



December 9, 2013

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

RE: PCAOB Rulemaking Docket Matter No. 034

Board Members:

Thank you for the opportunity to comment upon the PCAOB's proposed two new auditing standards, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, and *The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report*. We appreciate all the time and effort associated with the research, survey, compilation and drafting of these proposals.

The purpose of the new proposals is to make auditor's reports more informative as well as to increase the reports' relevance and usefulness to investors and other financial statement users. This purpose is well in line with the PCAOB's statutory mandate to protect investors and further the public interest in the preparation of informative, accurate and independent audit reports. All of our comments that follow are to be viewed in this light. Whether we agree or not with certain aspects of the proposals is dependent upon whether or not we believe that an investor will be better served with the adoption of specific additional requirements.

We agree that the pass/fail model for the Auditor's Report, in which the auditor states whether or not the financial statements are fairly presented and which has been relatively unchanged for the past 70 years, should be retained. Other aspects of the proposed changes to the auditor's reporting model are discussed below.

Addressees

Most auditor reports are addressed to shareholders and the board of directors. Requiring that addressees include, but are not necessarily limited to, (1) investors in the company, such as shareholders, and (2) the board of directors or equivalent body, is helpful in establishing consistency throughout the profession, and, more importantly, rightfully requires the identification of the appropriate parties for whom the report is written. Clearly the investor is better served by this requirement, and we support this change.

Statement that the auditor is a public accounting firm registered with the PCAOB

A requirement to make a statement in the auditor's report that the auditor is a public accounting firm registered with the PCAOB and is required to be independent with respect to the audited company in accordance with the United States federal securities laws and the applicable rules and regulations of the SEC and the PCAOB seems to us to create unnecessary redundancy. Since the title of the auditor's report is "Report of Independent Registered Public Accounting Firm," it seems excessive to repeat that point again in the body of the report.

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While our objection is of a minor nature, we believe the auditor's report is not enhanced by this requirement. Users of the report are unlikely to gain additional comfort from this repetitive statement, and additional unnecessary language only serves to distract the reader from what is important, namely, the basis of the opinion and the opinion.

Statement containing the year the auditor began serving consecutively as the company's auditor

The audit committee is responsible for hiring, retaining and approving fees for the auditor. In fulfilling these responsibilities, the audit committee considers, among other things,

- The auditor's expertise in the industry
- Technical strength and experience of the audit team
- Turnover
- In an incumbent situation, the firm's relationship with the audit committee and the firm's added value in helping the audit committee fulfill their duties in overseeing the financial reporting process

The audit committee also may consider the auditor's tenure. However, in most instances, consideration of tenure is not as important as the other criteria mentioned above when the audit committee determines whether or not to retain an audit firm.

Requiring a statement of audit tenure would appear to undermine the duties of the audit committee to select the auditors based on the far more important criteria detailed above. Highlighting tenure in the auditor's report indicates to the reader that this one particular criterion retains more importance than other information about the auditor that the audit committee considers annually. In fact, numerous studies cited by the Board reach differing conclusions concerning the value of auditor tenure. As there is no consensus regarding the relationship between audit quality and auditor tenure, disclosing tenure in the auditor's report undermines the authority of the audit committee and possibly sets in motion regulation concerning audit firm rotation. Should such regulation transpire, the audit committee's authority would be undermined further. Such regulation would substitute the audit committee's sound judgment with regulatory time limits and rotation requirements. It is clear to us that investors would not be better served by this requirement.

Statement that PCAOB standards require that the auditor plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud

We agree that clarifying, in the Basis of Opinion section of the auditor's report, that the auditor plans and performs the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, does help the financial statement users more fully understand the responsibilities of the auditor. We are in support of this recommended change.

Requirements for the auditor to communicate in the auditor's report "Critical Audit Matters"

We understand that investors are requesting improved relevance of the auditor's report, and that the Board is proposing communication of critical audit matters with the objective of providing more insight about the most significant matters that the auditor addresses in the audit. The belief is that communicating critical audit matters likely would provide meaningful information to investors and other financial statement users about the auditor's work in performing the audit and in forming an opinion on the financial statements, taken as a whole. We have a number of issues related to this perception, and they are detailed on the following page.

- The definition of critical audit matters are those 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. This definition clearly connotes that the subject matter is complex. Certain accounting rules are equally complex, as are the audit procedures designed to obtain appropriate audit evidence with respect to financial statement assertions. It is our belief that a majority of investors and financial statement users may not fully appreciate or understand disclosure and discussion of critical audit matters. Anyone who has tried to explain the significance or lack thereof of “uncorrected financial statement misstatements” to non-accountants understands this argument.
- In order to ensure, if at all possible, that the reader is not misled or misunderstands the explanation of a single critical audit matter, and certainly multiple critical audit matters, a significant amount of printed space in the auditor’s report may be required. This significant use of space in the report would only distract from the importance of the auditor’s opinion.
- It is the role of management to disclose critical accounting policies and discuss the important financial statement metrics with its shareholders in a company’s financial statements and annual report. Added information about the same from the auditors can only blur the line between management and the independent auditor in the eyes of the financial statement user.
- Audit costs will increase, most likely significantly, during the first year identification of critical audit matters is required. Drafting language addressing critical audit matters will be a difficult project to delegate to audit staff. Drafting of critical audit matters likely will be performed by higher level members of a firm, including partners, and may involve significant hours and, thus, increased cost.
- The auditor has always discussed critical audit matters with the audit committee. Drafting language regarding these critical audit matters for inclusion in the auditor’s report will require additional time spent with the audit committee developing and approving the language. Management will most likely comment on this language, increasing the likelihood of friction between management, audit committee and auditors, that would not normally exist. This friction cannot be beneficial to anyone.
- The proverbial Pandora’s Box – Will financial statement users view the disclosure of more critical audit matters as better or worse than the disclosure of less critical audit matters? Will companies in the same industry with the same issues but different auditors be viewed differently if one has more critical audit matters disclosed than the other? Will auditors with different clients in the same industry with the same issues need to take care to disclose the same critical audit matters for each client, less someone making a comparison would conclude something amiss?
- Auditors may conclude from a liability point of view that more critical audit matters are better. Additionally, the proposed requirement specifically states that the use of the word “most,” as in “most difficult” or “most complex,” is not intended to imply that only one matter qualifies as a critical audit matter. Management may conclude that more critical audit matters reflect poorly on their company’s operations. This scenario places the auditors and management in unintended conflict.
- Will audit opinions issued under generally accepted auditing standards (i.e. not under PCAOB standards) be viewed as audit opinions of a lesser quality, thus forcing all non-public audits to adapt to the same standards?

The auditor's responsibilities regarding other information in certain documents containing audited financial statements and the related auditor's report

We agree with the objectives of this proposed requirement and can readily understand the positive impact it can have on investors and financial statement users. However, as a firm that primarily audits registered investment companies (mutual funds), we see the potential for conflicts and problems resulting from this proposal. Registered funds file their annual reports with the SEC on form N-CSR. Fund annual reports typically contain (among other things) the following items of information that would qualify as "other information" under the proposed standard:

- A management discussion of fund performance
- Typically, a line graph of fund investment performance compared to the performance of a benchmark index or indices, accompanied by 3, 5 and 10-year or since inception average annual investment returns
- An expense example demonstrating the dollar amount of fund expenses incurred over the most recent six month period on an investment of \$1,000
- A tabular or graphical representation of the fund's investment portfolio holdings
- A discussion of the factors the board of directors considered in approving the fund's investment advisory contract

While some of the information detailed above can be evaluated, recomputed and/or verified by the auditor of a fund's financial statements without obtaining additional audit evidence, much of it cannot. Further, some of the items that can be verified and some that cannot may be included in the same portion of the annual report. We feel that this may lead to investor confusion regarding which particular portions of the annual report the auditor is covering in the required statement that no material inconsistency with the financial statements or misstatement of facts were found in the other information. In particular, we see the following potential areas of conflict with respect to each of the above:

- The management discussion of fund performance will typically include items that the auditor can evaluate based upon the audit evidence already obtained, such as investment total returns for fund shares or portions of an investment portfolio invested in certain industries or specific securities. It may also contain a significant amount of information that cannot be so evaluated. This may include index performance, overweighting or underweighting in certain sectors relative to a benchmark index, general economic data such as inflation or unemployment and segmented investment performance for certain portions of a fund's portfolio, among potentially many others. Without clarifying which particular information in a management discussion of fund performance that the auditor has evaluated for inconsistency and misstatement of fact, investors could be misled.
- Similarly, the line graph will include a graphing of index performance. The auditor may or may not collect evidence on the performance of the index as part of audit procedures. Furthermore, if the auditor has only performed the audit for the most recent fiscal year or two of the fund, would he be required to obtain the investment performance for the years presented that were audited by the prior audit firm and recompute average annual returns and evaluate the line graph? In many situations, the auditor has this information included in his audit evidence, and in many he may not. This again creates inconsistency and may lead to investor confusion.
- The expense example would typically not pose any problems for an auditor to evaluate.

- The auditor may be able to evaluate the tabular or graphical display of the fund's investment portfolio if it is characterized in the same manner as it is in the fund's portfolio of investments included in the financial statements. However, in many instances this display may not be organized in the same fashion as the portfolio of investments. For example, a stock fund may categorize its portfolio by industry in the financial statements but by country or geographic region or by market cap or some other metric in the tabular or graphical presentation. Again, in certain cases, the auditor may not be able to evaluate this presentation based on the audit evidence obtained, resulting in inconsistency.
- The auditor typically has no role in the presentation of the factors the board of directors considered in approving the fund's investment advisory contract. While some information can be evaluated (fund total return, fund expense ratio), much of it cannot. This portion of the annual report is truly a disclosure for which fund counsel takes primary responsibility. Auditor evaluation of this discussion seems inappropriate.

We feel that the proposed standard on other information should be amended to either exempt the audits of registered investment companies altogether or to clarify which specific elements of the other information included in a fund's annual report the auditor will be responsible for evaluating.

We would like to thank the Board for the opportunity to respond to the proposals as addressed in PCAOB Release No. 2013-005, and we appreciate the work and effort of the Board to protect investors and further the public interest in the preparation of informative, accurate and independent audit reports.

Sincerely,

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