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Ms. Phoebe W. Brown
Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB Proposed Auditing Standard on *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (PCAOB Release No. 2016-003, May 11, 2016) (PCAOB Rulemaking Docket Matter No. 034)

Dear Ms. Brown:

The U.S. Chamber of Commerce (the "Chamber") is the world's largest federation of businesses and associations, representing the interests of more than three million U.S. businesses and professional organizations of every size and in every economic sector. These members are both users and preparers of financial information. The Chamber created the Center for Capital Markets Competitiveness ("CCMC") to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. The CCMC believes that businesses must have a strong system of internal controls and recognizes the vital role external audits play in capital formation. We support efforts to improve audit effectiveness and appreciate the opportunity to comment on the Public Company Accounting Oversight Board ("PCAOB") Proposed Auditing Standard on *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (the "Proposal").

The CCMC is pleased that the PCAOB has dropped from the Proposal any new requirements on auditor responsibilities for other information outside the financial statements that were included in the prior proposal and is continuing research on these issues. The CCMC also appreciates the Proposal differs from the prior proposal in regards to critical audit matters ("CAMs") in that it reflects definitional refinements and narrows the scope and application of auditor reporting of CAMs. Nonetheless, many of the serious concerns we previously expressed about both the PCAOB's rationale for and approach to changing the auditor's report continue to apply. Specifically, our concerns include but are not limited to the following:

1. The need for the Proposal is not sufficiently addressed;
2. The required disclosure of CAMs is often duplicative and not decision-useful;
3. The treatment of original and confidential information and potential adverse consequences upon internal controls;
4. The increase of legal liability for business and auditors;
5. Additional concerns with CAMs and adverse consequences for business, auditors, and investors;
6. The Proposal should not apply to emerging growth companies; and
7. The PCAOB has not demonstrated why disclosure of audit firm tenure is necessary.

We discuss our concerns in more detail in corresponding sections below. This discussion reinforces a number of the concerns that we expressed in our prior comment letters, which should continue to be considered as part of the public record, and provides additional perspective incremental to those letters.

Background

Financial reporting is the responsibility of management and includes the GAAP financial statements and other disclosures, such as disclosures required by the Securities and Exchange Commission ("SEC") in Management's Discussion & Analysis ("MD&A"). In turn, the board of directors, largely through the audit committee, provides oversight of management's reporting and disclosures. The independent auditor's responsibility is to express an opinion on whether the company's annual financial statements, including the notes thereto, are presented fairly, in all material respects, in conformity with generally accepted accounting principles ("GAAP"). Determining GAAP for

U.S. companies is the responsibility of the Financial Accounting Standards Board ("FASB").

Another core principle of financial reporting is that the auditor is not an original source of information about the company. Accordingly, if there is material, decision-useful financial information for investors, it is not the auditor, but management that should provide it—based on guidance from FASB or the SEC.

This is the PCAOB's second proposal concerning revisions to the auditor's report. The CCMC commented on the prior proposal issued in August 2013, as well as a related Concept Release issued in June 2011.[3]

The Proposal would supersede or amend various existing PCAOB auditing standards on financial statement audit reports. The Proposal would require auditors to communicate in the auditor's report CAMs arising from the audit of the current period financial statements and certain information about each CAM. It would also add new language on auditor responsibilities regarding independence and obtaining reasonable assurance about whether the financial statements are free of material misstatements "whether due to error or fraud" and on audit firm tenure.[4]

These core principles provide a foundation for our discussion of the Proposal, including the threshold question of need.

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[3] *See* the December 9, 2013 letter from the United States Chamber of Commerce Center for Capital Markets Competitiveness on the PCAOB Proposed Auditing Standards—*The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion; The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report; and Related Amendments to PCAOB Standards* (PCAOB Release No. 2013-005, August 13, 2013; PCAOB Rulemaking Docket Matter No. 034) and the September 14, 2011 letter from the United States Chamber of Commerce Center for Capital Markets Competitiveness on the PCAOB *Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards* (PCAOB Release No. 2011-003, June 21, 2011, Rulemaking Docket Matter No. 034).
[4] *See* the Proposal, pages 3-4.

Discussion

Need for Proposal Not Sufficiently Addressed

We continue to seriously question the need for this initiative. Our previous comment letters have emphasized the necessity of addressing this threshold question and whether the PCAOB should engage in such a sweeping standard-setting initiative that would substantially change the role and responsibilities of the auditor and represent the most significant changes to auditor reporting in more than 70 years. This question is especially important given the strong support from stakeholders for retaining the current "pass-fail" model of auditor reporting—a model that reflects the core principles of financial reporting just described.

According to the Proposal, the Board believes that the communication of CAMs should help focus investor attention on these matters and provide a new perspective on the financial statements.[5] We respectfully disagree with this premise as an appropriate rationale for PCAOB standard-setting to significantly change the auditor's report.[6]

As previously discussed, any perceived inadequacies in the financial information currently provided to investors should be addressed by the SEC and/or FASB, not the PCAOB. Furthermore, based on the Proposal itself, we strongly believe that CAMs would, for the most part, simply duplicate information already disclosed by management, while creating a number of other unintended consequences.

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[5] *See* the Proposal, page 2.

[6] We have long supported global convergence of auditing standards. However, the Proposal focuses on auditor reporting and would not change any auditor performance standards. Thus, while we appreciate that regulators and standard-setters in other jurisdictions, such as the International Auditing and Assurance Standards Board ("IAASB"), have changed auditor reporting to include "CAM-like" disclosures, we also recognize that financial reporting frameworks, regulatory requirements, legal settings and the like in other parts of the world differ from the U.S. For example, not all reporting frameworks in other jurisdictions have an equivalent of the SEC's MD&A requirements, including management's disclosures of critical accounting policies and practices ("CAPs"). Further, jurisdictions, such as the United Kingdom, that relatively recently changed auditor reporting requirements did so in conjunction with changes in management and audit committee reporting, while the PCAOB has no authority over management reporting or audit committees.

Required Disclosure of CAMs Is Often Duplicative and Not Decision-Useful

The Proposal would require auditors to report on matters that were adequately and appropriately disclosed by management. For example, in addition to management's disclosures in the GAAP footnotes, SEC requirements for MD&A include management disclosure of critical accounting policies and practices ("CAPs"). CAPs are those accounting policies and practices that require management's most difficult, complex, and/or subjective judgments. Yet, the Proposal defines CAMs as "accounts or disclosures that are material to the financial statements and involved especially challenging, subjective, or complex auditor judgment."[7] At times, matters that may require disclosure of CAPs by management may coincide with required disclosure of CAMs under the Proposal. In these instances, CAMs disclosed by auditors will only duplicate information already disclosed by management in MD&A and/or the GAAP footnotes.

The Proposal provides two examples of CAM disclosures that reinforce this point.[8] Although the Proposal provides no illustration of management's disclosures, we believe that by its very nature much of the information in the two CAM disclosure examples would clearly duplicate information disclosed by management in MD&A and/or the GAAP footnotes.

In many circumstances, auditor information identifying the CAM, describing the principal considerations that led the auditor to determine that the matter is a CAM, and referring to the relevant financial statement accounts and disclosures would all duplicate information disclosed by management.[9] Otherwise, the remaining required information in the illustrative examples, uniquely disclosed by the auditor, describes how each CAM was addressed in the audit. As subsequently discussed, in our view this information is problematic and not actionable by or decision-useful for investors.

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[7] *See* the Proposal, page 3.
[8] *See* the Proposal, pages 32-35.
[9] This reinforces a concern we expressed in our prior comment letter as to whether the auditor would be allowed to refer to information disclosed by management in MD&A not just the GAAP financial statements and footnotes covered by the auditor's opinion. Any such limitation would also exacerbate financial reporting complexity.

To summarize, the two examples of CAM disclosures in the Proposal illustrate that the proposed auditor information would be duplicative of management's disclosures or otherwise not decision-useful for investors.

Treatment of Original and Confidential Information and Potential Adverse Consequences Upon Internal Controls

A core principle of financial reporting is that the auditor is not an original source of information about the company. In fact, the auditor is subject to both legal and ethical requirements on confidentiality that preclude this from occurring except in certain specific circumstances. We discussed in our prior comment letters that requiring auditor disclosure of CAMs is inconsistent with this core principle. Further, auditor reporting of CAMs undermines the financial reporting and disclosure frameworks of the SEC and FASB, as they can necessitate auditors disclosing matters that the SEC and/or FASB have specifically decided that companies are not required to disclose.

We appreciate that the PCAOB recognizes these problems and the Proposal reflects revisions from the prior proposal in an attempt to address them. However, we do not believe the Proposal solves these problems.

For example, while the Proposal emphasizes that a note in the proposed auditor reporting standard indicates that "when describing [CAMs] in the auditor's report, the auditor is not expected to provide information about the company that has not been made publicly available by the company." But, the note goes on to say, "unless such information is necessary to describe the principal considerations that led the auditor to determine that a matter is a [CAM] or how the matter was addressed in the audit."[10] Further, the Proposal adds:

[10] *See* the Proposal, pages 35 and A1-9.

> *[M]anagement may decide that additional management disclosures would be useful to financial statement users. However, management's decision about whether to disclose additional information does not affect the auditor's responsibility to describe the principal considerations that led the auditor to determine that a matter is a [CAM] or how the matter was addressed in the audit.*[11]

The Proposal provides another example related to deficiencies in internal control over financial reporting ("ICFR") that are not material weaknesses and, therefore, do not otherwise require any disclosure by management or auditors under SEC or PCAOB requirements, as follows:

> *However, matters that would not themselves constitute [CAMs] under the reproposed definition, such as information about the company's processes and controls, could be included, for example, in the description of the principal considerations that led the auditor to determine that a matter is a [CAM].*[12]

As we have stated in the past, the Chamber believes that spending a disproportionate amount of time on issues that are not material weaknesses, with respect to reporting on ICFR, do not promote investor protection or provide the basis for an effective and sustainable system of controls. This issue is particularly significant in the inspection context, where companies and auditors spend a significant amount of time documenting every judgment and decision. However, a natural consequence of the Proposal is that it could incentivize auditors to report potential deficiencies in ICFR in the auditor's report that are not material, adding more time and complexity to the ICFR process without any additional benefit to investor protection. The Proposal could also incentivize an expectation that controls need to be designed and tested to fit an audit, a concern that we have raised in the past.

To summarize, under the Proposal, auditors can still become an original source of information and/or disclose confidential company information in order to comply with PCAOB auditor reporting requirements, even though

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[11] *See* the Proposal, pages 35-36.
[12] *See* the Proposal, page 20.

doing so may violate codes of professional ethics and state laws. Consequently, the CCMC recommends the PCAOB include a statement in any final proposal that an auditor normally should not be an original source of information.

Also, we note that some of the quoted guidance appears in the release text of the Proposal, rather than in the proposed rule itself. The CCMC has previously expressed concerns about using release text in this manner.

Increase of Legal Liability for Business and Auditors

The CCMC remains very concerned about the legal liability implications of the Proposal. This encompasses potential liability for what auditors communicate and what they do not. The former includes liability for being an original source of statements, including disclosing confidential company information, as previously discussed, and the latter includes both private legal actions and regulatory activities (e.g., through PCAOB inspections and enforcement) based on second-guessing auditor judgments on matters that were deemed by the auditor not to meet the threshold of CAMs.

Additional Concerns with CAMs and Adverse Consequences for Business, Auditors, and Investors

The CCMC has additional concerns with the Proposal related to CAMs, some of which were expressed in our prior comment letters, as follows:

- Circumstances will arise when CAMs lack clarity and/or raise questions and there is no mechanism or venue for the auditor to respond. In addition, confidentiality restrictions will likewise constrain the auditor. As a result, the company and management are put in the position of having to explain, after the fact and in compliance with Reg FD, what the auditor meant.

- CAMs elevate for public disclosure matters that were fully addressed and resolved to the auditor's satisfaction before the audit report was issued.

- Auditor reporting on CAMs involves some practical considerations including creating potential impediments to timely SEC filings by companies. Perhaps, on average, auditors will identify CAMs well in advance of SEC filing deadlines and resolve all necessary issues with the company in this regard. Nonetheless, circumstances will arise when this is not the case, and so, the likelihood cannot be ruled out that the Proposal will result in situations where auditor reporting of CAMs delays the timely filing of information by companies.

- The reporting of CAMs is not likely to be a "free-writing" exercise at the engagement level. A number of forces, including legal forces will necessitate consistency in the drafting of CAMs over time and across companies. Thus, the likelihood is very high that this initiative would result in auditor reporting that is simply boilerplate.

- The Proposal adds a requirement to describe how the auditor addressed each CAM. It is unlikely that that an auditor's response to addressing "accounts and disclosures that are material to the financial statements and involved especially challenging, subjective, or complex auditor judgment" can be reduced to a few sentences of meaningful or decision-useful information for investors and other users. Any such disclosure does not provide actionable information for investors and is particularly susceptible to becoming boilerplate.

- The PCAOB expects that CAMs will be disclosed for most audits. Given the heterogeneity in the circumstances of an audit, this expectation may be misplaced. For example, some audits are less complex and more straight-forward.

- Mandating the disclosure of CAMs related to any matter communicated to the audit committee rather than matters required to be reported to the audit committee will have a harmful chilling effect on the normal communication processes between the auditor and management and the audit committee. For example, management and/or the audit committee may be more cautious and less open and/or timely in their discussions with auditors to avoid having a matter unnecessarily becoming elevated to a CAM.

- While we support principles-based auditing standards and avoiding a "one-size-fits-all" or "checklist" approach, the CCMC has also emphasized the importance of respecting reasonable judgments by auditors and encouraged the PCAOB to develop an auditor judgment framework, which has not occurred.

Thus, given the definition of CAMs in the Proposal, the CCMC is concerned about the potential for second-guessing of auditor judgments on the determination of CAMs and the disclosures made in the auditor's report in regard to CAMs via PCAOB inspections, regulatory enforcement actions, and private securities actions.

Moreover, any determinations of audit reporting deficiencies, such as via PCAOB inspections, may cause inconsistencies for companies with regards to their SEC filings that include the auditor's report, even though there is no issue with respect to the information provided by management.

Proposal Should Not Apply to EGCs

The CCMC appreciates that the Proposal does not provide for auditor reporting of CAMs by brokers and dealers, investment companies (except business development companies), and benefit plans. However, the question remains as to whether the Proposal applies to emerging growth companies ("EGCs").

As background, the PCAOB has not proceeded with Auditor Discussion and Analysis ("AD&A") as articulated in the Concept Release of June 2011. Unfortunately, CAMs appear substantively similar to AD&A, notwithstanding that CAMs are described as being grounded in auditing rather than financial reporting matters. This is important because the 2012 Jumpstart Our Business Startups Act ("JOBS") provides that any PCAOB rules on audit reporting of AD&A shall not apply to audits of EGCs.

Accordingly, we believe the Proposal should not apply to EGCs.

PCAOB Has Not Demonstrated Why Disclosure of Audit Firm Tenure is Necessary

The Proposal calls for disclosing auditor tenure (that is the year the auditor began serving consecutively as the company's auditor). Consistent with statements by PCAOB Board members Franzel and Hanson,[13] the CCMC questions the inclusion of this information in the auditor's report.

It is not obvious how tenure connects to the nature of the auditor's work performed or the auditor's opinion and, therefore, why this information belongs in the auditor's report. As the audit committee has the responsibility to oversee and monitor the selection and retention of the audit firm, the audit committee report in the annual proxy statement provides a more appropriate placement for such a disclosure. And, a number of audit committees already disclose this information in the proxy statement.[14]

By including tenure information in the auditor's report, the Proposal implies some systematic connection between audit quality and tenure. However, as explained in the Proposal and emphasized by board members, the PCAOB has not reached a conclusion regarding the relationship between audit quality and auditor tenure and the PCAOB's inspection process has not been designed to determine any such relationship. Unfortunately, even though the PCAOB does not have data to support a relationship between audit quality and auditor tenure, the fact that the PCAOB would require disclosure of auditor tenure might suggest that the PCAOB believes the information is meaningful.

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[13] *See* Statements by Board members Hanson and Franzel on Reproposing an Auditing Standard on the Auditor's Report at the PCAOB Open Board Meeting on May 11, 2016.
[14] We also note that the SEC solicited public comment on this matter in the Concept Release on *Possible Revisions to Audit Committee Disclosures*; 17 CFR Part 240; Release Nos. 33-9862, 34-75344; File No. S7-13-15; RIN 3235-AL70.

The Proposal acknowledges that information to determine auditor tenure is already publicly available, but suggests that disclosing this information in the auditor's report will reduce investors' search costs.[15] Clearly any such costs incurred by investors are trivial.

To summarize, in our view any benefits of disclosing auditor tenure in the audit report are questionable and would be heavily outweighed by the costs imposed, as we have noted in our previous correspondence on this issue. Moreover, the Proposal has not demonstrated any linkage between auditor tenure and audit quality. Thus, the CCMC does not support disclosure of information on auditor tenure in the audit report.

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Once again, the CCMC appreciates the opportunity to comment on the Proposal.

The CCMC continues to have serious concerns regarding the Proposal, including that the Proposal

1. blurs and even weakens lines of corporate governance, especially in cases where open communication may been needed between the audit committee and an external auditor;
2. may create duplicative disclosures in many cases while risking auditors serving as original sources of information in others; and
3. may raise the liability for auditors and businesses which ultimately harms investors.

All things considered, the CCMC questions whether the costs of the Proposal outweigh the benefits. We believe that these issues should be addressed before any Proposal moves forward.

Finally, if the PCAOB decides to proceed with this initiative in spite of all the concerns expressed about it, the PCAOB should recognize that auditor

[15] *See* the Proposal, page 68.

reporting of CAMs, in particular, is a giant experiment. As such, the CCMC recommends that any standard-setting that results from this initiative should include a sunset provision (of within three to five years of its effective date). Only after a robust post-implementation review of the costs and benefits and a determination that the benefits exceed the costs should a similar or revised auditor reporting standard be allowed to be re-implemented.

We stand ready to assist in this matter.

Thank you for your consideration.

Sincerely,

Andres Gil

cc: Wesley R. Bricker, Interim Chief Accountant, Office of the Chief Accountant, Securities and Exchange Commission