CENTER FOR CAPITAL MARKETS
COMPETITIVENESS

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December 9, 2013

Ms. Phoebe W. Brown
Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006

Re: 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)

Dear Ms. Brown:

The U.S. Chamber of Commerce (the "Chamber") is the world's largest federation, 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. The CCMC supports efforts to improve audit effectiveness and appreciates the opportunity to comment on the Public Company Accounting Oversight Board ("PCAOB") *Proposed Auditing Standards—The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report* ("the Proposal").

Rather than informing investors and financial statement users, the Proposal may create a tower of Babel that can sow confusion in a marketplace that SEC Chair Mary Jo White has acknowledged already suffers from "disclosure overload."[1] The CCMC is concerned that the Proposal does not address investor needs, causes investor confusion by creating overlap and competition with other regulatory mandates, increases financial reporting complexity and blurs the lines of responsibilities between auditors and businesses. This will degrade audit quality and hamper the utility of financial reports for users and issuers thereby making the capital markets less efficient.

Accordingly, the CCMC believes that the Proposal does not meet minimum thresholds required to move forward. Instead, the CCMC respectfully requests the PCAOB should work with the Securities and Exchange Commission ("SEC") and Financial Accounting Standards Board ("FASB") to move forward on a broad agenda of financial reporting modernization as outlined in the CCMC's letter October 9, 2013 to SEC Chair Mary Jo White.

Our concerns are discussed in greater detail below.

Discussion

The PCAOB issued a Concept Release on possible revisions to the auditor's report in June 2011 and received 155 comment letters. The CCMC provided comments on the Concept Release expressing serious concerns in a comment letter filed with the PCAOB.[2] We continue to have the same concerns regarding the Proposal, and accordingly, have attached the September 14, 2011 letter. At the same time the PCAOB also issued a Concept Release on Auditor Independence, and the CCMC responded by filing a comment letter on October 20, 2011.[3] As we continue

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[1] *See* October 15, 2013 speech of SEC Chairman Mary Jo White, *The Path Forward on Disclosure*, before the National Association of Corporate Directors.

[2] *See* 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).

[3] *See* October 20, 2011 letter from the United States Chamber of Commerce Center for Capital Markets Competitivness on the PCAOB *Concept Request for Public Comment on Concept Release on Auditor Independence and Audit Firm Rotation and Notice of Roundtable (PCAOB Release No. 2011-006, August 16, 2011, PCAOB Rulemaking Docket Matter No. 37)*

to have some of the same concerns on the Proposal's stance on auditor independence, we have also attached the October 20, 2011 comment letter. We respectfully request that these attachments be included as a part of the Proposal comment file.

I. Investor Concerns

While we recognize that the PCAOB has engaged in outreach activities since the Concept Release, we are concerned that the PCAOB has not defined the investor need it is attempting to address, what investors it has consulted, and if the outreach has included a broad representative sample of the investor community. A failure to articulate specific investor needs and transparently identify the investor consultations undertaken to develop the Proposal undermines the fairness of the process, composition of the Proposal, and the need to move forward.

The CCMC believes that the articulation of investor needs and transparency of outreach in the development of the Proposal is a minimum necessary threshold for moving forward. This is particularly true since the Proposal fundamentally changes the Audit report and the role of the auditor.

The CCMC believes that these threshold requirements for moving forward with the Proposal have not been met.

II. Alternatives to the Proposal

The Proposal would significantly change the role and responsibilities of the auditor and represent the most significant changes to auditor reporting in more than 70 years. In our September 14, 2011 comment letter, we emphasized the need to address the threshold question of whether the PCAOB should engage in such a sweeping standard-setting initiative. This threshold question still needs to be addressed with this Proposal. Simply put, why is the PCAOB proposing to fix an auditor reporting model that is not broken?

Addressing the threshold question is especially important given that the PCAOB has heard strong support from all stakeholders for retaining the current "pass-fail" model of auditor reporting. The Proposal appears to retain this model

with additive reporting requirements. However, auditor reporting of CAMs essentially turns the auditor's report into a graded model.

Accordingly, the CCMC believes the PCAOB should work with the SEC and FASB to move forward on a broad agenda of financial reporting modernization as outlined in the CCMC's letter October 9, 2013 to SEC Chair Mary Jo White.[4] We would be happy to meet with the PCAOB board members to discuss these ideas further.

III. Background of Proposal

The Proposal would require the following:

- A new section in the auditor's report describing critical audit matters ("CAMs");

- New auditor responsibilities for and reporting on other information ("OI") that include requirements to read and evaluate OI, describe the auditor's responsibilities for OI in the auditor's report and state whether the OI contains a material inconsistency, a material misstatement of fact, or both; and

- New language in the auditor's report regarding auditor tenure, auditor independence, and auditor responsibilities related to fraud and the notes to the financial statements.

The CCMC appreciates that the PCAOB has not proceeded with Auditor Discussion and Analysis ("AD&A") as articulated in the Concept Release. Unfortunately, CAMs appear substantively similar to AD&A, notwithstanding that CAMs are described as being grounded in auditing rather than financial reporting matters. Importantly, both CAMs and AD&A overturn the fundamental precepts of financial reporting, as explained below.

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[4] *See* October 5, 2012 letter from the CCMC to the PCAOB, *Information for Audit Committees about the PCAOB Inspection Process* (PCAOB Release No. 2012-003, August 1, 2012) and October 9, 2013 letter from the CCMC to SEC Chair Mary Jo White on financial reporting modernization

IV. Auditor Reporting on Critical Audit Matters ("CAMs")

The Proposal defines CAMs as:

- Those matters that involved the most difficult, subjective, or complex auditor judgments;

- Those matters that posed the most difficulty to the auditor in obtaining sufficient appropriate evidence; or posed the most difficulty to the auditor in forming an opinion on the financial statements; and[5]

- Further, the Proposal would require that the auditor's report identify the specific CAMs, describe the considerations that led to each matter being considered a CAM, and refer to the related financial statement accounts and disclosures in the financial statements (if applicable).

As we discussed in our letter of September 14, 2011, financial statements and disclosures are the responsibility of management. This fundamental premise also extends to OI outside the financial statements such as Management's Discussion & Analysis ("MD&A") and proxy statements—both of which management prepares in accordance with SEC requirements. In turn, the board of directors, largely through the audit committee, exercises oversight of management's reporting and disclosures. The independent audit firm's responsibility is to express an opinion as to 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").

An essential element of the fundamental premise 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. Notwithstanding these core principles, the requirement in the Proposal for the auditor to report CAMs can put the auditor in the position of stepping into the shoes of

[5] In addition, the Proposal lists a number of other factors that the auditor should take into accounting in determining whether a matter is a CAM (see paragraph 9 (pages A1-7 to A1-8) of the Proposal).

management, becoming an original source of information, and disclosing otherwise confidential information.

Furthermore, CAMs can require auditors to report on matters that management is not required to include or otherwise disclose in the GAAP financial statements, footnotes, or elsewhere, such as MD&A. If the Proposal is approved, management and auditors could be forced to make such disclosures, including disclosing information that would not be considered material by a reasonable and prudent investor. Thus, in multiple ways, the Proposal overturns the fundamental premise of financial reporting and corporate governance disclosures.

The PCAOB's proposed auditor reporting on CAMs also undermines the financial reporting and disclosure frameworks of the SEC and FASB. As the Proposal is currently drafted, CAMs can necessitate auditors disclosing matters that the SEC or FASB has specifically decided that companies are *not* required to disclose. If the SEC has decided that certain information is not useful for investors, thereby not meeting the threshold for disclosure, as a matter of public policy the PCAOB cannot override the SEC's decision.

Examples of this conflict include matters such as weaknesses in internal control over financial reporting ("ICFR") that were appropriately determined to be significant control deficiencies, considerations of going concern that were appropriately addressed by mitigating factors, contingent liabilities that were fully considered and appropriately found not to require disclosure, etc.

The potential to undermine the SEC and FASB reporting and disclosure requirements also occurs because the Proposal appears to preclude the auditor from referencing OI disclosed by management, including OI in MD&A. To illustrate, the Proposal states that "for each critical audit matter communicated in the auditor's report the auditor must … refer to the relevant *financial statement accounts and disclosures* that relate to the critical audit matter, *when applicable*" (emphasize added).[6] In other words, it appears that the Proposal limits the auditor's reference to information in the GAAP financial statements and footnotes covered by the auditor's opinion. Such a limitation would also exacerbate financial reporting complexity.

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[6] *See* paragraph 11 of the Proposal (pages A1-8 to A1-9).

The Proposal provides illustrative examples of CAMs and auditor reporting thereon.[7] These illustrations are instructive. For example, among other issues, the examples suggest that investors and other users may interpret the disclosure of CAMs consistent with the auditor providing differential (lesser) assurance on some aspects of the financial statements and notes or otherwise equivocating on providing assurance on the financial statements (including GAAP notes) as a whole. This consequence appears likely notwithstanding statements in the Proposal that it is not appropriate for the auditor to use language that could be viewed as disclaiming, qualifying, restricting, or minimizing the auditor's responsibility for CAMs.[8]

Other problematic aspects of the Proposal in regards to CAMs include the following:

- CAMs would require the auditor to report on matters that were adequately and appropriately disclosed by management. In turn, this will likewise unnecessarily add to financial reporting complexity. It also raises the essential question of the usefulness of this information to investors and other financial statement users. The illustrative examples of CAMs included in the Proposal only reinforce this point.

- On the other hand, circumstances will arise when CAMs lack clarity and/or raise questions and there is no mechanism or venue for the auditor to respond. Again, confidentiality restrictions will likewise constrain the auditor. As a result, this puts the company and management 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.

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[7] *See* pages A5-65 through A5-78 of the Proposal.
[8] *See* the note following paragraph 11(c) (page A1-9) of the Proposal.

- CAMs are not limited to or grounded in matters communicated to or discussed with the audit committee.[9] On the one hand, it is difficult to fathom how a matter could be important enough to disclose to investors but not among those discussed with the audit committee—whether as part of required auditor communications or otherwise. On the other hand, it makes the list of potential CAMs vague, open-ended, and subject to second-guessing.

- It cannot be ruled out that mandating the disclosure of CAMs will have a chilling effect on the normal communication processes between the auditor and management and audit committees. 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.

- The potential for second-guessing of the auditor's determination of CAMs via PCAOB inspections, regulatory enforcement actions, and private securities actions is also exacerbated by other requirements in the Proposal. For example, the Proposal would require the auditor to document the basis for the determination that each reported matter was a CAM *and* to document the basis for determining that *non-reported* audit matters addressed in the audit, which would appear to meet the definition of a CAM, were not critical audit matters.[10]

- 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

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[9] In this regard, the PCAOB's Proposal is unlike the guidance on auditor reporting of key audit matters (KAMs) in the exposure draft of the International Auditing and Assurance Board ("IAASB") on *Reporting on Audited Financial Statements*. The Proposal states that CAMs *ordinarily* are matters required to be documented in the engagement completion document, reviewed by the engagement quality reviewer, communicated to the audit committee, or any combination thereof (see paragraph 8 (pages A1-6 to A1-7) of the Proposal.

[10] *See* paragraph 14 (page A1-10) of the Proposal.

when this is not the case; and so, the likelihood that the Proposal will result in situations where auditor reporting of CAMs delays the timely filing of information by companies cannot be ruled out.

- The audit committee represents investors and the audit committee has the responsibility under the Sarbanes-Oxley Act of 2002 ("SOX") for oversight and monitoring of the external audit. The implication of this SOX mandate is that actionable elements of issues involving CAMs would come under the purview of the audit committee. Furthermore, the Proposal fails to appreciate that the PCAOB has only recently issued new guidance on auditor communications with audit committees.[11] The Proposal does not give adequate time for this new guidance to be implemented and assessed through post-implementation review. The PCAOB should let the audit committee communication process work before considering any external communications by auditors.

- The reporting of CAMs is unlikely 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 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.

- Furthermore, investors and other users may make inappropriate inferences about the quality of a company's financial reporting and the nature of the audit based on the number of CAMs disclosed. For example, a "large" number of CAMs may be interpreted as consistent with a contentious audit. On the other hand, very few, if any, CAMs

[11] *See* PCAOB Auditing Standard No. 16, *Communications with Audit Committees*, effective for audits of fiscal years beginning on or after December 15, 2012.

> may be interpreted as consistent with a less thorough audit and/or auditors that lack skepticism and otherwise fail to challenge management.

V. Other Information ("OI")

It appears the PCAOB has determined that there is no meaningful support for auditor assurance on OI, including auditor assurance on MD&A. Therefore, the Proposal focuses on enhancing the auditor's responsibilities for and auditor reporting on OI. However, once again the threshold question comes to the fore as it seems that there is no meaningful demand to clarify or enhance the auditor's current responsibilities in regards to OI or to report thereon.

The Proposal includes new auditor responsibilities to read and evaluate OI for consistency of amounts with the financial statements; consistency of qualitative statements with the financial statements; comparability with relevant audit evidence obtained and conclusions reached; and mathematical accuracy. The Proposal also includes a new requirement for auditor reporting on OI. The Proposal would require that the auditor's report describe the auditor's responsibilities for other information and state whether the other information contains a material inconsistency, a material misstatement of fact, or both (based on the relevant audit evidence obtained and conclusions reached during the audit).

Unfortunately, the proposed reporting is likely to confuse rather than inform investors. First, the auditor is providing no assurance on OI. Yet the proposed auditor report implies there is some (new) level of service—called an "evaluation"—based on which the auditor is providing at least negative assurance with respect to OI. For example, illustrative language in the Proposal for the auditor's report includes: "Based on our evaluation, we have not identified a material inconsistency or a material misstatement of fact in the other information."[12] An oddity is that the Proposal would have auditors reporting on the results of what they do not do, as the OI is neither audited nor reviewed.

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[12] *See* paragraph 14(b) (page A2-7) of the Proposal.

Discussions at the PCAOB's November 2013 Standing Advisory Group ("SAG") meeting revealed very different views on what the auditor should reasonably know with regard to OI based on the relevant audit evidence obtained and conclusions reached during the audit. The Proposal does not sufficiently tie the auditor's responsibilities for OI to the financial statements. This will be a source of great confusion and may force auditors into the position of having to do additional work.

The Proposal also has auditors intruding into areas such as MD&A that are intended to be where management discusses the state of the business. In doing so, MD&A uses qualitative, non-financial, and forward looking information. Again, it makes no sense to require the auditor "to read and evaluate" these MD&A disclosures (or OI generally) not derived from the financial statements. Current PCAOB standards are appropriate in regards to the role and responsibilities for OI.

OI also includes proxy statements, which raises the practical question of how the auditor reports on information not yet issued (or necessarily fully available to the auditor) at the date of the auditor's report.

These points illustrate another of our concerns with the Proposal—namely that the PCAOB is potentially undermining the disclosure requirements of others, including the SEC.

In addition, the Proposal creates confusion as to the new performance standards. Discussions at the PCAOB's November 2013 SAG meeting suggested that the PCAOB intends to formalize current practice with respect to OI. Yet, there was a good deal of ambiguity and uncertainty expressed at the SAG meeting as to what it means to "read and evaluate" (proposed guidance) versus "read and consider" (current guidance). This confusion occurs notwithstanding the guidance in the Proposal in regards to "evaluate."

Discussions at the November 2013 SAG meeting also revealed differences of views on what constitutes a "material misstatement of fact" that falls within the intended purview of the Proposal and whether OI can involve immaterial information. All things considered, it appears that the Proposal significantly extends the auditor's responsibilities for OI and will have significant legal liability implications

for auditors that need to be understood and addressed. As it stands, the Proposal will only create an expectations gap with respect to auditor responsibilities for OI.

VI. Auditor Tenure and Independence

The Proposal calls for several other changes in the auditor's report, including disclosing auditor tenure (that is the year the auditor began serving consecutively as the company's auditor), disclosing auditor independence (that is stating that the auditor is required to be independent in accordance with federal securities laws and applicable rules and regulations of the SEC and PCAOB), and including various statements regarding the auditor's responsibilities related to fraud and the notes to the financial statements.

First, is not obvious that more information in the auditor's report on either independence or auditor tenure is necessary. As to auditor independence, the auditor's report is typically headed "Report of the Independent Registered Public Accounting Firm." Furthermore, the audit committee reports in the company's annual proxy statement about its oversight and monitoring of auditor independence matters. So, on the one hand, the need for any additional information in regards to auditor independence is not obvious. And, on the other hand, if there is a need, it is better addressed by other regulators such as the SEC.

As to auditor tenure, 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, again 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.

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 one Board member, the PCAOB "has not reached a conclusion regarding the relationship between audit quality and auditor tenure and the Board's inspection process has not been designed to determine a relationship between audit quality and auditor tenure." Thus, the PCAOB does not have "any

data indicating that audit tenure has any correlation with audit quality." Yet, "the mere fact that the Board requires a disclosure about audit tenure, however, might suggest that the Board believes the information to be meaningful."[13] By that token, as an example, anecdotal musings, by the SEC, of ethical lapses by attorneys would not pass muster for regulatory action requiring disclosure of law firm tenure by companies.

Lastly, we would like to reiterate that the CCMC supports working to achieve one set of global high quality auditing standards through the convergence of PCAOB auditing standards with those of the AICPA's Auditing Standards Board ("ASB") and the IAASB. Particularly when it comes to auditor reporting, one global model for mandated auditor reporting seems not only desirable but essential. We encourage the PCAOB to work with the IAASB and ASB to develop an appropriate model.

VII. Cost Benefit Analysis

The Proposal recognizes that the 2012 Jumpstart Our Business Startups ("JOBS Act") now makes economic analysis a necessary pre-condition for applying new PCAOB auditing standards to an audit of any emerging growth company (EGC). Specifically, JOBS Section 103(a) (3) requires that rules adopted by the Board after the date of enactment of the JOBS Act (in April 2012) shall not apply to an audit of any EGC, unless the Commission determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation. Notwithstanding that JOBS Act exempted EGCs from any subsequent standard-setting on AD&A and, therefore, EGCs would likewise be exempted from CAMs, the need for subjecting this initiative to robust economic analysis remains.

The CCMC recognizes that the PCAOB is soliciting information on the estimated costs and burdens that will be placed upon businesses and auditors as a result of the Proposal, and to solicit other information on how the Proposal would contribute to investor protection and promote efficiency, competition, and capital

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[13] *See Statement on Proposed Auditing Standards Regarding the Auditor's Report and the Auditor's Responsibilities Regarding Other Information"* by Jay D. Hanson, Board Member, PCAOB Open Board meeting on August 13, 2013.

formation. Further, the CCMC recognizes that the Proposal does not represent a final standard. Thus, additional evidence and analysis will occur and be reflected in any ensuing standard adopted by the Board and submitted for approval by the SEC.

Nonetheless, the CCMC suggests that the PCAOB needs an appropriate and transparent framework for economic analysis—one that will serve as a template for such analysis across all PCAOB rulemaking initiatives. One example of such a framework is the SEC staff memorandum, "Current Guidance on Economic Analysis in SEC Rulemakings" dated March 16, 2012.

Thus, the CCMC recommends that the PCAOB develop guidance on economic analysis for PCAOB rulemaking. Once developed, the PCAOB should expose the framework for public comment and the finalized framework should be publicly disclosed. As a starting point, the PCAOB could consider adapting the framework in the SEC staff memorandum to an audit context.

In addition, the framework should preclude reliance on generic economic arguments that could apply to almost any proposed auditing standard regardless of topic or substance. The framework should likewise discourage conjectures or speculative type arguments, including those related to reducing information asymmetries and cost of capital that are not grounded in credible evidence related to the specifics of the initiative at hand. The framework should also articulate an appropriate economic baseline against which to measure the proposed requirements likely economic impact.

Finally, in regards to this Proposal, if the PCAOB decides to proceed with this initiative in spite of all the concerns expressed about it, the PCAOB should recognized that auditor 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 the benefits and a determination that the benefits exceed the costs should a similar or revised auditor reporting standard be allowed to be re-implemented.

Conclusion

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

The CCMC continues to have serious concerns regarding the Proposal – namely, that the Proposal blurs lines of corporate governance, may create duplicative disclosures and may raise liability for auditors and businesses which ultimately harms investors. We believe that these issues should be addressed before the Proposal moves forward.

In the alternative, the CCMC believes that the PCAOB should work with the SEC and FASB to move forward on a broad agenda of financial reporting modernization as outlined in the CCMC's letter October 9, 2013 to SEC Chair Mary Jo White.

Thank you for your consideration and the CCMC stands ready to assist in these efforts.

Sincerely,

Tom Quaadman