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December 11, 2013

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

Re: PCAOB Release No. 2013-005, Rulemaking Docket Matter No. 034, *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 "Release")*

Dear Board Members and Staff:

BDO USA, LLP is pleased to have the opportunity to comment on *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (the "Proposed Auditor Reporting Standard")*, 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 Proposed Amendments to PCAOB Standards Related to the Proposed Auditor Reporting standard* (together, the "Proposed Standards").

We continue to support the PCAOB's efforts to explore ways to enhance the usefulness and informational value of the auditor's report and provide transparency about the audit. We support many of the enhancements to auditor reporting set out in the Proposed Standards, such as expanding the existing language in the auditor's report related to the auditor's responsibilities for fraud and notes to the financial statements and other information, and communication of audit related matters the auditor considered critical. While we recognize that certain aspects of the Proposed Standards will likely present challenges in implementation, we expect that over time such challenges will lessen as auditors gain experience in their application.

While we are supportive of the overall direction of the Proposed Standards, we have reservations about the approach taken in some important areas, such as the identification and communication of critical audit matters, including the extent of documentation required, and the expansion of performance obligations and auditor reporting with respect to other information. Our views on these matters are more fully described in the sections below and in our response to selected questions posed in the Release.

Identification of Critical Audit Matters

We believe the identification of critical audit matters should be focused on those matters identified during the audit that required special audit consideration, such as significant risks, or areas of significant difficulty in the audit, for example, with respect to obtaining sufficient appropriate evidence. Such an approach is similar to that included within the International Auditing and Assurance Standards Board's (IAASB) proposed ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*. This contrasts with the PCAOB's identification of critical audit matters that has in large part focused on the difficulty of an auditor judgment or matter. While the identification of critical audit matters under the PCAOB Proposed Standard is likely to result in similar matters being identified under the IAASB's proposal, we believe that the use of a risk based approach, analogous to the approach used to focus the audit on the most important matters, better articulates those matters important to users of financial statements.

Furthermore, we believe that critical audit matters should be a subset of those matters communicated to the audit committee, and should not include matters from other sources, since we believe that the matters required to be communicated to audit committees under Auditing Standard No. 16, *Communications with Audit Committees*, encompass all matters that would be pertinent for a user to understand the matters arising from the audit that were of most significance to the financial reporting process. We understand that some concern has been expressed about the possibility of an auditor failing to communicate certain matters to the audit committee to avoid communication of that matter as a critical audit matter in the auditor's report. However, such a possibility could be avoided by ensuring that Auditing Standard No. 16 included the same criteria for identifying and communicating critical audit matters as the Proposed Standard. In this way, once a matter rose to the level of a critical audit matter, it would also have risen to the level of a required audit committee communication.

Communication of Critical Audit Matters

The requirement in paragraph 11 of the Proposed Auditor Reporting Standard explains that the communication of critical audit matters should identify the matter, describe the considerations that led the auditor to determine that the matter is a critical audit matter, and provide a reference to where that matter is described in the financial statements, if applicable. However, we note that all the illustrative examples provided in Appendix 5 of the Proposed Standard include a description of audit procedures performed, although such a description is not required. We believe that in some instances, a description of audit procedures performed may help to explain why a matter is considered a critical audit matter, and suggest including in the requirement that a description of a critical audit matter may include its effect on the audit, if considered necessary, taking care not to convey that a separate opinion or conclusion is provided on the critical audit matter. In this regard, we suggest providing examples of critical audit matter paragraphs that illustrate how to report in both circumstances.

We continue to believe that the auditor should not be the source of original information about the company and should not communicate matters that management is not required to communicate. As such, we do not support auditor communication of significant deficiencies, or other matters 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 generally expect that such matters would also be the most difficult, subjective, or complex management judgments, and would accordingly also be reported by management within the notes to the financial statements, or elsewhere in documents containing the financial statements.

Extent of Documentation

The Proposed Auditor Reporting Standard requires the auditor to document the basis for determining that a reported matter was a critical audit matter, in addition to why a non-reported matter that would appear to meet the definition of a critical audit matter was not determined to be a critical audit matter. We believe that the requirement to document why something is not a critical audit matter has the potential to result in excessive documentation and increase the cost of implementing the Proposed Auditor Reporting Standard without a corresponding benefit.

Furthermore, if critical audit matters were a subset of those matters communicated to the audit committee, as we suggest, the auditor's judgments relating to why a matter was considered to be a critical audit matter would likely be supported by the documentation already included as part of the auditor's communication with the audit committee. Conversely, that documentation would likely provide an indication of why other matters discussed with the audit committee did not rise to the level of a critical audit matter.

Other Information

Overall, we support the elements in the Proposed Other Information Standard that enhance the user's understanding of the nature of the work performed by the auditor and the information to which the auditor devoted attention. However, we do not support providing a conclusion on the work performed with respect to other information. We are concerned that the requirement for the auditor to address whether, based on reading and evaluating the other information, they have identified material inconsistencies in the other information or material misstatements of fact may be perceived by users as providing some level of assurance, which is not supported by the extremely limited procedures performed.

Moreover, we believe the use of the term "evaluate" in the Proposed Other Information Standard, in contrast to the term "consider," which is the current performance requirement under AU 550, *Other Information in Documents Containing Audited Financial Statements,* could inadvertently cause auditors to expand their procedures relating to other information, particularly if the auditor is required to provide a conclusion on the other information. The term "evaluate" has heretofore been associated with the performance of procedures to obtain either limited or reasonable assurance, which is not contemplated in the Proposed Other Information Standard; to use the term "evaluate" to describe procedures outside that context has a strong potential to mislead users about the nature of the procedures performed and the degree of comfort that users should take from the performance of the limited procedures.

Applicability of the Proposed Standards

We do not believe the provision to communicate critical audit matters should be required for audits of brokers and dealers, investment companies, or employee benefit plans (for example, employee stock purchase, savings, or similar plans). These types of issuers differ from the typical SEC issuer, and we do not believe investors or other financial statement users are demanding additional information with respect to these companies.

With respect to the Proposed Other Information Standard, we do not believe that audits of brokers and dealers or employee benefit plans should be subject to this proposal. We believe that the compliance or exemption report required to be filed by brokers and dealers and required to be reported on by auditors under the proposed *Standards for Attestation Engagements Related to Broker and Dealer Compliance or Exemption Reports Required by the U.S. Securities and Exchange Commission* provides users of their financial statements with sufficient information to make any additional reporting by the auditor unnecessary. Furthermore, employee benefit plans that file a Form 10-K contain limited other information that we do not believe is used by plan participants for investment decision making purposes, and for this reason we suggest the Proposed Other Information Standard should not apply to these audits.

As it relates to emerging growth companies, we believe that both the Proposed Auditor Reporting Standard and the Proposed Other Information Standard should be applicable to such companies, except as noted in our response to question 42 under the section, Considerations Related to Effective Date, to permit delayed compliance for smaller emerging growth companies.

Field Testing

We believe that field testing the provisions of the Proposed Standards, in particular the provisions relating to critical audit matters and the work effort relating to other information, both retrospectively and in live situations, has the potential to provide invaluable insights into the impact of these provisions on the audit, including cost benefit considerations. While we are currently engaged in performing some limited field testing of these provisions as a Firm and in conjunction with the Center for Audit Quality on a retrospective basis, we encourage the PCAOB to provide for sufficient time for the performance of both retrospective and live field testing and for the appropriate analysis of results before concluding on the matter.

Additional Commentary

We encourage the PCAOB to work with the IAASB to converge, to the greatest extent possible, the form and content of the auditor's report to increase comparability and ease of use by users so that any differences in reporting reflect genuine differences in approach. For example, the nature of the audit would seem to be largely similar between an audit performed in accordance with the International Standards on Auditing and an audit performed in accordance with the PCAOB Auditing Standards; thus we would expect that the description in the auditor's report would reflect that similarity. The greater the extent of differences, the greater the effort users will need to expend in understanding the significance of those differences when analyzing auditor reports between different jurisdictions.

Our responses to certain questions on select topics posed in the Release further expand upon our overall views expressed above, and are set out below.

The Proposed Auditor Reporting Standard

Basic Elements

2. **The proposed auditor reporting standard would require the auditor's report to be addressed at least to (1) investors in the company, such as shareholders, and (2) the board of directors or equivalent body. Are there others to whom the auditor's report should be required to be addressed?**

We believe the auditor's report should be addressed to the investors in the company, such as the shareholders and the board of directors, or equivalent body, and not expanded to include other third parties such as bondholders. The auditor's report on an issuer's financial statements is a general use report and as such is available to all users of those financial statements, through the SEC website. For this reason, we do not see a reason for or benefit to expanding those to whom the audit report should be addressed. There is; however, likely significant litigation costs, and potentially significant legal liability, associated with adding addressees to the report. In particular, addressing the auditor's report to third parties will likely lead to an increase in in state law claims by such third parties. It can be expected that these third parties will claim that, under a particular state law, the fact that it was listed as an addressee creates a relationship that can lead to significant state law audit firm liability. It is unclear whether a particular court would agree under the applicable state law; but, given the general use nature of the report, BDO can see no reason to create this increase in audit firm litigation costs and potential liability.

5. **The proposed auditor reporting standard would require the auditor to include in the auditor's report a statement containing the year the auditor began serving consecutively as the company's auditor.**
    a. **Would information regarding auditor tenure in the auditor's report be useful to investors and other financial statement users? Why or why not? What other benefits, disadvantages, or unintended consequences, if any, are associated with including such information in the auditor's report?**
    b. **Are there any additional challenges the auditor might face in determining or reporting the year the auditor began serving consecutively as the company's auditor?**
    c. **Is information regarding auditor tenure more likely to be useful to investors and other financial statement users if included in the auditor's report in addition to EDGAR and other sources? Why or why not?**

We understand that investors are interested in audit tenure and we support providing such transparency. However, we do not believe that including such information within the audit report provides the appropriate context for that communication. We are concerned that including such a disclosure in the audit report may infer a correlation between audit quality and audit tenure – a correlation which we believe has not been established. We believe such disclosure would be better placed on the PCAOB's Form 2.

6. **The proposed auditor reporting standard would require the auditor to describe the auditor's responsibilities for other information and the results of the evaluation of other information. Would the proposed description make the auditor's report more informative and useful? Why or why not?**

We believe it would be appropriate to describe the auditor's responsibility for other information in a separate paragraph of the auditor's report to enhance the informational value of the report. However, while the auditor has an existing responsibility to describe any material inconsistency between the audited financial statements and other information and whether a material misstatement of fact exists, we do not believe it is appropriate to provide an explicit statement where there is nothing to report, given the limited nature of the auditor's procedures.

7. **Should the Board require a specific order for the presentation of the basic elements required in the auditor's report? Why or why not?**

We do not believe the Board should require a specific order for the presentation of the basic elements required in the auditor's report. However, we would suggest the required use of section headings to assist users in understanding the auditor's report and making comparisons between audit reports of other issuers. Moreover, such an approach is consistent with the IAASB's exposure draft, *Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs),* and we believe it will be beneficial in circumstances where an entity is required to report under both the PCAOB Auditing Standards and the ISAs.

Critical Audit Matters

11. **What benefits or unintended consequences would be associated with the auditor's communication of critical audit matters?**

We understand that financial statement users believe that communication of critical audit matters will provide helpful insights into the audit of the financial statements and, as such, is responsive to their demands for more information about the audit. Moreover, including this information in the auditor's report would generally provide context to those areas in the financial statements that required significant auditor attention. However, in addition to these benefits, there are certain aspects of this communication, as proposed, that may result in unintended consequences, including:

- The disclosure of information that is the responsibility of management. For example, the severity of a control deficiency that is less severe than a material weakness may be considered a critical audit matter and result in the auditor providing information that was specifically exempted from disclosure by the SEC and PCAOB;

- The disclosure of consultations with others outside the engagement team may have a cooling effect on consultations, which would be contrary to enhancing audit quality;
- The chilling effect that disclosure of critical audit matters may have on communications with audit committees;
- Financial statement users may assume the auditor has provided a separate level of assurance on specific accounts or balances referenced in the critical audit matters, or conversely undermine the auditor's opinion on the financial statements taken as a whole.

13. Could the additional time incurred regarding critical audit matters have an effect on the quality of the audit of the financial statements? What kind of an effect on quality of the audit can it have?

The effect the additional time spent on identifying and communicating critical audit matters may have on audit quality is difficult to assess at this time, without the benefit of the results of field testing. However, a possible benefit could be increased attention by management and the auditor on the related financial statement disclosures. The more significant unintended consequences to audit quality include: an increased strain on resources at the end of the audit as a result of already tight filing deadlines; and a chilling effect on audit committee communications.

16. Are the factors helpful in assisting the auditor in determining which matters in the audit would be critical audit matters? Why or why not?

For the most part, we believe the factors in paragraph 9 of the Proposed Auditor Reporting Standard would be helpful in assisting the auditor in determining which matters should be considered in coming to a determination about whether a matter rose to the level of a critical audit matter. However, it is not clear whether once one factor is identified, on that basis alone, a matter would rise to the level of a critical audit matter. We do not believe that the intention of paragraph 9 is that the existence of one factor alone is the sole determination that a matter is a critical audit matter. If this is the case, we believe that additional guidance about how the factors are used in determining critical audit matters would be helpful. As such, we suggest moving the following guidance from page A5-29 of the Release into the proposed standard:

> Depending on the matter and its circumstances, the applicability and related degree or scope of just one factor might lead an auditor to conclude that a matter is a critical audit matter. In other cases, however, the auditor might take into consideration a combination of factors in determining that a matter is a critical audit matter.

Furthermore, while we agree that most of the factors are helpful, we do not believe that consultations outside the engagement team or use of auditor specialists should be considered factors in determining whether or not a matter rises to the level of a critical audit matter, as such consultations are often routinely performed during an engagement.

21. What are the additional costs, including indirect costs, or other considerations related to the auditor's determination, communication, and documentation of critical audit matters that the Board should take into account? Are these costs or other considerations the same for all types of audits?

As noted earlier, we believe that a more informed response about costs will be available once the results from field testing are evaluated. However, some initial thoughts on costs relating to the characteristics of the entity under audit include:

- While the content of the communications in the auditor's report are the responsibility of the auditor, as the audit issues encountered during the audit increase in difficulty and the more extensive the discussions between the auditor and the audit committee, the greater the cost will be.

- Smaller entities with fewer resources to address reporting complexities may be impacted to a greater extent than larger entities with greater resources. For this reason, we suggest the PCAOB consider a staged implementation such that larger issuers implement the standard first to afford smaller entities the opportunity to learn from the experience of their larger counterparts.

24. Are there specific circumstances in which the auditor should be required to communicate critical audit matters for each period presented, such as in an initial public offering or in a situation involving the issuance of an auditor's report on a prior period financial statement because the previously issued auditor's report could no longer be relied upon? If so, under what circumstances?

We support limiting critical audit matters to only the most recent financial statement period when the current period financial statements are presented on a comparative basis with those of one or more prior periods. Nevertheless, we believe the auditor should consider communicating critical audit matters relating to the prior periods when (1) the prior period's financial statements are made public for the first time, such as in an initial public offering, or (2) issuing an auditor's report on the prior period's financial statements because the previously issued auditor's report could no longer be relied upon.

Additionally, to provide clarity about the need to include critical audit matters when a predecessor is asked to reissue a report, we recommend that the guidance from page A5-34 of the Proposed Auditor Reporting Standard be included within the body of the standard. It states:

> In situations in which a predecessor auditor has been asked to reissue his or her audit report on the financial statements of a prior period, existing standards require the auditor to consider whether the auditor's report on those statements is still appropriate after certain required procedures are performed. If the predecessor auditor determines that the auditor's report is still appropriate and is reissued, the communication of critical audit matters for the prior period need not be repeated. Since the communication of critical audit matters is only required for one year, the proposed auditor reporting standard would not require the communication of critical audit matters in the reissued report of the predecessor auditor for prior years.

28. What effect, if any, would the auditor's communication of critical audit matters under the proposed auditor reporting standard have on an auditor's potential liability in private litigation? Would this communication lead to an unwarranted increase in private liability? Are there other aspects of the proposed auditor reporting standard that could affect an auditor's potential liability in private litigation? Are there steps the Board could or should take to mitigate the likelihood of increasing an auditor's potential liability in private litigation?

The proposed requirements relating to critical audit matters would, in all likelihood, lead to increased litigation expense and risk of liability. In particular, plaintiffs will likely argue under the federal securities laws and/or state law that the auditor has made a "statement" that was somehow misleading (e.g., contains a material misstatement or material omission) and it relied on that statement to its detriment. The Proposed Auditor Reporting Standard's broad definitions regarding what constitutes a critical audit matter will require the auditor to engage in frequent, and significant, judgment calls. Because the auditor will exercise these judgments in determining what, if any, "statement" is made regarding a potential critical audit matter; these judgments have the potential to be the subject of persistent second guessing by plaintiffs. Proposed changes to the proposal aimed at making clearer what is, and is not, a critical audit matter will be important to defending against such second-guessing of auditor judgments. While such changes have the potential of mitigating liability, they will of course not eliminate the significant risk associated with the auditor's communication of critical audit matters under the Proposed Auditor Reporting Standard.

Furthermore, there is also the potential for claims by issuers (e.g., for disclosing client confidential information) to the extent the auditor discloses matters that go beyond what is required to be disclosed under corporate disclosure rules. As such, we believe it is extremely important to align the auditor's responsibilities to identify and communicate critical audit matters with the corporate disclosure rules. The auditor ought not to be put in the position of having to choose between potentially violating a PCAOB rule and facing a legitimate claim by an issuer for disclosing confidential and/or otherwise protected information.

30. Is retaining the auditor's ability to emphasize a matter in the financial statements valuable? Why or why not?

We agree that retaining the auditor's ability to emphasize a matter in the financial statements is worthwhile to address those matters that do not fall within the scope of critical audit matters but the auditor nevertheless believes is worthwhile to emphasize. It may be helpful, however, to include application guidance that distinguishes how a critical audit matter differs from an emphasis of matter, to avoid confusion.

<u>Considerations Related to Effective Date</u>:

41. Is the Board's effective date appropriate for the proposed auditor reporting standard? Why or why not?

We believe the results from field testing will provide essential feedback to be considered in formulating a final standard. For this reason, until the results from field testing are evaluated, we believe it is premature to comment on a possible effective date. In this regard, it may be helpful to monitor the implementation of the UK's Financial Reporting Council's recently issued ISA (UK and Ireland) 700, *The Independent Auditor's Report on Financial Statements.* This standard requires the auditor's report on entities that report on how they have applied the UK Corporate Governance Code to: (1) describe the risks of material misstatement that were identified by the auditor and which had the greatest effect on the overall strategy, the allocation of resources on the audit, and directing the effects of the engagement team, and (2) provide an overview of the scope of the audit, including an explanation of how such scope addressed the assessed risk of material misstatement. While the FRC standard differs in some respects from the PCAOB's Proposed Auditor Reporting Standard, there are sufficient similarities such that the UK and Ireland experience could inform the Board's deliberations on this matter.

42. Should the Board consider a delayed compliance date for the proposed auditor reporting standard and amendments or delayed compliance date for certain parts of the proposed auditor reporting standard and amendments for audits of smaller companies? If so, what criteria should the Board use to classify companies, such as non-accelerated filer status? Are there other criteria that the Board should consider for a delayed compliance date?

Due to the significance of the changes in auditor reporting proposed in this Release, in particular as it relates to critical audit matters, we believe that a delayed compliance date for audits of smaller companies, such as non-accelerated filers, is appropriate.

The Proposed Other Information Standard

<u>Introduction and Objectives</u>:

2. Is it appropriate to apply the proposed other information standard to information incorporated by reference? Why or why not? Are there additional costs or practical issues with including information incorporated by reference in the scope of the proposed other information standard? If so, what are they?

When documents that are not yet available are incorporated by reference (e.g., the definitive proxy statement that is generally not available at the time of the issuance of the audit report), it is unclear how the auditor is to report at the audit report date and then subsequently when that document becomes available. We believe that it is inappropriate for the auditor to report on information that is not yet available, and suggest that additional guidance about how to report in such a circumstance be included within the Proposed Other Information Standard.

<u>Evaluating the Other Information</u>:

6. **Is it appropriate to require the auditor to evaluate the other information for both a material inconsistency and for a material misstatement of fact? If not, why not?**

We believe the auditor's responsibility for other information <u>directly related</u> to the audited financial statements should be to read and perform certain limited procedures, and based on that work report whether a material inconsistency or a material misstatement of fact is identified. However, for other information <u>not directly</u> related to the audited financial statements, we believe the auditor's responsibility should be consistent with AU 550, *Other Information in Documents Containing Audited Financial Statements,* which requires the auditor to read the other information and, if the auditor becomes aware of a potential material misstatement of fact in the other information, to discuss the matter with the client and request that misstatement to be corrected. Moreover, we believe the proposal should recognize that for information not directly related to the audited financial statements, the auditor may not have the expertise to assess its presentation and, accordingly, provide guidance for such circumstances.

9. **Are the proposed procedures with respect to evaluating the other information clear, appropriate, and sufficient? If not, why not?**

Paragraph 4 of the Proposed Other Information Standard requires the auditor to read and evaluate the other information based on relevant audit evidence obtained and conclusions reached during the audit. We are concerned that the phrase, "relevant audit evidence obtained and conclusions reached during the audit," has the potential to be misinterpreted to require a search of the audit documentation to determine what particular items included within other information may be included within the working papers. To address this concern, we suggest aligning the auditor's performance responsibilities in this regard to the audited financial statements or accounting records that are the subject to the audit, or that have been derived from such accounting records by analysis or computation.

<u>Other Considerations</u>:

24. **What effect, if any, would the reporting under the proposed other information standard have on an auditor's potential liability in private litigation? Would this reporting lead to an unwarranted increase in private liability? Are there steps the Board could or should take related to the other information requirements to mitigate the likelihood of increasing an accounting firm's potential liability in private litigation?**

The Proposed Other Information Standard would likely lead to an unwarranted increase in private litigation against auditors under the federal securities laws and state laws. In particular, plaintiffs would likely argue that (i) the proposed auditor obligation to "read and evaluate" such other information requires the auditor to conclude on the accuracy and sufficiency of disclosures by management in areas beyond the financial statements and the associated footnotes; (ii) the auditor's written observations with regard to such other information (proposed by the PCAOB to be an affirmative statement that it has not identified a material inconsistency or misstatement of fact in the other information) constitutes a “statement” under the federal securities laws; and (iii) they relied upon such “statements” to their detriment. The litigation risk would be expansive, and equally unwarranted, given the auditors specific role in the public markets. We have therefore proposed, and support, changes to the proposal that are aimed at avoiding this unwarranted expansion of liability. These changes would certainly not eliminate all potential liability associated with other information; but rather would more closely align this potential liability with the auditor’s legitimate role.

25. Would reporting under the proposed other information standard affect an auditor's potential liability under provisions of the federal securities laws other than Section 10(b) of the Exchange Act, such as Section 11 of the Securities Act? Would it affect an auditor's potential liability under state law?

Please see response to question 24 above.

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We would be pleased to discuss our comments with you at your convenience. Please direct any questions to Chris Smith, Audit and Accounting Professional Practice Leader, at 310-557-8549 (chsmith@bdo.com) or Susan Lister, National Director of Auditing, at 212-885-8375 (slister@bdo.com).

Very truly yours,

/s/ BDO USA, LLP

BDO USA, LLP