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

Re: PCAOB Rulemaking Docket Matter No. 34

Proposed Auditing Standards –

1. The Auditor's Report on an Audit of Financial Statements when the Auditor Expresses an Unqualified Opinion;
2. The Auditor's Responsibility Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report.

Mayer Hoffman McCann P.C. ("MHM") is pleased to provide the PCAOB (or "the Board") its comments on the above referenced proposed auditing standards. The PCAOB's desire to evaluate the auditor's reporting model is certainly understandable given that the current reporting model has remained in place without significant change for several decades.

We agree with the Board's decision to retain the current "pass/fail" reporting model. Our comments are directed at the Board's decision to significantly expand the auditor's reporting responsibilities, specifically the requirement to disclose in the auditor's report certain "critical auditing matters" as determined by the auditor and the auditor's responsibility for other information.

### **Disclosure of Critical Auditing Matters**

We believe that a significant reason the current auditor reporting model has stood the test of time is that it conveys to investors the auditor's opinion on the financial statements in a concise, straight forward manner. We are concerned that the proposed additions to the auditor's report (i.e., critical auditing matters) may produce unintended consequences that are not wholly desirable.

While we understand the desire to provide investors with additional "color" related to the current pass/fail model; it is entirely possible that such information will prompt investors to interpret the additional information disclosed by auditors in a manner inconsistent with the actual meaning of the auditor communication. For

example, does the disclosure of a significant number of critical audit matters infer something “bad” is happening with an entity’s financial reporting? There are many aspects of an entity’s financial reporting process that while routine in nature retain a high degree of complexity and subjectivity. Will these be disclosed as critical auditing matters? If so, will investors understand that nothing out of the ordinary was identified by the auditor? Will investors try to compare audit reports across companies and industries and reach conclusions that cannot be supported based on the subjective nature of the proposed auditor communication, which are almost always dependent on a set of facts and circumstances unique to the company and audit engagement. Our observations are not intended to ignore the possibility that in many cases the additional proposed disclosures might be useful to investors. However, we want to voice our concern that in some cases the information disclosed by auditors will have the potential to be misunderstood by investors, thereby greatly diminishing the value of the communication or leading to unintended consequences. The subjective nature of critical auditing matters leads to other operational concerns within the existing regulatory environment. For example, how will the PCAOB evaluate decisions about what to include in the auditors’ report? How will the PCAOB determine and describe its conclusion during the inspection process if it disagrees with the decisions of an engagement team? Additionally, how will the Board ensure that its interpretations are consistently applied given that each firm may address audit matters differently, even with the same set of circumstances (i.e., choose different things as critical audit matters or go into more or less detail about such issues, etc.)?

The matter of legal liability must also be considered when evaluating the Board’s proposed auditing standards. Some commentators have suggested that the disclosure of critical audit matters will serve as a road map to the “plaintiff’s bar” when an auditor’s work is subject to regulatory and/or legal action. Auditors will have to carefully evaluate which matters to disclose and choose the appropriate wording that best reflects the facts and circumstances underlying the critical audit matter. Firms will by necessity involve their most senior and technically proficient audit and legal professionals in the drafting process. The amount of dialogue between the auditor, management and the audit committee will likely be significant. Some firms may resort to “boiler plate” disclosure while others may include everything “under the sun” in an attempt to deal with regulatory and legal risk. The combination of these factors leads us to believe that the cost related to the disclosure of critical audit matters is almost certain to be significant, while the actual benefit to investors may prove difficult to accurately determine. Additionally, we believe the proposed reporting requirements will likely place additional strain on both the auditor and management with respect to meeting existing reporting deadlines.

The proposed changes to the auditor’s reporting model may imply that the auditor could, or even should, provide information to investors not previously made available to investors by management. The auditor’s role has always been to verify information prepared by management as opposed to becoming a source of new information for investors. Is it possible that investors might try to use information coming from the auditor in a manner inconsistent with its intended use, thereby altering the role and function of the auditor? For example, determining the existence of critical audit matters requires the auditor to consider the severity of control deficiencies identified relevant to the matter, if any. This could imply the auditor discloses internal control deficiencies at a level below a material weakness, where management has no requirement to do so. We respectfully ask the Board to clarify that it does not intend for auditors to “grade and report” internal control deficiencies through the communication of critical audit matters, when existing auditing standards that apply to the audit engagement do not require the auditor to do so.

We note that in the examples provided by the Board to illustrate the determination of critical audit matters, the Board chose to describe certain auditing procedures related to the critical audit matter. It is not clear whether the Board intends the auditor to provide a description of the auditing procedures related to the critical audit matter. We believe the inclusion of detailed auditing procedures in the auditor's report will be operationally difficult, distracting to investors, and may add significant volume to the auditor's report that does not provide a significant benefit to most investors. If the PCAOB believes that auditors should describe the auditing procedures related to the underlying critical audit matter, we request that the PCAOB clarify their expectation related to describing audit procedures and provide a sufficient number of examples to help auditors understand the expectation.

### **Other Information**

With respect to the Board's proposal on "other information" we are principally concerned with two major items. The first is the possibility that an "expectation gap" will exist whereby investors believe that they have some form of audit assurance related to other information simply because the auditor is required to make an assertion about it in the auditor report. The second is the increase in cost related to the audit engagement that is virtually certain to occur under the current proposal. While some firms may already perform procedures related to other information (as a form of best practice), the inclusion of an assertion related to such procedures in the auditor's report is likely to prompt more rigor in both the procedures themselves and the documentation of the procedures performed related to other information. We note that both an "expectation gap" and an increase in costs occurred when the CEO and CFO certifications were implemented several years ago, as part of the Sarbanes Oxley Act of 2002.

We are also concerned with the meaning of the term "evaluate" used in the proposed standard on other information to describe the procedures required of auditors. The term "evaluate" could infer that an auditor needs to do whatever is necessary to reach a conclusion about the other information, as opposed to performing a standard set of procedures. We ask the Board consider whether the term "evaluate" is precise enough in its meaning to appropriately describe the Board's expectation of auditors under the proposed auditing standard on other information.

There are other matters that may create operational difficulties for auditors, for example, what responsibility does an auditor have for other information not derived from the accounting systems and internal controls over financial reporting that are the subject of the audit? There are typically a number of statements made by management in the annual report that are highly subjective in nature. While we understand the Board expects auditors to work through such matters by engaging in conversation with management, such activities will certainly contribute to the overall cost of implementing the standard given that subjective judgments are often selected by regulators and plaintiff's attorneys as potential issues to challenge.

### **Disclosure of Auditor Tenure**

We do not believe the disclosure of the auditor's tenure is particularly relevant and therefore we question its value to investors. We note that many commentators have noted the lack of empirical evidence that

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establishes a direct correlation between auditor tenure and audit quality. We are also concerned that disclosure of auditor tenure in the auditor's report may be interpreted by investors as implying a problem with auditor independence when none exists. We believe the appropriate place for the disclosure of the auditor's tenure is the Company's proxy statement.

In closing, we note that recently the PCAOB repropoed an amendment to its auditing standards that would provide greater transparency to audits of public companies and broker-dealers about the engagement partner and certain other participants in the audit. Because this proposed amendment also impacts the auditor's report, we respectfully recommend that the timing related to the issuance of a final auditing standard pertaining to the proposed standards noted in number one and two above be delayed until the PCAOB concludes the process related to its auditor transparency standard. This allows for a one-time change to the auditor's report that encompasses all of the PCAOB's identified changes as opposed to a multi-step process.

Finally, while we acknowledge and support the Board's desire to improve audit quality; we are concerned that ultimately the improvements that arise from the proposed auditing standards will be outweighed by the financial cost necessary to achieve the benefit. We encourage the Board to carefully study the cost/benefit relationship related to these proposed auditing standards before the issuance of the final standards.

Sincerely,

*Mayer Hoffman McCann P.C.*