Pennsylvania Institute of Certified Public Accountants

July 28, 2016

Public Company Accounting Oversight Board
Attention: Office of the Secretary
1666 K Street, NW
Washington, DC 20006-2803
comments@pcaobus.org

Re: PCAOB Release No. 2016-003 Docket 034: Proposed Auditing Standards on the Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards

The Accounting and Auditing Procedures Committee (the committee) of the Pennsylvania Institute of Certified Public Accountants (PICPA) appreciates the opportunity to comment on the proposed auditing standards update. The PICPA is a professional association of more than 20,000 members working to improve the profession and better serve the public interest. Founded in 1897, the PICPA is the second-oldest CPA organization in the United States. Membership includes practitioners in public accounting, education, government, and industry. The committee is composed of practitioners from both regional and small public accounting firms, members serving in financial reporting positions, and accounting educators. Our general comments are included below.

The committee believes that its Dec. 10, 2013, response to the PCAOB's previously issued exposure document remain valid to the re-exposed proposal. A copy of the committee's response to the original document is attached to this correspondence.

The committee appreciates that the PCAOB has restricted the definition of critical audit matters to matters communicated or required to be communicated to the audit committee and that relate to accounts or disclosures that are material to the financial statements. However, the committee remains concerned regarding the impact of the proposed requirements on the practitioner's ability to comply with legal obligations to maintain client confidentiality and independence, the risk of increased legal exposure, and the implementation costs.

1. Confidentiality – Most state CPA laws, as well as the AICPA Code of Conduct, require CPAs to maintain the confidentiality of their clients' information in the absence of specific permission to disclose. The definition of what is confidential is broad and generally encompasses all information that is not in the public domain. As further described below, the examples and wording included in the proposed standard seems to suggest a level of communication that goes beyond what a client normally disclosures. The committee is concerned that the proposed requirements would require CPAs to share nonpublic information with third parties, presenting threats to the practitioners' compliance with the confidentiality provisions within the Code.

- The definition of confidentiality extends to auditors' procedures. For example, without the client's consent, CPAs would be precluded from disclosing their audit methodology for a client's reserve process. However, the example for Company A provided within the release at pages 32-33 suggests that the auditor would describe the company's loan loss model in more detail than would normally be publicly available or included within the footnotes. The comment "since management has limited historical loss data for the nine-year loans…" might not be included in the footnotes or other publicly available information. To comply with confidentiality rules, the auditor would be precluded from communicating this kind of information in the absence of the client's permission.

- Some internal control or IT issues might be identified as critical audit issues, but may not have represented a condition required to be reported in the internal control report or otherwise disclosed publicly by management.

- Note 2 on page A1-9 specifically indicates that the auditor would not be required to provide information about the company that has not been made publicly available by the company "unless such information is necessary to describe the principal considerations that led the auditor to determine that a matter is a critical audit matter or how the matter was addressed in the audit." The committee believes that this requirement is in direct conflict with a CPA's legal confidentiality requirements.

2. Independence – The Committee believes that the proposed opinion increases the likelihood of adverse interest challenges, threatening practitioners' compliance with the independence rules included within the SEC rules, state CPA statutes, PCAOB guidance, and AICPA professional standards and Code of Professional Conduct.

   Requiring public disclosure of the type of information proposed by the PCAOB could result in adversarial type challenges by clients dissatisfied with certain disclosures. The client could disagree with an auditor's judgement on the materiality of a particular issue and challenge the release of specific information. The client could also challenge the auditor's wording, leading to significant wordsmithing. Concern over challenges such as these could lead to unwarranted auditor compromise solely to secure the client's permission to provide information to company stakeholders. The committee does not believe that the risk of such compromise is in the best interest of the client/auditor relationship, and does not think it would lead to greater transparency and enhanced value to financial statement users.

3. Misunderstanding and Legal Liability – The committee is concerned regarding the potential increased liability that could result from financial statement users' misunderstanding of and overreliance on the proposed critical audit matters.

   Comments such as the following from page 71 of the proposal clearly raise the concern that financial statement users may rely more on these matters than their actual nature and limitations warrant. "Some commenters stated that the communication of critical audit matters would focus the users' attention on issues that would be pertinent to understanding the financial statements for purposes of investment decisions or financial analysis." A critical audit matter may, or may not, represent an appropriate indicator upon which to make an investment decision, or predictor of the future health of the company.

Despite the revisions to the original proposal, the committee still believes that practitioners will use a lower threshold for reporting critical matters to deter the threat of litigation for failure to identify a specific matter as critical. Practitioners may also believe that adopting standardized language will provide safeguards against charges of inadequate disclosure.

4. Cost, Training, Communication – The committee questions the merit of the costs that will be incurred for outreach and communication to clients and financial statement users and for training of the staff of the public accounting firms that will result from adoption of the proposed audit reporting model. The committee does not perceive these as being value-added costs.

While the committee does not agree that the auditors should be required to publicly communicate confidential client information, there is nothing to preclude greater transparency by the audit committee. A separate communication of critical audit matters uncovered during the audit with a corresponding confirmation of these items from the external CPA is a reasonable approach. This approach would encourage improved audit committee/auditor communications and greater audit committee involvement, eliminate the threats to the CPA's compliance with the confidentiality and independence rules, reduce liability resulting from misunderstanding of the wording in the audit opinion, and reduce the overall cost of compliance over the proposed approach.

We appreciate your consideration of our comments, and members of the committee are available to discuss any of these with you at your convenience.

Sincerely,

Robert E. Williams, CPA
Chair, PICPA Accounting and Auditing Procedures Committee

ATTACHMENT - Committee's Response to the PCAOB Release No. 2013-005 Docket 034: Proposed Auditing Standards on the Auditor's Report and the Auditor's Responsibilities Regarding Other Information and Related Amendments

December 10, 2013

Public Company Accounting Oversight Board
Attention: Office of the Secretary
1666 K Street, NW
Washington, DC 20006-2803
comments@pcaobus.org

Re: PCAOB Release No. 2013-005 Docket 034: Proposed Auditing Standards on the Auditor's Report and the Auditor's Responsibilities Regarding Other Information and Related Amendments

The Accounting and Auditing Procedures Committee (the committee) of the Pennsylvania Institute of Certified Public Accountants (PICPA) appreciates the opportunity to comment on the proposed auditing standards revisions. The PICPA is a professional association of more than 20,000 members working to improve the profession and better serve the public interest. Founded in 1897, the PICPA is the second-oldest CPA organization in the United States. Membership includes practitioners in public accounting, education, government, and industry. The committee is composed of practitioners from both regional and small public accounting firms, members serving in financial reporting positions, and accounting educators.

Section I. 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.

The committee understands that financial statement users would like greater transparency from companies and are looking to the auditors for this additional information. However, the committee disagrees with the underlying concept and role being proposed for the auditor in this proposal. The committee believes that the proposed communications are fundamentally flawed, are in direct conflict with professional ethics standards, and would not result in meaningful communication to the financial statement user.

1. As the requirement to communicate critical audit matters would likely greatly increase the auditor's practice management exposure, it is unclear which risk areas that an auditor would be willing to leave out. As a result, the audit report would likely become a lengthy document noting all risk areas material and immaterial. Standardization would likely result, as each firm looking to manage its practice risk would centralize and standardize the communication process. The value of the proposed communications is questionable, as the end result would be a lengthy document that would read like an audit textbook.

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2. The auditor is not permitted by many state statues and the AICPA Code of Professional Conduct to release confidential client information without the client's permission. The Code defines confidential client information as follows:

"ET Section 92 – Definitions .05 Confidential client information. Confidential client information is any information obtained from the client that is not available to the public. Information that is available to the public includes, but is not limited to, information

- in a book, periodical, newspaper, or similar publication;
- in a client document that has been released by the client to the public or that has otherwise become a matter of public knowledge;
- on publicly accessible websites, databases, online discussion forums, or other electronic media by which members of the public can access the information;
- released or disclosed by the client or other third parties in media interviews, speeches, testimony in a public forum, presentations made at seminars or trade association meetings, panel discussions, earnings press release calls, investor calls, analyst sessions, investor conference presentations, or a similar public forum;
- maintained by, or filed with, regulatory or governmental bodies that is available to the public; or
- obtained from other public sources.

Unless the particular client information is available to the public, such information should be considered confidential client information.

Members are advised that federal, state, or local statutes, rules, or regulations concerning confidentiality of client information may be more restrictive than the requirements contained in the Code of Professional Conduct."

3. As the audit firm would be precluded from communicating any confidential client information, the client would have to approve the final wording of the audit report, including information about audit difficulties, negating the overall value of the communication. The auditors would likely involve their attorneys and the final audit opinion would result from a negotiation process involving the auditor, attorneys representing both parties, public relations specialists, and key members of a client's management. The process for issuing an audit opinion would not only be untenable, but if the process results in an adversarial situation, the auditor could lose independence and become unable to issue the opinion.

The auditor's role is to provide an opinion on the fairness of the financial statement presentation, not to provide communications regarding the overall health of the audited entity. If greater transparency is needed, the committee believes that financial statement users should look to the company's management for additional information (e.g., the "important information concerning the company, the company's environment, and the preparation of the company's financial statements" that is noted in the introduction to the proposal). If the financial statement users cannot ascertain this important information from the financial statements, then the communications included in the financial statements should be enhanced. The committee does not agree that the fundamental role of the auditor should change to correct a deficiency in financial reporting requirements.

Ultimately, the committee is supportive of proposed changes that would better communicate to the financial statement user the nature and limitations of an audit. The committee, for example, suggests that any proposed change to the audit report seek to minimize the gap between what financial statement users expect from the audit and what the audit is designed to accomplish. For example, improvements to the opinion could focus on further explaining the roles and responsibilities of the auditor and the audited entity's management, and that the audit is not designed to detect fraud due to the nature of fraud and the scope of the audit. The committee recommends that the PCAOB consider the findings included in the 103rd American Assembly Report, "The Future of the Accounting Profession," The American Assembly, Columbia University, which included tailoring the attestation level for the nature of the financial statement to remove the "illusion of exactitude." Two specific suggestions are as follows:

- More limited attestation on subjective judgments (e.g. accounting estimates and fair value determinations) instead verify reasonableness of process used.
- A new audit opinion to permit the external auditors to adhere to different attestation standards for different parts of the financial statements.

Section II. 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.

The question infers that the length of the auditor's tenure has a definite and measurable impact on the quality of the audit, with the longer the tenure the less the quality. The committee disagrees with this premise and believes that audit quality is lessened with mandatory firm rotation.

Section III. 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, whether due to error or fraud.

The committee supports the changes included in this area.

We appreciate your consideration of our comments, and members of the committee are available to discuss any of these with you at your convenience.

Sincerely,

Pennsylvania Institute of Certified Public Accountants

Richard E. Wortmann, CPA
Chair, PICPA Accounting and Auditing Procedures Committee