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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

Dear Office of the Secretary:

RSM US LLP appreciates the opportunity to offer our comments on the PCAOB's *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*. RSM US LLP is a registered public accounting firm serving middle-market issuers, brokers and dealers.

We are pleased that the reproposal retains the existing pass/fail model of auditor reporting, which generally is acknowledged to be useful to investors and other users of audited financial statements. We continue to support the PCAOB's objective of enhancing the auditor's report with more disclosure and agree that the disclosure of critical audit matters would provide investors with more information than previously provided in the auditor's report. However, we are concerned that the material additional costs associated with critical audit matters will be disproportionate for nonaccelerated filers, smaller reporting companies, and emerging growth companies, and may outweigh the perceived benefits their investors gain from the information provided. As discussed below, we therefore suggest a phased-in approach with a period of evaluation after implementation by large accelerated filers and accelerated filers before the communication of critical audit matters would be required for audits of nonaccelerated filers, smaller reporting companies and emerging growth companies.

Our letter further explains other enhancements that could be made to the repropoed standard, and includes comments related to specific paragraphs of the reproposal that we believe should be clarified or modified.

## **Critical audit matters**

### ***Determination of critical audit matters***

We support narrowing the source of potential critical audit matters to only those matters arising from the audit of the financial statements that were communicated, or required to be communicated, to the audit committee. We believe this is the most logical starting point for the auditor to discern which matters are to be considered worthy of public disclosure in the auditor's report because they involve especially challenging, subjective or complex auditor judgment.

We also support including the concept of materiality in the definition of a critical audit matter as we believe that will focus the auditor on those matters deemed to be most critical to the audit. However, the current materiality factor to be used in identifying a critical audit matter is "accounts or disclosures that are material to the financial statements." We believe this materiality threshold could result in the auditor being required to disclose a nonmaterial matter (related to a material account or disclosure) that would not

otherwise be disclosed by the registrant, and therefore would inadvertently make the auditor the original source of information about a registrant. For example, it should not be necessary to disclose in the auditor's report a significant deficiency related to a material account when management is not required to disclose the significant deficiency under SEC rules.

We believe it would be more appropriate for the concept of materiality in identifying critical audit matters to relate to the financial statements taken as a whole so as to not require disclosure of nonmaterial matters related to material accounts or disclosures. We therefore suggest the following revisions to the definition of a critical audit matter in paragraphs .11 and A2 of the repropoed standard (deletions are struck through and additions are noted in bold font):

"A critical audit matter is any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) ~~relates to accounts or disclosures that are~~ **is** material to the financial statements **taken as a whole** and (2) involved especially challenging, subjective, or complex audit judgment."

To further clarify that the auditor should not be the original source of information about a registrant, we recommend the Board consider revising Note 2 to paragraph .14 to read as follows (deletions are struck through):

"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.~~

### ***Illustrative examples of the communication of critical audit matters***

We appreciate the Board providing illustrative examples of the communication of critical audit matters as we believe such examples will be helpful resources for auditors. We are concerned, however, that the illustrative examples go beyond the requirement in paragraph .14.b. to describe the principal considerations that led the auditor to determine that the matter is a critical audit matter. The illustrative examples included in the repropoed standard seem to indicate that all aspects of the audit be included in the description of the critical audit matter. We suggest the Board consider revising the illustrative examples to clarify that they are intended to illustrate how an auditor may describe the *principal* considerations that led the auditor to determine that the matter is a critical audit matter.

### ***Cost Considerations***

Our firm was one of nine public accounting firms that field tested the implementation of the originally proposed standard to directly assess the impact on various aspects of the audit, including, among others, the additional involvement of senior audit partners, the efforts that would occur during the final stages of the audit and the cost to the client. As documented in the June 19, 2014 letter from the Center for Audit Quality to the PCAOB, feedback from audit engagement teams that participated in this field test, as well as from management and audit committees, was that the additional time and effort was likely to be incurred during the completion phase of the audit by senior members of the audit engagement teams and may require national office consultations and possibly legal review on behalf of the auditors and the registrant. This could occur at a time when auditors, management and audit committees are focused on a number of other issues in connection with a particular filing, and the finalization of critical audit matters may delay, or cause distraction in, the resolution of these issues. Further, many of the accounting firms expressed the view that the incremental time required may not decrease significantly in future years, given (a) that one of the stated objectives of the originally proposed auditor reporting standard is to avoid

boilerplate descriptions and (b) the need to address new potential critical audit matters each year as a result of transactions or other changing business or financial reporting dynamics.

The expenditure of additional time ultimately will be reflected in increased costs for the auditor resulting in increased audit fees for the registrant. Additional legal counsel reviews also may result in increased costs for the registrant. Further, we believe the compression of work by both management and the auditor during the final stages of the audit may adversely impact the quality of financial reporting. This may be particularly burdensome for smaller reporting companies, most of which historically need all of the time available up to the reporting deadline for financial reporting.

Because nonaccelerated filers, smaller reporting companies and emerging growth companies have small market capitalization and typically less extensive investor and analysts' reviews of their financial statements, we are concerned the material additional costs associated with critical audit matters may outweigh the perceived benefits investors gain from the information provided.

#### *Applicability*

We agree that the following entities should be excluded from the requirement to communicate critical audit matters in the auditor's report:

- Nonissuer brokers and dealers
- Investment companies other than those regulated as business development companies
- Employee benefit plans

We continue to believe the repropose disclosure of critical audit matters would not be scalable based on the size of the registrant. Smaller registrants often do not have the same level of sophistication in terms of information technology systems or financial reporting professionals as larger registrants are able to have. This lack of sophistication can cause the auditor to need to make more difficult, subjective and complex auditor judgments and also can pose more difficulty to the auditor in obtaining sufficient appropriate evidence. All of these matters are required to be communicated to the audit committee and therefore are the population from which critical audit matters will be determined. For these reasons, we believe auditors' reports on the financial statements of smaller registrants may be required to include a disproportionately higher number of potential critical audit matters than those of larger registrants. As discussed below, we believe a robust analysis of the costs and benefits of the repropose auditing standard should be conducted prior to determining whether and when the standard should be implemented for nonaccelerated filers, smaller reporting companies and emerging growth companies.

#### **Effective Date**

If finalized, the auditor reporting of critical audit matters required by the repropose standard will require audit firms a considerable amount of time to develop and implement effective quality control procedures and related training. Also, the new requirements likely will require extensive discussions with client management and audit committees as they evaluate the potential effect of the additional auditor communications in the auditor's report. Due to the extent of these efforts, we believe it would be prudent for the repropose standard to first be effective for large accelerated filers for audit periods ending two years after the SEC approves the final standard. To allow firms to benefit from the experience of audits of large accelerated filers, we suggest the final standard be effective for accelerated filers one year after the effective date for large accelerated filers.

As to the effective date for nonaccelerated filers, smaller reporting companies and emerging growth companies, we continue to encourage the PCAOB to conduct a robust analysis of the costs and benefits of the repropoed audit reporting standard before concluding that the benefits of the additional disclosures outweigh the costs and the impact on timeliness of information. Therefore, subsequent to the implementation of the standard by large accelerated filers and accelerated filers, we encourage the PCAOB Center for Economic Analysis to perform a post-implementation review of the overall effect of the standard, similar to the approach used to assess Auditing Standard 7, *Engagement Quality Review*. This review could evaluate the costs and benefits associated with the standard, whether the adopted standard is accomplishing its intended purposes, and whether and when the standard should be implemented for nonaccelerated filers, smaller reporting companies and emerging growth companies. This review also should include evaluation of the unique needs of the investors for these filers as compared to large accelerated filers and accelerated filers.

We believe this phased-in approach would allow for more efficient implementation of the standard in audits of nonaccelerated filers, smaller reporting companies and emerging growth companies because initial implementation issues could be resolved, and related costs would be absorbed, by issuers with the most sophistication and the largest economic footprint. This approach also would align the with PCAOB's mission of protecting the interest of investors, without placing an undue burden on smaller players in the capital markets.

## **Tenure**

In 2011, the PCAOB issued Release No. 2011-006, *Concept Release on Auditor Independence and Audit Firm Rotation*, to seek comment on the advantages and disadvantages of mandatory audit firm rotation, among other matters. Because auditor tenure continues to be a topic of PCAOB discussion and the subject of academic research, we continue to believe the concept of auditor tenure and mandatory audit firm rotation should be addressed in that context separately from any other proposed auditing standard.

Paragraph .10.b. of the repropoed auditor reporting standard, however, requires the auditor to include in the auditor's report a statement containing the year the auditor began serving consecutively as the company's auditor. We are not supportive of including auditor tenure in the auditor's report for the reason discussed in the preceding paragraph and because it is unclear what a user should infer from such a disclosure. Disclosure of auditor tenure also has the potential of distracting the user from more relevant information in the auditor's report. Further, investors who are interested in information about auditor changes can obtain relevant information publicly.

If the PCAOB wishes to consider disclosure of auditor tenure, we believe it would be more appropriate to make such disclosure in Form AP, *Auditor Reporting of Certain Audit Participants*, rather than in the auditor's report. Also, if the auditor is required to disclose auditor tenure either in Form AP or in the auditor's report, we believe guidance should be issued to address how tenure should be calculated so as to provide comparability across all firms. Such guidance should address the following issues, among others:

- The impact of the following on the calculation of auditor tenure:
  - Audit firm mergers and acquisitions
  - Registrant mergers, reverse mergers and acquisitions
- Whether periods audited before an initial public offering count toward auditor tenure or whether auditor tenure begins with the first effective registration statement

- Whether tenure for a new auditor begins when the firm signs an initial engagement letter to audit a registrant's financial statements or when the firm begins the audit

**Clarification of auditor responsibilities in the auditor's report**

We support the proposed change to move the auditor's opinion on the financial statements to be in the opening paragraph of the auditor's report. We also support the additional language clarifying the requirements related to auditor independence. Further, we agree with the expanded language regarding the auditor's responsibilities regarding financial statement material misstatement, whether due to error or fraud.

To promote consistency of auditor reporting globally, we strongly encourage the Board to consider additional auditor report language so as to further align it with the language used in auditor reports issued in accordance with the standards of the International Auditing and Assurance Standards Board. Such language would include expanded descriptions of the responsibilities of management and those charged with governance in a paragraph that is separate from the description of the auditor's responsibilities. Such additional disclosures would enhance financial statement users' understanding of the various responsibilities in the financial reporting and audit processes.

We would be pleased to respond to any questions the Board or its staff may have about our comments. Please direct any questions to Sara Lord, National Director of Assurance Services, at 612.376.9572.

Sincerely,

*RSM US LLP*

RSM US LLP