American Bankers Association
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Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
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Via website submission: comments@pcaobus.org

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

To Whom It May Concern:

The American Bankers Association[1] (ABA) appreciates the opportunity to comment on the Proposed Auditing Standard – *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (Proposal). The major change proposed is the inclusion within the standard auditor's report of a description of "critical audit matters" (CAMs), intended to provide audit-specific information about especially challenging, subjective, or complex aspects of the audit as they relate to the relevant financial statement accounts and disclosures.

Representing both users and preparers of financial information, ABA recognizes the importance of effective auditing procedures as the underlying lynchpin of the securities markets. In short, investors rely on the reasonableness of reported financial performance. With that in mind, ABA has evaluated the Proposal in light of the current state of the auditing profession, new accounting standards recently issued, and the interface auditors have with both investors and preparers. We have also evaluated the Proposal in light of the fact that bank financial statements are normally full of matters that are especially challenging, subjective, or complex. In addition to those issues not unique to the financial services industries, valuation of financial instruments (including many equity and debt securities, derivatives, retained interests in variable interest entities, and other financial instruments) and goodwill, as well as estimating credit losses in a broad range of loan portfolios, will likely qualify as CAMs in a typical bank audit.

If the Proposal is approved, the new auditing standard could be the biggest change ever to the auditor's report. It also will largely converge with international standards. In the end, however, ABA sees little, if any, ongoing value provided to investors and analysts, while burdening both registrants and auditing firms with costly processes that will take the focus away from the registrant and onto the auditing firm – from the results of operations to the results of auditing procedures.

[1] The American Bankers Association is the voice of the nation's $16 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $12 trillion in deposits and extend more than $8 trillion in loans.

The PCAOB must carefully assess both the short- and long-term benefits and costs of reporting CAMs. Prudent investors already understand that auditors focus their efforts on those areas disclosed by registrants in various sections of their quarterly and yearly filings. The incremental value of a separate auditor's discussion will be minimal to these stakeholders, especially because descriptions of auditing procedures will inevitably become boilerplate and unnecessary scrutiny will accompany even the tiniest of CAM wording changes made by auditors. We believe investor focus should be on the registrant and not the auditor.

There is little doubt that the Proposal will generally result in increased auditing documentation requirements over issues identified as CAMs. In light of the continually increasing emphasis on auditing procedures over internal controls over financial reporting during the past several years, the Proposal could become the final blow to the PCAOB's common sense Auditing Standard No. 5 *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* (AS 5). If the Proposal is approved, check-the-box-like audit procedures that require overly-detailed documentation– those audit procedures that have increased dramatically over the past several years – will become a central part of registrant audits. This will provide value to no one.

As a result, ABA recommends that the PCAOB suspend this project and perform the steps described below.

Provide Transparency to Audit Practice Expectations

It appears that the disclosure of CAMs could undermine the importance of attestation reports of internal controls over financial reporting. Since Significant Deficiencies normally result in additional audit procedures, the Proposal appears to require, on a practical basis, the disclosure of Significant Deficiencies[2]. As per the SEC's guidance related to Sections 302 and 404 of the Sarbanes-Oxley Act of 2002 (SOX), Significant Deficiencies are currently reported by the auditor only to the Audit Committee and, therefore, should be excluded from the scope of the Proposal. Unless this contradiction is addressed prior to a final auditing standard, both investors and auditors will be confused on how to assess such internal control deficiencies. Significant deliberation had been conducted over these SOX internal control reporting requirements, and any auditing standard that changes those requirements should be subject to a similar extensive due process.

Although the above must be resolved, a much more urgent effort is needed from the PCAOB to help alleviate the confusion experienced by many companies (bank and non-bank) and their auditors about the appropriate level of documentation needed to support internal controls. It seems that auditors and PCAOB have constantly expanded requirements for detailed supporting documentation to the point of overkill.

[2] While the CAM may not explicitly name the Significant Deficiency, an investor will be able to review the internal control attestation report to identify Material Weaknesses and deduce the Significant Deficiencies through the CAMs.

Over the past several years, continuous changes to auditors' supporting documentation requests have transformed much of the "top-down" and "risk-based" approach of AS 5 to one that requires untenable levels of detail and precision that often do not reflect the company's internal control structure – work is performed merely to satisfy auditor demands that are apparently made in response to PCAOB inspection comments. This has particularly affected banks, which normally have very large balance sheet totals in comparison to net income statement results. Income statement materiality thresholds are often applied to balance sheet account testing, resulting in inordinately detailed documentation required to support items that are often clearly trivial to the balance sheet.

This situation needs to change, as the demand for detail grows with each passing audit. Since internal control testing, and the challenges thereof, will be fundamental aspects of any CAM, companies and their auditors must be able to anticipate what levels of detail and precision will be acceptable. Until these concerns are addressed, companies will not be able to adequately assess and structure their internal control systems. This is a high priority for not only auditors and SEC registrants, but also non-SEC registrants, in the likely event that similar auditing standards are adopted for all financial statement audits.

We recommend that comprehensive and ongoing outreach and education be performed by the Inspections Division of the PCAOB. The focus should be on the acceptable levels of audit evidence and other supporting documentation over internal controls. Roundtable and workshop sessions that include both auditing firms and SEC registrants should be a part of this effort. Without such discussions, the level of internal control testing and documentation will either remain at high levels or continue to skyrocket, and CAM challenges will unnecessarily turn the investor's attention from one of substance to one of compliance. That should not be the intent of the Proposal.

Reevaluate Whether Actual CAM Disclosures will Add Value to Investor Decisions

If the PCAOB decides to issue a final auditing standard that contains CAMs, the issuance of FASB's Current Expected Credit Loss accounting standard (CECL) promises to open the floodgates to not only more internal control concerns as expressed above, but also to a continuous stream of CAMs to be listed in a typical bank's audit opinion. Given the high measurement uncertainty related to the highly subjective and judgmental process of estimating credit losses[3], the Proposal could result in requiring a separate CAM discussion on the allowance for credit losses related to virtually every lending product offered by a bank[4]. Such an expansion

[3] Such challenges related to measurement uncertainty will be significantly increased upon the adoption of FASB Accounting Standards Update 2016-13 *Measurement of Credit Losses on Financial Instruments*. Detail on the additional challenges can be found in the International Auditing and Assurance Standards Board's paper *The IAASB's Project to Revise ISA 540: An Update on the Project and Initial Thinking on the Auditing Challenges Arising from the Adoption of Expected Credit Loss Models*. (March 2016)

[4] While auditors will conceivably limit discussion to one CAM covering the entire loan portfolio, we believe auditors will feel a need to break out their discussions to align with how they will be discussed by registrants within their public filings.

of the auditor's report will result in pages of narrative of little worth, as general auditing procedures will likely be similar for each product. We question whether this is the intent of the PCAOB, as the focus should be on areas that are *especially* challenging, subjective and complex compared to the rest of the audit.

With this in mind, the Proposal attempts to rank some audit challenges as being higher than others (if *especially* challenging, it is deemed a CAM). Although we do not agree with identifying the entire ALLL estimation process as being a CAM (as described above), the ranking of audit challenges into CAMs versus non-CAMs could lead one to believe the standard ALLL estimation process is without significant risk. For instance, in the Illustrative Example on page 32 of the Proposal, a CAM is identified on a new loan product that represents 18% of one segment of a loan portfolio held by a company. Investors could be wrong to assume that accounting matters related to the other portions of this loan portfolio are not challenging, but that is what the disclosure implies. Worse, any possible subsequent financial statement restatements related to those challenges that did not rank high enough to be a CAM will unnecessarily increase audit liability to the point that nearly every challenge could eventually be considered a CAM. Thus, there is risk of identifying too few CAMs as well as the risk of watering down disclosures if there are too many CAMs.

Finally, we question how CAMs that are continuously disclosed will be handled in years subsequent to implementation. Will unnecessary attention be given to trivial language changes in the CAM disclosures? We believe this could be the case, which, along with the confusion just noted on the risks related to too-extensive CAM disclosure and non-CAMs, would divert investor focus from registrant performance to work by the auditors.

Determine How Other Disclosures Can Address CAMs

Analysts that are familiar with specific industries normally have a reasonable level of knowledge related to the most challenging audit areas. Banking analysts, for example, normally identify a critical auditing matter after reading sections in periodic registrant filings addressing key accounting policies, accounting estimates, fair value measurements, risks, and management's discussion and analysis. At the level of detail that can be expected during a bank audit, it is difficult to see significant incremental value provided to an investor derived from the information provided in a CAM, considering other existing reports (internal control attestations and the overall audit opinion, in combination with company disclosures) address the auditor's focus and the related results (including those for financial statement accounts, footnote disclosures, and internal controls).

As drafted, the Proposal will result in bank audit opinions that span pages with CAM disclosures of little difference between each other. Investors and analysts do not normally possess detailed knowledge of specific audit procedures and, therefore, will likely either ignore CAM disclosures or unnecessarily question them. In the event there are questions, it would appear that investors will need to speak directly with the auditors, and this seems to virtually eliminate the purpose of the audit committee. We do not believe this is a good result.

If the PCAOB wishes to consolidate information related to key accounting issues or otherwise educate the investing public on the nature and extent of auditing procedures, we believe such efforts can be done outside the audit opinion. In addition to other disclosures within a typical filing, the PCAOB can explore working with the SEC in appending such consideration to their project reviewing the recent SEC Concept Release *Possible Revisions to Audit Committee Disclosures*. The Concept Release currently addresses certain processes performed by audit committees, but mainly in regards to the audit committee's relationship to the external auditor. Overseeing the company's relationship to the external auditors is only one of the various purposes of the typical audit committee. The SEC should consider whether a discussion by the audit committee of key audit risks is appropriate within periodic filings.

In summary, ABA supports efforts to provide investors with relevant and decision-useful information. However, the Proposal will result in increasing the visibility of the audit report with noise that will not provide incremental decision-useful information for investors, and could create unwarranted and unnecessary confusion. Considering the evolving and ever-detailed audit demands that have resulted from PCAOB inspections, we believe the PCAOB should resolve those issues before ratifying a new audit opinion.

Thank you for your attention to these matters and for considering our views. Please feel free to contact me (mgullette@aba.com; 202-663-4986) if you would like to discuss our views.

Sincerely,

Michael L. Gullette