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TO: Office of the Secretary, PCAOB

DATE: December 2, 2013

SUBJECT: Comments on PCAOB Rulemaking Docket Matter No. 034

We appreciate the opportunity to submit our comments with respect to the Proposed Auditing Standards on the Auditor's Report (the Proposal) released by the PCAOB. Our comments below are in response to questions outlined in Section V of Appendix 5 and are based on some of our recent research.¹

Question 10. Would the auditor's communication of critical audit matters be relevant and useful to investors and other financial statement users? If not, what other alternatives should the Board consider?

Question 11. What benefits or unintended consequences would be associated with the auditor's communication of critical audit matters?

In response to Questions 10 and 11, our research suggests that information communicated in critical audit matters would be relevant and useful to investors and other financial statement users. In our study, we examine how experienced and knowledgeable nonprofessional investors react to the inclusion of a critical audit matter paragraph in the audit report.² We find that investors are more likely to stop considering a company as an investment when a critical matter paragraph in the audit report highlights significant estimation uncertainty. This is true both when compared to investors who receive a *standard audit report* and when compared to investors who receive the same information about estimation uncertainty in *management's footnotes*. These results indicate that both the existence *and* the source of the information is important.

Further, we find that information in the critical audit matter paragraph influences investors' perception of risk as well as their confidence in the potential investment. These results indicate that the Proposal's suggestion to include critical audit matters in the auditor's report would provide both useful and relevant information to investors. Our study did not identify any unintended consequences of including a critical audit matter paragraph in the auditor's report.

We note that our study does not answer all potential questions about how investors would use the information suggested in the Proposal. For example, would this information retain

¹ For additional information, see: Christensen, B. E., S. M. Glover, and C. J. Wolfe. 2013. "Do Critical Audit Matter Paragraphs in the Audit Report Change Nonprofessional Investors' Decision to Invest?" Available at <http://ssrn.com/abstract=2318590>.

² Study participants obtained at least a bachelor's degree in business; have on average 25 years of professional work experience; and have significant experience making personal investment decisions.

its usefulness in years subsequent to initial adoption, or would the disclosures lose their usefulness over time by becoming boilerplate? Additionally, we only test the inclusion of a single critical audit matter paragraph.

Question 15. Would including the audit procedures performed, including resolution of the critical audit matter, in the communication of critical audit matters in the auditor's report be informative and useful? Why or why not?

In a second experiment, we include a paragraph following the critical audit matter that provides a brief description of the audit procedures performed on the account in question. This second paragraph also includes either positive or negative assurance specifically related to the critical audit matter. Our study finds that investors who receive both the critical audit matter and the second paragraph are less likely to stop investing than investors who receive the critical audit matter paragraph alone. As such, our findings would suggest that discussing the critical audit matter's resolution is informative and useful to investors.

25. Do the illustrative examples in the Exhibit to this Appendix provide useful and relevant information of critical audit matters and at an appropriate level of detail? Why or why not?

Of the three hypothetical scenarios included in Appendix 5, our study can most explicitly speak to the third hypothetical scenario, which is similar in both content and length to the scenario in our experiment. Based on the results of our study, including information at this level of detail in critical audit matter paragraphs is viewed by investors as useful and relevant in making investment decisions.

We appreciate the opportunity to offer our comments.

Kind regards,



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