KPMG

KPMG LLP
345 Park Avenue
New York, N.Y. 10154-0102

Telephone +1 212 758 9700
Fax +1 212 758 9819
Internet www.us.kpmg.com

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Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

PCAOB Rulemaking Docket Matter No. 034
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

Dear Ms. Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) Release No. 2013-005, *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* (the PCAOB Release or the Proposed Standards).

The Board has requested public comment on the PCAOB Release for changing the auditor's reporting model. The objective of the Proposed Standards is to improve the auditor's reporting model and to increase the informational value and promote the usefulness and relevance of the audit and the related auditor's report, while not placing undue burden on the financial reporting process. We are supportive of the Board's objective.

The Board has proposed two auditing standards, and related amendments, to meet this broad objective. The first proposed auditing standard, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (the Proposed Auditor Reporting Standard), which retains the current pass/fail model, is intended to provide more information to investors and other financial statement users about the audit and the auditor through various proposed changes to the auditor's report, including the communication of critical audit matters. The second proposed auditing standard, *The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report* (the Proposed Other Information Standard), is intended to be responsive to investors' desire to better understand the auditor's responsibility for other information outside the financial statements that is contained in documents that include the audited financial statements and the related auditor's report.

Overview

As noted in the PCAOB Release, the communication of critical audit matters "could help investors and other financial statement users focus on aspects of the company's financial statements that the auditor … found to be challenging," and would also "provide investors and other financial statement users with previously unknown information about the audit that could enable them to analyze more closely any related financial statement accounts and disclosures." We believe that this is consistent with what the Board heard in its prior outreach activities, where investors identified certain information that they would recommend be included in the auditor's report, including (1) communication of areas with the most significant financial statement and audit risk and the work performed in those areas, (2) discussion of significant estimates and judgments made by management, the auditor's assessment of their accuracy and how the auditor arrived at that assessment, and (3) communication of results of sensitivity analyses in significant areas of judgment.

As originally noted in our comment letter dated September 30, 2011 on PCAOB Rulemaking Docket Matter No. 034, *Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards* (the Concept Release), we support the Board's objectives to improve the auditor's reporting model and increase its relevance to financial statement users, in a way that both serves the interests of investors and provides benefits that outweigh their costs. We also noted in our comment letter on the Concept Release that current SEC rules and regulations require disclosures that substantially overlap with many of the items that investors have requested to be included in the auditor's report. For example, with respect to material estimates or assumptions with significant levels of subjectivity and judgment (i.e., critical accounting estimates), management is directed to provide within Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) greater insight into the quality and variability of information regarding financial condition and operating performance, and the analysis should include, to the extent material, such factors as to how management arrived at the estimate, how accurate the estimate or assumption has been in the past, how much the estimate or assumption has changed in the past, and whether the estimate or assumption is reasonably likely to change in the future. Furthermore, the disclosures require analysis of the critical accounting estimate's sensitivity to change, based on other outcomes that are reasonably likely to occur and could have a material effect.[1]

Given that there continues to be a significant overlap between investors' request for additional information relative to the most significant financial statement and audit risks and the incremental disclosures required within MD&A compared to what is required by generally accepted accounting principles, we remain of the mindset that the most effective way to achieve the above objective would be to require auditor association with a critical accounting estimates section within MD&A. We acknowledge that the SEC would likely need to amend Regulation S-X to

[1] Refer to Section 501.14 of Financial Reporting Codification, *Critical Accounting Estimates*, for a complete description of the MD&A disclosure requirements for critical accounting estimates.

require the critical accounting estimates section to be subject to attestation. Additional action on the part of the SEC and PCAOB might be required to implement this recommendation, including:

- The SEC requiring that the critical accounting estimates section be clearly identified within MD&A;
- The SEC reviewing existing interpretive guidance relative to critical accounting estimates to determine the adequacy of such guidance, and whether it should be formally adopted as part of Regulation S-K; and
- The PCAOB reviewing existing PCAOB attestation standards (i.e., AT section 101, *Attest Engagements*, and AT section 701, *Management's Discussion and Analysis*) to determine whether such standards would be suitable to be used by registered public accounting firms for purposes of attesting to the critical accounting estimates section of MD&A.

While we believe that auditor attestation of the critical accounting estimates section of MD&A would be the most effective way to meet the Board's overall objectives, as stated above, we would also support an approach that requires the communication of critical audit matters, with certain specific enhancements as described further below. Our comment letter with respect to the Concept Release described several overarching principles for consideration when developing possible areas of the auditor's reporting model for further evaluation. Those principles, which we believe are also relevant to the Proposed Standards, are as follows:

- Auditors should not be the original source of information about the entity; management's responsibility should be preserved in this regard. A fundamental shift from the auditor attesting to information prepared by management to the auditor providing original information about the company could result in unintended consequences that are not in the best interest of investors.
- Any changes to the auditor's reporting model should enhance, or at least maintain, audit quality.
- Any changes to the auditor's reporting model should narrow, or at least not expand, the expectation gap.
- Any changes to the auditor's reporting model should add value and not lead to investor misunderstanding. Specifically, any revisions should not require investors to sort through "dueling information" provided by management, the audit committee, and the independent auditors.
- Auditor reporting should focus on the objective rather than the subjective. Financial reporting matters assessed by the auditor can be highly subjective; however it is important that auditor communications provide objective information about these matters.

The remainder of this letter provides our specific comments on the Proposed Auditor Reporting Standard, the Proposed Other Information Standard, and other matters.

I) The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion

As noted in the PCAOB Release, the Proposed Auditor Reporting Standard would make the following significant changes to the existing auditor's report:

- Require the auditor to communicate in the auditor's report critical audit matters that were addressed during the audit of the current period's financial statements. If the auditor determines there are no critical audit matters, the auditor would state such in the auditor's report.
- Add new elements to the auditor's report related to auditor independence, auditor tenure, and the auditor's responsibility for, and evaluation of, other information in annual reports containing the audited financial statements and the related auditor's report.
- Enhance certain standardized language in the auditor's report, including the addition of the phrase "whether due to error or fraud," when describing the auditor's responsibility under PCAOB standards to obtain reasonable assurance about whether the financial statements are free of material misstatements.

Auditor Reporting of Critical Audit Matters

The Proposed Auditor Reporting Standard would require the auditor to determine whether there are critical audit matters in the audit of the current period's financial statements, based on the results of the audit or evidence obtained. The auditor would then be required to communicate these critical audit matters in the auditor's report. The auditor's report would be required to include a description of the critical audit matters and would:

- Identify the critical audit matter;
- Describe the considerations that led the auditor to determine that the matter is a critical audit matter; and
- Refer to the relevant financial statement accounts and disclosures that relate to the critical audit matter, when applicable.

As noted above, we are supportive of the Board's objective to provide investors additional information relative to the most significant financial statement and audit risks. We agree that the Proposed Auditor Reporting Standard may provide additional and more meaningful information to financial statement users. However, we believe that certain significant enhancements, clarifications, and illustrative guidance are required in order to ensure the Proposed Auditor Reporting Standard is operational, as further described below.

Definition of a Critical Audit Matter

An important element of the implementation and adoption of the Proposed Auditor Reporting Standard by auditors is ensuring that it includes an appropriate definition of a critical audit matter and an appropriate framework and application guidance to ensure the consistent identification and reporting of critical audit matters in a manner that meets the expectations of users. We believe that the definition of a critical audit matter, and the process used to determine critical audit matters, should be refined. We also believe that the population of potential critical audit matters is too broad, as currently written. We acknowledge that critical audit matters ordinarily would be documented in the engagement completion document and reviewed by the engagement quality reviewer. However, we believe that a critical audit matter would always be communicated to the audit committee pursuant to Auditing Standard No. 16, *Communications with Audit Committees* (AS 16). Therefore, the inclusion of the first two items noted in paragraph 8 of the Proposed Auditor Reporting Standard (i.e., documented in the engagement completion document or reviewed by the engagement quality reviewer) appears to be redundant and unnecessary. In determining whether a matter is a critical audit matter, we believe that the auditor should utilize a two-step process to first identify "significant audit matters," which would be those matters that are significant to the audit of the financial statements and required to be communicated to the audit committee pursuant to AS 16. The auditor also would take into consideration the factors noted in paragraph 9 of the Proposed Auditor Reporting Standard when identifying those matters deemed to be a significant audit matter. Critical audit matters would be a subset of significant audit matters, using the definition of a critical audit matter in the Proposed Auditor Reporting Standard, as further refined by adding two additional criteria. The first additional criterion is that a matter must be material to the financial statements in order for it to be a critical audit matter. The other criterion that we would recommend be added to the definition of a critical audit matter is one that is based on the level of auditor interaction (in terms of nature or extent) with the audit committee.

We also believe that certain wording related to identifying a critical audit matter should be refined and clarified in order to drive consistency in application. We agree with the Proposed Auditor Reporting Standard's intention to report those matters that are the most challenging, subjective, or complex. The word "most" implies that the number of critical audit matters should be limited, and we agree with the general premise that the greater the number of critical audit matters, the less useful the auditor's communication of critical audit matters may be. Therefore, we believe that the Proposed Auditor Reporting Standard should make this explicit, by indicating that the auditor should consider reassessing whether each of the matters meets the definition of a critical audit matter, if the auditor has initially identified a large number of matters for potential communication in the auditor's report.

Reporting of Original Information

As noted above, one of the overarching principles that we believe should be adhered to when developing the framework and basis for reporting is that auditors should not be the original source of information about the entity (referred to herein as original information); management's responsibility should be preserved in this regard. The Proposed Auditor Reporting Standard could require the auditor to convey original information, based on the definition of a critical audit matter and the manner in which the illustrative examples interpret the requirement in paragraph 11b.

We believe the illustrative examples included in the PCAOB Release, without any further application guidance, reflect an implicit requirement to communicate all of the paragraph 9 factors that are present, which would not be instructive, and may lead to less tailoring of the critical audit matter communication. As a result, we believe there are a number of items that may require communication by the auditor under the Proposed Auditor Reporting Standard that could have unintended consequences to the company and/or the users of the financial statements. These include (1) matters that may relate to confidential or privileged information; (2) information that would be harmful or detrimental to the company's operations; and (3) information that is not required by current securities laws to be communicated by the company.

The definition of a critical audit matter does not include any restrictions or any provisions related to this type of information. As an example, current securities laws do not require companies to disclose certain items, such as significant deficiencies in internal control and corrected or accumulated uncorrected misstatements, either in their financial statements or otherwise. However, based on the Proposed Auditor Reporting Standard, these items, if present in connection with a critical audit matter, would appear to be required to be communicated by the auditor, based on how paragraph 11b has been interpreted through the illustrative examples included in the PCAOB Release. As discussed in more detail below (see *Litigation Risks Raised by the Proposed Auditor Reporting Standard That Could Impact Auditors*), there also are potential legal issues that could arise if the auditor is the conveyor of original information.

In order to rectify this potential problem in the PCAOB's framework, we believe the auditor should describe the principal considerations that led the auditor to conclude that the matter was a critical audit matter. This would allow an auditor to exercise judgment in highlighting which particular factor, or factors, was most important to the auditor's determination that the matter was a critical audit matter, which would provide additional context as to why the critical audit matter is important to the financial statements. In addition, we believe the Proposed Auditor Reporting Standard should include a provision to preclude the auditor from communicating any original information, except in those rare situations where, in the auditor's judgment, the communication of such original information is necessary to the auditor's description of the critical audit matter.

We also noted that the illustrative examples included in the PCAOB Release contain a discussion of specific audit procedures performed by the auditor (e.g., consultations with the national office or the involvement of specialists). We do not support the communication in the auditor's report of consultations with the national office. Consultations with the national office can occur for a variety of reasons. Without any context regarding the experience of the engagement team, specific nature of the consultation, or details of discussions between the auditor and management and/or the audit committee, the inclusion of information about consultations with the national office, in the context of a communication about a critical audit matter, could have a number of adverse consequences, including widening the expectation gap (i.e., the user of the financial statements might improperly infer a higher level of assurance in those situations where consultation with the national office is communicated in the description of a critical audit matter).

Description of Audit Procedures

The PCAOB Release indicates that the "proposed auditor reporting standard would not require the auditor to describe the audit procedures related to critical audit matters. It would, however, not preclude an auditor from doing so." This is similar to the International Auditing and Assurance Standards Board's (the IAASB) proposal, which states that the auditor may communicate the effect on the audit, to the extent that the auditor considers it necessary for purposes of explaining why the auditor considered the matter to be one of most significance in the audit.[2] We note, however, that each of the illustrative examples in the PCAOB Release includes descriptions of audit procedures related to the critical audit matter. We believe that a description of the critical audit matter's effect on the audit would be of interest to users, and communicating it would be consistent with the objective of providing more transparency into the audit. In order to avoid inconsistent practice and interpretation of this provision, which would affect comparability, we believe the PCAOB's framework could be enhanced by explicitly requiring the auditor to provide a description of the critical audit matter's effect on the audit. If this enhancement to the framework is made, we believe it is essential that the PCAOB develop guidance on how the auditor should communicate the critical audit matter's effect on the audit. Such guidance should indicate that the description of the effect on the audit should be (1) a brief, high-level summary of the key audit procedures performed (e.g., the auditor's response to the risk of material misstatement identified in the critical audit matter) to address the principal considerations that led the auditor to conclude that a matter is a critical audit matter, (2) focused only on those assertions (e.g., completeness, valuation) that result in the matter being communicated as a critical audit matter, and (3) focused on the most significant assumptions or estimates, if applicable, affecting such assertions. While we believe this enhancement may provide more transparency into the audit, there are significant legal issues that the PCAOB should consider as it develops its guidance, which are discussed in more detail below (see *Litigation Risks Raised by the Proposed Auditor Reporting Standard That Could Impact Auditors*).

No Piecemeal Opinion

The auditor's report per the Proposed Auditor Reporting Standard would include an identification and description of critical audit matters and would make reference to the relevant financial statement accounts and disclosures that relate to the critical audit matter, when applicable. Auditing standards require that an audit be planned and performed to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to fraud or error. The audit opinion is based on the financial statements taken as a whole. We believe that the Proposed Auditor Reporting Standard should include a statement that the audit report does not contain all significant matters identified and communicated to the audit committee and should clarify that the auditor is not reporting on the individual accounts or issues related to each critical audit matter, but on the financial statements taken as a whole.

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[2] See IAASB exposure draft entitled *Reporting on Audited Financial Statements: Proposed New and Revised Standards on Auditing (ISAs).*

Documentation of Critical Audit Matters

The Proposed Auditor Reporting Standard requires the auditor to document those items that would appear to meet the definition of a critical audit matter but were determined not to be a critical audit matter. This requirement is not operational, in our view, as there is no guidance in the Proposed Auditor Reporting Standard on how an auditor could demonstrate that such a matter is not a critical audit matter. Consistent with the enhancements noted above, we believe a more practical approach would be to require the auditor to document: (1) those matters communicated to the audit committee that were determined to be significant audit matters, and (2) the determination of which significant audit matters are critical audit matters. We believe this approach mitigates the practical challenges associated with documenting matters that "appear to be critical audit matters, but are not."

IAASB Proposal

In preparing our response to the PCAOB, we reviewed the criteria set out in the Proposed Auditor Reporting Standard to those in the IAASB's exposure draft. We note that the two proposals are similar, but not identical. This suggests that different items could be reported depending on which standard was applicable. We are concerned that auditors reporting under both PCAOB and IAASB requirements (e.g., for dual listed entities) may spend unnecessary time trying to understand and reconcile the differences. We strongly recommend that the PCAOB seek to work with the IAASB to ensure that the criteria for identifying and reporting critical or key audit matters are the same, because we do not believe that such differences are meaningful or helpful to users of the financial statements.

Litigation Risks Raised by the Proposed Auditor Reporting Standard That Could Impact Auditors

While any addition to the statements that an auditor is required to make increases the chance of civil litigation each time a company's performance differs from expectations, we believe the suggestions outlined in this letter will be helpful in limiting undue litigation risk.

The mere fact that the matter caused loss to an investor can make it appear critical. A significant litigation risk raised by the Proposed Auditor Reporting Standard is a claim that the cause of loss should have been identified as a critical audit matter. The factors listed in paragraph 9 of the Proposed Auditor Reporting Standard are very general, making it easy in hindsight for a third party to claim that an audit matter touches on one or more of them. The two-step process outlined above not only helps auditors identify and describe critical audit matters, it also will help courts and investors distinguish a truly critical audit matter from one that is merely claimed to be so after the fact.

With the benefit of hindsight, a third party also is in a position to second-guess what the auditor communicated about a critical audit matter. Requiring an auditor to communicate original information about the company magnifies the risk of such a claim. It would place sole responsibility on the auditor for information about the company beyond that which the company itself did not have to disclose to investors, allowing an investor to claim that the auditor should have provided more detail, or characterized the information differently. At the same time, more detail can put the auditor in conflict with other legal requirements. A company might object that the characterization is too negative, or that the added detail communicates a competitive confidence. A regulator (such as a bank examiner) might object that the auditor's communication of the information is prohibited by law. An employee (such as the subject of an investigation) might object that the details are personal.

In addition, the PCAOB Release notes that "the prominence with which information is disclosed can have implications for investment decision making." There is a risk that investors will give statements about critical audit matters a prominence that is undue, and such risk is increased when the auditor is communicating original information about the company since, by definition, such information was not considered of sufficient importance to investors to require disclosure by the company. The suggestions set out above can limit (although not eliminate) the harms caused by both misunderstanding and wasteful litigation.

Finally, statements about descriptions of audit procedures can appear to provide a level of line-item assurance not intended by an audit opinion. A plaintiff who believes that the communicated procedures were not performed adequately can claim that the auditor's description of such procedures is a misrepresentation, with the potential to turn every dispute over the auditor's communication of the critical audit matter's effect on the audit into an allegation of fraud. Just as the communication of a critical audit matter is not a separate opinion on that matter, the inclusion of the effect on the audit is not a separate opinion on those procedures. While such risks are an inherent risk of describing the critical audit matter's effect on the audit, we believe that undue risk can be limited if (1) the audit opinion contains a clear and explicit statement that the audit procedures that might be referenced in the auditor's communication of the critical audit matter's effect on the audit are directed toward the auditor's opinion on the financial statements taken as a whole, and (2) the Proposed Auditor Reporting Standard includes robust guidance on how the auditor should communicate the critical audit matter's effect on the audit.

As noted at the beginning of this section, an increase in litigation against auditors is a probable if not inevitable result of the expansion of the auditor's report contemplated by the Proposed Auditor Reporting Standard. Although the suggestions contained in this letter can help limit that risk, before proceeding with the recommendations included in our letter, it is essential that the Board review the scope of the litigation risk and its attendant costs, as well as the best means to avoid undue increase in litigation risk, in light of the field testing discussed in more detail below (see *Costs*).

Addition of New Elements

We agree with the addition of language on auditor independence explicitly stating that the auditor is independent. This is consistent with the requirement that the auditor's report be titled "Report of Independent Registered Public Accounting Firm" and provides clarification of this within the auditor's report.

We do not believe, however, that the inclusion of a sentence about the auditor's tenure within the auditor's report is appropriate. As noted in the PCAOB Release, no nexus has been established between an auditor's tenure and audit quality, and requiring such information in the auditor's report would give the false impression to the reader of the auditor's report that a correlation between the two does exist. We acknowledge that the communication of an auditor's tenure may be an item of interest to some stakeholders and support the communication and transparency that disclosing this information may provide. Therefore, we recommend that this information be required to be disclosed through different means (e.g., in the audit committee's report or by way of Form 2 reporting).

Changes to Standardized Language

We agree with the addition of the clarifying language proposed to be added to the current auditor's report, as it will enhance users' understanding about the audit and the auditor. However, we believe that the Board should re-consider adding the language noted by the Center for Audit Quality (CAQ) in their comment letter dated June 28, 2011, and re-iterated in their comment letter dated December 11, 2013 (see Appendix C in the CAQ's letter), as we continue to believe this language would provide added clarification for investors. This additional language also would more closely align the standardized language used by the PCAOB with the IAASB's proposed auditor's reporting model. The suggested additional language includes:

- Stating in the basis of opinion paragraphs that the procedures performed and the audit evidence obtained provide a reasonable basis for the opinion.
- Highlighting that references to the financial statements throughout the auditor's report relate to the financial statements taken as a whole.
- Providing an expanded discussion of the responsibilities of management and the audit committee with respect to the financial statements.
- Describing the meaning of reasonable assurance in the context of the basis for the auditor's opinion.
- Highlighting the necessity of using professional judgment in making audit risk assessments and in the selection of audit procedures, and the consideration the auditor gives to the company's internal control over financial reporting when making such determinations, as well as highlighting the auditor's use of professional skepticism throughout the audit.

We support allowing flexibility in the ordering of paragraphs provided the auditor's report includes the key elements set out in the Proposed Auditor Reporting Standard. However, we recommend that section headings be required for all elements within the auditor's report.

Litigation Risks Raised by the Ambiguity in Adding Additional Addressees That Could Impact Auditors

The principal risk created by the Proposed Auditor Reporting Standard concerning addressees of the auditor's report is the possibility that it will be confused with concepts (such as privity) that govern the scope of an auditor's liability under state law. Different users of financial statements are very differently situated: the board that oversees management of the company is not in the same position as its shareholders; shareholders have different interests than bondholders and other creditors; etc. The Proposed Auditor Reporting Standard does not purport to alter any state's rules governing who may bring a lawsuit against the auditor, just as it does not purport to alter the state's rules governing when an auditor may be held liable. Appendix 5 in the PCAOB Release suggests that the auditor's report could be addressed to others, such as bondholders. The guidance in the PCAOB Release does not provide any circumstances where an auditor would be required to address its report to bondholders, and we are unaware of any example where such an addressee would be appropriate.

II) The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report

We acknowledge and agree that there is a shortcoming in the existing standard (AU section 550, *Other Information in Documents Containing Audited Financial Statements* (AU 550)) with respect to the non-reporting of the auditor's responsibility related to other information. We support the Board's objective to provide a specific basis for the description in the auditor's report of the auditor's responsibilities for the other information outside the financial statements. We furthermore agree that the inclusion in the auditor's report of the auditor's responsibilities for other information in annual reports filed with the SEC containing the audited financial statements is the most effective manner of achieving the Board's objective.

However, the Proposed Other Information Standard goes beyond adding a reporting element to AU 550, and appears to have a number of flaws that would make the proposal difficult and costly to implement. The Proposed Other Information Standard expands the auditor's performance requirements, including raising the required level of assurance provided by the auditor on the other information to a level above what the extant standard currently requires, and to a level that could be construed as being consistent with the level of assurance being provided in the audit of the related financial statements. In addition, we believe that requiring the auditor to state in the auditor's report that the auditor has evaluated the other information and, based on that evaluation, has not identified a material inconsistency or material misstatement of fact would imply a level of assurance that is inconsistent with the proposed procedures.

We also believe that the Proposed Other Information Standard requires clarification with respect to certain other areas, including: (1) the scope of other information subject to the Proposed Other Information Standard; (2) the lack of a concept of risk assessment and materiality related to the other information; and (3) the documentation requirements under the proposal.

Auditor Performance Requirements

The Proposed Other Information Standard requires that an auditor "read and evaluate" the other information. The term "evaluate" appears to suggest a higher assurance and responsibility level than "read and consider," which is the performance requirement in AU 550. In existing auditing standards, the term "evaluate" is used in order to address auditor performance requirements. The context of the word "evaluate" in those standards is in connection with the auditor obtaining reasonable assurance on whether the financial statements are fairly stated in all material respects. We further note that proposed Auditing Standard No. 17, *Auditing Supplemental Information Accompanying Audited Financial Statements,* includes a requirement for the auditor to evaluate whether the supplemental information is presented in conformity, in all material respects, with the relevant regulatory requirements or other applicable criteria.

We believe the use of the word "evaluate" could be construed as providing reasonable assurance (or something akin to reasonable assurance, although not fully defined in the PCAOB Release) on the other information and this could have unintended consequences for investors or other users of the other information. We recommend that the requirement be changed from "evaluate" to "perform certain limited procedures" (such limited procedures would include reading the other information), which would more closely align the requirements to the extant standard and would be practicable from an operational perspective as well.

AU 550 states that the auditor's responsibility does not extend beyond the financial information that is identified in the auditor's report. The Proposed Other Information Standard extends this responsibility to include "relevant audit evidence obtained and conclusions reached during the audit." Relevant audit evidence is a broad concept and it could be interpreted to mean that the auditor who is fulfilling the performance requirement is required to be aware of each facet of each piece of audit evidence obtained during the course of the audit. This issue could be further exacerbated in a group audit situation, where the group auditor may only receive highlight memos from the component auditors, and may not have direct visibility into specific audit evidence that is present in the work papers of the component auditors. We believe that the interpretation described above is too broad and that the Proposed Other Information Standard should limit the responsibility of the auditor to compare the other information to the amounts in the financial statements and the accounting records that are subject to the audit, or have been derived directly from such accounting records by analysis or computation. This would clarify the auditor's responsibility and make the responsibility more consistent with current auditing standards and today's practice.

AU 550 also limits the auditor's responsibility to reading the other information not directly related to the financial statements, and requires additional procedures to be performed related to such information only if the auditor becomes aware of a potential material misstatement of fact. The Proposed Other Information Standard makes no distinction as it relates to requiring an evaluation to be performed with respect to other information directly related to the financial statements and other information not directly related to the financial statements. Given that the auditor's procedures are likely to be less in scope and generally may not entail any or a very limited amount of audit work with respect to other information not directly related to the financial statements, we believe that the Proposed Other Information Standard should be revised so that it requires the auditor to perform additional procedures with respect to other information not directly related to the financial statements only if the auditor becomes aware of a material misstatement of fact while reading such information.

Auditor Reporting Requirements

While we support the Board's proposal to include communication of the auditor's responsibility for other information, we believe that the format of the reporting should be amended to address several matters. Such changes include providing a description of the procedures that were performed and specifically stating that no audit or review has been performed on the other information. In addition, due to the heightened litigation risk that the Proposed Other Information Standard presents (see further description below), we believe that the reporting that should be required in situations where the auditor is not aware of a material inconsistency with the financial statements or a material misstatement of fact would be to indicate what the auditor's responsibilities are, without providing an explicit conclusion or statement about the results of that work. This could be accomplished by requiring the auditor to include a statement in the auditor's report that in the event the auditor becomes aware, based on the limited procedures performed, that the other information contains a material inconsistency and/or a material misstatement of fact that has not been appropriately revised, the auditor is required to describe the inconsistency and/or misstatement of fact in the auditor's report.

Scope of Other Information

The Proposed Other Information Standard defines other information broadly as information in the annual report other than the audited financial statements and the related auditor's report, including (1) information incorporated by reference in the annual report that is available to the auditor prior to the issuance of the auditor's report and (2) when the annual report is a Form 10-K, information incorporated by reference from the company's definitive proxy statement filed within 120 days after the end of the fiscal year covered by the Form 10-K. We believe that clarification is required to further define and illustrate what exhibits would be within the scope of the auditor's responsibility. As an example, certain exhibits (e.g., a merger agreement in connection with a business combination transaction) may have already been considered by the auditor in connection with determining whether a transaction was properly accounted for within a company's financial statements. Since such documents were already considered by the auditor in carrying out the audit, we do not believe that they should be further subjected to the requirements of the Proposed Other Information Standard. In addition, there may be other documents that are included as exhibits to the Form 10-K that have minimal, if any, relationship to the financial statements (e.g., articles of incorporation). We recommend that the PCAOB clarify whether the Proposed Other Information Standard is intended to be applicable to all exhibits, or only to those exhibits that are specifically prepared for purposes of complying with SEC rules and regulations.

Furthermore, as noted above, the Proposed Other Information Standard indicates that the auditor's responsibility regarding other information extends to information that is incorporated by reference from the company's definitive proxy statement filed within 120 days after the end of the fiscal year covered by the Form 10-K. It is unclear to us how this requirement would work in practice, since such information may not yet be prepared or available to the auditor and will not be filed until after the Form 10-K is filed. Since the auditor would be required to report on the other information (including the other information in the proxy statement not yet available) pursuant to the Proposed Other Information Standard, we believe it is inappropriate for an auditor to provide a "conclusion" on information that is not yet available or in final form. As such, it appears to us that the auditor would be required to reissue its report in connection with the filing of the proxy statement to convey that the other information in the proxy statement has been subjected to the auditor's performance requirements after the original issuance of the auditor's report. We are not sure how this would be applied in practice, since the auditor would presumably have to dual date its report, even if there was no change to the financial statements. We believe that the modifications we suggest above in the *Auditor Reporting Requirements* section appropriately address this timing issue, which is consistent with practice today under AU 550 (i.e., auditor reporting on the other information only on an exception basis).

Materiality

The Proposed Other Information Standard introduces specific procedures related to the auditor performance requirements. These procedures include comparing amounts in the other information to the financial statements and relevant audit evidence and re-calculating amounts presented in the other information. As currently written, there is no reference to materiality, as it relates to the requirement to perform the procedures in paragraph 4 of the Proposed Other Information Standard. We believe this is inconsistent with current auditing standards, whereby an auditor undertakes a risk assessment process to identify risks of material misstatement. We recommend that the Proposed Other Information Standard explicitly address or state that the performance requirements only apply to material other information.

Documentation

The Proposed Other Information Standard does not provide any guidance related to the nature or extent of the documentation that would be required with respect to the procedures performed on the other information, or the results of performing those limited procedures. With the change to a "read and evaluate" performance requirement, the level of effort that would be required to document the performance of the procedures described in paragraph 4 of the Proposed Other Information Standard (including having to perform procedures on other information that is not directly related to the financial statements) would increase. While some of our recommendations above may lessen the incremental impact related to documentation, we believe that further guidance would be helpful, in order to reduce any potential inconsistencies that could occur in practice. Therefore, we recommend that the PCAOB include specific guidance related to documentation within the Proposed Other Information Standard, in order to provide an auditor with a basis for documenting and retaining the results of its work.

CAQ Comment Letter

The CAQ's comment letter dated December 11, 2013 provides suggested changes to the auditor's performance and reporting requirements under the Proposed Other Information Standard, and the rationale for such changes. We believe those changes are consistent with our comments, and we are in agreement with those proposed changes.

Litigation Risks Raised by the Proposed Other Information Standard That Could Impact Auditors

Absent incorporating the changes suggested above, the Proposed Other Information Standard could create undue litigation risk to the extent it creates the impression that the auditor provides a level of assurance beyond the limited procedures contemplated. A court might construe the term "evaluate" to have the same meaning as it does in other auditing standards, and impose the requirements of those standards onto the consideration of other information. A court also might construe "relevant audit evidence" to hold an audit firm liable if anything in the company's filing does not comport with any part of the documentation in the work papers, or the understanding of any member of the engagement team. Where the other information in the filing is not directly related to the financial statements, its connection with the work of an auditor is that much less clear. That lack of clear connection leaves the auditor subject to more varied interpretations of its responsibilities, determined only after the fact in the context of civil litigation. The added clarity suggested above would help auditors know what to do, investors know what to expect, and courts know how to decide between the two.

Because an auditor can be held civilly liable under the federal securities laws only for the statements that it makes, requiring the auditor to make an affirmative statement that it has not identified a material inconsistency or material misstatement of fact creates a further, substantial expansion of the auditor's litigation risk. Even though the Proposed Other Information Standard cautions that the auditor is not expressing an opinion, and even though the actual procedures contemplated by such standard are limited, investors and courts may well find in this affirmative statement a conclusion that all of the other information set out by the company is accurate. Plaintiffs can argue that any error in the other information renders the auditor's statement false and actionable, greatly multiplying the chances of litigation. Meritless claims of this sort largely can be avoided if auditors are not required to conclude on a negative (i.e., the apparent absence of a material inconsistency or material misstatement of fact).

III) Other Matters

Scope

If adopted by the Board and approved by the SEC, the Proposed Standards would be applicable to the audits of employee stock purchase, savings and similar plans (benefit plans) that are required to file with the SEC an annual report on Form 11-K. The Proposed Standards would also apply to brokers and dealers that will be required to be audited in accordance with PCAOB standards for fiscal years ending on or after June 1, 2014, as well as registered investment companies.

With respect to the Proposed Auditor Reporting Standard, we recommend that the Board exempt all three types of entities (i.e., benefit plans, brokers and dealers, and registered investment companies) from the requirements to determine, communicate, and document critical audit matters pursuant to such standard. Benefit plans and registered investment companies are (1) designed for a specified purpose and, as a result, would likely have similar critical audit matters and (2) inherently less complex and entail fewer estimates and judgments. The typical critical audit matter that would be applicable to such entities would generally relate to auditing difficult to value investments, and there are extensive disclosure requirements regarding the fair value of investments pursuant to Accounting Standards Codification 820, *Fair Value Measurement.* In addition, as noted in the PCAOB Release, the ownership of brokers and dealers is primarily closely held (per the PCAOB's Office of Research and Analysis, approximately 75% of the brokers and dealers have five or fewer direct owners), and the direct owners are generally part of the entity's management. Therefore, the informational needs of these individuals would typically be different from those of an investor.

With respect to the Proposed Other Information Standard, we recommend that the Board exempt benefit plans and brokers and dealers from the requirements of such standard. We believe that the compliance or exemption report required to be filed by brokers and dealers under Rule 17a-5 and required to be reported on by auditors under Attestation Standard No. 1, *Examination Engagements Regarding Compliance Reports of Brokers and Dealers*, or Attestation Standard No. 2, *Review Engagements Regarding Exemption Reports of Brokers and Dealers*, provide users of broker and dealer financial statements with sufficient information to make any additional reporting by the auditor for such entities under the Proposed Other Information Standard unnecessary. In a similar fashion, there is limited other information that is included in a Form 11-K, and such document is not the predominant source of information that is used by plan participants when making their investment decisions.

We believe that the Proposed Auditor Reporting Standard and the Proposed Other Information Standard should be applicable to emerging growth companies, and therefore recommend that no exemption from the standards be provided to such companies.

Costs

We believe that the requirement of the auditor to determine and report on critical audit matters and the proposed increased requirements under the Proposed Other Information Standard will result in additional audit effort and increased audit cost. The enhancements put forth in this letter are intended to temper the incremental costs to implement the Proposed Standards, while still meeting the Board's stated objectives.

We are participating in a CAQ-led field test, and we believe that the results of that field test will provide some insights into the effect that the Proposed Standards will have on audit effort, audit costs, and a company's financial reporting process. We recommend that the Board also consider field testing the significant aspects of the Proposed Auditor Reporting Standard and the Proposed Other Information Standard to assist it in carrying out its cost benefit analysis of the Proposed Standards.

Amendment to AU Section 722

AU section 722, *Interim Financial Information*, is proposed to be amended to state that the auditor should consider the requirements of the Proposed Other Information Standard. We believe that the reference to "requirements" is too broad, as the reporting requirement of the

Proposed Other Information Standard would not be applicable in a review of interim financial information.

Reporting When the Auditor Was Not Engaged to Examine Management's Assertion on the Effectiveness of Internal Control Over Financial Reporting

SEC regulations do not currently require companies to disclose in their annual report, or for auditors to communicate in their auditor's report, that an attestation on internal control over financial reporting has not been performed. If a company is not required to obtain auditor attestation, then the auditor is permitted, but not required, to indicate in the auditor's report that the auditor was not engaged to examine management's assertion on the effectiveness of internal control over financial reporting and that the auditor does not express an opinion on management's report. We believe that this reporting should continue to be optional, given the fact that an investor can easily determine whether an attestation of internal control over financial reporting has been performed, based on currently available information.

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We appreciate the Board's careful consideration of our comments, and fully support the Board's efforts to enhance the auditor's reporting model and increase the value of the audit. If you have any questions regarding our comments included in this letter, please do not hesitate to contact George Herrmann ((212) 909-5779 or gherrmann@kpmg.com) or Rob Chevalier ((212) 909-5067 or rchevalier@kpmg.com).

Very truly yours,

KPMG LLP

cc:

PCAOB
James R. Doty, Chairman
Lewis H. Ferguson, Member
Jeanette M. Franzel, Member
Jay D. Hanson, Member
Steven B. Harris, Member
Martin F. Baumann, Chief Auditor and Director of Professional Standards

<u>SEC</u>
Mary Jo White, Chair
Luis A. Aguilar, Commissioner
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Michael S. Piwowar, Commissioner
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Paul A. Beswick, Chief Accountant
Brian T. Croteau, Deputy Chief Accountant
Daniel Murdock, Deputy Chief Accountant