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Washington, DC 20548

August 15, 2016

Ms. Phoebe W. Brown  
Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street NW  
Washington, DC 20006-2803

**PCAOB Rulemaking Docket Matter No. 034: PCAOB Release Number 2016-003: *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 (May 2016)***

Dear Ms. Brown:

This letter provides the U.S. Government Accountability Office’s (GAO) responses to the Public Company Accounting Oversight Board’s (PCAOB) Release Number 2016-003, *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* (hereafter Release No. 2016-003 or the Reproposal). GAO promulgates generally accepted government auditing standards, which provide professional standards for auditors of government entities in the United States.

We support efforts to improve the quality of financial reporting and increase the confidence users have in the audit of financial statements. Release No. 2016-003 is a reproposal of various changes to the audit report initially proposed in the PCAOB’s Release No. 2013-005.

Consistent with our December 11, 2013, letter in response to the PCAOB’s Release No. 2013-005, we continue to support the PCAOB’s proposal to improve the format of the auditor’s report, which should result in meaningful improvements for users. For the specific format, we encourage the PCAOB to consider using a format that more closely aligns with the International Auditing and Assurance Standards Board’s (IAASB) International Standard on Auditing (ISA) 700 (Revised), including discrete sections that describe management’s responsibilities and the auditor’s responsibilities instead of including such information within the proposed Basis for Opinion section. We have consistently advocated for harmonized standards and consistent practice, absent any compelling reasons that would require different practice, to ensure audit quality. We acknowledge that ISA 700 (Revised) and ISA 701 call for including in the auditor’s report (1) key audit matters and (2) a statement related to the auditor’s independence. We believe that the PCAOB’s Release No. 2016-003 represents an improvement to the original release and is better aligned with the standards adopted by the IAASB.

Also, we encourage the PCAOB to study early results from the changes implemented by the IAASB and perform periodic look-back analyses of the PCAOB implementation to determine whether the changes in the PCAOB reporting standards ultimately had the desired effects and whether the changes resulted in unanticipated or unintended consequences.

We are not persuaded that the Reproposal’s addition of a requirement to disclose auditor tenure in the auditor’s report represents an improvement to PCAOB standards. The information is

already available by other means, and the PCAOB has not clearly indicated what it expects the users to infer from such information. Inclusion of the auditor tenure in the auditor's report may create user confusion about how to interpret the information with respect to the auditor's opinion. Further, the PCAOB seems to be adding information to the audit report that is beyond the report's primary purpose. While the additional information may be useful to users, we do not believe that the audit report is the appropriate place for it. Instead, we believe that the PCAOB should coordinate with the Securities and Exchange Commission (SEC) and jointly determine what type of additional information, if any, is critically important to users and determine the best communication method. We believe that if the PCAOB and SEC determine that additional auditor information is critical to users, the proxy statement would be the most appropriate place to communicate it, as investors consider the information in the proxy statement in determining whether to elect, approve, or ratify the principal auditor for the current year.

We believe that the Reproposal's interaction between the communication of critical audit matters, required explanatory paragraphs, and emphasis paragraphs may create unnecessary duplication and confusion for investors and financial statement users. For example, if descriptions of how a critical audit matter was addressed are provided in the required explanatory paragraph, a user may not be able to consistently locate the information when looking at multiple audit reports. Integrating critical audit matters and required explanatory paragraphs can also confuse the impact of some required explanatory paragraphs. For instances where a critical matter is also an explanatory paragraph or emphasis of matter, we suggest that the PCAOB harmonize its approach with that of the IAASB, which requires a reference in the key audit matter section but waives the requirements to describe the key audit matter and how it was addressed during the audit. The auditor would still have to follow the applicable standards related to reporting the required explanatory paragraph. The PCAOB is seeking comment on a number of questions related to the Reproposal. We have provided our responses to certain specific questions in the enclosure to this letter.

If you have any questions about this letter or wish to discuss any of our responses, please feel free to contact me at (202) 512-3133 or [dalkinj@gao.gov](mailto:dalkinj@gao.gov).

Sincerely yours,

A handwritten signature in black ink, appearing to read "James R. Dalkin". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

James R. Dalkin  
Director  
Financial Management and Assurance

## Enclosure: Answers to Questions

**1. Is the definition of “critical audit matter” appropriate for purposes of achieving the Board’s objective of providing relevant and useful information in the auditor’s report for investors and other financial statement users? Is the definition sufficiently clear to enable auditors to apply it consistently? If not, describe why the definition may not be clear, including examples demonstrating your concern.**

We have consistently advocated for robust standards that are in harmony among the various standard setters to ensure audit quality. While the proposed approach generally appears to be appropriate for achieving the Public Company Accounting Oversight Board’s (PCAOB) stated objective, we believe that the PCAOB should harmonize the definition of critical audit matters with the International Auditing and Assurance Standards Board’s (IAASB) definition of key audit matters to enhance overall consistency.

**2. Are factors helpful in assisting the auditor in determining which matters involved especially challenging, subjective, or complex auditor judgment? Why or why not?**

We have consistently advocated for robust standards that are in harmony among the various standard setters. While the proposed factors generally appear to be appropriate for determining which matters involved especially challenging, subjective, or complex auditor judgment, we believe that the factors should be harmonized with International Standard on Auditing (ISA) 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*, paragraphs 9 and 10. In addition, additional application and explanatory guidance may help the auditor determine which matters involved especially challenging, subjective, or complex auditor judgment.

**3. Are there any factors that the Board should consider adding or removing to better assist the auditor in determining which matters involved especially challenging, subjective, or complex auditor judgment? If so, what are those factors?**

As noted in our response to question 2, we believe that the factors should be harmonized with ISA 701 paragraphs 9 and 10.

**4. Are there specific circumstances in which the auditor should be required to communicate critical audit matters for each period presented, rather than only the current period? For example, should communication be required in an IPO or in a reaudit? Why or why not?**

We believe that the PCAOB should consider requiring the auditor to report critical audit matters fully for the current year along with additional information sufficient to provide context on changes to critical audit matters from the prior year.

**5. Are the repropoed requirements regarding the description of critical audit matters in the auditor’s report, including the principal considerations and how the matter was addressed in the audit, sufficiently clear for consistent implementation by auditors? Why or why not? If not, how could the requirements be clarified?**

We believe that the repropoed requirement for describing the critical audit matters is sufficiently clear to facilitate consistent implementation. However, over time, we believe that the content may evolve into standard (boilerplate) language.

- 6. Do the repropoed communication requirements appropriately address commenter concerns regarding auditor communication of critical audit matters, such as:**
- a. The auditor providing original information in describing the principal considerations for the determination that the matter is a critical audit matter or describing how the matter was addressed in the audit, and**
  - b. Investors and other financial statement users misinterpreting critical audit matters as undermining the auditor’s pass/fail opinion or providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate?**

**Are there other steps the Board could take to address these concerns? If so, what are they?**

If the PCAOB requires auditors to include critical audit matters in auditor’s reports, we suggest that the PCAOB perform periodic look-back analyses to determine whether the changes in PCAOB reporting standards had the desired effects and whether the changes resulted in unanticipated or unintended consequences.

- 7. In addition to referring to the relevant financial statement accounts and disclosures, would it be appropriate for the auditor to refer to relevant disclosures outside the financial statements when communicating a critical audit matter? Why or why not?**

Since an audit report relates to specific relevant financial statement accounts and disclosures, it would be appropriate for the auditor’s reporting of critical audit matters to relate to those financial statement accounts and disclosures.

- 8. Is it appropriate for the repropoed standard to retain the possibility of the auditor determining that there are no critical audit matters and, if so, require a statement to that effect in the auditor’s report? Why or why not?**

As some audits do not involve especially challenging, subjective, or complex auditor judgment, we believe that it is appropriate for the standard setter to allow for the auditor to determine that there are no critical audit matters. We concur that if the auditor deems that there are no critical audit matters, a statement to that effect in the auditor’s report should be required to inform financial statement users of that conclusion.

- 9. Is the repropoed documentation requirement clear and appropriate? Why or why not? If not, how should the documentation requirement be formulated?**

We have consistently advocated for robust standards that are in harmony among the various standard setters. While the repropoed documentation requirement for critical audit matters generally appears to be clear and appropriate, the repropoed requirement differs from ISA 701 in that it does not address how to document the rationale for reporting no critical audit matters or instances where a critical audit matter would not be reported in an auditor’s report because of circumstances such as a law or regulation precluding the disclosure of the information.

- 10. What effect, if any, could the auditor’s communication of critical audit matters under the repropoed standard have on private litigation? Would this communication lead to an unwarranted increase in private liability?**

We are not providing comments responding to this question.

**11. Do the changes from the 2013 proposal address concerns that have been raised about private liability? If not, what additional changes would you suggest should be made?**

We are not providing comments responding to this question.

**12. Are there other steps the Board could or should take to address the likelihood of increasing an auditor's or company's potential liability in private litigation through the requirement to communicate critical audit matters in the auditor's report?**

We are not providing comments responding to this question.

**13. Is the repropoed requirement relating to auditor independence clear? Would this information improve investors' and other financial statement users' understanding of the auditor's independence responsibilities? Why or why not?**

We believe that the repropoed requirement relating to auditor independence is clear, and it is generally consistent with ISA 700 (Revised). We are not certain how this would meaningfully improve investors' and other financial statement users' understanding of the auditor's independence responsibilities.

**14. Is it appropriate to limit the required addressees to the shareholders and the board of directors, or equivalent for companies not organized as corporations? Are there other parties to whom the auditor's report should be required to be addressed, and if so, who are they?**

We believe that the current auditor's report address format is appropriate and the PCAOB does not need to add additional addressees.

**15. Is it clear how the auditor's report would be addressed for companies not organized as corporations? Why or why not?**

We are not providing comments responding to this question.

**16. Are the repropoed requirements for information regarding auditor tenure appropriate and clear? Why or why not? Are there any specific circumstances that could affect a firm's ability to include tenure information in the auditor's report which the Board should consider? If so, what are they?**

We believe that including auditor tenure in the audit opinion is unnecessary and may lead to user confusion and potentially inconsistent and inappropriate interpretation of the information. Also, the PCAOB has not clearly indicated what it expects the users to infer from such information. For example, are users expected to infer that an extended tenure diminishes independence or audit quality? Or should users infer that a long tenure is preferable, as presumably the auditor has a better understanding of the history of the issuer? This information is already available by other means, and the PCAOB seems to be adding information to the audit report that is beyond the report's primary purpose. While the additional information may be useful to users, we do not believe that the audit report is the appropriate place for it. Instead, we believe that the PCAOB should coordinate with the Securities and Exchange Commission (SEC) and jointly determine what type of additional information, if any, is critically important to users and determine the best communication method. We believe that if the PCAOB and SEC

determine that additional auditor information is critical to users, the proxy statement would be the most appropriate place to communicate it, as investors consider the information in the proxy statement in determining whether to elect, approve, or ratify the principal auditor for the current year.

**17. Is it appropriate to disclose the earliest period the auditor began auditing any company in the group of investment companies even if the auditor has not audited all of the companies in the group for the same period of time? Why or why not?**

Please see our response to question 16.

**18. Should disclosure of auditor tenure be made on Form AP rather than in the auditor's report? Why or why not?**

As indicated above, if the PCAOB and SEC believe that auditor tenure should be disclosed, the more appropriate place would be in the proxy statement. However, if the PCAOB requires the disclosure of auditor tenure, making such disclosure on Form AP would be preferable to doing so in the auditor's report.

**19. Would requiring disclosure of auditor tenure in the auditor's report reduce investor search costs? Why or why not? Should the Board require a specific location for disclosure of auditor tenure in the auditor's report? If so, where and why?**

Please see our response to question 16.

**20. Are the changes to the basic elements of the auditor's report to communicate the nature of an audit, the auditor's responsibilities, the results of the audit, or information about the auditor appropriate and clear? Why or why not?**

The changes to the basic elements of the auditor's report to communicate the nature of an audit, the auditor's responsibilities, the results of the audit, or information about the auditor appear appropriate and clear. Consistent with AU-C 700 and ISA 700 (Revised), we suggest that the format include discrete sections for management's responsibilities and auditor's responsibilities, instead of including such information in the proposed Basis for Opinion section.

**21. Is the interaction between the communication of critical audit matters and required explanatory paragraphs clear and appropriate? Why or why not?**

We believe that the interaction between the communication of critical audit matters and required explanatory paragraphs may create unnecessary duplication and confusion for the investors and financial statement users. For example, if descriptions of how a critical audit matter was addressed are provided in the required explanatory paragraph, a user may not be able to consistently locate the information when looking at multiple audit reports. Integrating critical audit matters and required explanatory paragraphs can also confuse the impact of some required explanatory paragraphs. For instances where a critical audit matter is also a required explanatory paragraph, we suggest that the PCAOB harmonize its approach with that of the IAASB, which requires a reference in the key audit matter section but waives the requirements to describe the key audit matter and how it was addressed during the audit. The auditor would still have to follow the applicable standards related to reporting the required explanatory paragraph.

**22. Should auditors be permitted to include the critical audit matter communications in the required explanatory paragraph? Would integrating explanatory paragraphs and critical audit matters be helpful to investors? Alternatively, would it decrease the impact of the explanatory paragraph? Why or why not?**

Please see our response to question 21.

**23. Should the Board's requirement to include an explanatory paragraph in the auditor's report when the auditor did not perform an audit of ICFR apply not only if company's management is required to report on ICFR, but also if management is not required to report, such as for investment companies?**

We are not providing comments responding to this question.

**24. Is the interaction between the communication of critical audit matters and emphasis paragraphs clear and appropriate? Why or why not?**

We believe the interaction between the communication of critical audit matters and emphasis paragraphs can create unnecessary duplication and confusion for the investors and financial statement users. Integrating critical audit matters and emphasis paragraphs can also confuse the impact of some emphasis paragraphs. Similar to our response to question 21, we believe that the PCAOB should include a reference in the critical audit matter section but waive the requirement to describe the critical audit matter in the emphasis paragraph.

**25. Would the repropoed requirements for a specific order of certain sections in the auditor's report and for section titles make the auditor's report easier to use? Should the standard allow more or less flexibility in the presentation of the auditor's report?**

The repropoed requirements for a specific order of certain sections in the auditor's report and for section titles will make the information in the auditor's report easier for users to locate. Also to ensure consistent presentation, the PCAOB should be consistent with other standard setters in the ordering and sections titles of the auditor's report.

**26. Are the repropoed amendments to PCAOB standards appropriate? If not, why not? Are there additional amendments related to the repropoed standard that the Board should consider? If so, what are they?**

As noted in our other responses, we do not believe that the repropoed language on auditor tenure and the statement of independence improve audit quality or meaningfully inform users about the audit.

**27. How would investors use the information communicated in critical audit matters? Would the communication of critical audit matters help reduce information asymmetry between investors and management? Investors and the auditor?**

We are not certain how investors would use information communicated in critical audit matters sections, and as noted earlier, we believe that such information may evolve into standard (boilerplate) language.

**28. How would each of the elements of the communication (i.e., identification, principal considerations, audit response, and financial statement reference) be used by investors?**

We are uncertain whether investors and other financial statement users will find the elements of the communication useful. Accordingly, we suggest that if the PCAOB adopts the changes proposed, it should perform periodic look-back analyses to determine whether the standard achieved its objective, including whether the information was ultimately useful to users.

**29. Would critical audit matters be useful in assessing company financial performance? If so, how?**

We are not certain that the audit report would be an appropriate source for information for assessing a company's financial performance. The company's performance data need to be presented in the financial statements and regulatory filings in accordance with the corresponding standards, laws, or regulations. The role of the audit report is to report whether the information in the financial statements is fairly presented in conformity with the accounting framework, in all material respects.

**30. Would critical audit matters be useful in assessing audit quality? If so, how?**

We are not persuaded that requiring auditors to report critical audit matters in the auditor's report will be useful for assessing audit quality. If the PCAOB requires auditors to report critical audit matters, we encourage the PCAOB to conduct periodic look-back analyses to assess whether the critical audit matters resulted in the desired effects and whether this reporting resulted in additional unexpected or unintended consequences.

**31. Would the communication of critical audit matters enhance attention by auditors, audit committees, and management to the matters identified as critical audit matters? If not, why not? Would such changes enhance audit quality, improve management's disclosures, or otherwise be beneficial to investors? Why or why not?**

We do not believe that under current auditing and regulatory standards there is insufficient communication among auditors, audit committees, and management to address matters critical to their audits. Accordingly, we are not persuaded that including critical audit matters would enhance communication among such parties. If the PCAOB adopts the proposal to require critical audit matters, we encourage the PCAOB to perform periodic look-back analyses to determine whether such reporting resulted in the desired effects and whether it resulted in unexpected or unintended consequences.

**32. Would the communication of critical audit matters trigger other changes in behavior? If so, what changes? Would such changes enhance audit quality or otherwise be beneficial to investors? Why or why not?**

As discussed in our December 11, 2013, letter, we believe that critical audit matters may evolve into standard (boilerplate) language. Thus, if the PCAOB requires critical audit matters reporting, we encourage the PCAOB to perform periodic look-back analyses to determine whether such reporting resulted in the desired effects and whether it resulted in unexpected or unintended consequences.



**33. Would the impact of critical audit matters vary depending on the size of the accounting firm? The size of the company? If so, what would the differences be?**

We believe the nature and complexity of the audit is more relevant to the impact of critical audit matters than the size of the accounting firm or the company.

**34. Would the communication of critical audit matters provide a basis on which auditors could differentiate themselves? Why or why not?**

We are not certain that the communication of critical audit matters would provide a basis on which auditors could differentiate themselves, but if the PCAOB adopts the proposal to require critical audit matters, the PCAOB should perform look-back analyses to assess the impact on auditors.

**35. Are there additional academic studies or data the Board should consider? The Board is particularly interested in studies or data that could be used to assess potential benefits and costs.**

We are not providing comments responding to this question.

**36. Are there additional benefits, costs or unintended consequences, or other economic considerations, such as competitive effects, associated with critical audit matters or the additional improvements to the auditor's report that the Board should consider? If so, what are they?**

We are not providing comments responding to this question.

**37. Is it appropriate for the communication of critical audit matters not to be required for the audits of brokers and dealers reporting under Exchange Act Rule 17a-5, investment companies other than BDCs, and benefit plans? Why or why not?**

We are not providing comments responding to this question.

**38. For these specific types of entities, are there situations in which critical audit matters would be useful to investors? If so, what are these situations?**

We are not providing comments responding to this question.

**39. While not requiring communication of critical audit matters in the audits of these specific entities, should the Board encourage voluntary communication? Why or why not?**

We are not providing comments responding to this question.

**40. Should the requirements related to critical audit matters not apply to the audits of other types of companies, such as shell companies? Why or why not?**

We are not providing comments responding to this question.

**41. Should the repropoed requirement regarding communication of critical audit matters be applicable for the audits of EGCs? Should the other elements of the repropoed standard and amendments be applicable for the audits of EGCs? Should the repropoed requirements be modified to make their application to EGCs more appropriate? Would excluding audits of EGCs benefit or harm EGCs or their investors? Why or why not?**

We are not providing comments responding to this question.

**42. If the Board determines not to apply all or part of the repropoed standard and amendments to the audits of EGCs, would there be any unintended consequences if auditors complied voluntarily? If so, what are they?**

We are not providing comments responding to this question.

**43. Are there any other benefits, costs or considerations related to promoting efficiency, competition, and capital formation that the Board should take into account with respect to applying the repropoed standard to audits of EGCs?**

We are not providing comments responding to this question.

**44. If the repropoed standard is adopted by the Board and approved by the SEC, how much time would auditors need to implement it? Should the Board consider a delayed compliance date for the repropoed standard, or for certain parts of the repropoed standard, for audits of smaller companies? If so, what criterion should the Board use to classify companies, for example smaller reporting companies? Are there criteria other than the size of the company that the Board should consider for a delayed compliance date?**

We believe that the PCAOB should consider an implementation strategy that phases in companies by size. This approach may reduce implementation costs to companies and auditors, as lessons and accepted practices will emerge from the large company audits.