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November 26, 2013  
Public Accounting Oversight Board

**Re: PCAOB Rulemaking Docket Matter No.034; Proposed Rule under Release No.2013-005;  
*Proposed Auditor Reporting Standard – Critical Audit Matters (Paragraphs 7-14)***

Dear Members of the Board:

As a member of the financial community and potential investor, I would love to make some responses on the Public Company Accounting Oversight Board's (here after PCAOB) Release No. 2013-005, specifically on the Proposed Auditor Reporting Standard regarding the Critical Audit Matters (hereafter CAMs).

***General comment***

In general, I find the proposed auditor reporting standard regarding CAMs really helpful for financial community to focus on aspects of the company's financial statements that the auditor also found to be challenging and unknown information about the audit, for reducing the level of information asymmetry and resulting in more efficient capital allocation, and for potential improvement in the financial statement disclosures due to increased attention by the auditor, management, and the audit committee. However, there are certain anticipated challenges and concerns on the proposed standard. If it is possible, I would recommend that the PCAOB give out further detailed criteria on CAMs and promote unified procedures for different CPA firms on

coordinating the CAMs disclosures with management and audit committee, which I believe would be critical to address the public concerns on the proposed standard.

### ***Benefits for the Financial Community and Potential Investors***

I. Provide focus and additional information on certain areas of financial statement

The proposed “communication of critical audit matters in the auditor’s report is intended to make the auditor’s report more informative, thus increasing its relevance and usefulness to investors and other financial statement users.” As many investors believe that “auditors have unique and relevant insight based on their audits”, the CAMs could provide some additional information for the community and support financial statement users to make better and more informed decisions.

For example in the analysis of Diamond Foods Inc., we had concerns on its correctness of cost and payment record, but we don’t have enough information to get to a conclusion whether or not the company has cut-off issue. In that sense, the disclosure of CAMs from auditors would be great help. Through the audit process, auditor might already examine vouchers and ledger regarding the date of invoice and match that with the fiscal year end. Otherwise, it might suggest “posed the most difficulty to the auditor in obtaining sufficient appropriate evidence” which should be disclosed in CAMs and alert the investors.

II. Reduce information asymmetry and potentially lower the average cost of capital

“The communication of critical audit matters could help to alleviate the information asymmetry that exists between company managements and investors. More specifically, company management is typically aware of the auditor’s most challenging areas in the audit because of regular interactions with the auditor as part of the audit, but this information is not usually known to investors. Reducing the level of information

asymmetry between company management and investors could result in more efficient capital allocation and, as academic research has shown, could lower the average cost of capital.” This benefit for both the company side and investor community is stated in the appendix of PCAOB release No.2013-005.

With my experience of conducting financial analysis on different companies’ 10-k, I find this statement very true. For example in the analysis on Diamond Foods Inc., I would be really interested to know the goodwill assessment related to the acquisition of Kettle Foods, since the result and assurance I got from auditor might significantly impact on my valuation of the investment opportunity on Diamond Foods Inc.. But unfortunately, very limited information was provided while I believe intensive communications between management and auditors had covered the topic. From investors’ perspectives, if I can have more detailed information provided to address my concern, I could make a more informed decision. Thus, lower risk and higher level of assurance I have will allow me to require a lower rate of return on the investment.

### III. Improve financial statement disclosures

PCAOB has specified the potential benefit of improvement on financial statement disclosures, “The auditor’s focus on, and communication of, critical audit matters could lead to improved financial statement disclosures related to areas of the financial statements that gave rise to critical audit matters. Potential improvements to financial statement disclosures in such areas could occur because of increased attention by the auditor, management, and the audit committee of matters communicated by the auditor in the draft auditor's report regarding critical audit matters. The improvement in the related financial statement disclosures could incrementally increase the amount or quality of the information in the financial statements.”

Throughout the audit process, regular interaction between auditors and managements should already cover a great amount of issues including financial statement adjustments and internal control deficiencies. The public disclosure of the most challenging issues could bring in incentive and pressure for the management to react and rectify in a timely manner. In long-term, this practice could lead to higher quality of the information disclosed in the financial statements and create a virtuous cycle for managements to focusing on shareholders' value creation.

### ***Potential Challenges***

#### I. New judgment to auditors to select the "key" or "critical" audit issues

In PCAOB release, CAMs are defined as "matters addressed during the audit that (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 the opinion on the financial statements." And PCAOB also listed factors specific to the audit to help auditors to determine whether a matter is a critical audit matter.

While the wordings and the description of CAMs make a great deal of sense, there is still huge room for auditors to make the judgment call. This might be the least wanted from the investors' standpoint, to propose a subjective judgment call on information disclosure selection. In the process of audit, a quantitative material level is applied to guide the work of auditors. I am wondering if a more detailed quantitative criteria coupled with a qualitative description on the CAMs could solve this potential challenge.

II. Extract cost and efforts for auditors and companies to be in compliance with the proposed standard

PCAOB has anticipated that some cost increases would be in line with the proposed standard, including “one-time costs that related primarily to updating an audit firm’s methodology and training”, “recurring costs in each individual audit relative to the determination, communication in the auditor’s report and documentation of critical audit matters”, and “recurring costs for the company, including the audit committee, for reviewing the critical audit matters included in the draft auditor’s report”. Besides, the standard setter also expressed its concern on reducing time available to the auditor to review and complete the audit work.

In my opinion, the annual audit cost comparably contributes a very small portion of SG&A cost of a public company each year. That said, even in the case of cost increase due to the new standard, the financial impact would be acceptable to most of the shareholders, as this would be critical to protect their own interest and value. Moreover, audit report nowadays which just gives a pass/fail grade for the company only reflects a small part of the audit effort. Auditors continually communicate with management and audit committee on adjustments on financial statements and deficiencies on internal controls, which suggests management and audit committee are already reviewing some non-disclosed “critical matters” with the auditors before the proposed standard. What we asked for now is just to disclose the most challenging matters already be discussed back door. Meanwhile, academic community has raised evidence that the reduce of information asymmetry between management and investors could help to lower the average cost of capital, which is beneficial to the company and might potentially wash out the increase costs related to the proposed standard. In addition, if PCAOB could provide more unified procedures for auditors on coordinating the CAMs disclosures

with management and audit committee, it will even lower the incremental cost and establish a comparable environment for different companies' audit reports and continually improve the usefulness of audit report.

### III. Change of auditors' current role criticism

Understand that most auditors are concerning about the alter of the role of being an auditor, as they believe the new disclosure requirement might lead them to inappropriately step into the roles of managements and audit committee. Auditors claim that it is managements' responsibility to prepare financial statement and increase the transparency. In addition, the profession is concerned that users of the financial statements may not have sufficient context to digest the information provided in CAMs.

In my opinion, this concern could be addressed by more promotion on the unified procedures for CAMs. First of all, most of the users of the financial statements are sophisticated investors and experienced with continually changes on accounting and auditing standards throughout years. The group of people should have the ability to adapt themselves with the new proposed standard and adjust their financial analysis with the newly provided information. Besides, PCAOB specified that "the proposed auditor reporting standard does not intend to change the auditor's traditional role of attesting to matters in the financial statements when communicating critical audit matters". And the new standard is actually requiring the auditors to "provide insights about the most difficult, subjective, or complex matters that the auditor addressed in the audit". That said, the CAMs in the auditor's report would not replace the efforts for investors and other financial statement users to analyze and review the financial statements. Through sufficient education and promotion, the investor community in my

opinion will be able to adjust the expectation and better leverage the unique insights from auditors regarding the company's financial statements in their own usage.

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In conclusion, as a member of the financial community and potential investor, I support the proposed audit standard regarding the critical audit matters and recommend that the PCAOB could give out further detailed criteria on CAMs and promote unified procedures for different CPA firms on coordinating the CAMs disclosures with management and audit committee to better facilitate the changes and address concerns from different stakeholders of the standard.

Sincerely,

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