recommended Paragraph .03 of AS 1000 is as follows (new language, deleted language):<sup>23</sup>

*OBJECTIVES OF THE AUDITOR*

*.03 The objectives of the auditor are as follows:*

*a. In an audit of financial statements – To (1) obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud; and (2) issue an auditor’s report that expresses an opinion about whether the financial statements, taken as a whole, are presented fairly, in all material respects, in conformity with the applicable financial reporting framework;*

*b. In an audit of internal control over financial reporting – To (1) obtain reasonable assurance about whether material weaknesses exist as of the date specified in management’s assessment; and (2) issue an auditor’s report that expresses an opinion on the effectiveness of the company’s internal control over financial reporting;*  
~~and~~

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<sup>20</sup> The average number of CAMs in audit reports of large, accelerated filers have decrease from 1.69 to 1.43 from fiscal years ending June 29, 2020 to May 31, 2022. (PCAOB Release No. 2022-007 Interim Analysis Report, Further Evidence on the Initial Impact of Critical Audit Matter Requirements. December 7, 2022.)

<sup>21</sup> Annual reports filed on Form 10-K for fiscal years ending in 2022 by Apple Inc., Alphabet Inc., Amazon.com Inc., Nvidia Corporation, Tesla, Inc., Taiwan Semiconductor Manufacturing Company Ltd., Visa Inc., First Republic Bank, SVB Financial Group, and Signature Bank. Silvergate Capital delayed its 2022 annual report filing and liquidated before it was filed, but the auditor report in its 2021 annual report communicated zero CAMs.

<sup>22</sup> Miguel Minutti-Meza (2021); *The Art of Conversation: The Expanded Audit Report*; Accounting and Business Research, 51:5, 548-581.

<sup>23</sup> Letter from Members of the PCAOB Investor Advisory Group (IAG) to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board. [Comment letters for Docket 049 \(May 16, 2023\)](#).

*c. Determine whether there are any critical audit matters in the audit of the current period's financial statements. A critical audit matter is any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex auditor judgment. Critical audit matters are not a substitute for the auditor's departure from an unqualified opinion (i.e., a qualified opinion, adverse opinion, or disclaimer of opinion on the financial statements as described in AS 3105).; and*

*d. Communicate externally, as required by applicable professional and legal requirements.*

#### 4. Audit Documentation Completion Date

We support the Board's amendments to AS 1215, *Audit Documentation*, to accelerate the completion date for the assembly of a final set of audit documentation from 45 days to 14 days because it reduces the opportunity for "revisionist history" well after the audit is completed and should not impose significant costs on auditors given advancements in technology supporting the audit process. If this enables the Board to begin – and finish – its audit inspection process sooner, that would be an added, but not primary, benefit.

The Board's audit inspections are essential to improving audit quality and investor confidence in audited financial statements and the effectiveness of internal controls. However, the significant lag between the date of audit reports and inspection rate harms the relevance of the inspection process for investors and auditors. Inspection reports dated in the spring of 2023 refer to inspections of audits for fiscal years ending in 2020 or earlier. While we agree with the acceleration in the audit documentation timeline of 31 days, we ask the Board and staff to scrutinize the audit inspection process and identify what steps in the process could be accelerated, modified, or eliminated to more significantly reduce the overall timeline, i.e. by months or years, not days.

### RESPONSES TO SELECT QUESTIONS

We considered all 25 questions posed in the Proposal and chose to respond to a selection of the questions, on topics of interest to us, which are presented below by reference to the question number presented in the Proposal.

#### 5. *Ethics Requirements* – *Are the proposed requirements related to ethics clear and comprehensive? If not, why not?*

No. The proposed standard states that "*the auditor must comply with applicable ethics requirements, including the rules and standards of the PCAOB.*"<sup>24</sup> Such a meager statement does not reflect the importance of ethics nor acknowledge how a lack of ethical behavior is a principal driver of audit failures. Following the law and regulations is a minimum ethical standard.

We recommend the Board augment the proposed standard by requiring audit firms to create and maintain codes of ethics that embrace the principles proposed in EI 1000, *Integrity and Objectivity*,<sup>25</sup> as well as upholding the integrity of capital markets and auditor's fundamental

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<sup>24</sup> Proposed AS 1000, Paragraph .06.

<sup>25</sup> PCAOB Release No. 2022-006.

obligation to investors, competence, independence, due professional care, professional skepticism and judgment, and encouraging others in the profession to practice ethically.

CFA Institute has a long history of ethics advocacy, enforcement, and education since the creation of its [Code of Ethics and Standards of Professional Conduct](#) in the 1960s. We welcome a broader discussion of ethical requirements in the audit profession.

**6. Auditor Competence** – *Are the proposed requirements related to the auditor’s competence clear and comprehensive? If not, why not?*

We agree with the members of the PCAOB Investment Advisory Group<sup>26</sup> that the professional development of auditors must include a focus on:

- (a) investors, because they are the primary beneficiary of the audit process and the perspective auditors are required to take by AS 2105, *Consideration of Materiality in Planning and Performing an Audit*, to determine materiality; and
- (b) the business of the entities they are auditing and the industries to which they belong; because “it is axiomatic that an auditor cannot audit what the auditor does not understand.”<sup>27</sup>

Therefore, we recommend revising Paragraphs .07 and .08 of AS 1000 as follows (new language, ~~deleted language~~):

**COMPETENCE**

*.07 The audit must be performed by an auditor who has the competence to conduct an audit in accordance with applicable professional and legal requirements. Competence consists of having the knowledge, skill, and ability that enable an auditor to perform the assigned activities in accordance with applicable professional and legal requirements and the firm’s policies and procedures. The , of competence is qualitative rather than quantitative because quantitative measurement may not accurately reflect the experience gained over time.*

*Note: Competence includes knowledge and expertise in accounting and auditing standards and SEC rules and regulations relevant to the company being audited and the related industry or industries in which it operates. Knowledge of the business and industry of the company under audit, including its business model, strategy, risk factors, and competitive landscape is fundamental to appropriately planning and conducting the audit.*

*.08 The auditor should develop and maintain competence through an appropriate combination of:*

- a. Academic education;*
- b. Professional experience in accounting and auditing, with proper supervision; and*
- c. Training, including a focus on investors as the primary beneficiary of the audit and perspective through which materiality is determined, as well as accounting, auditing, independence, ethics, and other relevant continuing professional education.*

We cannot over emphasize the importance of training and professional education with respect to the perspective of investors. Such perspective should permeate auditors’ mindset when executing the audit.

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<sup>26</sup> Letter from members of the PCAOB IAG to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board. Comment letters for Docket 049 (May 16, 2023).

<sup>27</sup> Colonial BancGroup v. PricewaterhouseCoopers LLP, No. 2:11-cv-975-BJR, Order on the Liability Phase of the PWC Bench Trial, at 35, (M.D. Ala. Dec. 28, 2017), <https://www.dandodiarary.com/wp-content/uploads/sites/893/2019/03/pwc-liability-order.pdf>.

9. ***Consideration of Relevant Guidance*** – *Is the proposed requirement for the auditor to take into account relevant guidance such as PCAOB auditing interpretations, Board-issued guidance, and releases accompanying the standards, amendments, and rules of the PCAOB appropriate? If not, why not?*

Experienced auditors and audit firms have no problems navigating regulatory labyrinths, but the proposed requirement poses significant difficulty to those entering and new to the profession as well as to outsiders (e.g., investors). The Board’s standards, including the proposed AS 1000 which is the foundational and first standard, are already challenging to read because there are numerous cross-references to other standards and statements like “as required by applicable professional and legal requirements” that direct readers to other locations outside the PCAOB but without hyperlinks.

While we agree with the principle of requiring auditors to consider all authoritative materials, we recommend the Board take a “codification” approach and include all guidance, interpretations, releases, amendments, and rules in the same location as the applicable auditing. Staff notes directing users to what is current, controlling, and has been superseded would be most helpful.

11. ***Engagement Partner Responsibilities*** – *Are the proposed clarifying amendments related to engagement partner responsibilities appropriate? If not, why not?*

Yes. We strongly support the amendments to AS 1201, *Supervision of the Audit Engagement*, and AS 2101, *Audit Planning*, which clarify that an engagement partner is not relieved of their responsibility for an engagement and its performance by seeking assistance from others.

We appreciate the fact that audits are done by teams, including the engagement partner, quality review and other partners, professional staff and staff support, specialists, and national office consultation staff. The same is true for preparation of financial statements and the related internal controls over financial reporting that support their creations. That too is a team effort by the CEO and CFO of a company and many professionals and staff supporting that important process. The Sarbanes-Oxley Act firmly establishes that it is the CEO and CFO who bear ultimate responsibility for the financial statements and internal controls, a responsibility they must attest to in every quarterly and annual report filed with the SEC. The CEO and CFO are responsible because they have personnel and supervisory decision-making power. They are well compensated for these responsibilities of leadership.

Engagement partners are leaders of audit engagements and leaders in their firms, which comes with decision-making power and commensurate levels of compensation. Engagement partners seeking assistance from others ultimately remain accountable for the entirety of the audit. It is why investors asked for the disclosures of the engagement partner name. We sought the behavioral accountability which ensues from such public disclosure. We see these revisions as a complement to that requirement and believe that the language included herein will ensure, just as it did for SOX, that the appropriate internal control and accountability and review processes are implemented within firms – not to unnecessarily seek enforcement against engagement partners, but to ensure they operate within the ecosystem of their respective firm that recognizes and supports partners with the appropriate staffing and specialized resources.



We also believe this language will facilitate a culture of accountability within the firms, reduce audit failures and protect investors. Investors want audits to be effective and audit partners to succeed and they are willing to compensate auditors fairly for their services.

*15. **Scalability of Audit Documentation** – Does the size of a firm or type of engagement affect the time necessary to assemble a complete and final set of audit documentation? If so, please describe which sizes of firms or types of engagements may need additional time and what period of time should be required.*

– And –

*24. **Applicability and Impact on EGCs** – The Board requests comment generally on the analysis of the impact of the proposal on EGCs. Are there reasons why the proposal should not apply to audits of EGCs? If so, what changes should be made so that the proposal would be appropriate for audits of EGCs? What impact would the proposal likely have on EGCs, and how would this affect efficiency, competition, and capital formation? Please specify.*

We believe all companies that seek and receive financing from investors should prepare high-quality financial statements and be subject to high-quality audits. We oppose the “scaling” of any requirements for issuer, auditor, or audit engagement size, including the issuer’s status as an Emerging Growth Company.

Reducing requirements reduces investor’s confidence in the affected issuers audited financial statements and effectiveness of internal controls. While scaling requirements is a well-intentioned attempt to reduce costs for smaller companies, the result is simply a shift of costs from one form (regulatory) to another (market-imposed premiums to costs of capital and steep valuation discounts for issuers that must restate financials), both of which are born by investors.

Rather than scaling down requirements for smaller capitalization issuers, we believe there is a case for *stricter* requirements and stronger investor protections related to these issuers:

- Since 2005, the vast majority of restatements have been made by non-accelerated filer registrants, with these issuers accounting for 73% of restatements in 2021.<sup>28</sup>
- Small capitalization issuers have a far greater proportion of their equity owned by individual investors than large capitalization issuers.<sup>29</sup>
- Small capitalization issuers have far less coverage by sell-side analysts than larger capitalization issuers.<sup>30</sup>

If auditors are willing to assume the risks of auditing publicly traded firms and reap the consequent rewards, they should abide by a single set of high-quality rules and standards set by the PCAOB.

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<sup>28</sup> Financial Restatements: A Twenty-One Year Review. Audit Analytics, May 2022.

[https://www.auditanalytics.com/doc/2021\\_Financial\\_Restatements\\_A\\_Twenty-One-Year\\_Review.pdf](https://www.auditanalytics.com/doc/2021_Financial_Restatements_A_Twenty-One-Year_Review.pdf)

<sup>29</sup> “Only small caps see minority of shares held by institutions, research shows.” IR Magazine. Jan 18, 2022.

<https://www.irmagazine.com/small-cap/only-small-caps-see-minority-shares-held-institutions-shows-research>

<sup>30</sup> Companies with a market cap of at least \$10B had, on average, current estimates from 19 analysts on FactSet compared to 4 and 1 analysts for companies with market caps less than \$5B and \$300M, respectively.



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Thank you for your consideration of our views and perspectives. We would welcome the opportunity to meet with you to provide more detail on our letter. If you have any questions or seek further elaboration of our views, please contact Sandra J. Peters at [sandra.peters@cfainstitute.org](mailto:sandra.peters@cfainstitute.org) and Matthew P. Winters at [matt.winters@cfainstitute.org](mailto:matt.winters@cfainstitute.org).

Sincerely,

*/s/ Sandra J. Peters*

Sandra J. Peters, CPA, CFA  
Senior Head, Global Financial Reporting Policy Advocacy  
CFA Institute

*/s/ Matthew P. Winters*

Matthew P. Winters, CPA, CFA  
Senior Director, Global Financial Reporting Policy Advocacy  
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