



December 9, 2013

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

Re: Rulemaking Docket 034

Board Members:

We appreciate the opportunity to comment on two new proposed auditing standards in PCAOB Release No. 2013-005 (the "Release"):

- The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion (the "proposed auditor reporting standard"), and
- The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report (the "proposed other information standard")

... and on other matters or questions raised in the Release.

Our comments are primarily from the perspective of an audited public company based on our experience with the traditional auditor reporting model, generally accepted auditing standards ("GAAS"), generally accepted accounting principles ("GAAP") as codified in the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") and public registrant reporting requirements of the Securities and Exchange Commission ("SEC").

In developing our comments, we have given consideration to the roles of the following entities and perspectives relative to the content of the Release to address the proposed reporting standard, proposed other information standard and other matters and questions.

- The SEC has oversight authority over the PCAOB and appoints the accounting standards setting body, the FASB, which establishes GAAP.
- The PCAOB has authority to regulate registered public accounting firms ("auditors" or "audit firms") and "oversee the audits of public companies in order to protect investors and the public interest by promoting informative, accurate, and independent audit reports."¹
- Registered public accounting firms audit entities that file reports and financial statements with the SEC.

¹ See PCAOB Mission, <http://pcaobus.org/About/History/Pages/default.aspx>



- Audit Committees of public companies are required to be independent of management and are “directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm employed by that issuer (including resolution of disagreements between management and the auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or related work, and each such registered public accounting firm shall report directly to the audit committee.”² Further, audit committees have oversight over an audited entity’s financial reporting and related activities.
- Investors (i.e., company share or unit holders and note holders), creditors and the investing public have an interest in the financial statements of a public company and the related audit reports issued by a registered public accounting firm.

The following sections address the proposed auditor reporting standard, proposed other information standard, and other matters or questions raised in response to the Release.

Proposed Auditor Reporting Standard

The proposed auditor reporting standard includes two major features: (a) retention of the historical pass/fail model incorporated in the standard auditor’s report and (b) addition of auditor disclosure of any deemed critical audit matter(s) (“CAM”).

Pass/Fail Model

The premise of the pass/fail model is the financial statements reported upon by the auditor are fairly presented, in all material respects, in conformity with GAAP (“pass” or unqualified opinion) or not (“fail”).

The pass/fail model has been the basis of the auditor reporting standard with very little change for more than 70 years³ and a historical focus of financial statement users. We believe that most financial statement issuers will continue to maintain their focus on whether a company received an unqualified opinion as it relates to the financial statements presented and support the decision of the PCAOB to retain the pass/fail model.

Critical Audit Matters

The PCAOB defines a CAM as those matters addressed during the audit that:

- Involved the most difficult, subjective, or complex auditor judgments;
- Posed the most difficulty to the auditor in obtaining sufficient appropriate evidence; or
- Posed the most difficulty to the auditor in forming the opinion on the financial statements.⁴

² See Sarbanes-Oxley Act of 2002, Sec 301. (2)

³ See PCAOB Release 2013-005, page 2, Introduction, paragraph 2

⁴ See PCAOB Release No. 2013-005, page 15



The PCAOB's underlying presumption is that auditors would encounter multiple CAMs in most audits, and on a recurring basis, with the source of the CAMs identified as being:

- Documented in the engagement completion document, which summarizes the significant issues and findings from the audit;
- Reviewed by the engagement quality reviewer;
- Communicated to the audit committee; or
- Any combination of the three.⁵

It is our belief that the proposed disclosure of CAMs will most likely become a corollary of management's existing disclosures of critical accounting policies ("CAP"), use of estimates or other significant events and matters in Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A"), which are required under the SEC Regulation S-K, Item 303 and related SEC interpretations and guidance, or in the notes to the financial statements.

Our concerns with the proposed inclusion of CAMs in the auditor's report include:

- The underlying PCAOB presumption that auditors will encounter multiple CAMs in most audits will most likely result in items being classified as CAMs that otherwise would not have previously been considered by auditors to be CAMs.
- Auditor judgments which could result in more CAMs in a report due to auditors erring to inclusion of items that may not otherwise rise to the level of a CAM to avoid a later challenge by PCAOB inspectors.
- Increased auditor workload and client billings to justify why CAM treatment is appropriate for certain items but not appropriate for other items.
- The potential for financial statement users to interpret a CAM as an issue indicative of an issue with the quality of the financial statements, conflicting with management's assessment of internal control over financial reporting, or as a qualification of the auditor's opinion.
- The potential for the use of CAMs over time to become repetitive "boilerplate" language included in the auditor's report.
- The potential for the use of CAMs over time to become an abbreviated version of the Auditor's Discussion and Analysis alternative which has been rejected by the PCAOB.
- The inclusion of CAMs in the auditor's report may result in situations where an auditor is required to disclose information in an audit report that is not required to be reported by management.

⁵ See PCAOB Release No. 2013-005, page 15



- Management already discloses CAP, use of estimates or other significant events and matters extensively in MD&A as well as in the notes to the financial statements. There is no gain in clarity to financial statement users from a restatement of these items as CAMs in the auditor's report.

We do not support inclusion of CAMs in the auditor's report for the reasons noted above and believe that this item should not be implemented as part of a new proposed auditor reporting standard.

Proposed Other Information Standard

Other information is described as information other than the audited financial statements and related auditor's report in a company's audited financial statements filed with the SEC under the Securities Exchange Act of 1934 ("Exchange Act").⁶ This information would include, among other items, business and property description and related statistics, selected financial data, MD&A and certain information incorporated by reference filed on SEC Form 10-K.⁷

In the existing standard, the auditor's responsibility is to "read and consider" other information in the SEC Form 10-K with no audit report requirement describing the auditor's responsibility with respect to other information. If the auditor concludes there is a material inconsistency between other information and the financial statements, the auditor performs certain procedures to respond to the material inconsistency. If the auditor becomes aware of a material misstatement of fact in the other information, the auditor would discuss with management and perform other procedures based on the auditor's judgment.

The proposed other information standard expands auditor responsibilities related to non- financial statement information included in SEC Form 10-K and would:

- Apply the auditor's responsibility for other information specifically to a company's annual reports filed with the SEC under the Exchange Act that contain that company's audited financial statements and the related auditor's report;
- Enhance the auditor's responsibility with respect to other information by adding procedures for the auditor to perform in evaluating the other information based on relevant audit evidence obtained and conclusions reached during the audit;
- Require the auditor to evaluate the other information for a material misstatement of fact as well as for a material inconsistency with amounts or information, or the manner of their presentation, in the audited financial statements; and
- Require communication in the auditor's report regarding the auditor's responsibilities for, and the results of, the auditor's evaluation of the other information.⁸

⁶ See PCAOB Release No. 2013-005, page 19

⁷ *ibid*

⁸ See PCAOB Release No. 2013-005, pages 20 and 21



The auditor's responsibilities for other information contained in a SEC Form 10-K are changed from "read and consider" to "read and evaluate" based on relevant evidence obtained and the conclusions reached during the audit.

Our concerns with the proposed change from "read and consider" to "read and evaluate" other information include:

- Increased auditor workload, which could include substantial audit procedures, and client billings to evaluate and report on other information.
- Assumption by users of financial statements that the auditors have a greater degree of accountability for other information than warranted under the particular circumstances.
- Presumption by users of financial statements that the auditors have a greater degree of understanding of the business or industry described in the other information than is required or warranted.
- Confusion on the part of users of financial statements due to inclusion of disclaimer language as it relates to other information within the auditor's report.

We do not support changing the auditor's other information responsibilities to "evaluate" from "consider" for the reasons noted above and believe that the proposed other information standard not be implemented as written. It would appear more appropriate to clarify auditor responsibility for other information in SEC Form 10-K within the auditor's report.

Other Matters

Auditor Tenure

While there may be some investor interest in auditor tenure, there is no evidence that associates audit tenure with audit quality. There are circumstances where disclosure of auditor tenure makes sense; for example, in a proxy statement related to an Audit Committee report or a ratification action that requires a shareholder vote. However, a statement of when the audit relationship began incorporated in the auditor's report with no context would appear to be of limited or no value; especially given the mandatory rotations of engagement and concurring audit partners on a five (5) year basis.

We do not support inclusion of auditor tenure in the auditor's report.

Materiality

In Appendix 6 of the Release, the PCOAB asks the question:

"Is the federal securities law definition of materiality the appropriate standard for the auditor's responsibility to evaluate other information?"



The federal securities law definition of materiality is incorporated within the SEC guidance⁹ and operates in two dimensions – quantitative and qualitative. The application of materiality is based on the concept of assessments of the inferences a reasonable shareholder’ would draw from a given set of facts and the significance of those inferences to him.¹⁰ Similarly, the FASB states “the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item.”¹¹ Additionally, the FASB has made it clear that “[M]agnitude by itself, without regard to the nature of the item and the circumstances in which the judgment has to be made, will not generally be a sufficient basis for a materiality judgment.”¹²

Materiality as addressed by SEC relates directly to financial statements and, presumably, all other information filed in SEC Form 10-K that is derived from the financial statements. Thus, it would appear that the federal securities law definition of materiality would be directly applicable to certain other information (e.g., selected financial data and MD&A) and arguably to any other information a reasonable shareholder or person may rely upon in a SEC Form 10-K.

Although we do not support the change from “consider” to “evaluate”, we believe that the federal securities law definition of materiality as incorporated in the SEC guidance is not only the appropriate standard for the auditor’s responsibility to evaluate other information but equally is applicable to financial statements.

Auditing Standards

In the Release, the PCAOB shows proposed amendments to current audit standards based on the proposed auditing standards. We note in PCAOB Rulemaking Docket No. 40 that the PCAOB has proposed a framework for reorganizing the existing interim and PCAOB issued auditing standards into a topical structure with a single integrated numbering system as well as proposing (a) certain conforming amendments, (b) certain related amendments to the PCAOB auditing standards and (c) to rescind certain interim auditing standards that the Board believes are no longer necessary under the proposed reorganization.

While we applaud these administrative actions, we also believe the PCAOB should begin a review of all auditing standards to modernize audit practices and processes to recognize the significant changes in the business environment, business practices and technology since many of the auditing standards were developed. We also believe that the PCAOB should give due consideration to the differences in industry

sectors when it revises auditing standards as the current one size fits all approach is not an effective or efficient approach to delivering high quality audit results.

Conclusion

We appreciate the opportunity to comment on the proposed auditor reporting standard, proposed other information standard, and other matters or questions raised in response to the Release. If the

⁹ See SEC Staff Accounting Bulletins No. 99 which is codified as SAB Topic 1. M.

¹⁰ *ibid*, footnote 27

¹¹ *ibid*, footnote 26

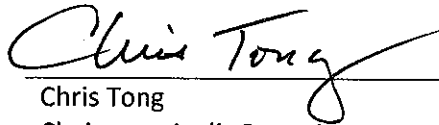
¹² *ibid*, footnote 35



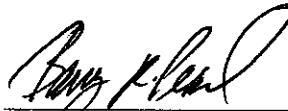
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PCAOB has any questions regarding these comments, please contact Bob Sparger at 713-584-1021 / bobsparger@targaresources.com or John Klein at 713-584-1314 / johnklein@targaresources.com.

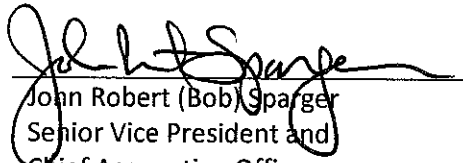
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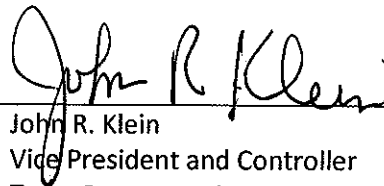
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