

From:
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To:
Office of the Secretary, PCAOB
1666 K Street, N.W.
Washington, DC 20006-2803

Dated: November 26, 2013
RE: Comments on Proposed Auditor Reporting Standards

To Whom It May Concern:

I am writing today in support of *The Auditor's Report on an Audit of Financial Statements When Auditor Expresses an Unqualified Opinion* (the "proposed auditor reporting standard").¹ Auditors are granted a rare, unadulterated view of a company's financial position and the assumptions that go into creating the "estimated" values that are reported on the financials. Many minority shareholders, such as myself, will never have such an opportunity. A majority of this valuable knowledge is lost in the auditor's overly simplified binomial decision as to whether a company's financials are reflected fairly or not. The remainder of this letter is intended to add additional support to my position by addressing some of the PCAOB's proposed questions. Specifically, I will focus on questions regarding the critical audit matters section within the proposed auditor reporting standard.

Definitive Benefits:

One of the first questions proposed by the PCAOB is "[w]ould the auditor's communication of critical audit matters be relevant and useful to investors and other financial statement users?"² As expressed earlier, I obvious feel that the addition of a critical audit

¹ See, Proposed Auditor Reporting Standard, PCAOB Release No. 2013-005, August 13, 2013.

² Appendix 5 of Proposed Auditor Reporting Standard, PCAOB Release No. 2013-005, August 13, 2013, at A5-44.

matters section would add tremendous value to investors and users of financial statements. This conclusion stems from three lines of reasoning.

The first line of reasoning revolves around the notion of minimizing the effects of the principal/agent problem at play within public companies. Investors rely on executives and management of an organization to conduct business in a way that is profit maximizing for the shareholders, not for themselves. The financial statements are the primary way shareholders can evaluate an executive's performance. Audit firms are granted rare insight into the actual happenings within these public companies. As part-owners in these public companies, shareholders pay a significant amount of money to have audit firms verify that the information they are receiving in the financial statements is a fair assessment of the financial health of the company. Should an auditor have difficulty or concerns verifying certain aspects of the financial statement, why should the investors not be entitled to this information? I feel they should be, and doing so will help inform investors about the inner operations of their companies and reduce implications arising from the principal/agent problem.

The second line of reasoning for my option partly extends from my first. Should investors have a better understanding of the context around the difficulties encountered during an auditor's investigation, they will have a better idea of where to concentrate their efforts when evaluating a company's performance. This could save a tremendous amount of time and money for the typical investor.

The last line of reasoning for my option revolves around the notion that adding a critical audit matters section could provide more motivation for public companies to be as forthcoming and honest on their estimates and financials as possible. Certain accounting standards allow for some flexibility on how companies report certain line-items. By allowing auditors the ability to

call into question the appropriateness of these subjective accounting decisions, management will be more likely to record these line-items in the most appropriate manner from an investor's view point.

Example of Potential Benefits:

To help provide context to the benefits, consider a recent company evaluation that I conducted regarding a publicly traded snack foods conglomerate. This snack foods company had been involved in a tremendous amount of M&A over the past several years. As a result, over 69 percent of their assets were within the goodwill and other intangible assets accounts.

Moving forward, management of the snack foods company will have a lot of influence over the assumptions that go into re-evaluating those assets for impairment. A critical audit matters section would have allowed an auditor to explain the subjectivity involved within these calculations and address the potential issues to shareholders. Thus, I would have been in a much better informed position regarding the financial state of the company moving forward.

Potential Obstacles to Implementation:

The PCAOB additionally raised many questions regarding the potential obstacles for the proposed auditor reporting standard. In particular, many of these questions revolved around the additional cost concerns for both the auditing firm and its client. Audit firms could face additional direct costs should they need to hire more personnel, increase the duration of the audit process with each client, or add training programs related to complying with the new standard. Client companies could incur additional direct costs relating to their audit committees reviewing the necessary matters included within the critical audit matters section.³

³ PCAOB exposure draft lists this cost along with many other direct costs. See, Appendix 5 of Proposed Auditor Reporting Standard, PCAOB Release No. 2013-005, August 13, 2013, at A5-41.

Ultimately, I find little merit in arguments that these direct costs would outweigh the potential gains. First, as addressed in the PCAOB exposure draft, the changes made within the proposed auditor reporting standards are designed to ensure an “unduly burdening”⁴ in the financial reporting process. Little to no additional time and resources will be used in complying with these reporting standards. The audit firm as already invested significant time and energy into verifying their client’s financials. Any additional reporting within the critical audit matter section would not increase this initial sunk-cost imposed on the audit firm.

The second reason these direct costs will not outweigh the benefits to the proposal is that, ultimately, neither the audit firm nor its client will bear the full cost. Any additional direct costs that might be encountered by an auditing firm will most likely be passed along to the client. However, the proposed auditor reporting standards will instill more confidence in potential investors, thus lowering the overall cost the capital for the client. Any increase in direct costs for either the audit firm or its client would eventually be off-set.

Skeptics of the proposed auditor reporting standards also refer to the related indirect costs. These costs might not be initially tangible, but could cause major issues later on. For example, some argue that there could be a decrease in the quality of the audit of the financial statements due to the resource constraint imposed by the need to fulfill any new auditor obligations. However, I feel my previous comment regarding no additional “unduly burdening” adequately rebukes that concern.

Others argue that an additional indirect cost might include issues arising from auditors disclosing information that otherwise would not have required disclosure and could potentially be beneficial for the auditor’s client’s competitors. Understandably, some managers and senior

⁴ See, Appendix 5 of Proposed Auditor Reporting Standard, PCAOB Release No. 2013-005, August 13, 2013, at A5-22.

executives will be hesitant to publicly disclose business sensitive information. However, any information discussed or potentially exposed in the critical audit matters section will not be of any particular advantage to a competitor. This section would not expose product secrets or covert corporate strategies, but merely discuss where the auditor had a difficult time verifying assumptions or receiving information. While this type of knowledge could be extremely beneficial to a potential investor, it should have no influence on the business practices of a competitor.

An additional challenge facing the proposed auditor reporting standard is that of standardization. In theory, standardization could help minimize many of the costs associated with the transition. From the view point of the auditor, standardization of the critical audit matters section could help to reduce any necessary training and help create more economies of scale within the process. From the financial statement users' prospective, standardization would allow for less time and energy to read and examine the difference and similarities between companies. However, over standardization of a critical audit matter section would completely nullify the purpose of the exercise. While it is a noble idea to provide a general outline and formatting instructions for the section (as is currently done within the PCAOB exposure draft), you must allow the auditor the necessary autonomy to disclose whatever matter he/she finds important. Thus the current proposed outline seems to be a good compromise.

All of the previous obstacles/implications to implementing the proposed auditor reporting standards are not valid or have an easily implemented solution. As an investor, however, there is one issue that is concerning regarding the roll out of the proposed auditor reporting standard. This proposed practice could reinforce the already high conflicts of interest existing in the auditing industry. The audit industry currently faces numerous conflicts of interests. Anytime

an auditor is paid to verify the financial integrity of another organization, the auditor will feel pressure (if not an obligation) to sign-off on the related financials. Else, the auditor could feel they will be terminated and/or replaced. In a way, these proposed standards could reinforce those pressures. An auditor could feel pressure not to discuss any issues related to the audit. Given that no critical audit matters were disclosed in the new appropriate section, investors would feel more assured about the financial integrity of the company. Thus the results could be exponentially worse.

Many other potential issues still face the proposed auditor reporting standard (such as specific term definitions, documentation requirements, additional audit fees, or potential for liability in private litigation). However, these issues seem fairly minuscule and I would be unqualified to comment. As indicated earlier in this letter, I am a concerned personal investor, not an attorney or a classically trained accountant. Regardless, I strongly feel that the proposed auditor reporting standard and its critical audit matters section as it currently stands is a step in the right direction and will add significant value for the typical investor.

Thank you for considering these points.

Respectfully,

A handwritten signature in black ink that reads "Tyler L. Prince". The signature is written in a cursive, flowing style.

Tyler L. Prince