



August 15, 2016

Office of the Secretary  
Public Company Accounting Oversight Board  
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Via Email to [comments@pcaobus.org](mailto:comments@pcaobus.org)

**Re: PCAOB Rulemaking Docket Matter No. 034 – Proposed Auditing Standard on the Auditor’s Report on an Audit of Financial Statements when the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards**

Dear Board Members and Staff:

Grant Thornton LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board’s (PCAOB or Board) repropoed 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* (Reproposal), and we respectfully submit our comments and recommendations thereon.

We continue to support the Board’s efforts to enhance the relevancy and transparency of the auditor’s report and commend the Board for their thoughtful consideration of comments received from various stakeholders on the original proposal in 2013. We are pleased to see many of the revisions contained in the Reproposal. We also note certain of the revisions tend to align with the model adopted by the International Auditing and Assurance Standards Board (IAASB), which we support from a global consistency perspective. However, we continue to have concerns with certain aspects of the Reproposal, which we discuss in greater detail below.

**Critical audit matters (CAM)**

**Definition**

We are supportive of limiting the population of potential CAM to matters communicated or required to be communicated to the audit committee. We believe this provides a better, narrower starting point for auditors in their determination of CAM and communication of matters that may be most meaningful to the users of the financial statements. We also agree with including matters required to be communicated as well as matters actually communicated to the audit committee.

We also appreciate the inclusion of the notion of materiality in the definition of CAM. We believe this will better enhance practical application of the repropoed standard. We also recognize the Board’s intentions when using the phrase “relates to” as described on page 20 of the Reproposal.

However, we are concerned about unintended consequences in utilizing materiality in this specific fashion. We are concerned that specifically relating to “accounts or disclosures” could give the reader of the auditor’s report the impression that piecemeal opinions are being provided despite the revisions made to the introductory language, as discussed further below. We are further concerned that, in retrospect, any audit matter relating to a material account or disclosure would have been expected to be considered a de facto CAM, in spite of the other considerations and factors. In order to minimize unintended consequences and better align the determination with the auditor’s overall objective of expressing an opinion on the financial statements taken as a whole, we recommend the Board consider the following revisions (marked from the Reproposal) to paragraph 11 of Proposed AS 3101 to better integrate materiality into the definition.

A critical audit matter is any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) ~~relates to accounts or disclosures that are~~ **is** material to the financial statements **taken as a whole** and (2) involved especially challenging, subjective, or complex auditor judgment.

We believe this language still sufficiently provides for the scenarios laid out on page 20 of the Reproposal, including goodwill impairment, evaluation of the company’s ability to continue as a going concern or the risk of management’s override of internal controls.

#### Factors

We are supportive of the revisions made to the factors an auditor would consider in the determination of CAM. Most notably, we believe the direct linkage to the auditor’s risk assessment provides a meaningful starting point on the path of determining those matters that involved especially challenging, subjective or complex auditor judgment. We further support that the reproposed standard does not include circumstances or matters that, if present, would always constitute critical audit matters. We commend the Board on recognizing that significant risks, including fraud risks, may not always involve especially challenging, subjective, or complex auditor judgment and appreciate the Board maintaining a principles-based approach in this area.

#### Communication

We are supportive of the revisions made to the standard introductory language that would precede the specific CAM discussion. We believe clearly stating that the auditor is not providing a separate opinion on CAM could minimize users’ potential misunderstanding of the CAM communications. However, we do recommend the Board revise the introductory language to align with our proposed revision to the CAM definition described above; the following provides suggested revisions (marked from the Reproposal) to better clarify the introductory language.

The critical audit matters communicated below are matters arising from the current period audit that were communicated or required to be communicated to the audit committee and that: (1) ~~relates to accounts or disclosures that~~ **are** material to the financial statements **taken as a whole** and (2) involved our especially challenging, subjective, or complex auditor judgment. **The communication of critical** ~~Critical~~ audit matters ~~do does~~ 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.

In our 2013 letter, we supported providing the auditor the option to include the audit procedures performed if, in the auditor's judgment, conveying those procedures provides a better understanding regarding the significance of the matter. We note in the Reproposal, however, that the Board has made it a requirement to describe how the CAM was addressed in the audit for each CAM communicated in the auditor's report. We continue to believe that this information should be optional in reporting CAM since circumstances will vary and information surrounding how the matter was addressed may not be relevant in all situations. However, we recognize the Board provided additional commentary on its intentions for this requirement on page 31 of the Reproposal. If the Board retains the requirement to describe how the CAM was addressed in the audit for each CAM communicated in the auditor's report, we ask the Board to consider including the language after "For example" in the third paragraph of page 31 as a "Note" in the final standard. This information more clearly conveys the Board's intention and will be valuable to auditors in operationalizing this requirement.

#### Documentation

We appreciate that the scope of required documentation was revised due to the Board's proposed changes to the definition of CAM, but we continue to have concerns regarding the nature and extent of the documentation the repropoed requirement would seem to require. Our view of the requirement is that it leads the auditor to documenting why each matter communicated to the audit committee was or was not deemed to be a CAM. We are concerned that this approach is inconsistent with current audit documentation requirements as it requires documenting what the auditor considered but did not act on. We note that application material adopted by the IAASB in International Standards on Auditing 701, *Communicating Key Audit Matters in the Independent Auditor's Report* (paragraph .A39) also is helpful in providing guidance on documentation to the auditor with a focus on matters that were concluded to be key audit matters.

In order to address this anomaly, we considered the Board's related comments on pages 39-40 of the Reproposal and our previous comments related to the definition of CAM, and accordingly we submit the following edits to proposed paragraph .17 for the Board's consideration.

The auditor must document the basis for the auditor's determination for 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~~ **is** material to the financial statements **taken as a whole**

involved especially challenging, subjective, or complex auditor judgment.

**Note: This documentation may be prepared as an extension to the audit committee documentation or the auditor may prepare separate documentation. The amount of**

**documentation could vary with the circumstances. This standard does not require the documentation of why other matters communicated to the audit committee were not matters that involved especially challenging, subjective, or complex auditor judgment.**

We believe this “Note” is important guidance to clarify expectations for focusing documentation on those matters that were ultimately communicated as CAM.

#### Proposed AS 3105

While we support reporting CAM in instances where the auditor expresses a qualified opinion, it is unclear how such qualification(s) interacts with the CAM reporting. While we understand the circumstances resulting in a qualified opinion for an issuer is limited (due to the fact that those opinions do not meet the general reporting requirements of the Securities and Exchange Commission) there may be other reporting circumstances where such interactions may occur. The IAASB approach, as described on page 61 of the Reproposal, is clear that the matter that gives rise to the qualified opinion is not described in the key audit matter section; rather, a reference to the basis for modified opinion section is made in the key audit matters section. We encourage the Board to clarify the interaction between CAM and matters resulting in report qualifications by including additional guidance. We submit the following language for the Board’s consideration for inclusion in proposed AS 3105.

If the auditor determines that the matter for which the auditor qualified his or her opinion is also a critical audit matter, (1) the matter should not be described in the critical audit matter section of the auditor’s report, (2) the auditor should report on the matter in accordance with applicable standards, and (3) the auditor should include a reference in the critical audit matter section to the basis for qualified opinion section where the matter is reported.

We believe this approach provides clarity to the readers of the financial statements and reduces potential redundancy in reporting a matter in two different sections of the auditor’s report if/when the auditor determines the matter is also a CAM.

#### Exclusions from CAM requirements

We support excluding non-issuer broker-dealers, investment companies other than business development companies, and benefit plans from the required CAM communications for the reasons enumerated by the staff in the Reproposal.

#### Areas for further guidance

In light of the repropoed requirements, we have identified certain other areas where the profession may benefit from further guidance on how CAM reporting applies. These areas include:

- AS 3305, *Special Reports* – we note the proposed amendments to this standard included in Appendix 2 of the Reproposal and believe more guidance could be given around how or whether CAM determination may differ in instances where the auditor is reporting on the topics covered by this standard.

- AS 1205, *Part of the Audit Performed by Other Independent Auditors* – recognizing the Board is currently in the proposal process to revise this standard, it is unclear whether the enhanced reporting in the Reproposal would change any requirements related to communications between the lead auditor and the referred-to auditor or the other auditor. It is also unclear whether the other auditor would be expected to communicate CAM to the lead auditor in the reporting requirement set forth in the Board’s proposal. We encourage the Board to consider, in conjunction with moving forward on the Supervision of Other Auditors project, its intentions or current views as to the determination and communication of CAM in those circumstances.

### **Additional improvements to the auditor’s report**

#### **Independence**

We are supportive of the reproposed requirement to include a statement regarding the auditor’s independence and status as a firm registered with the PCAOB. We believe this clarity will be beneficial to users of the financial statements. While we believe the requirement is sufficiently clear for those audits required to be performed under PCAOB standards, we encourage the Board to develop and provide robust guidance with regard to audits voluntarily performed under PCAOB standards, as acknowledged in footnote 68 on page 43 of the Reproposal. We believe guidance in this area is essential considering the potential confusion that may arise in this area.

#### **Auditor tenure**

While we support greater transparency to users of the financial statements, we continue to have significant reservations regarding the requirement to disclose auditor tenure in the auditor’s report. As noted in our comment letter to the original proposal dated December 11, 2013 (2013 letter), we believe the auditor’s report is not the appropriate place to convey this information. It would be a data point without appropriate context and could lead to inappropriate inferences being made by users regarding the auditor. We further note that an audit firm has little to no control over its tenure with a client. The audit committee selects and retains the audit firm as part of executing its duties. Therefore, the most appropriate location for this information is in the audit committee’s report in the company’s proxy statement or other filing, where appropriate context can be provided by the decision-makers themselves.

#### **Addressees**

We are pleased to see the reproposed requirement regarding report addressees. We believe limiting the addressees to shareholders and the board of directors or equivalents is appropriate and will create consistency in practice.

#### **Enhancements to basic elements**

We continue to support the enhancements to the basic elements of the auditor’s report regarding financial statement footnotes, error or fraud, and nature of the audit. However, as we noted in our 2013 letter, we recommend the Board consider aligning those requirements with the IAASB model to further enhance the benefits to financial statement users. Specifically, we recommend also including the following:

- Definition of “reasonable assurance”

- Auditor's responsibility related to obtaining an understanding of internal control relevant to the audit (for non-integrated audits)
- Auditor's responsibility to communicate with the audit committee

While we recognize the concern that adding these elements will unnecessarily lengthen the auditor's report, we believe they are important concepts for financial statement users to understand and would promote consistency in global reporting conventions.

#### **Standardized form of auditor's report**

We also support the form of the auditor's report as reproposed. We believe requiring a specific order for the Opinion and Basis for Opinion sections as well as requiring section titles for all sections will make the auditor's report easier to use. We commend the Board on finding a reasonable "middle ground" that provides the appropriate level of flexibility to promote consistency and ease of use without being overly prescriptive.

#### **Considerations related to effective date**

While we don't believe a significant amount of effort would be required for most of the other enhancements to the auditor's report, we believe a considerable amount of time will be necessary for firms to formulate firm policies and quality control procedures around the determination and communication of CAM. Recognizing that CAM reporting should not be or become boiler-plate, we believe it will be essential to audit quality for firm to establish the proper protocol around this new reporting requirement. Therefore, we encourage the Board to consider an effective date of fiscal years ending on or after December 15, 2018, assuming the Reproposal is adopted by the Board and approved by the SEC in late 2016 or early 2017. Since CAM will likely require incremental effort on the part of firms, we would not be opposed to an earlier effective date for the additional improvements to the auditor's report described in the Reproposal. We would also encourage the Board to consider whether early adoption would be permitted. Although this may create reporting differences among firms for a short period of time, it would provide an opportunity to begin reporting under the new standards for firms that wish to move forward on an accelerated schedule.

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If you have any questions about our response, or wish to further discuss our comments, please contact Trent Gazzaway, National Managing Partner of Professional Standards, at (704) 632-6834 or [Trent.Gazzaway@us.gt.com](mailto:Trent.Gazzaway@us.gt.com).

Sincerely,

