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Office of the Secretary
PCAOB
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Washington, DC 20006-2803

Rulemaking Docket No. 34 - PCAOB Release No. 2016-003:
Proposed Auditing Standard—The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards

Dear Secretary:

My comments and responses to certain of the questions asked in the above-mentioned proposed auditing standard (the "reproposal") are set out below. For convenience, this comment letter uses the term "investor" to include collectively every type of investor, shareholder, creditor, analyst, and other financial statement user including stakeholders.

Critical Audit Matters ("CAMs")

General Comments

I am opposed to the inclusion of Critical Audit Matters in the auditor's report for the reasons outlined in this letter.

It will be argued by some respondents to the reproposal that any disclosure by the auditor would be informative and useful, add value, enhance audit quality, reduce asymmetrical information between management and investors, make the audit report more relevant and credible, and consequently help investors to incorporate whatever information the auditor deems appropriate to provide in the form of CAMs into their investment strategies, voting considerations and lending decisions.

Nevertheless, the reproposal does not support by compelling and reliable evidence that these objectives will be met. Based on the unpersuasive evidence in the reproposal, Critical Audit Matters will –

- not be "valuable" or "useful" to investors (as some respondents to the reproposal would hope),
- not provide investors with any real "insight into the extent and appropriateness of the auditor's work,"[1]
- increase (not decrease) information asymmetry between the auditors and investors,

[1] Page 79.

- run many pages and overwhelm other information in the audit report (for some industries), and
- be redundant, repeating information that has already been disclosed by management.

Investors always want more data and more information, especially when it is free. However, every public company will bear some portion of the cost of that information, which cost will be passed on to them by their auditors, and the auditors will in turn reap the monetary benefits of the reproposed CAM reporting. The reproposal says that the PCAOB staff found that the average change in audit fees was an increase of approximately 5 percent.[2] For 2014, the average audit fees for 7,071 SEC filing companies were $1,533,438, totaling $10,842,940,098 of audit fees.[3] Using the 5 percent cited in the reproposal results in an increase in <u>recurring</u> total audit fees of approximately $542 million (aka a half billion dollars each year), an <u>average</u> of $76,672 for each of the 7,071 SEC filing companies.

The reproposal has not established that the benefits (as yet unknown and unproven) exceed the costs to be borne by every public company.

By definition, a CAM "is not expected to provide information about the company that has not been made publicly available by the company."[4] Nevertheless, the reproposal weakly argues that CAMs are important to investors because the auditors can "more effectively" convey company information than management.

> The Board believes that expanding the auditor's report to provide information about especially challenging, subjective, or complex auditor judgments should help investors and other financial statement users <u>"consume" the information presented in management's financial statements more effectively</u>.[5] (Emphasis added.)

In addition, the reproposal points out that there may be matters that are relevant or important to investors, but may <u>not</u> be reported as a CAM.

> With a materiality component, however, matters that are not material to accounts or disclosures in the financial statements but may be important to investors would not be included as critical audit matters in the auditor's report.[6]

Since auditors would not be required to present information about the company that has not been made publicly available,[7] it then follows that if investors really want useful and valuable information, they should read firsthand the registrant's <u>entire</u> Form 10-K, including MD&A and the financial statements, then they would immediately have the data, comparisons, trend

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[2] Page 83. The 5 percent pertains to the expanded auditor reporting in the United Kingdom.

[3] See the *2015 Audit Fee Report*, Financial Executives Research Foundation (issued October 2015).

[4] Paragraph 14, Note 2 of Proposed AS 3101. See discussion of the "unless" clause in answer to Question 6.

[5] Page 64.

[6] Page 95.

[7] See discussion of the "unless" clause in answer to Question 6.

information, business, operations, prospects, contingencies, the entity's "critical accounting policies" and "significant accounting policies," and much more.

The information contained in "critical accounting policies and estimates" and "significant accounting policies" includes the entire universe of accounts and disclosures required to be included in a CAM, and all the information investors need to understand the registrant's significant risks, management's judgments, operating trends and potential variability of a company's earnings, cash flow and more.

I do not believe that investors fully use the information they already have in the annual report on Form 10-K, interim reports on Form 10-Q, and other SEC filings – information much more usable and valuable than the limited amount of information that investors could glean from any CAM reported by the auditor.

Critical Accounting Policies

As mentioned, investors reading the SEC filings would be aware of the registrants "critical accounting policies." The SEC requires that registrants include in their MD&A a full explanation of their critical accounting policies, including "the judgments and uncertainties affecting the application of those policies, and the likelihood that materially different amounts would be reported under different conditions or using different assumptions."[8] The SEC advises that in the MD&A disclosure of critical accounting policies and estimates "companies should consider whether they have made accounting estimates or assumptions where:

> the nature of the estimates or assumptions is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and
>
> the impact of the estimates and assumptions on financial condition or operating performance is material."[9]

The reproposal defines CAMs (in part) as [audit matters that] "involved especially challenging, subjective, or complex auditor judgment." The definitions of "critical accounting policies"[10] and CAMs are fundamentally the same, the only difference is that auditor's must report on those accounts or disclosures that were particularly "hard to audit" for any number subjective reasons and disclose some (but not all) of the audit procedures used to audit the CAM.

Significant Accounting Policies

As said, investors reading the SEC filings would be aware of the registrants "significant accounting policies." Hence, an investor reading the notes to the financial statements will learn, in great detail, the "significant accounting policies" followed by the registrant.

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[8] See Cautionary Advice Regarding Disclosure About Critical Accounting Policies, SEC Release 33-8040 and Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations, SEC Release 33-8350, FR 72.

[9] SEC Release 33-8350, FR 72.

[10] See paragraph .12, Item 2, and Appendix A to AS 1301 and Question 1.

FASB Topic 235, *Notes to Financial Statements*, requires the disclosure of all significant accounting policies. This ASC states "… a description of all significant accounting policies of the entity shall be included as an integral part of the financial statements.[11] ASC Topic 235 then defines accounting policies disclosure as –

> The accounting policies of an entity are the specific accounting principles and the methods of applying those principles that are judged by the management of the entity to be the most appropriate in the circumstances to present fairly financial position, cash flows, and results of operations in accordance with generally accepted accounting principles (GAAP) and that, accordingly, have been adopted for preparing the financial statements.[12]

IAASBs Key Audit Matters ("KAMs")

There are those who believe that convergence with the IAASBs KAM disclosure is a desirable goal. However, while somewhat similar, there are very significant differences between the IAASBs KAM disclosures and the reproposed CAM disclosures.

ISA 701 defines Key Audit Matters as "[t]hose matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance."[13]

The definitions of a KAM and a CAM do not align in many respects including the terminology used and the materiality (vs. significance) of the audit matter. Thus, audit reports using the ISAs KAM standard will contain significantly different information than the reproposed CAM standard.

Exhibit 2 contains a small sample from a number of audit reports of how the auditor addressed specific company KAMs. This is deadly reading, and confirmation of how useless these descriptions of the audit procedures undertaken by the auditor will be for investors.

Information Asymmetry

The reproposal states that "in economic terms, an expanded auditor's report should reduce the information asymmetry between investors and auditors, which should in turn reduce the information asymmetry between investors and management about the company's financial performance."[14]

While at first this argument sounds appealing, the reproposal does not provide any evidence that the reporting of a CAM will in fact close the information gap between auditors and investors, and therefore in turn reduce asymmetric information between management and investors.

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[11] ASC 235-10-50-1.

[12] ASC 235-10-50-3.

[13] Paragraph .08 of ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*.

[14] Page 64.

The argument that CAM reporting will reduce the asymmetric information between the management and investors is wholly conjectural and there is no basis for the assertion. How does the reporting of audit procedures decrease the "information asymmetry" between the management and an investor? How can knowing that certain audit procedures were applied to an account or disclosure increase an investor's knowledge of a company's financial performance? The reproposal provides no answers to these "how" questions.

Useful Information?

The reproposal itself questions the usefulness of CAM reporting:

> Overall, the results from research analyzing whether the information provided in expanded auditor reporting is useful to investors are limited. Collectively the results are ambiguous as to whether the expanded auditors' reports have provided investors with new information beyond what is contained in the financial statements. The Board will continue to monitor academic research in this area during the rulemaking process.[15]

On the other hand, in making the case for the reporting CAMs, the reproposal observes:

> The Board believes that the communication of critical audit matters should help focus investors' and other financial statement users' attention on these matters by making them more prominent, which could facilitate their analysis of the financial statements and other relevant disclosures.[16]

Hence, it is possible that the reporting of CAMs could help investors, but the reproposal contains no concrete evidence that it would, or just how investors will use this information in their analysis of financial statements. The reproposal continues –

> The communication of critical audit matters in the auditor's report would also help investors and analysts who were interested in doing so engage management with targeted questions about these issues.

Auditors have not historically been engaged by management to act as a primary stimulus of investors to ask "targeted questions" of management regarding information in the auditor's report. In my view, these "targeted questions" inspired by CAM reporting will be a negative by-product of CAM reporting.

Still more from the reproposal (footnotes omitted):

> The communication of critical audit matters may also assist investors in assessing the credibility of the financial statements and, in at least some instances, audit quality. For example, the audit matter may help investors understand the types of issues that the auditor grappled with in addressing these challenging, subjective, or complex areas of the audit, which may allow a more nuanced understanding of the related financial statement accounts and disclosures. Furthermore, investors have stated that having the auditor, a third party expert, rather than the company provide this type

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[15] Page 74.

[16] Page 64.

> of information would be of added value to investment decision making. Because the auditor is required to be independent, information provided by the auditor <u>may be viewed</u> by investors as having greater credibility.[17] (Emphasis added.)

The basis for these claims is very weak and speculative: "may assist," "may help," "may allow," "may be viewed" tells the reader that there is also a possibility that CAMs may do none of these things and that the Board just does not know enough about the value and utility of CAM reporting.

Question: 1. Is the definition of "critical audit matter" appropriate for purposes of achieving the Board's objective of providing relevant and useful information in the auditor's report for investors and other financial statement users?

When first read the definition seems clear enough, but when examined more closely, the definition is not as clear as it could be. To eliminate any ambiguity, I believe that "involved especially challenging, subjective, or complex auditor judgment" should be read as "involved <u>any combination of</u> especially challenging, subjective or complex auditor judgment."

<u>What Do the Words Really Mean?</u>

Almost every word in the definition has an element of uncertainty and will mean different things to different auditors. The usual definitions of some of the words used in the definition follow:

- Especially: "to a great extent; very much." How much is very much?
- Challenging: "testing one's abilities; demanding." Obviously, the abilities and judgments of auditors differ.
- Subjective: "personal feelings, tastes, or opinions; existing in the mind; open to interpretation." What is the level and degree of objectivity? How much of auditor judgment is subjective?
- Complex: "consisting of many different and connected parts." This word only adds to the difficulty of having a uniform understanding of the definition.
- Judgment: "the ability to make considered decisions or come to sensible conclusion."
- Lastly, what is the meaning of the phrase "complex auditor judgment"? This is not a term of art, and as far as I could determine it appears nowhere in the PCAOB, AICPA, FASB or SEC literature.

AS 1301 (*Communications with Audit Committees*) defines "critical accounting policies and practices" as –

> … a company's accounting policies and practices that are both most important to the portrayal of the company's financial condition and results, and require <u>management's most difficult, subjective, or complex judgments</u>, often as a result of

[17] Pages 64-65.

> the need to make estimates about the effects of matters that are inherently uncertain (emphasis added).[18]

AS 1301 also says

> Critical accounting policies and practices are tailored to specific events in the current year, and the accounting policies and practices that are considered critical might change from year to year.[19]

However, the similar usage in AS 1301 is not under discussion here.

Question 1 (continued). Is the definition sufficiently clear to enable auditors to apply it consistently? If not, describe why the definition may not be clear, including examples demonstrating your concern.

The definition cannot be applied consistently when auditors, be they in different firms or engagement teams, attempt to follow imprecise terms used in the reproposal and discussed immediately above, namely: "material," "especially," "challenging," "subjective," "complex," and "audit judgment."

a. Are matters communicated or required to be communicated to the audit committee the appropriate source for critical audit matters? Why or why not?

Yes. The source of CAMs should be limited to only those matters communicated to the audit committee.

b. Are there any audit committee communications that should be specifically excluded from consideration as a source of potential critical audit matters? If so, identify and explain the reason for the exclusion.

Yes, not all required communications should be the source of a CAM. For example, Item 2-07, *Communication with Audit Committees*, of Regulation S-X requires the auditor to report to the audit committee:

> (2) All alternative treatments within Generally Accepted Accounting Principles for policies and practices related to material items that have been discussed with management of the issuer or registered investment company, including:
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> > (i) Ramifications of the use of such alternative disclosures and treatments; and
> >
> > (ii) The treatment preferred by the registered public accounting firm;
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> (3) Other material written communications between the registered public accounting firm and the management of the issuer or registered investment company, such as any management letter or schedule of unadjusted differences;

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[18] Appendix A to AS 1301.

[19] Paragraph 12 of AS 3101.

Both of these requirements should not be the source of a CAM. In addition, the overall planned audit strategy,[20] the qualitative aspects of significant policies and practices,[21] uncorrected and corrected misstatements,[22] violations or possible violations of laws or regulations,[23] and disagreements with management,[24] should not be considered as a source of potential CAMs.

c. Is the "relates to accounts or disclosures that are material to the financial statements" component of the definition of a critical audit matter appropriate and clear? Why or why not?

As to the materiality component of the definition, the reproposal cites the US Supreme Court cases TSC Industries v. Northway, Inc. and Basic, Inc. v. Levinson.[25]

Obviously, any materiality definition cited in a final standard should reference the FASBs final standards (if issued) regarding (1) Conceptual Framework for Financial Reporting, Chapter 3 - Qualitative Characteristics of Useful Financial Information, and (2) Notes to Financial Statements – Assessing Whether Disclosures are Material.

Pending the issuance of these documents, the definition in FASB Concepts Statement 2, paragraph 132, should be referenced.

The proposal requires that the following language be included in the auditor's report: "The critical audit matters communicated below … (1) relate to accounts or disclosures that are material to the financial statements …." I suggest that the words "material to the financial statements" be followed by the words "taken as a whole" in order for the definition to be congruent with the other verbiage required by the reproposal in the audit report. Thus, the first sentence would read, "… (1) relate to accounts or disclosures that are material to the financial statements, <u>taken as a whole</u>, and …."

d. Is the "involved especially challenging, subjective, or complex auditor judgment" component of the definition of a critical audit matter appropriate and clear? Why or why not?

See above discussion.

Question: 2. Are factors helpful in assisting the auditor in determining which matters involved especially challenging, subjective, or complex auditor judgment? Why or why not?

Yes, the nonexclusive listing of various factors[26] will be helpful in deciding in determining CAMs.

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[20] Required by paragraphs .10 and .11 of AS 1301.

[21] Detailed in paragraph .13(a) to (g) of AS 1301

[22] Paragraphs .18 to .20 of AS 1301.

[23] Paragraph .08 of AS 1301.

[24] Paragraph .22 of AS 1301.

[25] Footnote 40, page 20.

[26] Paragraph .12 of Proposed AS 3101.

Question: 3. Are there any factors that the Board should consider adding or removing to better assist the auditor in determining which matters involved especially challenging, subjective, or complex auditor judgment? If so, what are those factors?

Audit evidence must be appropriate and sufficient; therefore, the factor "[t]he nature of audit evidence obtained regarding the matter" should be expanded to say "nature, extent (i.e., sufficiency) and quality of the audit evidence."

Another factor entering into "matters involved especially challenging, subjective, or complex auditor judgment" would be the complexity, in the auditor's judgment, of the US GAAP accounting required to properly record transactions or an event. This factor would include among other considerations those FASB accounting standards that rely on "management's intent."

Still another factor would be the specific consultation protocols internal to the audit firm, such as when transactions involve complex or innovative accounting issues, or where there are differences of opinion regarding an accounting treatment or a financial reporting matter.

Question: 4. Are there specific circumstances in which the auditor should be required to communicate critical audit matters for each period presented, rather than only the current period? For example, should communication be required in an IPO or in a reaudit? Why or why not?

1. The reproposal[27] leaves investors in a twilight zone. An investor does not know why certain CAMs appear in one year <u>and</u> disappear the next year, or conversely.

What should an investor infer if a CAM regarding, for example, a loss allowance is reported for the prior year and is not reported as a CAM for the current year, notwithstanding that the current year's financial statement discloses a much larger loss allowance? Should an investor infer that the audit of the allowance is no longer "especially challenging"? That a different, smarter, more sophisticated audit term replace last year's team? That the company's internal controls strengthened? There is more evidence to support the allowance? That the auditors obtained a greater level of "reasonable assurance"?

Similarly, what should an investor conclude if a CAM is reported for the current year and was not reported for the prior year, notwithstanding the fact that similar accounts or disclosures were made in the financial statements for both years? Of course, any number of subjective factors go into the CAM decision, but what should an investor conclude when the audit report is silent as to the disappearance of last year's CAM? How should an investor interpret this mix of information?

2. One solution is to require CAM reporting for all periods reported on by the auditor. This solution would obviously expand the auditor's report to some as yet unknown size, and will overshadow in length and likely overwhelm the opinion and basis for the opinion paragraphs.

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[27] Paragraph .11 of Proposed AS 3101 requires, "The auditor must determine whether there are any critical audit matters in the audit of the current period's financial statements." Paragraph .13 of Proposed AS 3101 requires, "The auditor must communicate in the auditor's report critical audit matters (footnote omitted) relating to the audit of the current period's financial statements or state that the auditor determined that there are no critical audit matters."

Where the prior year has CAMs 2, 4, 6 and 8, and this year has CAMs 2, 6 and 10, an investor would not understand why CAMs 4 and 8 disappeared and why 10 is now a CAM, when the account and disclosures for 10 also appeared in the prior year's financial statements.

The solution would be for the auditor to explain why there was no CAM last year but there is one this year, and conversely to explain why there is no CAM this year despite the fact there was one last year.

As said, this would enlarge the auditor's report, but an investor would learn why CAMs are moving in and out of the report. Auditors will need a creative writing course to explain cogently the reasons why CAMs appear and disappear during the three years covered in the auditor's report. This solution is odious and repugnant.

3. The reproposal leaves CAM reporting to the professional judgment of the auditor, thus each year stands on its own with no explanation as to why certain items disappear or reappear. Information asymmetry between the auditor and investors will increase under all of the above-outlined scenarios, and information asymmetry between the company and investors may also increase.

Question: 5. Are the reproposed requirements regarding the description of critical audit matters in the auditor's report, including the principal considerations and how the matter was addressed in the audit, sufficiently clear for consistent implementation by auditors? Why or why not? If not, how could the requirements be clarified?

While the definition of CAMs may be "sufficiently clear" to some auditors, because it uses highly subjective terms[28] it is very unlikely that the requirements would be consistently addressed and reported on.

Holding constant the financial statement accounting and disclosures, if three different audit firms (or engagement teams from the same firm) audited the same registrant for the same year, each using their professional judgment in interpreting the reproposal's highly subjective definition, they would not arrive at a consistent application of the standard. The odds would be low that the reported CAMs and the description of the audit procedures will be the same, or similar, for all three firms (or engagement teams).

<u>Identify Each CAM</u>

The reproposal says that "For each critical audit matter communicated in the auditor's report the auditor must: a. Identify the critical audit matter …."[29] Perhaps it would be clearer to say, "The auditor's report a. Must identify each critical audit matter…."

The reproposal cautions auditor's not to be the source of original (and potentially confidential) information about the company stating "When describing critical audit matters in the auditor's

[28] There is little question that all of the following terms used in the definition are subjective: "material to the financial statements," "especially," "challenging," "subjective," "complex," "judgment."

[29] Paragraph 14 of Proposed AS 3101.

report the auditor is not expected to provide information about the company that has not been made publicly available by the company…."[30]

Hence, in identifying each CAM, the auditor is duplicating information investors already have. For example, reading the examples given in the reproposal we see that they do not provide any new information that has not already been disclosed and that is readily available to the investor.

The example for Company A[31] says, "as more fully described in Note 7" regarding the Allowance for Loan Losses – New Loan Product. The auditor's report for Company A[32] then apparently repeats what has been disclosed in Note 7.

Similarly, the Company B example states, "Accounting for Acquisitions Refer to Notes 2 and 13 to the financial statements." The auditor's report for Company B[33] then restates information that is in Notes 2 and 13 to the financial statements, albeit using different words.

Question: 6. Do the reproposed communication requirements appropriately address commenter concerns regarding auditor communication of critical audit matters, such as: a. The auditor providing original information in describing the principal considerations for the determination that the matter is a critical audit matter or describing how the matter was addressed in the audit, and b. Investors and other financial statement users misinterpreting critical audit matters as undermining the auditor's pass/fail opinion or providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate? Are there other steps the Board could take to address these concerns? If so, what are they?

<u>Principal Reasons Why the Matter is a CAM</u>

The reproposal requires the auditor's report to "b. Describe the principal considerations that led the auditor to determine that the matter is a critical audit matter …."

The reproposal illustrates this "principal reasons" disclosure as follows:

> The Company A example says "The principal considerations for our determination that the allowance for loan losses for nine-year auto loans is a critical audit matter are that it is a new loan product with limited historical loss data and auditing the estimated allowance for losses on these loans involved our complex and subjective judgment."
>
> The Company B example says "Auditing the accounting for the Company's 2015 acquisitions involved a high degree of subjectivity in evaluating management's estimates, such as the recognition of the fair value of assets acquired and liabilities assumed."

These two examples illustrate the disclosure of the principal considerations that led the auditor to identify a CAM, and they illustrate that the disclosures do not provide any information about the company that has not been already made publicly available management.

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[30] Note 2 to Paragraph 14 of Proposed AS 3101.

[31] Page 33.

[32] Page 32.

[33] Page 33.

Now that the auditor has repeated certain information that was already in the financial statements, how does the investor actually use this redundant information? See Question 27 below.

Audit Procedures

The reproposal then requires the auditor's report to "c. Describe how the critical audit matter was addressed in the audit …."[34]

Now the investor can read some (but likely not all) of the audit steps the auditor undertook to verify the CAM. See Exhibit 2 for a partial list of some procedures undertaken in response to the IAASBs KAM reporting. After a few minutes reading the audit procedures undertaken by the auditor, some investors will be in a deep sleep.

Investors reading the exposition of various audit procedures will and should believe that the account or disclosure reported by the auditor as a CAM has had much more scrutiny than is "normal" and is therefore is "certified"[35] by the auditor, notwithstanding the auditor has neither said or implied a separate opinion on the CAM, and notwithstanding the report does not contain any language that "could be viewed as disclaiming, qualifying, restricting, or minimizing the auditor's responsibility for the critical audit matters or the auditor's opinion…."[36]

The "Unless" Clause

The reproposal states that a CAM "is not expected to provide information about the company that has not been made publicly available by the company **unless** such information is necessary to describe the principal considerations that led the auditor to determine that a matter is a critical audit matter or how the matter was addressed in the audit"(emphasis added).[37]

The reproposal provides the following example of the "unless" clause:

> [I]n describing the principal considerations that led the auditor to determine that revenue recognition is a critical audit matter, it is possible that the auditor could provide more information than is provided in management's disclosures.[38]

The reproposed audit report is required to include in the basis for the opinion the following sentence, "These financial statements are the responsibility of the Company's management." In addition, the first part of Note 2 says that that the auditor should not be the source of original information about the company, but when following the "unless" clause the auditor will now

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[34] Paragraph 14 of Proposed AS 3101.

[35] I use "certified" in the old-fashioned, circa 1915, sense, i.e., "WE HEREBY CERTIFY that in our opinion the described CAM correctly presents the account, amount and disclosure communicated in this audit report."

[36] Paragraph 14 of Proposed AS 3101.

[37] Note 2 to paragraph 14 of Proposed AS 3101.

[38] Page 35.

be responsible for financial statement information. Not a desirable consequence of CAM reporting, see Question 10 concerning litigation.

It is not clear from the example audit reports for Company A and Company B[39] whether the "unless" clause was followed; however, Example B discusses the auditors assessment of "revenue growth rates, projected profit margins, and the expected rate of return" of the 2015 acquisitions. This information (likely confidential information and not disclosed by management in any public filing) is viewed as an example of the "unless" clause and would inspire investors to ask for the rates and margins from management – an unintended consequence of this "unless" type of disclosure.

Question: 7. In addition to referring to the relevant financial statement accounts and disclosures, would it be appropriate for the auditor to refer to relevant disclosures outside the financial statements when communicating a critical audit matter? Why or why not?

Since I do not support the auditor reporting of CAMs, it follows that I cannot support CAM-type reporting of disclosures, even if relevant, that are outside the financial statements. Auditors should confine all CAM reporting to the audited financial statements, including notes to the statements and related schedules. Opening up disclosure to data or information outside of the audited financial statements is well beyond the scope of the usual audit engagement and the audit report.[40]

Question: 8. Is it appropriate for the reproposed standard to retain the possibility of the auditor determining that there are no critical audit matters and, if so, require a statement to that effect in the auditor's report? Why or why not?

There are many reasons for having no CAMs to report. For instance, this years financial statements contain no new transactions, there were no new GAAP requirements to implement, and an experienced audit team staffed the audit and in their professional judgment there were no unusually subjective or complex audit decisions – hence no reported CAM.

The PCAOBs expectation that "in most audits the auditor would determine that at least one matter involved"[41] a CAM, may "pressure" auditors to move at least one account or disclosure into a CAM category to meet the Boards presumption. How difficult would it be to move a subjective audit judgment to a very subjective audit judgment?

The absence of a CAM will be evidenced by the simple fact that there is no mention of one in the audit report. Said differently, the absence of the disclosure of a CAM should tell an investor that there was none.

There is no logical reason for auditors to state that "we did not audit intangible assets" if the audited entity does not in fact have such assets. It follows then that there is no reason for

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[39] Pages 32-35.

[40] If disclosures outside of the financial statements were referred to in a CAM, such disclosures should be considered as audited supplemental information and subject to the audit and reporting requirements of AS 2701 (*Auditing Supplemental Information Accompanying Audited Financial Statements*).

[41] Paragraph .12 of Proposed AS 3101.

auditors to state "that there were no matters that met the definition of a CAM during this year's audit."

Defining a CAM in the auditor's report,[42] and then saying that the matter did not exist is ludicrous. The sentence "We determined that there are no critical audit matters"[43] should be eliminated from any final standard.

Question: 9. Is the reproposed documentation requirement clear and appropriate? Why or why not? If not, how should the documentation requirement be formulated?

The documentation required in the reproposal is clear and appropriate.

However, the reproposal's discussion about documentation does not appear to agree with the requirements in the proposal. The reproposal says:[44]

> Thus, under the reproposed standard, auditors would be required to document the basis for the auditor's determination whether each matter that both: (1) was communicated or required to be communicated to the audit committee and (2) relates to accounts or disclosures that are material to the financial statements, involved <u>or did not involve especially challenging, subjective, or complex auditor judgment</u>. (Emphasis added.)

While Proposed AS 3101 states:[45]

> Documentation of Critical Audit Matters
>
> The auditor must document the basis for the auditor's determination whether each matter that both:
>
> a. Was communicated or required to be communicated to the audit committee; and
>
> b. Relates to accounts or disclosures that are material to the financial statements involved especially challenging, subjective, or complex auditor judgment. (Footnote omitted)

This proposed language does not require documentation of the basis for matters that did <u>not</u> meet the definition of a CAM. However, if matters that do not meet the definition of a CAM are to be documented, then the documentation requirements quoted above should be clarified.

Question: 10. What effect, if any, could the auditor's communication of critical audit matters under the reproposed standard have on private litigation? Would this communication lead to an unwarranted increase in private liability?

For the following reasons, I believe that litigation against auditors and registrants will increase.

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[42] Required by paragraph .16 of Proposed AS 3101.

[43] Paragraph .16 of Proposed AS 3101.

[44] Page 39.

[45] Paragraph .17 of Proposed AS 3101.

At this time, there is no direct evidence for an increase in litigation involving CAMs; however, auditors should never underestimate the resourcefulness of the securities class action bar.

CAMs are prominently set out in the audit report and put investors on notice that in the auditor's judgment the account, transaction or disclosure is material to the financial statements (by definition) and were especially challenging to audit. Therefore, class action lawyers will tag CAMs as potential "red flags" which may provide a road map to probable "smoking guns" and material risks and weaknesses, all required to be documented in the audit work papers.

Assuming a class action lawyer can make a plausible case that their client relied on the CAM disclosures in making investment decisions that resulted in provable damages, and the CAM accounts or disclosures were either misstated or omitted a material fact, the auditors and the registrant will likely then be defendants in litigation.

In addition, there is significant litigation risk when the auditor's description of the CAM does not accurately and completely describe the CAM, or the "principal considerations that led the auditor to determine that the matter is a" CAM, or fully describe exactly how the CAM was addressed in the audit, or does not properly (or inaccurately) refer to the financial statement accounts and disclosures that relate to the CAM.

The reproposal attempts to make the case that CAMs will reduce information asymmetry between the audit and the investors, which will in turn reduce information asymmetry between management and the investor. While this argument is baseless, it could open up another path for class action lawyers to maintain that auditors were somehow negligent (or worse) in fulfilling the desired outcome and goal of reducing the information gap between the company and the investor.

There is also a question concerning whether a CAM is an "opinion" on specific accounts or disclosures versus whether the auditor is making a factual statement in reporting a CAM and the audit procedures undertaken. I do not know whether the Supreme Court's decision in Omnicare[46] regarding audit "opinions" applies to CAM reporting. It is possible that CAMs may not be the expression of an opinion since some of the information comes directly from the auditor and may be viewed as specifically "carved out" of the audit report. The reproposal requires the report to say –

> Critical audit matters do not alter in any way our opinion on the financial statements, taken as a whole, and we do not provide separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.[47]

Question: 27. How would investors use the information communicated in critical audit matters?

Question 27 goes to the heart of another significant problem with CAMs. This is the key question, how would investors use CAMs?

Why is it important for an investor to know that the audit team believes the accounting for a specific transaction was particularly complicated and therefore "harder to audit," or the

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[46] Omnicare, Inc. v. Laborers Dist. Council Const. Indus. Pension Fund.

[47] Paragraph .15 of Proposed AS 3101.

valuation of a class of investments (for example, Level 3 fair values) required "complex" auditor judgment in verifying that valuation?

What really matters is that the auditor conducted the audit in accordance with the standards of the Public Company Accounting Oversight Board (United States) and that in the auditor's opinion, the financial statements are presented fairly, in all material respects.

Investors will be directed to read about critical audit matters and procedures that may in actually detract their attention from whatever the real operational issues and risks are. CAM disclosures will produce no (perhaps very little) signal and a great deal of noise, i.e., a low signal to noise ratio. See the discussion under Question 4.

Despite all the discussion and research, no one has yet made a believable case as to exactly how investors will factor the required CAM disclosures into any technical or fundamental analysis regarding how many dollars to invest in a company, how much of the investment to sell, when to buy or just to hold. The reproposal does not say exactly how investors can use these disclosures in their trading strategy or in deciding how to vote their shares.

The reproposal and the investment community have not demonstrated that CAMs would have some direct and objectively measurable influence on investment strategies.

In addition, assuming CAM reporting did have some small value to some segment of the investor universe; this value is diminished because it is historical, after the fact and stale information.

Some questions concerning the usefulness of CAMs –

- How can investors determine which CAM is important and which CAM is not?
- Is a reported CAM a negative or positive?
- Is the description of an account and the five audit steps followed by the auditor (of the seventeen actually undertaken) likely to be important and relevant to the decision to trade in a security?
- Will an investor have better and more useful information and really be motivated to trade a security if all seventeen audit steps were set out in the audit report?
- Which of the seventeen audit steps should the reader focus on?
- How do investors grade the audit procedures reported?
- Should investors feel more secure about the stated account or disclosure because the auditor highlighted that matter for inclusion in the audit report?
- Should investors reading the exposition of various audit procedures believe that the account or disclosure reported by the auditor as a CAM has had much more scrutiny than is "normal" and is therefore is "certified"?

The reproposal never does answer these questions other than to say investors want whatever the auditors see fit to say in the CAM disclosure.

As said earlier, investors will gather information that is more useful reading the Form 10-K and other SEC filings in their entirety, than they can from reading CAMs.

Question 27 (continued). Would the communication of critical audit matters help reduce information asymmetry between investors and management? Investors and the auditor?

Asymmetric information occurs when an investor has less knowledge than management about the financial condition, the results of operations, cash flows, liquidity, capital resources, trends, commitments, etc.

Investors must bridge this information gap by deriving information directly from management by reading SEC filings and the financial statements as are available. Investors cannot and should not rely on CAM reporting to reduce this gap.

Question: 29. Would critical audit matters be useful in assessing company financial performance? If so, how?

The reproposal does not persuasively present enough believable facts that support how

- most investors would actually use CAMs (Question 27),
- all or most CAMs can actually be used in assessing financial performance, and
- CAMs really reduce information asymmetry between management and investors.

Question: 30. Would critical audit matters be useful in assessing audit quality? If so, how?

The reproposal says the reporting of CAMs –

> may … lead to an incremental increase in audit quality[48];
>
> may lead to an incremental increase in the quality of information presented[49]; and
>
> may lead to an incremental increase in audit quality and financial reporting quality, which could increase investors' confidence in the reliability of the financial statements.[50]

However, the above-quoted possibilities are nothing more than conjecture, and it is entirely possible that CAMs will not lead to any increase in audit quality, or the quality of the information provided, or an increase in investor confidence in the reliability of financial statements.

The reproposal says –

> While these studies analyze potential effects of expanded auditor reporting on the perception of financial reporting quality, at least one study analyzes how the IAASBs expanded auditor's report influenced perceptions of audit quality. (Footnote omitted) The authors did not find evidence that key audit matters had an effect on the participants' perception of audit quality.[51] (Emphasis added.)

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[48] Page 3.

[49] Page 76.

[50] Id.

[51] Page 73.

> The second study concluded that additional reporting in the auditor's report can increase investors' attention to financial statement disclosures mentioned in the auditor's report, but that the communication of critical audit matters <u>led to a decrease in the perceived level of audit quality and a perception that the level of assurance provided by the audit was not uniformly applicable across all aspects of the financial statements</u>.[52] (Emphasis added.)

Question 34. Would the communication of critical audit matters provide a basis on which auditors could differentiate themselves? Why or why not?

Since the definition of CAMs is entirely subjective, it is possible (but not likely) that some auditors can distinguish themselves through a creative and innovative approach to the expression, or display of CAMs.

Question: 40. Should the requirements related to critical audit matters not apply to the audits of other types of companies, such as shell companies? (Footnote omitted) Why or why not?

Shell companies that qualify as an emerging growth company should not be subject to CAM reporting. See the response to Emerging Growth Companies, Question 41 et seq., below.

Auditor Independence

Question: 13. Is the reproposed requirement relating to auditor independence clear? Would this information improve investors' and other financial statement users' understanding of the auditor's independence responsibilities? Why or why not?

Yes, the requirement is clear, but the additional language does little to improve an investors' understanding of the auditor's independence responsibilities.

The heading to the auditor's report says that the auditor is in fact independent when it states "Report of Independent Registered Public Accounting Firm."

The reproposal dictates the audit report to say we "are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB." Rather than communicate independence by inference, the report language would be more informative if it explicitly said "and <u>we</u> are ~~required to be~~ independent with respect to the Company in accordance with …."

The reproposed standard should allow, when appropriate, the report language be modified to include reference to other government agencies that license audit firms and CPAs. For instance,

[52] Page 73, footnote 142.

licensed New York State CPAs are required to comply with the independence requirements of the New York State Rules of the Board of Regents.[53]

Addressee

Question: 14. Is it appropriate to limit the required addressees to the shareholders and the board of directors, or equivalents for companies not organized as corporations? Are there other parties to whom the auditor's report should be required to be addressed, and if so, who are they?

Yes, the addressee should be limited to include both the shareholders and the board of directors. I know of no other party to whom the audit report should be addressed.

Question: 15. Is it clear how the auditor's report would be addressed for companies not organized as corporations? Why or why not?

Yes.

Auditor Tenure

Question: 18. Should disclosure of auditor tenure be made on Form AP rather than in the auditor's report? Why or why not?

No. This information has no discernible value to investors.

Question: 19. Would requiring disclosure of auditor tenure in the auditor's report reduce investor search costs? Why or why not? Should the Board require a specific location for disclosure of auditor tenure in the auditor's report? If so, where and why?

The reproposal includes many persuasive arguments against the inclusion of this information in the audit report, for example:[54]

- information regarding the auditor's tenure included in the auditor's report could result in inappropriate and inconsistent assumptions about correlations between auditor tenure and audit quality
- [a]cademic research on the relationship of tenure to audit quality has varied conclusions – for example
  - engagements with short-term tenure are relatively riskier
  - that audit quality is improved when auditors have time to gain expertise in the company under audit and in the related industry

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[53] Specifically § 29.10 "Special provisions for the profession of public accountancy of" Part 29, "Unprofessional Conduct."

[54] Pages 90-91.

- that investors are more likely to vote against, or abstain from, auditor ratification as auditor tenure increases … [suggesting] that investors view long-term auditor-company relationships as adversely affecting audit quality
- that, at least prior to 2001, both short tenure (less than five years) and long tenure (greater than fifteen years) can have detrimental effects on audit quality

- it is possible that some investors may draw incorrect inferences about auditor tenure that could have an unwarranted effect on cost of capital
- [it] could also result in conversations that are an inefficient use of management and audit committee time

The reproposal observes –

> While commenters' views and academic research (footnote omitted) continue to be divided on the relationship of auditor tenure and audit quality, the Board is proposing to include auditor tenure (footnote omitted) to make this data point readily available in the auditor's report. Requiring the disclosure of auditor tenure in the auditor's report would ensure that the disclosure is in a consistent location – the auditor's report – for all companies and would reduce search costs for investors and other financial statement users who are interested in this piece of information.[55] (Emphasis added.)

The reproposal does not (a) make a cogent argument as to why it is necessary to make this data point readily available, (b) support the argument that auditor tenure is in anyway useful to investors, (c) allude to the idea that audit tenure has an impact on independence or the "quality" of the audit.

The reproposal expresses the view that some investors may find audit tenure useful.[56] What is missing from the tenure discussion are answers to the questions:

> Exactly why are investors interested "in this piece of quantitative information"? How will investors use it? In what way?
>
> Does it make any difference to an investor whether Peggy Smith LLP has served as the Company's auditor since 2005? Since 1999?

The reproposal provides no answers to these questions and never definitively says exactly what this information about tenure implies.

There is no relationship of audit tenure and audit quality; there is no correlation between audit tenure and independence – so why add this information to the auditor's report when no one has any evidence regarding its significance.

It is also noted that PCAOB Release No. 2015-005 (*Concept Release on Audit Quality Indicators*), neither directly nor indirectly, mentions audit tenure as an indicator of audit quality.

[55] Page 49.

[56] Page 48.

SEC Initiative

I believe that many of the comments submitted to the SEC on its Release No. 33-9862 *(Possible Revisions to Audit Committee Disclosures, July 1, 2015*), which discusses auditor tenure, are relevant to this reproposal.

Exhibit 1 to this letter contains the questions asked in the Release and selected responses to the questions, which provide additional compelling arguments against the disclosure of, audit tenure.

To sum up, for all the above-mentioned reasons, auditor's tenure is neither relevant nor useful to investors, and the reproposal does not support the need for its disclosure.

Clarifications of Existing Auditor Responsibilities

Question: 20. Are the changes to the basic elements of the auditor's report to communicate the nature of an audit, the auditor's responsibilities, the results of the audit, or information about the auditor appropriate and clear? Why or why not?

Related Notes

I agree with the reproposal to require the audit report identify the financial statements as including the related notes, and when applicable, schedules, as part of the audited financial statements.

Error or Fraud

As the release points out, this language tracks the language in AS 1001 (*Responsibilities and Functions of the Independent Auditor*); therefore, I agree with the inclusion of this language in the auditor's report.

Standardized Form of the Auditor's Report

Question: 25. Would the reproposed requirements for a specific order of certain sections in the auditor's report and for section titles make the auditor's report easier to use? Should the standard allow more or less flexibility in the presentation of the auditor's report?

In General

The reproposal maintains –

> … the existing standards do not require a uniform approach to basic content, such as the addressee of the report and the form of the auditor's report. The reproposed standard contains provisions requiring the basic elements in the auditor's report to be presented more uniformly.[57]

While having a "uniform approach" initially sounds good, I favor a more flexible audit report. The proposed new headings will easily guide the reader through the audit report without the need for a rigid, inflexible format.

[57] Page 67.

The reproposal argues –

> These enhancements should increase the usability of the auditor's report by improving financial statement users' understanding of the auditor's responsibilities, reducing search costs for information in the auditor's report, and facilitating comparisons across auditor's reports."[58]

The reproposal provide no evidence to support that premise that an investors understanding of the auditor's responsibility will measurably improve, or that search costs for information in the auditor's report were ever a factor in audit reporting.

<u>Opinion Paragraph</u>

For many years (decades), investors have read, understood and digested the auditor's report in its current form. Reading and understanding the current audit report (which ordinarily, and before CAM reporting) fit nicely to one page or less. Investors have had no difficulty reading the auditors opinion in its current location.

Obviously, if auditors are required to report CAMs, the report will grow to an indeterminate length and moving the opinion paragraph to the second sentence of the first paragraph will relieve investors from having to read further than the pass/fail words. The reproposal does not convincing make any case for exactly <u>how</u> investors will be better served by this move.

As said, I favor a more flexible, less rigid ordering of the audit report and suggest the Board express a preference about where the opinion should appear in the audit report and not mandate its location.

Overall, the PCAOB audit report is substantially different from the IAASBs audit report,[59] and there is no pressing need to have the PCAOB fall into lockstep with the IAASB as to the placement of the opinion language. There is nothing sacred about the IAASBs formulation of the report and there is little gained in having a uniform and inflexible report other than help lazy investors.

<u>Headings</u>

While the heading requirement is not a substantive issue, I support to use of headings in the audit report notwithstanding the following comments.

1. Today, the standard audit report normally 4 paragraphs and some 350 words long. The reproposal adds about another 100 words (without the <u>description</u> of specific CAMs and the <u>procedures</u> undertaken). No one really knows the length of future audit reports if this reproposal is adopted.

2. The reproposal would require section headings telling the reader that they are looking at the "opinion," then further down the page they will be reading the "basis for the opinion", then "critical audit matters" and lastly some other information, (i.e., the audit signature, the auditor's tenure, the location of the auditor and the date of the audit report).

3. The requirement for these headings is viewed by some accountants as a dumbing down of the audit report since it assumes investors and shareholders will not understand the report,

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[58] Page 96.

[59] See paragraph 37 of ISA 700.

have to be told what they are reading and then must be led through it. Again, the current audit report is quite short – do readers need to be told what they are reading? Is the idea here to allow readers of the report to skim it and land on only those parts of the report they may have an interest in? For example, an investor can read the "Opinion," then the "CAMs," and skip the mildly boring "Basis for Opinion."

4. The required headings differ from the AICPAs requirements.[60]

Emerging Growth Companies

Question: 41. Should the reproposed requirement regarding communication of critical audit matters be applicable for the audits of EGCs?

In theory, and assuming the need for and utility of the disclosure of Critical Audit Matters, such CAM reporting should be of equal or greater importance to investors in EGCs vis-à-vis investors in non-EGCs.

As discussed in the reproposal,[61] the JOBS Act requires that rules adopted by the PCAOB do not apply to an audit of any EGC, unless the SEC "determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation."

Unfortunately, the reproposal presents no persuasive evidence, empirical or otherwise, that the CAM disclosures are in the public interest, protects investors, and presents no economic analysis (other than mention the associated higher audit costs) as is required under the JOBS Act.

Information Asymmetry

The reproposal asserts[62] that EGCs "may have a higher degree of information asymmetry relative to the broader population of issuers." With regard to information asymmetry, the reproposal references to some stale "research" dated before the 2012 JOBS Act.[63]

One of the objectives of the JOBS Act was to simplify the registration process, reduce the costs and overall burden of financial reporting, and consequently the overall costs and burden of auditing the financial statements.

Like it or not, information asymmetry is exactly one of the objectives, and a by-product, of the JOBS Act. It is well understood that EGCs are eligible to take advantage of exemptions from various disclosure and reporting requirements that apply to non-EGCs including, but not limited to:

1. Not being required to comply with the auditor attestation of internal controls over financial reporting;[64]

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[60] AU-C 700, *Forming an Opinion and Reporting on Financial Statements*.

[61] Page 106.

[62] Page 107.

[63] Footnote 224, page 107. The four articles cited are dated 2000, 1995, 1988 and 1988.

2. being allowed to present only two years of audited financial statements and only two years of the related MD&A, instead of three years;
3. being permitted to present the same number of years of selected financial data as the years of audited financial statements presented (i.e., two years), instead of five years;
4. reduced disclosure obligations about executive compensation, including no Compensation Disclosure and Analysis;
5. not being required to comply with any requirement that may be adopted by the PCAOB regarding mandatory audit firm rotation, or a supplement to the auditor's report providing additional information about the audit and the financial statements (i.e., *Auditor's Discussion and Analysis*); and
6. exemptions from the requirements of holding a non-binding advisory vote on executive compensation and shareholder approval of any golden parachute payments not previously approved.

The reproposed audit report is not the proper vehicle to alter the JOBS Acts built in information gap (asymmetry) between management and investors. Until it has been firmly established that CAMs are truly useful to investors, and that the audit report is the logical and proper vehicle to fix asymmetrical information, EGCs should be exempt from the disclosure of CAMs.

As mentioned in Item 5 above, the JOBS Act[65] exempts EGCs from any future PCAOB rules calling for the expansion of the auditor's report to include a supplemental auditor's discussion and analysis (AD&A) of an EGC. The reproposed CAM reporting closely resembles the PCAOBs proposed supplemental AD&A reporting[66] and, therefore, will be considered an end run around the Section 104 prohibition regarding such reporting by the auditor.

Should the other elements of the reproposed standard and amendments be applicable for the audits of EGCs?

Language regarding auditor independence (see the suggested revision above), the addressee, and the clarifications of the existing auditor responsibilities, should apply to EGCs.

The requirement for disclosure of auditor tenure and CAMs should not be required for EGCs, or any public reporting entity.

As stated in this letter, I am opposed to the standardized and inflexible uniformity of the auditor's report imposed by this reproposal including the mandatory requirement that the opinion be in the first paragraph of the report.

I support the required headings to the report.

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[64] Required by Section 404(b) of the Sarbanes-Oxley Act of 2002.

[65] Section 104.

[66] PCAOB Release No. 2011-003, June 21, 2011.

Should the reproposed requirements be modified to make their application to EGCs more appropriate?

No.

Would excluding audits of EGCs benefit or harm EGCs or their investors? Why or why not?

I do not know of any research or evidence that demonstrates either benefit or harm if CAMs, or auditor tenure, where excluded from audit reports.

As discussed above, by law, EGCs provide much less information to investors than is required by non-EGCs, and auditors should not be assigned by the PCAOB to attempt to fix this information gap (asymmetry) in any way.

Question: 42. If the Board determines not to apply all or part of the reproposed standard and amendments to the audits of EGCs, would there be any unintended consequences if auditors complied voluntarily? If so, what are they?

When auditors of EGCs comply voluntarily with a standard that is not applicable EGCs, they run the risk of additional scrutiny and possible litigation. Auditors who make such voluntary disclosures should have answers to the following questions:

- Why were the standards not applicable to EGCs?
- What is the justification for the gratuitous disclosure?
- Does it present litigation or other risks?
- Could the voluntary disclosure be selective, that is, must the disclosures follow the exact requirements of the standard?
- If the disclosure is voluntary, must such disclosures be made every year?

Question: 43. Are there any other benefits, costs or considerations related to promoting efficiency, competition, and capital formation that the Board should take into account with respect to applying the reproposed standard to audits of EGCs?

Additional costs to auditors (which will be passed on to their clients) are discussed in the reproposal.[67] As to other benefits, I cannot think of any.

Question: 44. If the reproposed standard is adopted by the Board and approved by the SEC, how much time would auditors need to implement it? Should the Board consider a delayed compliance date for the reproposed standard, or for certain parts of the reproposed standard, for audits of smaller companies? If so, what criterion should the Board use to classify companies, for example smaller reporting companies?

[67] Pages 82 and 83.

In answer to the last question, not all EGCs qualify as smaller reporting companies ("SRCs"), and a full exposition of these differences is beyond the scope of these comments. However, SRCs are permitted to –

- provide simplified executive compensation disclosures in their filings,
- are exempt from the provisions of Section 404(b) of the 2002 Sarbanes-Oxley Act (requiring an attestation report on the effectiveness of internal control over financial reporting),
- limit the required description of the business, and
- have certain other decreased disclosure obligations in their SEC filings, including, among other things,
    - only being required to provide two years of audited financial statements in annual reports, rather than the three years required of other companies, and
    - are allowed to provide MD&A for these two years.

It is well known that EGCs and "smaller reporting companies" (SRCs) present unavoidable risks to investors and the reduced disclosure requirements may make investments in these entities less attractive to investors.

In sum, SRCs should be considered as EGCs for purposes of applying any final audit standard.

Question: 44 (continued). Are there criteria other than the size of the company that the Board should consider for a delayed compliance date?

If CAM disclosure is proven to have real value, then in theory CAM disclosures should be of equal or greater importance to investors in EGCs versus investors in non-EGCs. However, until the Board believably establishes that CAMs are truly useful and that there are in fact measureable benefits to investors by giving investors immediate and sufficient information needed to make informed investment, lending or voting decisions, the disclosure of CAMs should not apply to EGCs or SRCs.

Internal Control over Financial Reporting

Question: 23. Should the Board's requirement to include an explanatory paragraph in the auditor's report when the auditor did not perform an audit of ICFR apply not only if company's management is required to report on ICFR, but also if management is not required to report, such as for investment companies?

There is no need to report matters that are not required. Conceivably, there is no limit as to this type of gratuitous disclosure in the future.

* * * * *

I appreciate your consideration of my comments, suggestions and responses to the reproposal and would be pleased to answer any questions the Board or the Staff may have.

Sincerely,

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EXHIBIT 1

This Exhibit sets forth the questions asked in the SECs Release No. 33-9862 *(Possible Revisions to Audit Committee Disclosures, July 1, 2015*), relating to audit tenure and some selected responses to the questions.

Questions

The SEC Release asked for comments on the following questions:

45. Should the audit committee's report include information about the length of the audit relationship? What types of disclosures could the audit committee make in this regard? Should it be just the years of auditor tenure?

46. Should there also be disclosure as to whether and, if so, how auditor tenure was considered by the audit committee in retaining the auditor? Should there be disclosure of how tenure was considered in evaluating the auditor's independence and objectivity? Why or why not?

47. Would disclosure of auditor tenure be more appropriately disclosed in the auditor's report? Why or why not? Would it be better disclosed somewhere else (such as in a form filed with the PCAOB)? Why or why not?

Selected Responses –

Securities Industry and Financial Markets Association ("SIFMA")

We do not believe that the audit committee should be required to provide any disclosures regarding auditor tenure. Such disclosure places an undue emphasis on one factor (i.e., audit firm tenure) and ignores information regarding partner rotation; differences in audit firms' industry expertise and other possibly more relevant information regarding the totality and the context of the audit committee's decision regarding the selection of the audit firm.

Autoliv, Inc.

In particular, companies should not be required to make specific disclosures related to audit firm tenure. Tenure is not necessarily an indicator of audit quality or audit firm qualifications since the relationship between auditor tenure and audit quality is necessarily fact and circumstance-specific to each issuer. Requiring disclosure related to audit firm tenure could lead investors to make arbitrary comparisons between companies without further information regarding the background of the relationship between a company and audit firm.

New York State Society of Certified Public Accountants

… auditor tenure should not be required to be disclosed as it might imply that there is a correlation between auditor tenure and audit quality or auditor independence. However, if the tenure of the external auditor is to be disclosed, it would be prudent for the audit committee report to discuss how the reappointment of the auditor was determined to be appropriate.

BDO USA, LLP

… while investors may find information about audit tenure to be interesting, we do not believe that including such information within the audit report provides the appropriate context for that communication. We are concerned that including such a disclosure in the audit report may infer a correlation between audit quality and audit tenure – a correlation which we believe has not been established.

Mutual Fund Directors Forum

Disclosure of Auditor Tenure Is Unhelpful With Respect to Funds. The Release raises the issue of whether disclosing the auditor's tenure might be "a relevant consideration to the audit committee's determination of whether or not to engage or retain the auditor." Whether or not that is true in the operating company context (and the Release concedes that neither short nor long auditor tenure is correlated with audit quality), it is not sufficiently significant for funds to justify highlighting it.

Deloitte & Touche LLP

… while auditor tenure is currently disclosed by almost two-thirds of the S&P 100, we have concerns that if the Commission were to require this disclosure, it would suggest that the Commission believes it has a relevance that is not supported by evidence.

EXHIBIT 2

IAASBs Standard re Key Audit Matters (KAM) requires disclosure regarding how the key KAM was addressed in the audit (see paragraph 13 of ISA 701). The following is a random listing of procedures found in audit reports reporting KAMs:

- Our procedures included understanding and testing management's controls around the completeness and accuracy of
- We agreed the recorded amounts during the year to contractual evidence on a sample basis
- Amounts were either confirmed, recalculated or reconciled to
- We performed a retrospective review of subsequent collections
- We tested cut-offs
- We tested the identification and valuation
- We evaluated the competency and objectivity of the third party external appraiser
- We involved our tax experts
- We reviewed the work of the Company's predecessor auditor
- On a sample basis we
- We observed inventory counts
- We conducted additional audit procedures
- We evaluated the Company's policies and procedures
- We challenged management's assumptions
- We involved our valuation experts
- We assessed the legal advice
- We obtained confirmations
- We evaluated the actuarial and demographic assumptions and valuation methods
- We assessed whether the key actuarial assumptions are reasonable
- We validated that assumptions are consistently applied
- We involved our pension experts
- We tested management's controls
- We evaluated the adequacy of
- We verified the accuracy and completeness of (used several times to describe the audit procedures)
- We verified that the valuation of
- We verified the disclosure of
- We substantively tested the accuracy of
- We verified the additional costs incurred of
- We determined that the disclosure is complete and consistent with the financial statements
- Understanding and testing of the design and operating effectiveness of the key
- We assessed the eligibility of the development costs for capitalization
- We have reviewed the design of the key controls identified by management surrounding
- We tested such key controls and performed substantive test of details
- We tested on a sample basis testing underlying evidence
- We evaluated the assumptions and methods used by the company
- We assessed the adequacy of the company's disclosures

- With the assistance of tax specialists, we audited the available tax losses carried forward
- We obtained an understanding of the processes related to revenue recognition
- We evaluated the design and tested the effectiveness of controls in this area relevant to our audit
- We performed a combination of internal control and substantive audit procedures to address revenue recognition
- We performed extensive sales cut-off procedures
- We tested the calculation of the underlying data
- We obtained an understanding of the warranty process
- We evaluated the design of, and performed tests of controls in this area