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Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
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Dear Sir:

Reference: Concept Release No. 33-9862, *Possible Revisions to Audit Committee Disclosures*
File Reference No. S7-13-15

CFA Institute,[1] in consultation with its Corporate Disclosure Policy Council ("CDPC"),[2] appreciates the opportunity to comment on the Securities and Exchange Commission (SEC) request for comment on the SEC Concept Release, *Possible Revisions to Audit Committee Disclosures* (the Concept Release).

CFA Institute is comprised of more than 130,000 investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. CFA Institute seeks to promote fair and transparent global capital markets and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that corporate financial reporting and disclosures provided to investors and other end users is of high quality.

Initiative Welcome

Financial reporting information is the lifeblood of capital markets. Concurrently, the extent to which investors can place reliance on the issued financial reports depends on the existence of robust and effectively functioning corporate governance mechanisms. In this respect, and as articulated in a past CFA Institute publication, *The Corporate Governance of Listed Companies: A Manual for Investors*, audit committees fulfill a pivotal role in the overall corporate governance structure of reporting entities including providing oversight over the financial reporting process and in overseeing the selection and work of the external auditors – who provide assurance on the financial reporting information. It is the audit committee's responsibility to ensure that the financial information reported by the company to shareowners is complete, accurate, reliable, relevant, and timely. At the same time, investors need to have the capacity to gauge and monitor how effectively audit committees have fulfilled their mandate. The ability of investors to assess audit committee

[1] With offices in Charlottesville, New York, London, Brussels, Hong Kong, Mumbai, Beijing, CFA Institute is a global, not-for-profit professional association of more than 130,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 150 countries, of whom nearly 123,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 144 member societies in 69 countries and territories.

[2] 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.

performance is largely dependent on the quality of communication and disclosures provided by audit committees.

For these reasons, we welcome the SEC's Concept Release on audit committee disclosures and the intention to enhance the overall package of audit committee disclosures. The focus on audit committee disclosures is both timely and necessary because existing guidance is:

a) out-of-date (SEC requirements were last updated in 1999);
b) minimalistic in its requirements; and
c) based on a fragmentary sources of specified requirements.

It is also observable that there is significant and ever increasing variation in the quality of audit committee disclosures provided across existing corporate reports.

Enhanced Audit Committee Disclosures & Auditor Reports: Both Required

We have observed a tendency by some stakeholders to view enhanced audit committee reporting as being a substitute for enhanced auditor reporting. In other words, there are some who consider that enhanced audit committee disclosures can or ought to pre-empt the need for enhanced auditor reporting. We disagree with such a viewpoint because, as noted earlier, audit committees have a role that goes beyond oversight of the auditors and independent of the role of auditors. We support the SEC and the Public Company Accounting Oversight Board (PCAOB) working to improve communications from both audit committees and auditors. As an organization, we have previously articulated our support for enhanced auditor reporting in the audit report as a measure towards improving the quality of audits from an investor perspective. That said, it is beneficial for investors to have distinctive and comprehensive communication from both audit committees.

More Time Needed To Better Elicit Detailed Investor Perspectives

Considering the key role that audit committees fulfill, it is necessary for the SEC to provide both the time and opportunity for investors to adequately evaluate and share their perspectives on these proposals. The process of comprehensively eliciting perspectives from our members in particular and investors in general necessitates our providing an education on:

- The background and importance of the proposed changes;
- Differences between existing versus potential mandated requirements as well as voluntarily disclosures by companies; and
- Areas where investor perspectives are particularly important.

Given the importance of this matter, we would like to have had an opportunity to perform direct outreach and poll our members so as to be able to present a detailed view of what investors want in response to the 74 questions posed in the Concept Release. The length of time required to elicit and articulate investor perspectives on financial reporting and audit matters is generally greater than the 60-day comment period allowed for this Concept Release, particularly in the context of when the document has been released for comment (i.e. the summer months of July and August). It would be unfortunate, if important changes slip past the radar of most investors' attention simply due to the timing of the issuance of the concept release and limited time to respond. We would suggest an extension of the deadline for responses to the Concept Release by sixty days to enable more comprehensive investor views.

Investor Perspectives on Key Themes

Under your current time frame for responses – and based upon our history of dialoguing with investors on these issues – we address key themes of the Concept Release.

Audit Committee Responsibilities: Broader than External Auditor Oversight & Selection – The last two questions of the Concept Release (Questions 73 and 74) are central to the discussion of audit committee communications. The Concept Release's focus on external auditor oversight and selection overlooks, in our view, the responsibility the audit committee has to engage with management on financial reporting, internal controls and risks inherent in the business. Investors are keen to understand how the audit committee comes to understand the company including its financial reporting and control environment and how management executes, and how the audit committee oversees these themes. Investors we obtained input from want to know whether the audit committee is considering items such as the following:

a) How does the audit committee assess the financial reporting systems and whether they need to be improved?
b) How does the audit committee assess the quality of the organizations accounting staff?
c) What does the audit committee do to understand and assess internal controls and ensure remediation of any internal control issues?
d) Did the audit committee assess the work of internal audit and the sufficiency of the internal audit function?
e) What does the audit committee do to assess the quarterly financial reporting?
f) Does the audit committee engage in assessing the quality of non-GAAP reporting and other information presented to shareholders – as it may be most influential to investors?
g) What work or review does the audit committee do around regulatory filings, including regulatory filing such as tax returns?
h) Does the audit committee oversee regulatory communications and relationships?

Many investors believe audit committees are detached and have a limited understanding of the business. Greater disclosure regarding their interaction with management and the topics discussed provide insight into the oversight activities and whether the audit committee members have the requisite skills to provide oversight on behalf of investors of key issues. For example, if fair value measurements are a key business, accounting and auditing issue, do members of the audit committee have the necessary skills to provide investor oversight on such key issues? Another example is the audit committee's understanding of the auditors' use of employed (that is, its own) and engaged (consultants not employed by the auditor but in many cases, employed by the audit client) specialists. The PCAOB Staff Consultation Paper on the auditors' use of specialists notes that there is little, if any, guidance on the use of specialists or communication about such use to the audit committee or investors. Additional disclosures around the experience, competence and the commitment of audit committee members could go a significant way to improving investor confidence in the oversight provided by audit committee members.

Without understanding how the audit committee interacts with and supervises management and the external auditors, it is unclear how the audit committee could effectively engage with, oversee and select the auditor.

Location & Accessibility of the Communications – Also towards the end of the Concept Release (Questions 50, 51, 52, 65 & 66), the Commission queries investor preferences with respect to the location of audit committee communications. Investors would like disclosures and reference materials in one location. Hyperlinks to the information elsewhere to shorten the length of filings documents is appropriate. Investors don't want to have to search for the information comprising the totality of the governing documents and compliance with disclosure requirements.

Investors prefer communications from the audit committee be in a single consistent location which is accessible in an interactive data format so that such information can be readily retrieved and compared period over period and between entities.

Investors would not want such communication to be listed solely on the company's website. The information should be filed, or incorporated by reference into filings with the SEC under the Securities Act in either the proxy statement or annual report. As noted above, a single uniform location would be most helpful to investors.

Different Disclosures for Different Types of Entities – The Concept Release raises the question regarding differential disclosures based upon the nature of the issuer (Questions 53 & 54). When capital is at risk, the nature of the issuer or its size does not change the nature of the communication and transparency necessary from the investee. Differences in transparency result in different assignments of risk premiums. Not providing such information simply raises the cost of capital to the issuer. Accordingly, we are supportive of consistent disclosure for all issuers. Further, in assessing these differential disclosures, the cost of failing to provide that information to investors is generally not, but should be, considered in the cost versus benefit equation.

Audit Committee Oversight of the Auditor – The proposed areas of additional disclosures addressed in the concept release pertaining to audit committee oversight on the auditor include the following:

- Increased information about communications between the audit committee and the auditor;
- Information about frequency of meetings between audit committee and auditor;
- Review/discussion about the auditor's own internal quality review and the most recent PCAOB inspection report;
- Whether and how the audit committee assesses, promotes and reinforces the auditor's objectivity and skepticism.

In response to these proposed areas of enhanced disclosures, we observe that, in general, any communication regarding the frequency and nature of topics that are discussed between the audit committee and auditors will further help investors to identify the key risk areas faced within the reporting entity's business model. Disclosures on the frequency of communications and the nature of communications give an idea of the degree to which there is interaction, on what topics and whether such interactions are at a level sufficient for the audit committee member to truly have an understanding of the key issues faced by the business and by the auditor. Consequently, we are supportive of these disclosures as they can provide insight on the business, the risks and the skills necessary of the auditor and audit committee members who are charged with protecting investor interests.

In addition, auditors' professional skepticism is at the heart of ensuring a high quality audit. Concurrently, we recognize that it is difficult to observe on a continuous basis, measure and thereafter compare the degree of professional skepticism exercised by auditors. This mentioned difficulty may lead to a reticence by audit committees towards disclosing how this attribute is being assessed within individual companies. Nevertheless, if investors are periodically informed about any measures taken by the audit committee to encourage professional skepticism, it can certainly help further engender investors comfort on the reliability and rigor of the overall assurance process. For this reason, we support the proposed communication on how the audit committee assesses, promotes and reinforces objectivity and skepticism – while at the same time recognizing that some work is required to identify the type of work to be done and disclosures that can be meaningfully provided on this matter.

There is an expectation by investors that audit committees ought to have adequate oversight on auditor resolution of inspection findings. Investors are interested in related audit committee – auditor discussions, if there is a trend of poor inspections as it impacts investors' perception of the skills and quality of the audit firm. That said, investors can't evaluate the quality of the level of discussion on non-public inspection findings as they don't have insight into the level of detail provided in such reports and the bearing it ultimately has on the investee company. Clearly, there are likely to be questions on whether the audit committees can divulge more than what is disclosed in the publicly disclosed quality review reports – which tend to be highly generic (i.e. not entity-specific) in content. Broad discussions of findings on other engagements of the auditor doesn't seem to improve the quality of the audit in the investee company. To the degree to which there are systemic firm-wide issues with the auditors' execution of its responsibilities (e.g. poor training of staff, lack of procedures to ensure independence, lack of requisite skills, etc.) then investors would find it useful that the audit committee address such issues and communicate their resolution before retaining or allowing the auditor to stand for reappointment. The question does not address what investors would find most useful to know – that the audit committee has been made aware of a PCAOB inspection of the investee company's audit and that any findings have been discussed with the auditor. Investors would be interested in disclosures regarding any such company-specific auditor inspection and findings and how the audit committee addressed such inspection and findings with the auditor.

Audit Committee's Process for Appointment or Retention of the Auditor – The proposed areas of additional disclosures addressed in the concept release pertaining to audit committee's process for appointing or retaining the auditor include the following:

- How the audit committee assessed the auditor, including the auditor independence, objectivity and audit quality, and the audit committee's rationale for selecting or retaining the auditor;
- If the audit committee sought requests for proposal for the independent audit, the process the committee undertook to seek such proposals and the factors they considered in selecting the auditor;
- The Board of Directors' policy, if any, for an annual shareholder vote on the selection of the auditor, and the audit committee's consideration of the voting results in its evaluation and selections of the audit firm.

Effective auditor selection requires the audit committee to have a full handle on the intricacies of the reporting entity's business model and its key risk areas so as to have the ability to judiciously review the capabilities of and assess the suitability of the candidate audit firms. From the outside looking inwards, and bar there being high quality of disclosures on the factors that shaped the auditor appointment, it is difficult for investors to assess the extent to which audit committees are up to the task of appointing the best qualified auditors. Hence, we support the disclosures that shed light on how auditor qualifications and suitability are assessed by the audit committee during the appointment phase. These disclosures can signal and illustrate the extent to which the audit committee has an understanding on the factors that are germane to ensuring audit quality and the extent to which the committee is fully abreast with the specificities of the reporting entity business model and the underlying key risk areas. The factors the board of directors considered in selection of the auditor and the impact of the changes in the nature of the business which necessitate change in involvement or skills of auditors are something investors are interested in understanding.

Further, investors are interested in the overall process which the audit committee undertook in selecting or retaining the auditor to ensure that the process was open, fair and transparent and that there was a balance between skills and cost in their selection. Investors are not interested in the audit committee selecting the lowest bidder as this generally results in audit quality issues. Investors are interested in disclosures regarding how the audit committee assessed the reasonability of the audit fee and the level of detail they receive in assessing the fee. Are they receiving a lump sum figure or a detailed budget by audit area as discussed between management and the auditor? Understanding where audit hours are spent and fees incurred provides valuable insight into the nature of the underlying people, processes and technologies used to manage the business as well as the risks inherent in the financial statements. Such detail also provides an understanding of the leverage model (i.e. ratio of partner to staff time) deployed by the audit firm in executing the audit. Investors would like to know that the audit firm is compensated fairly for the work performed and is not relying on fees from other services to provide a reasonable profit on their efforts as this ensures a degree of independence and objectivity. Investors are also interested in additional information on how the audit committee approved various non-audit services. Some investors reported to us that the lack of information on the nature of non-audit services resulted in them failing to support reappointment only to learn later with more information that such non-audit services and fees would not have resulted in a failure to support reappointment. For these reasons, investors would like disclosures regarding the selection process, how the audit committee has assessed the reasonability of the audit fee and additional disclosure on the nature of non-audit services.

Disclosure of the policy with respect to shareholder ratification and the board's decision to proceed with the auditor irrespective of significant number of votes are something investors are interested in knowing as it provides insight into how the audit committee perceived this vote and addressed any investor concerns. Investors are keen to know the factors shaping shareholder vote for /against the auditor appointment and how these factors and voting outcome ultimately influenced the audit committee's final selection decision.

Qualifications of Audit Firm &
Certain Members of Engagement Team Selected by Audit Committee – The proposed areas of additional disclosures addressed in the concept release pertaining to qualifications of the audit firm and certain members of the engagement team selected by the audit committee include the following:

- Disclosures of certain individuals on the engagement team;
- Audit committee input in selecting the engagement partner;
- The number of years the auditor has audited the company; and
- Other firms involved in the audit.

We have previously responded to similar queries with respect to disclosure of certain individuals on the engagement team (Questions 34-42) and disclosure of other firms involved in the audit (Questions 48 & 49) in our recent correspondence with the PCAOB. There is general consensus amongst investors that they want such items disclosed in the audit report. We urge the SEC to support the PCAOB in its transparency projects while at the same time moving forward with the SEC's audit committee disclosure project. As it relates to the audit committees' input on the selection of the engagement partner (Questions 43 & 44), investors are interested in the criteria used and their input into the selection of this individual as it provides insight into the skills and experiences necessary to address the business and audit risks. Investors are interested in understanding from the audit committee the number of years the auditor has audited the company (Questions 45-47) and they are interested in how the audit committee assessed the importance of continued retention over a fresh look at issues by another firm in their decision not to put the audit up for proposal. While we have not supported mandatory auditor rotation, we do think it is important for new and objective perspectives brought to key audit decisions.

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We thank the SEC for the opportunity to express our views on this proposal. If the SEC has questions or seeks further elaboration of our views, please contact Vincent Papa by phone at +011.44.207.330.9521, or by e-mail at vincent.papa@cfainstitute.org or Sandra Peters by phone at +1.212.754.8350, or by e-mail at sandra.peters@cfainstitute.org.

Sincerely,

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