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Via e-mail: [comments@pcaobus.org](mailto:comments@pcaobus.org)

Office of the Secretary  
PCAOB  
1666 K Street, N.W.  
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 034

Proposed Auditing Standards –

1. The Auditor's Report on an Audit of Financial Statements when the Auditor Expresses an Unqualified Opinion;
2. The Auditor's Responsibility Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report.

The Accounting Principles and Auditing Standards Committee (the "Committee") of the California Society of Certified Public Accountants ("CalCPA") respectfully submits its comments on the referenced proposal. The AP&AS Committee is the senior technical committee of CalCPA. CalCPA has approximately 40,000 members. The Committee is comprised of 53 members, of whom 47 percent are from local or regional firms, 27 percent are from large multi-office firms, 12 percent are sole practitioners in public practice, 10 percent are in academia and 4 percent are in international firms. Members of the Committee are with firms which serve a large number of public and nonpublic business entities, as well as many non-business entities such as NFP's, pension plans and governmental organizations.

#### **The Committee's Overall Comments**

The Committee appreciates this opportunity to comment on the PCAOB's very significant auditor reporting proposals. While the Committee has provided its responses to the specific questions set forth in the proposed reporting standards, we also want to address a global concern. The two proposed auditing standards have as their goal the retention of the current "pass-fail" audit reporting model, with significant expansion of responsibilities for reporting on critical audit matters and on other information. The Committee believes this approach is seriously flawed for the following reasons:

First, requiring the auditor to report on critical audit matters results in a perceived difference in audit quality when none should exist. Each audit conducted in accordance with PCAOB Standards includes an assessment of the business in which the entity operates and the control risk within the entity, and addresses the audit risks that result from such assessments. In reporting critical audit matters, the users of the audit report do not learn whether such assessments were properly carried out or adequately addressed, nor do they learn any more about the business or control risks than is currently reported in other information filed with the Securities and Exchange Commission (the "Commission") and made public to users. Accordingly, an audit report that identifies many critical audit matters may be perceived to be

of higher quality than a report with few such matters identified when the opposite may be true. In addition, an audit report that identified many critical audit matters may be perceived to reflect more difficulty in arriving at an opinion that the financial statements are fairly presented in accordance with accounting principles generally accepted in the United States of America ("US GAAP") which may also be untrue.

Second, identifying critical audit matters would duplicate disclosures already in annual reports under risk factors, management's discussion and analysis and summary of significant accounting policies, which are often currently duplicative. Since the auditor's report will only appear in annual reports containing all these disclosures, adding critical audit matters to the auditor's report would be duplicative and unnecessary.

Third, requiring the auditor to report on the other information associated with the filing of the annual report for material inconsistencies and/or a material misstatements of fact results in perceived assurance on such information that the auditor cannot provide. PCAOB Standards require the auditor to compare such information to the audited financial statements, but there are significant additional disclosures in other information, including forward-looking information and information requiring technological, marketing and other skills not possessed by most auditors, that prevent the auditor from being able to reasonably assess whether they meet the Commission's requirements. Accordingly, an audit report that fails to identify any material inconsistencies and/or material misstatements of fact provides no assurance to the user of that other information that it is, in fact, free of misstatements.

Fourth, the proposed requirements for the auditor to report on other information are unclear as to the scope of assurance the auditor might be providing, and the proposed requirements, to the extent they deal with misstatements of fact, are beyond the professional competence of auditors.

## **Auditor's Report**

### **Question Related to Section II Objectives:**

- 1. Do the objectives assist the auditor in understanding the requirements of what would be communicated in an auditor's unqualified report? Why or why not?**

The objectives of the proposed auditor reporting standard are appropriately set forth. However, the Committee believes additional clarity is required in order to implement the Board's proposal to communicate critical audit matters, as the definition is inherently subjective, and unlikely to be consistently applied in practice.

### **Questions Related to Section IV Basic Elements:**

- 2. The proposed auditor reporting standard would require the auditor's report to be addressed at least to (1) investors in the company, such as shareholders, and (2) the board of directors or equivalent body. Are there others to whom the auditor's report should be required to be addressed?**

No. The report should be addressed to the Company's Board of Directors (the Audit Committee having responsibility to contract with the auditors) and the shareholders. Since the report is a publicly available document, the report does not need to be addressed to other possible users.

- 3. The proposed auditor reporting standard retains the requirement for the auditor's report to contain a description of the nature of an audit, but revises that description to better align it with the requirements in the Board's risk assessment standards. Are there any additional auditor responsibilities that should be included to further describe the nature of an audit?**

No. The Board's proposed revision regarding describing the nature of the audit is sufficient.

- 4. The proposed auditor reporting standard would require the auditor to include a statement in the auditor's report relating to auditor independence. Would this statement provide useful information regarding the auditor's responsibilities to be independent? Why or why not?**

No. The Board's proposal is somewhat redundant, since the title of the report already includes the word "independent", and the report goes on to state the audit was performed in accordance with PCAOB audit standards, which sets forth independence requirements.

- 5. The proposed auditor reporting standard would require the auditor to include in the auditor's report a statement containing the year the auditor began serving consecutively as the company's auditor.**

- a. Would information regarding auditor tenure in the auditor's report be useful to investors and other financial statement users? Why or why not? What other benefits, disadvantages, or unintended consequences, if any, are associated with including such information in the auditor's report?**

No. We do not believe the information on auditor tenure is particularly useful, and serves only to satisfy idle curiosity. It is not clear what inferences can be correctly drawn from the length of an auditor's tenure, so the information is not considered useful.

- b. Are there any additional challenges the auditor might face in determining or reporting the year the auditor began serving consecutively as the company's auditor?**

No, but the requirement should make clear that if the auditor of an acquired entity becomes the auditor of the acquirer, its tenure be measured from when it became auditor of the acquirer.

- c. Is information regarding auditor tenure more likely to be useful to investors and other financial statement users if included in the auditor's report in addition to EDGAR and other sources? Why or why not?**

No. We do not believe the information on auditor tenure is useful.

6. **The proposed auditor reporting standard would require the auditor to describe the auditor's responsibilities for other information and the results of the evaluation of other information. Would the proposed description make the auditor's report more informative and useful? Why or why not?**

The Committee, in responding to the Concept Release, stated its opposition to the auditor providing any required assurance on other information. The Committee was concerned that any form of assurance provided to general users of the financial statements, either directly or indirectly, that the other information is complete or complies with applicable rules and regulations was likely to be misunderstood. The Committee continues to hold that view, in spite of the PCAOB's more modest current proposal, and finds the proposal's requirement to have the auditor address "misstatements" objectionable.

The Committee believes the PCAOB's proposed reporting requirement is beyond the professional competence of the auditor. Currently, the auditor is accountable for determining if there is an inconsistency between the financial statements and the other information, and reconciling them (AU 551). If requested to provide a report on the other information, the report would state that the other information "is fairly stated in all material respects in relation to the basic financial statements taken as a whole" (AU 552). The current PCAOB proposal goes a step further by requiring the auditor to state that there is no material misstatement of fact in the other information. This is a significant expansion of the auditor's responsibility, and is a far broader conclusion than can be drawn based on performing the procedures set forth in paragraph 4 on page A-2. In addition, the determination of the accuracy of the factual content of the other information is a legal matter, generally beyond the professional competence of the auditor. Further, a misstatement of fact may exist because the other information presented is wrong, or because relevant information is not presented; the auditor currently is not required to search for information that may be missing, and may not be competent to know that it is missing. Therefore, we recommend the current proposal, at a minimum; remove the requirement for the auditor to address whether the other information contains a material misstatement of fact.

"Other Information" should be limited to historical information included in or amounts derived from historical information included in the financial statements. In no circumstances should the auditor have any association with any prospective financial data.

The scope of assurance given by the auditor when saying they "have not identified any material inconsistency with the financial statements" is very unclear. There is no basis for the auditor to say that any individual amounts in the financial statements are correct, since the materiality threshold is the financial statements taken as a whole, and no other materiality threshold for the other information is set forth. Further, it is unlikely that any individual amount will, by itself, be materially inconsistent with the financial statements, so is the auditor's assurance based on a lack of a pattern of inconsistency that is in the aggregate material? While clarification might be desirable, this may be the essential flaw in the PCAOB's proposal for reporting on other information.

For the foregoing reasons, the Committee is opposed to the proposed requirement to report on other information.

7. **Should the Board require a specific order for the presentation of the basic elements required in the auditor's report? Why or why not?**

No. The Committee believes the current proposal, which provides flexibility in the presentation of the basic elements required in the auditor's report, is appropriate.

8. **What other changes to the basic elements should the Board consider adding to the auditor's report to communicate the nature of an audit, the auditor's responsibilities, the results of the audit, or information about the auditor?**

No additional changes need to be considered.

9. **What are the potential costs or other considerations related to the proposed basic elements of the auditor's report? Are cost considerations the same for audits of all types of companies? If not, explain how they might differ.**

The Committee believes that audit costs will likely increase by at least ten percent or as high as twenty five percent or more as a result of reporting on critical audit matters and by a substantially greater amount if reporting on other information which contains a material misstatement of fact.

**Questions Related to Section V Critical Audit Matters:**

10. **Would the auditor's communication of critical audit matters be relevant and useful to investors and other financial statement users? If not, what other alternatives should the Board consider?**

No. The proposed content of the critical audit matters section of the auditor's report can be expected to duplicate all or most of the topics already covered in the "risk factors" section of periodic financial statements filed with the SEC along with the content of management's discussion and analysis and summary of significant policies. The information in these topics is already available to users of financial statements, and it does not significantly enhance the understanding of the financial statements. So, it is questionable whether the auditor's reporting of specified critical audit matters will add anything to the information already considered by the users of the financial statements and raises the additional question of whether the additional work to add critical audit matters to the auditor's report is cost-beneficial.

It is also unclear whether adding critical audit matters to the auditor's report will be useful since the matters to which they relate will have been resolved before publication of the financial statements or will be explained in an exception in the auditor's report. The coverage of critical audit matters in the auditor's report can be expected to be brief and even cryptic; questions about critical audit matters from users can be expected to be addressed to management, who may be able to respond, but responses, particularly as to the content of the auditor's report, may be incomplete since the auditor's report is not prepared by the respondent. The auditor cannot be expected to respond beyond what is in the audit report. So, while the discussion of critical audit matters might be interesting to some users, its usefulness seems marginal at best.

**11. What benefits or unintended consequences would be associated with the auditor's communication of critical audit matters?**

The Committee sees several consequences, the first unintended, the second foreseeable and undesirable.

First, questions and comments from regulators concerning the auditor's determination of critical audit matters can be expected, perhaps with the benefit of hindsight, and these can be extremely burdensome, both to those charged with governance and to the auditors, particularly if regulators do not agree with the auditors and demand restatement of the auditor's report. Differences of professional opinion between auditors and regulators are not unusual. Client reaction is often to try to respond and satisfy the regulators, but if that process bogs down, to acquiesce to the regulators even if the regulators position is not correct. The cost of this additional regulatory involvement could significantly offset any perceived benefits of the discussion of critical audit matters.

Second, the Committee believes that critical audit matters can be expected to become a focus of the plaintiff's bar in asserting claims against auditors. The fact that something is considered "key" by the auditors in a public document raises the bar higher than it is right now where such information is found only in the audit workpapers and communication to those charged with the entity's governance. It may cause each key matter to assume a materiality of its own, outside of the context of materiality associated with the audit of the financial statements. The Committee believes this is a potential undesirable result.

In addition, and notwithstanding the use of the word "most," there is a danger that the number of critical audit matters could expand substantially beyond that apparently intended by the PCAOB. One only needs to look to the discussion of "risk factors" which has grown over time to a multi-page exposition of almost any adverse event that an issuer may encounter.

**12. (a) Is the definition of a critical audit matter sufficient for purposes of achieving the objectives of providing relevant and useful information to investors and other financial statement users in the auditor's report? (b) Is the definition of a critical audit matter sufficiently clear for determining what would be a critical audit matter? (c) Is the use of the word "most" understood as it relates to the definition of critical audit matters?**

The Committee believes that paragraph 8 of the proposed auditor reporting standard creates certain boundaries regarding the identification of critical audit matters as a matter that ordinarily would be included in the engagement completion memo, reviewed by the engagement quality reviewer and communicated to audit committee (or a combination of the three).

The PCAOB definition of critical audit matters focuses on various "difficulties" encountered in an audit. The actual level of difficulty can vary substantially based on the issue itself and the knowledge and experience of the auditor or the audit team, with those with less knowledge and experience likely encountering more difficulty and those with more knowledge and experience encountering no difficulty at all. The Committee recommends the Board set forth discussion of an additional factor which focuses on audit risk and significant modifications to the audit approach (indicative of audit difficulties); these are less subjective and likely would elicit more consistency in designating a matter as a critical audit matter.

In addition, the Committee believes it would be useful to resolve the inconsistency between the IAASB proposal on “key audit matters” and the PCAOB’s factors, set forth in Paragraph 9, to consider in determining critical audit matters. The IAASB refers to significant audit risks, significant difficulty encountered in the audit or significant modifications in the audit approach. The PCAOB refers to matters which (1) involved the most difficult, subjective, or complex auditor judgments (2) posed the most difficulty to the auditor in obtaining sufficient appropriate evidence; or (3) posed the most difficulty to the auditor in forming an opinion on the financial statements. The definitions differ, and are reasonably likely to elicit the identification of different issues, which will complicate compliance by those auditors who are required to comply with both audit standards.

- 13. Could the additional time incurred regarding critical audit matters have an effect on the quality of the audit of the financial statements? What kind of an effect on quality of the audit can it have?**

The Committee believes the proposed new requirements will impact the quality of the audit and not all of the impacts will be positive. Auditors will have to spend time evaluating what matters to discuss and then carefully draft the discussion in the auditor’s report. This process will undoubtedly involve the most senior level personnel on the audit team, technical departments and possibly in-house counsel. The concern for the litigation exposure resulting from not discussing a matter, or not being sufficiently robust in the discussions of matters will add significant time to the audit process and could complicate the timeline required to file timely. To allow for sufficient time for the drafting and review of the critical audit matters, the audit work process related to these matters will have to be completed earlier and probably under considerable time pressure. In general, such conditions do not result in the best audit work.

- 14. Are the proposed requirements regarding the auditor’s determination and communication of critical audit matters sufficiently clear in the proposed standard? Why or why not? If not, how should the proposed requirements be revised?**

The Committee believes the proposed requirements are clear enough to be operational even though inherently subjective language is used throughout.

- 15. Would including the audit procedures performed, including resolution of the critical audit matter, in the communication of critical audit matters in the auditor’s report be informative and useful? Why or why not?**

No. The Committee believes this is a wholly unrealistic suggestion. Including the audit procedures related to the specific critical audit matters within the auditor’s report could be deemed by a reader to be a separate opinion on the identified critical audit matters, which is contrary to current PCAOB audit standards.

- 16. Are the factors helpful in assisting the auditor in determining which matters in the audit would be critical audit matters? Why or why not?**

Yes, but as noted previously, they are inherently subjective.

- 17. Are there other factors that the Board should consider adding to assist the auditor in determining which matters in the audit would be critical audit matters? Why or why not?**

Please see the Committee's response to Question 12. Both the IAASB and PCAOB proposed requirements are reasonably clear, but it would be useful if they were the same.

- 18. Is the proposed requirement regarding the auditor's documentation of critical audit matters sufficiently clear?**

Yes.

- 19. Does the proposed documentation requirement for non-reported audit matters that would appear to meet the definition of a critical audit matter achieve the Board's intent of encouraging auditors to-consider in a thoughtful and careful manner whether audit matters are critical audit matters? If not, what changes should the Board make to the proposed documentation requirement to achieve the Board's intent?**

The PCAOB should not establish any specific documentation requirements beyond requiring that audit documentation be adequate in the circumstances. The exercise of the auditor's professional judgment should determine what is needed.

- 20. Is the proposed documentation requirement sufficient or is a broader documentation requirement needed?**

Please see the Committee's response to questions 18 and 19.

- 21. What are the additional costs, including indirect costs, or other considerations related to the auditor's determination, communication, and documentation of critical audit matters that the Board should take into account? Are these costs or other considerations the same for all types of audits?**

The Committee believes that incremental audit costs to be paid by clients will be proportionate and directly related to the complexity of the audit. As the Committee noted in its response to Question 9, there will be additional time incurred by the audit team and then by every layer of review from above, plus consultation time with technical reviewers, national office personnel, in-house counsel, and discussions with management, audit committees and others charged with governance. The Committee believes the nature of the costs will be the same for all audits.

The Committee would expect that audit firms will also incur substantial one-time implementation costs of developing firm internal guidance, templates and training. In addition, audit firms will likely develop outreach programs to discuss the significant changes arising from the two new reporting standards for those charged with governance. These costs would be expected to be passed on to audit clients over time.



- 22. What are the additional costs, including indirect costs, or other considerations for companies, including their audit committees, related to critical audit matters that the Board should take into account? Are these costs or other considerations the same for audits of both large and small companies?**

The Committee believes that indirect costs can be considerable, but will likely fall more heavily in most cases on management, who must deal directly with the auditor on the content of the auditor's report before it is presented to the audit committee. There may not be nearly as much incremental time for the audit committee, since they likely would be informed of all or most critical audit matters under the existing PCAOB audit requirements to communicate details related to the audit plan.

- 23. How will audit fees be affected by the requirement to determine, communicate, and document critical audit matters under the proposed auditor reporting standard?**

Please refer to the Committee's responses to Questions 9, 21 and 22 above.

- 24. Are there specific circumstances in which the auditor should be required to communicate critical audit matters for each period presented, such as in an initial public offering or in a situation involving the issuance of an auditor's report on a prior period financial statement because the previously issued auditor's report could no longer be relied upon? If so, under what circumstances?**

The Committee believes it is appropriate to communicate critical audit matters for all periods presented only if the audited financial statements have never been publicly available, or if they are being reissued because previously issued financial statements were no longer reliable. Critical audit matters can normally be expected to be largely the same from year to year, except for critical audit matters related to non-recurring transactions and changes in the business. Therefore, there is no need to be repetitive.

- 25. Do the illustrative examples in the Exhibit to this Appendix provide useful and relevant information of critical audit matters and at an appropriate level of detail? Why or why not?**

The Committee believes the examples are generally appropriate, as they illustrate what the PCAOB has in mind. However, all three of these illustrative matters would have been discussed by the client under risk factors and significant accounting policies and also likely in the MD&A section, so the inclusion as a critical audit matter will likely add nothing to the information available to investors. The Committee believes that investors are more interested in information than in the audit process used to form the final conclusion on the individual matters.

However, the Committee believes the wording in the auditor's report examples is far too lengthy. It needs to be reduced substantially if anyone expects users to read it. Bear in mind that financial statements are already being criticized as being so long that few people actually read them.

In example C, the results of audit procedures should not be included. The inference is that there were no other errors, and that should not be something that a reader might be led to infer.

- 26. What challenges might be associated with the comparability of audit reports containing critical audit matters? Are these challenges the same for audits of all types of companies? If not, please explain how they might differ.**

The Committee believes that audit reports containing critical audit matters ought to be reasonably comparable within a specific industry. Of course, the exercise of professional judgment by the auditor in evaluating the critical audit matters for significance would have to be communicated in the report. The Committee believes these challenges are similar across all industries.

- 27. What benefits or unintended consequences would be associated with requiring auditors to communicate critical audit matters that could result in disclosing information that otherwise would not have required disclosure under existing auditor and financial reporting standards, such as the examples in this Appendix, possible illegal acts, or resolved disagreements with management? Are there other examples of such matters? If there are unintended consequences, what changes could the Board make to overcome them?**

Many issues not currently subject to disclosure could be considered critical audit matters. For example, potential litigation, a fraud investigation (resolved satisfactorily), or confidential inquiries from government agencies. To expand the “disclosure” requirements, by shifting the burden to the auditor to identify and then disclose such information as a critical audit matter in the audit report, is unreasonable. Under the circumstances, the Committee believes the entity has the disclosure obligation, or there should be no disclosure. And, if there is already a disclosure obligation, then the critical audit matters add little or nothing to the information already available.

- 28. (a) What effect, if any, would the auditor’s communication of critical audit matters under the proposed auditor reporting standard have on an auditor’s potential liability in private litigation? (b) Would this communication lead to an unwarranted increase in private liability? (c) Are there other aspects of the proposed auditor reporting standard that could affect an auditor’s potential liability in private litigation? (d) Are there steps the Board could or should take to mitigate the likelihood of increasing an auditor’s potential liability in private litigation?**

The Committee presents the following responses to the specific questions:

- (a) The expansion of the auditor’s report to include both critical audit matters and other information is highly likely to expand the risk of the auditor being drawn into private litigation if a plaintiff were to attempt to claim the auditor did not go far enough in dealing with a specific critical audit matter.
- (b) Yes, consistent with our response to (a) above.
- (c) The Board’s proposed expansion of the audit report, under the assumption that such information will meet the investors’ need for information, has limitless negative consequences to the auditor’s potential liability. There is no end to what an investor can argue should have been discussed as a critical audit matter, and that the auditor is liable for either not discussing it and/or coming to the wrong conclusion.
- (d) Any steps the Board, or the SEC (possible safe harbor?), could take in considering ways to mitigate the likelihood of increasing the auditor’s potential liability ought to be considered.

**Questions Related to Section VI Explanatory Language:**

- 29. Is it appropriate for the Board to include the description of the circumstances that would require explanatory language (or an explanatory paragraph) with references to other PCAOB standards in the proposed auditor reporting standard?**

The Committee believes it is appropriate for the Board to include this guidance.

- 30. Is retaining the auditor's ability to emphasize a matter in the financial statements valuable? Why or why not?**

The Committee recommends the Board provide the auditors with the continuing ability to emphasize a particular matter, such as a material subsequent event.

- 31. Should certain matters be required to be emphasized in the auditor's report rather than left to the auditor's discretion? If so, which matters? If not, why not?**

The Committee believes the examples included in paragraph 16. a-f of the proposed auditor reporting standard provide sufficient guidance, and no specific matters should be required to be emphasized.

- 32. Should additional examples of matters be added to the list of possible matters that might be emphasized in the auditor's report? If so, what matters and why?**

Additional examples are not required to convey the Board's intent with regard to the matters the auditor might choose to emphasize.

**Questions Related to Section VII Conforming Amendments:**

- 33. Are the proposed amendments to PCAOB standards, as related to the proposed auditor reporting standard, appropriate? If not, why not? (b) Are there additional amendments to PCAOB standards related to the proposed auditor reporting standard that the Board should consider?**

- (a) Yes
- (b) No

- 34. What are the potential costs or other considerations related to the proposed amendments? Are these cost considerations the same for all types of audits? If not, explain how they might differ.**

Please refer to the Committee's responses to Questions 9, 21 and 22 above with regard to the overall economic costs of adopting the proposed auditor reporting standard.

**Questions Related to Section VIII Specific Entities:**

- 35. Are the proposed auditor reporting standard and amendments appropriate for audits of brokers and dealers? If yes, are there any considerations that the Board should take into account with respect to audits of brokers and dealers?**

The Committee believes the proposed auditor reporting standard should only be applied to brokers and dealers who are considered issuers as such companies have a reporting responsibility to stockholders and prospective investors. The Committee understands that most brokers and dealers are closely or privately held, and subject to specific operating rules and regulations so the proposed reporting standard would be unnecessary.

- 36. Is the requirement of the proposed auditor reporting standard to communicate in the auditor's report critical audit matters appropriate for audits of brokers and dealers? If not, why not?**

See the Committee's response to question 35 above.

- 37. Since a broker or dealer may elect to file with the SEC a balance sheet and related notes bound separately from the annual audited financial statements, should the Board address situations in which the auditor may issue two different reports for the same audit of a broker or dealer? Why or why not?**

See the Committee's response to question 35 above.

- 38. Are the proposed auditor reporting standard and amendments appropriate for audits of investment companies? If yes, are there any considerations that the Board should take into account with respect to auditors' reports on affiliated investment companies, as well as companies that are part of master-feeder or fund of funds structures?**

The Committee believes the proposed auditor reporting standard should only be applied to investment companies who are considered issuers as such companies have a reporting responsibility to stockholders and prospective investors. The Committee understands that many investment companies are closely or privately held, and subject to specific operating rules and regulations so the proposed reporting standard would be unnecessary.

- 39. Are the proposed auditor reporting standard and amendments appropriate for audits of benefit plans? If yes, are there any considerations that the Board should take into account with respect to audits of benefit plans?**

The Committee believes the proposed auditor reporting standard should only be applied to benefit plans that are considered issuers as such companies have a reporting responsibility to stockholders and prospective investors. The Committee understands that most pension plans are closely or privately held, and subject to specific operating rules and regulations so the proposed reporting standard would be unnecessary.

- 40. Should audits of certain companies be exempted from being required to communicate critical audit matters in the auditor's report? Why or why not?**

As stated in our responses to questions 35-39 above, the proposed additional reporting requirements should only be applied to companies that are considered issuers.

**Questions Related to Section X Effective Date:**

- 41. Is the Board's effective date appropriate for the proposed auditor reporting standard? Why or why not?**

The Committee believes the Board has provided sufficient time to apply the new standard.

- 42. Should the Board consider a delayed compliance date for the proposed auditor reporting standard and amendments or delayed compliance date for certain parts of the proposed auditor reporting standard and amendments for audits of smaller companies? If so, what criteria should the Board use to classify companies, such as non-accelerated filer status? Are there other criteria that the Board should consider for a delayed compliance date?**

The Committee recommends the Board consider a delayed effective date for non-accelerated filers, and also consider soliciting feedback from the auditors and users of the initial group of accelerated filers who would initially apply the new auditor reporting standard.

**Other Information**

The Committee is opposed to the proposed requirement that auditors report on other information as set forth in our response to Question 6 to the PCAOB's Auditor's Report section above.

**Questions Related to Section I Introduction:**

- 1. (a) Is the scope of the proposed other information standard clear and appropriate? Why or why not? (b) Are there Exchange Act documents, other than annual reports, that the Board should consider including in the scope of the proposed other information standard?**

(a) The Committee believes the scope of the other information standard is unclear. Much data, including that filed with the SEC, are made available on company websites, in some cases directly, in other cases by a link to the EDGAR database; it appears the former is not covered by the proposed standard, but the latter is; we question whether this makes any sense. And if the "glossy" annual report is partially incorporated by reference, readers will have difficulty sorting out what is covered and what is not; this seems to make little sense.

(b) The Committee believes the proposed other information standard should be limited to annual reports.

- 2. (a) Is it appropriate to apply the proposed other information standard to information incorporated by reference? Why or why not? (b) Are there additional costs or practical issues with including information incorporated by reference in the scope of the proposed other information standard? If so, what are they?**

(a) The Committee believes the proposed other information standard should be restricted to information that is expressly included in the document which includes the audited financial statements.

(b) The Committee believes there are substantial incremental costs associated with requiring the auditor to include other information incorporated by reference within the scope of the proposed other information standard, along with the practical difficulties of identifying such information, which may have changed since the date the auditor's report was issued.

3. **Is it appropriate to apply the proposed other information standard to amended annual reports? Why or why not? Are there additional costs or practical issues with including amended annual reports in the scope of the proposed other information standard? If so, what are they?**

The Committee believes that unless the cause of the amendment requires the auditor to update their audit report for information that impacts the amended financial statements, it is not appropriate to apply the proposed other information standard to amended annual reports. To do so would require the auditor to continuously update their audit report which would be unduly expensive.

4. **Should the company's auditor, the other entity's auditor, or both have responsibilities under the proposed other information standard regarding audited financial statements of another entity that are required to be filed in a company's annual report under Article 3 of Regulation S-X? Why or why not? Are there practical issues with applying the proposed other information standard to the other entity's audited financial statements?**

The Committee believes the proposed requirement is unclear. If it means that audited financial statements furnished pursuant to Article 3 are considered "other information," the Committee disagrees with the requirement; audited financial statements should not be considered "other information". Further, reporting on those financial statements is the responsibility of the other entity's auditor; the company's auditor should have no responsibility for them. To require some responsibility would be a waste of time and money.

In addition, if the "other information" concerning the other entity is interspersed in the document with that of the registrant, identifying which auditor has responsibility for what information could be extremely problematic.

**Question Related to Section II Objectives:**

5. **Do the objectives assist the auditor in performing the procedures required by the proposed other information standard to evaluate the other information and report on the results of the evaluation?**

The Committee believes the stated objectives are helpful, but we disagree with the auditor being held responsible for evaluating whether the other information has a material misstatement of fact. Please refer to the Committee's response to Question 6 under the proposed auditor reporting standard.

**Questions Related to Section III Evaluating Other Information:**

- 6. Is it appropriate to require the auditor to evaluate the other information for both a material inconsistency and for a material misstatement of fact? If not, why not?**

The Committee agrees with the proposed requirement to evaluate the other information for a material inconsistency with the financial statements, but we do not agree with evaluating it for a material misstatement of fact. Please refer to the Committee's response to Questions 6 under the proposed auditor reporting standard, and the Committee's response to Question 5 above.

- 7. Would the evaluation of the other information increase the quality of information available to investors and other financial statement users and sufficiently contribute to greater confidence in the other information? If not, what additional procedures should the Board consider?**

The Committee agrees that providing an auditor evaluation may convey greater confidence in the other information. However, the Committee is doubtful the reporting requirement will have any impact on the content of the other information. No additional procedures are necessary or appropriate.

- 8. Is the federal securities laws' definition of materiality the appropriate standard for the auditor's responsibility to evaluate the other information? Would applying this definition represent a change to the materiality considerations auditors currently use under AU sec. 550?**

The Committee believes the appropriate standard of materiality to apply in the proposed other information standard is that currently stated in AU sec. 550. Auditors already consider the implications of the SEC's definition of materiality in evaluating the impact of any variances.

- 9. Are the proposed procedures with respect to evaluating the other information clear, appropriate, and sufficient? If not, why not?**

The Committee believes the proposed procedures are appropriate for evaluating inconsistency with the financial statements, but they are not appropriate for evaluating any material misstatement of fact. There may be no link between audit evidence obtained and conclusions reached during the audit with the facts included in the other information, so the auditor would have no basis for the negative assurance proposed by the PCAOB. Arguably, since the fact is not within the scope of the evaluation, there is no assurance given, but a reader would then have no way of knowing what facts are subject to assurance and what facts are not.

- 10. Is it understood which amounts in the other information the auditor would be required to recalculate under paragraph 4.d.? If not, why not?**

The requirements set forth in paragraph 4.d. appear clear. However, to the extent recalculation is based on "other audit evidence" a user will not know whether it has been recalculated because the user will not know the content of the "audit evidence."

- 11. Are there additional costs beyond those described in this Appendix related to the proposed required procedures for the evaluation of the other information? If so, what would these costs be?**

If the auditors are required to deal with misstatements of fact in the manner proposed, they may feel forced to investigate the validity of facts not subject to audit evidence obtained and conclusions reached during the audit, and the cost of this could be substantial.

- 12. Are the proposed auditor responses under paragraph 5 appropriate when the auditor identifies a potential material inconsistency, a potential material misstatement of fact, or both? If not, why not?**

The Committee believes the proposed auditor responses under paragraph are appropriate.

- 13. Are there additional costs beyond those described in this Appendix related to responding when the auditor identifies a potential material inconsistency, a potential material misstatement of fact, or both? If so, what would these costs be?**

The Committee believes the increased cost of implementing the proposed other information standard would be substantial. Also refer to the Committee's response to Question 11. above.

**Questions Related to Section IV Responding to Inconsistencies and Misstatements in Other Information**

- 14. Are the proposed auditor's responses under paragraphs 8 and 9 appropriate when the auditor determines that the other information that was available prior to the issuance of the auditor's report contains a material inconsistency, a material misstatement of fact, or both? Why or why not?**

The Committee believes the proposed auditor responses are appropriate.

- 15. (a) Is it appropriate for the auditor to issue an auditor's report that states that the auditor has identified in the other information a material inconsistency, a material misstatement of fact, or both, that has not been appropriately revised and describes the material inconsistency, the material misstatement of fact, or both? (b) Under what circumstances would such a report be appropriate or not appropriate?**

- (a) The Committee believes such reports are appropriate in the circumstances, but hope the client and auditor resolve the issues prior to the report's issuance.  
(b) Such a report would always be appropriate.



- 16. Are the proposed auditor's responses under paragraphs 10 and 11 appropriate when the auditor determines that the other information that was not available prior to the issuance of the auditor's report contains a material inconsistency, a material misstatement of fact, or both? Why or why not?**

The Committee believes the proposed responses are appropriate, but this situation creates a real problem. The auditor has no responsibility to investigate what occurs after its report is issued, and it is possible that a client may publish the other information without clearing it with the auditor; this is not unlikely if non-financial personnel are preparing the other information and controls over its release are not followed. As the time between the release of the auditor's report and the availability of the other information increase, the likelihood of inconsistencies increases.

**Question Related to Section V Responding if there is a Misstatement of the Financial Statements Based on Other Information**

- 17. Are the proposed auditor's responses appropriate when, as a result of the procedures performed under the proposed other information standard, the auditor determines that there is a potential misstatement in the financial statements? Why or why not?**

The Committee believes the proposed responses are appropriate.

**Questions Related to Section VI Reporting in the Auditor's Report:**

- 18. Is the proposed reporting, including the illustrative language, appropriate and sufficiently clear? If not, why not?**

As pointed out in the Committee's response under Auditor's Reports Question 6, the scope of assurance given by the auditor when saying they "have not identified any material inconsistency with the financial statements" is very unclear. The committee does not have a recommendation on how to fix this. For this, among other reasons discussed elsewhere in this letter, the committee is opposed to the proposed requirement that auditors report on other information.

- 19. Should the Board consider permitting or requiring the auditor to identify in the auditor's report information not directly related to the financial statements for which the auditor did not have relevant audit evidence to evaluate against? If so, provide examples.**

The Committee believes that if the auditor does not have relevant audit evidence against which to evaluate certain other information (which may be relatively frequent under the PCAOB's proposal), the auditor will need to say so in its report. However, such a statement, which may run to multiple pieces of information, is bound to create confusion to the reader, which is undesirable. This potential for confusion is yet one more reason that the Committee is opposed to the proposed requirement that auditors report on other information.

- 20. What additional costs would the auditor or the company incur related to auditor reporting when the auditor identifies a material inconsistency, a material misstatement of fact, or both?**

The Committee does not believe these costs will significant, and only marginally greater than incurred under the current reporting standards.

- 21. Would the proposed reporting, including the illustrative language, provide investors and other financial statement users with an appropriate understanding of the auditor's responsibilities for, and the results of, the auditor's evaluation of the other information? Why or why not?**

The Committee believes there is a real danger that financial statement users will consider any information that the auditor refers to in its report to be "verified," "certified," "approved" or similar terminology, regardless of what the auditor actually says in its report.

- 22. Are there any practical considerations that the Board should consider when an auditor identifies a material inconsistency or a material misstatement of fact in the other information that management has appropriately revised prior to the issuance of the auditor's report?**

No, the presumption is reasonable that management will resolve the material inconsistency or material misstatement in the other information.

**Question Related to Section VII Responsibilities of a Predecessor Auditor:**

- 23. Are the proposed responsibilities of the predecessor auditor appropriate and sufficiently clear? If not, why not?**

The Committee believes the proposed responsibilities are appropriate and sufficiently clear.

**Questions Related to Section VIII Other Considerations:**

- 24. (a) What effect, if any, would the reporting under the proposed other information standard have on an auditor's potential liability in private litigation? (b) Would this reporting lead to an unwarranted increase in private liability? (c) Are there steps the Board could or should take related to the other information requirements to mitigate the likelihood of increasing an accounting firm's potential liability in private litigation?**

The Committee presents the following responses to the specific questions:

- (a) The expansion of the auditor's report to include other information is likely to expand the risk of the auditor being drawn into private litigation, although perhaps to a lesser degree than the proposed reporting of critical audit matters. Nevertheless, there is some increased risk.
- (b) It could, consistent with our response to (a) above.
- (c) Any steps the Board, or the SEC (possible safe harbor?), could take in considering ways to mitigate the likelihood of increasing the auditor's potential liability under the proposed other information standard ought to be considered.

- 25. Would reporting under the proposed other information standard affect an auditor's potential liability under provisions of the federal securities laws other than Section 10(b) of the Exchange Act, such as Section 11 of the Securities Act? Would it affect an auditor's potential liability under state law?**

The Other Information reporting requirements are stated to apply only to annual reports in Exchange Act filings. However, many of those filings are incorporated by reference into Securities Act filings. It is unclear how Section 11 liability can be avoided in this situation.

We suggest that the PCAOB, possibly with the assistance of the commission's staff, carefully examine the potential effect on auditor's liabilities under the securities acts and state laws.

**Questions Related to Section IX Conforming Amendments:**

- 26. (a) Are the proposed amendments to PCAOB standards, as related to the proposed other information standard, appropriate? If not, why not? (b) Are there additional amendments to PCAOB standards related to the proposed other information standard that the Board should consider?**

- (a) Yes
- (b) No

- 27. In the situations described in the proposed amendments to existing AU sec. 508, should the Board require, rather than allow, the auditor to include statements 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?**

The Committee believes the Board should require such statements in order to remove a possible ambiguity.

**Question Related to Section X Broker Dealers:**

- 28. Are the proposed other information standard and amendments appropriate for audits of brokers and dealers? If not, why not?**

No, unless the broker/dealer is publicly held.

**Questions Related to Section XI Effective Date:**

- 29. Is the Board's effective date appropriate for the proposed other information standard? Why or why not?**

The Committee recommends the Board establish a tiered effective date for accelerated and non-accelerated filers similar to our response in Question 42 related to the proposed auditor reporting standard.

- 30. Should the Board consider a delayed compliance date for the proposed other information standard and amendments for audits of smaller companies? If so, what criteria should the Board use to classify companies, such as non-accelerated filer status? Are there other criteria that the Board should consider for a delayed compliance date?**

See the Committee's response to Question 29 above.

**Questions Related to Section XII Securities Act Documents:**

- 31. Should the Board extend the application of the proposed other information standard to documents containing audited financial statements and the related auditor's report that are filed under the Securities Act? If so, are there obstacles other than those previously mentioned that the Board should consider before such a proposal is made? If not, why not?**

The Committee does not believe the application of the proposed other information standard should be extended to other securities act filings containing audited financial statements. For example, in an underwritten offering, the other information external to the financial statements is usually thoroughly vetted by the underwriter and further reporting by the auditor would not add any value.

- 32. Are there some elements of the proposed other information standard that the Board should consider requiring the auditor to perform related to other information contained in filings under the Securities Act, such as the auditor's responsibility to evaluate the other information? If so, which elements of the proposed other information standard should the Board consider including in the procedures currently required for Securities Act documents under AU sec. 711? If not, why not?**

The Committee does not believe the application of the proposed other information standard should be extended to other Securities Acts filings that do NOT contain audited financial statements, as the basis for reviewing such other information is the financial statements.

Further, the Committee believes the proposal should be limited to Exchange Act filings and does not believe any part of the proposal should be extended to any Securities Act filings.

- 33. What costs or other challenges should the Board consider when assessing whether to propose extending some elements of the proposed other information standard to other information contained in documents filed under the Securities Act?**

As we stated in our responses to several questions above, the Board should limit the required other information standard to securities filings that contain the annual report and should not be extended to Securities Act filings.

## Emerging Growth Companies

### Questions:

1. **Should the proposed standards and amendments be applicable for audits of EGCs? Why or why not?**

The proposed standards and amendments should not be applied to EGC's until they are fully effective for accelerated and non-accelerated filers and they have been evaluated for effectiveness. Imposing these complex new reporting requirements on EGCs could make the capital raising process more difficult for them.

2. **Are there any other considerations related to competition, efficiency, and capital formation that the Board should take into account with respect to applying the proposed standards and amendments to audits of EGCs?**

No.

3. **Are there any special characteristics of EGCs that the Board should consider related to the proposed auditor reporting standard, including the communication of critical audit matters?**

No.

4. **Would audits of EGCs be more, less, or equally likely to have critical audit matters?**

EGC's in a particular industry are no more or less likely to have critical audit matters than established companies.

5. **Are there any special characteristics of EGCs that the Board should consider related to the proposed other information standard and amendments?**

No.

6. **What costs would audit firms incur when implementing the proposed auditor reporting standard, including the communication of critical audit matters, for audits of EGCs? How will those costs differ from the costs for audits of larger and more established companies?**

The Committee cannot distinguish between the cost of implementing the proposed auditor reporting standard or the proposed other information standard between EGCs and established companies. However, it is likely the costs could be higher due to dealing with a newly formed company's need to establish its significant accounting policies and procedures, and may be disproportionately higher because of the relatively smaller size of EGCs.

7. **What costs would audit firms incur when implementing the proposed other information standard for audits of EGCs? How will those costs differ from the costs for audits of larger and more established companies?**

See the response to Question 6 above.

8. Are there particular costs or burdens applicable to EGCs that the Board should consider when determining what recommendation to provide the Commission regarding the application of the proposed auditor reporting standard and amendments to EGCs?

See the response to Question 6 above.

9. Are there particular costs or burdens applicable to EGCs that the Board should consider when determining what recommendation to provide the Commission regarding the application of the proposed other information standard and amendments to EGCs?

See the response to Question 6 above.

10. For auditors of both EGCs and other SEC registrants, would it be more costly not to apply the proposed standards and amendments to audits of EGCs because the firms would need to develop and maintain two audit methodologies?

This would not have a significant cost impact for audit firms, as PCAOB audit firms have been maintaining two audit methodologies since the formation of the PCAOB in 2003 (referring to PCAOB audit standards for publicly held clients and AICPA audit standards for non-public clients).

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The Committee would be glad to discuss its comments further should the Board have any questions or require additional information.

Very truly yours,



Michael D. Feinstein, Chair  
Accounting Principles and Auditing Standards Committee  
California Society of Certified Public Accountants