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Via E-mail: comments@pcaobus.org

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

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

Dear Office of the Secretary:

BDO USA, LLP appreciates the opportunity to respond to the request for comments on the Public Company Accounting Oversight Board's (the PCAOB or the Board) reproposal of the auditor reporting standard, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, and Related Amendments to PCAOB Standards (the 'Rep proposal' or 'reproposed standard'). As previously expressed in our comment letter dated December 13, 2013 on PCAOB Release No. 2013-005, *Proposed Auditing Standards - The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion; The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report*, and Related Amendments to PCAOB Standards (the '2013 Proposal'), we support the PCAOB's efforts to modernize the auditor reporting model by enhancing the usefulness and informational value of the auditor's report, including: (1) expansion of the existing language in the auditor's report related to the auditor's responsibilities for error or fraud, (2) a description of the nature of the audit, and (3) the communication of audit related matters the auditor considered critical, among other enhancements. While we are supportive of the overall direction of the Rep proposal, we have provided suggestions for areas of improvement and refinement of some of the concepts presented in the proposal that we believe will result in improved implementation of the standard, and where appropriate, alignment with the International Auditing and Assurance Standards Board's (IAASB) revised suite of auditor reporting standards¹.

As noted in the Rep proposal, the form and content of the auditor's report is undergoing change globally. The IAASB, the European Union, and additional national bodies such as the Financial Reporting Council in the United Kingdom and the Authority for the Financial

¹ The International Auditing and Assurance Standards Board's (IAASB) new and revised suite of auditor reporting standards are effective for audits of financial statements for periods ending on or after December 15, 2016.



Markets in the Netherlands, have all adopted requirements for expanded auditor reporting. While the details of the standards established by these bodies differ, there is a common theme - to increase the informational value of the auditor's report for users of the financial statements. We recognize that the regulatory environment in each jurisdiction differs, and we appreciate the Board's consideration of the initiatives and developments already undertaken by other regulators and standard setters in an effort to minimize differences where appropriate. Minimizing differences will strengthen comparability among reports, making it easier for investors to make comparisons between reports from different jurisdictions.

Our specific comments relate to the following topical areas:

- Critical Audit Matters (CAM)
- Additional Improvements to the Auditor's Report
- Audit Firm Tenure
- Exclusions to the Reproposed Standard and Considerations of Emerging Growth Companies
- Effective Date

Determining and Communicating Critical Audit Matters

Determination of Critical Audit Matters

The repropoed standard defines a critical audit matter as 'any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and involved especially challenging, subjective, or complex auditor judgment.' This definition reflects a change from the 2013 Proposal which was more prescriptive and included a larger population of matters that could potentially have been considered a critical audit matter. We support the revised CAM definition for a number of reasons, but most importantly because we believe that given the audit committee's oversight role in representing the interests of shareholders, communications to the audit committee is the appropriate starting point for considering potential critical audit matters. Furthermore, limiting the population of potential CAM to matters communicated or required to be communicated to the audit committee is consistent with the findings of the CAQ's field testing, in which BDO participated, that found that most matters determined to be CAM had been previously communicated to the audit committee.

As noted in our introductory remarks, we believe that alignment with the International Standards on Auditing (ISAs) is an important objective because of the interconnected nature of the global economy and the needs of investors for a consistent reporting framework in evaluating decision useful information such as CAM. While we recognize that there are differences in the actual definition between the IAASB's Key Audit Matters and the PCAOB's CAM, we believe that the approach in both are substantially similar and for all practical purposes would result in similar communications - which are the matters of interest to investors and other users of the auditor's report.



Office of the Secretary
Public Company Accounting Oversight Board
Page 3 of 7

Communication of Critical Audit Matters

Original Information Regarding the Company

The note to requirement 14 on page A1-7 of the Reproposal states:

When describing critical audit matters in the auditor's report the auditor is not expected 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.

Consistent with our views set out in our 2013 comment letter, we do not believe that the auditor should be required by this rule to provide information about the company that has not been made publicly available to the company, nor is it the auditor's responsibility to communicate matters within the auditor's report that are not already required to be reported on by management. Given that critical audit matters are intended to focus on those matters the auditor addressed during the audit that involved the most difficult, subjective, or complex auditor judgments or posed the most difficulty to the auditor in obtaining sufficient appropriate evidence, we would expect that such matters would also be the most difficult, subjective, or complex management judgments, and would also be reported by management within the notes to the financial statements, or elsewhere in documents containing the financial statements. If this understanding is not correct, then we believe that changes to the rules and regulations that management is required to comply with would be the appropriate starting point for expanding disclosure. Accordingly, we suggest deleting the phrase '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' from the note.

Furthermore, to explain why it would not be appropriate for the auditor to provide original information about an entity, we suggest looking to paragraph A34 of ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, which explains that 'the nature and extent of the information provided by the auditor is intended to be balanced in the context of the responsibilities of the respective parties (i.e., for the auditor to provide useful information in a concise and understandable form, while not inappropriately being the provider of original information about the entity).' We believe such guidance would be helpful to practitioners in applying the provisions of the reproposed standard.

Description of How Each CAM is Addressed

Paragraph 14, on page A1-9 of the reproposed standard, states that for each CAM communicated in the auditor's report, the auditor must describe, among other details, how the critical audit matter was addressed in the audit. However, the reproposed standard does not provide any guidance relating to the level of detail that might be expected. While we support a principals-based approach that allows for auditor judgment in how best to explain how a CAM was addressed in the audit, we also believe that it would be helpful to



practitioners if the repropoed standard included guidance that outlined matters the auditor may consider describing.

We note that paragraph A46 of ISA 701 explains that the amount of detail to be provided is a matter of professional judgment, and that in exercising such judgment, the auditor may describe (1) aspects of the auditor's response or approach that were most relevant to the matter or specific to the assessed risk of material misstatement, (2) a brief overview of procedures performed, (3) an indication of the outcome of the procedures, and (4) key observations with respect to the matter. We believe such guidance would benefit practitioners in the consistent application of the requirement and, accordingly, should be included within the repropoed standard. We note that these factors are included in the introductory section of the Reproposal; however, to ensure that this supportive guidance is not lost in the process of codifying the repropoed standard and to reflect the high level of subjectivity that is inherent in how auditors can potentially describe their procedures, we recommend moving this content into the body of the repropoed standard.

Additionally, ISA 701, paragraph A48 explains that the language used in describing a CAM (or in ISA 701 terminology, a Key Audit Matter or KAM) should be carefully structured to ensure the description of a KAM (1) does not imply the matter has not been appropriately resolved by the auditor in forming the opinion, (2) relates the matter directly to the specific circumstances of the entity, while avoiding generic or standardized language, (3) takes into account how the matter is addressed in the related disclosure(s), and (4) does not contain or imply discrete opinions on separate elements of the financial statements. While Note 1 to paragraph 14 of the repropoed standard states that the language used to communicate a critical matter should not imply that the auditor is providing a separate opinion on the critical audit matter or on the accounts or disclosures to which they relate, matters (1) - (3) are not included within the repropoed standard and we believe the inclusion of such guidance would be helpful to auditors in implementing the standard.

Significant Deficiencies

Auditing Standard 2201, *An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of Financial Statements*, requires the expression of an adverse opinion on internal control over financial reporting (ICFR) when a material weakness has been identified and also requires a description of the material weakness. Significant deficiencies, in and of themselves, do not result in an adverse opinion on ICFR and are not required to be described in management's assessment of ICFR nor in the auditor's report.

However, Note 2 to paragraph 14, on page A1-9 of the repropoed standard, states that while the auditor is not expected to provide original information about the company, it may be necessary to provide original information if it 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. We continue to believe that the auditor should avoid descriptions of CAM that inappropriately provide original information about the entity that is properly within the responsibility of management and Audit Committee, and therefore the communication of significant deficiencies would not be appropriate. Such an



Office of the Secretary
Public Company Accounting Oversight Board
Page 5 of 7

approach is consistent with ISA 701, and we encourage the PCAOB to look to the ISA guidance in this regard.

Additional Improvements to the Auditor's Report

Consistent with our comments on the 2013 proposal, we support including the opinion as the first section of the auditor's report followed by the basis for opinion. Such an approach aligns with ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, and is consistent with investor feedback to provide the most relevant information in a more prominent position. In addition, we support providing for flexibility in the placement of other components of the auditor's report and the inclusion of a statement regarding independence.

With respect to the addition of the phrase 'whether due to error or fraud' to the description of the auditor's responsibilities regarding obtaining reasonable assurance about whether the financial statements are free of material misstatement, we suggest including the phrase 'as a whole' to this statement to clarify that the objective of an audit is to provide an opinion on the financial statements as a whole and not on individual accounts, balances, or disclosures. As a result, paragraph .09 of the reproposed standard would be revised as follows: (additions in bold italics)

.09 d. A statement that PCAOB standards require that the auditor plan and perform the audit to obtain reasonable assurance about whether the financial statements *as a whole* are free of material misstatement, whether due to error or fraud;

As noted in the introductory section of this letter, we believe it is important to eliminate unnecessary differences between the standards of the IAASB and the PCAOB to avoid any confusion in the market-place about whether differences between auditor's reports are the result of meaningful differences in the way an audit is conducted or simply a matter of format and presentation. For example, ISA 700 (Revised) includes expanded descriptions of the responsibilities of management, including those charged with governance, and the auditor, which is missing from the PCAOB standard. In addition to promoting consistency in reporting, we believe including these descriptions would be helpful to users in understanding more fully the separate responsibilities of each of the parties as it relates to the audited financial statements.

Audit Firm Tenure

While we understand that investors are calling for disclosure of auditor tenure, we do not believe such disclosure is appropriate within the auditor's report. The auditor's report is the communication mechanism audit firms use to convey the results of the audit and describe the responsibilities of each of the parties involved in the issuance of the audited financial statements. The disclosure of auditor tenure does not fit within this context. Moreover, we understand that some proponents of the disclosure of auditor tenure believe that it may be useful as an indicator of audit quality, and as such should be included within the auditor's report; however, as noted in the Reproposal, the academic research on this matter is



inconclusive. For these reasons we do not support disclosure of auditor tenure within the auditor's report, nor do we believe there is support for a regulatory requirement for such disclosure.

We believe a more appropriate manner to disclose auditor tenure would be through audit committee disclosures as proposed by the SEC in Concept Release No. 33-9862, *Possible Revisions to Audit Committee Disclosures*. We note that some audit committees are already voluntarily disclosing auditor tenure as part of their responsibility for oversight of the auditor. In 2015, 54% of audit committees disclosed the tenure of their auditors, according to the 2015 *Audit Committee Transparency Barometer*.

Exclusions to the Reproposed Standard and Considerations of Emerging Growth Companies

We support the PCAOB's decision to exclude brokers and dealers reporting under Exchange Act Rule 17a-5, investment companies that are not business development companies, and benefit plans from the communication of CAM. As explained in the Reproposal, providing such information would not provide meaningful information for this group of entities.

While we support the limited exclusions noted above, we do not believe that emerging growth companies should be excluded from communicating CAM, as investors and other financial statement users would likely find the communication of these matters informative for this group of issuers.

Effective Date

The implementation of the Reproposal, in particular as it relates to the identification and communication of CAM, will require the development of training programs and quality control processes, to ensure the identification of CAM is done in a timely manner and there is appropriate oversight and review of the development of CAM by senior members of the engagement team. Additionally, it will be important to inform management and audit committees about the implication of changes to the expanded auditor's report (including additional areas of oversight and communication) to ensure successful implementation. For this reason, we believe that the effective date should be, at a minimum, a year after SEC approval, and no earlier than for audit reports issued on or after December 15, 2018.

Due to the significance of the proposed changes to the auditor's report, in particular as it relates to critical audit matters, we believe that a delayed compliance date for audits of smaller filers, such as non-accelerated filers, is appropriate. A delayed compliance date would provide auditors of smaller entities additional time to learn from the experience of audits of larger filers.



Office of the Secretary
Public Company Accounting Oversight Board
Page 7 of 7

We appreciate your consideration of our comments and suggestions and would be pleased to discuss them with you at your convenience. Please direct any questions to Chris Smith, National Accounting & Auditing Professional Practice Leader at 310-557-8549 (chsmith@bdo.com), Susan Lister, National Director of Auditing at 212-885-8375 (slister@bdo.com), or Jan Herring, National Assurance Partner at 732-734-3010 (jherring@bdo.com).

Very truly yours,

/s/ BDO USA, LLP

BDO USA, LLP