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December 10, 2013

Office of the Secretary
Public Company Accounting Oversight Board
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Via email to comments@pcaobus.org

Subject: PCAOB Rulemaking Docket Matter No. 034

I appreciate the opportunity to comment on the proposed auditing standards, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion, and The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report.*

As background, I am the chief accounting officer for a publicly held life sciences company and an individual retail investor. I am also a former audit partner with KPMG LLP, and previously served as the chief accounting officer of a mid-cap public company and as the audit committee chairman for a community bank. I am writing this letter in my capacity as an individual investor, since the PCAOB is seeking to provide information which would be useful to investors.

The proposed auditing standards document uses many words such as “could” and “might” in its description of potential benefits to investors. Although some investors have expressed the desire for more information when surveyed, investors do not usually ask the auditors any questions at shareholder meetings, which to me indicates that investors are not normally looking for additional information from auditors. Requiring a significant change to audit reports should be based upon more factual evidence of benefit than has been presented to justify the increase in costs, which may be significant.

<u>Auditor’s Report</u>
As an investor, there is significant information available to analyze for public companies. One of the biggest challenges for investors is discerning what information is the most important and relevant for decision making purposes. The current pass/fail model of reporting in the auditor’s opinion enables the investor to quickly understand the audit report. Although additional information could be provided in the audit report, it does not mean that the information would be helpful for decision making by investors. Instead, the additional information regarding critical audit matters could in fact be confusing to investors, as further discussed below.

If additional information were added to the audit report, it would be largely redundant with information provided by management within the financial statements or MD&A. As an investor, I don’t want to spend time reading information which is redundant. Management is responsible for providing the information about its accounting policies, its financial condition and results of operations; this information should not be reported by the auditor as this may confuse investors as to what the auditor is responsible for.

Auditing Standard No. 16, *Communications with Audit Committees*, requires auditors to communicate with audit committees regarding critical accounting estimates, overall audit strategy, significant unusual transactions, difficult or contentious matters subject to consultation outside of the audit team, and other matters. It is the audit committee's responsibility to evaluate this information, and the audit committee has sufficient financial expertise and background to do so.

While information on critical audit matters is already provided by the auditor to the audit committee, more time would be required to ensure the description of critical audit matters are correct for publication. The audit committee has the ability to ask the auditors questions about the information reported and discuss the issues, whereas investors do not. Therefore additional time will be required to ensure the critical audit matters are described properly. This additional time will primarily need to be spent during the final phase of the audit engagement and will require significant information from senior members of the audit team and senior management to ensure that there is consistency in disclosures.

Timeliness of reporting is important. Requiring lengthy audit reports would only serve to extend the time required for the reporting process as the auditors would need to spend even more time ensuring that the documentation of critical audit matters is appropriate for public reporting. This additional time delay in reporting would not be in the best interest of investors.

There are other factors to consider:

- What basis or framework does an investor have to evaluate the critical audit matters described by an auditor for one company compared to that described for another? Differences in descriptions may be due to differences in auditors but not the underlying risks of the companies involved.
- Investors may misunderstand information presented. Investors may view the number of critical audit matters as a positive or a negative, which may not be the correct conclusion. Investors may view the critical audit matter discussion as a piecemeal opinion.
- How does knowledge of the audit process actually help the investor make investment decisions?
- The focus on critical audit matters may remove the focus on the financial statements taken as a whole, which is the basis for the auditor's opinion.
- Would the descriptions of critical audit matters become boilerplate in order to address the consistency and timeliness concerns? In that case the critical audit matters would become more noise that an investor needs to wade through to find information which is useful in assessing the future prospects for a company.

In many cases the information regarding critical audit matters may not be helpful in making investment decisions. For example, accounts receivable and inventory are often considered to be critical audit matters for manufacturing companies since the audits of those accounts requires significant effort and there is judgment in the valuation allowances. A description of the critical audit matters and the audit procedures would not likely enhance the user's ability to understand the financial statements of the company.

The description of the auditor's procedures for critical audit matters may give the reader the wrong conclusion. For example, if going concern is a critical audit matter and the auditor is satisfied that the opinion does not need to be modified for this matter, the description as a critical audit matter may have either the effect of a going concern opinion, or conversely, could subject the auditor to liability due to the statements made which indicate that the auditor has overcome significant doubt about the entity's ability to continue as a going concern, as noted on page A5-42. Valuation allowances are other areas where the additional information could amount to a piecemeal opinion and give the investor more or less assurance than warranted. Difficulty in auditing assets or liabilities which are impacted by management forecasts could give investors the wrong impression, either overly positive or negative.

In the example discussion of a critical audit matter on page A5-68, regarding sales returns, how does knowledge that the auditor consulted with their national office on the design and performance of the audit procedures and evaluation of the results aid in the investor's understanding of the financial statements and future risks, beyond what was disclosed by management? The auditor provided some additional information about the company's sales channel and process; if that information was significant to understanding the financial statements, it should have been provided by management.

In the example on A5-77, the description of the critical audit matter states that the audit of the securities required "an extensive amount of audit work, including significant involvement of senior members of the engagement team and the involvement of a third party valuation specialist." How would this information help the user of the financial statements make judgments, beyond the disclosures already provided? Would users take more comfort than they should, because they may believe that this provides more assurance on a particular account? How does the reader benefit by knowing that there was "extensive audit work" and "involvement of specialists" in particular areas of the audit? This could be viewed as a piecemeal opinion by some investors.

Auditors should not be reporting internal control deficiencies which are not a material weakness. Doing so creates an unnecessary concern about something which is not material. Where does an auditor draw the line between information to report or not report? Concerns about liability would likely influence an auditor to report more rather than less information, but that will not necessarily be helpful to investors.

The exposure draft indicated that additional disclosure would lower the cost of capital – which would mean investors would be willing to accept a lower return if they had more information about the audit. There are many factors which influence the price of stocks, particularly expectations for performance of the company in the future. I don't believe that additional information about the audit would lower the cost of capital; there is not a sufficient reduction in risk to warrant a lower expectation of return by investors.

Additional audit costs either reduce the return to shareholders or reduce investments that may be made in other areas of the company, such as in R&D or marketing, for example. Are investors really better served by this additional investment in audit fees? In my opinion, they are not.

Auditor's Responsibilities Regarding Other Information

The proposed standard for auditor's responsibilities regarding other information requires the auditor to "evaluate" the other information. While the proposed standard states that the auditor does not need to perform additional work other than that performed in conjunction with the audit, it is unclear how the auditor will "evaluate" other information which is disclosed, such as non-gaap reporting and forward looking information which is provided by management in an effort to help the reader of the annual report understand not only the financial statements (which have been audited) but the underlying trends and management's expectations for the business in the future. The auditor may not have the expertise to evaluate other information contained in the document. Under the existing standards, if the auditor believes that a disclosure is incorrect or misleading, the auditor would discuss that with management and if necessary, the audit committee, so that the disclosure was revised. This provides sufficient protection for investors. The auditing standards should not be changed to require additional audit procedures and disclosures for other information.

Other Comments

The fact that the auditor is independent is already in the title of the report and need not be repeated.

Auditor tenure is not relevant to the evaluation of the financial statements or the audit. Tenure should not be reported since there is no correlation between tenure and audit quality, and reporting on tenure implies that it is useful information. If considered necessary, disclosure in the proxy would be a more appropriate place to report that. Tenure should be defined as beginning with the earliest consecutive year audited, not the initial year of engagement as suggested.

In summary, the proposed standards appear to reach farther than necessary to expand the scope and responsibilities of auditors, beyond what is needed by investors. Timeliness and cost are also important factors to investors. I appreciate the opportunity to provide comments on the proposed standards affecting audit reporting. Thank you for your consideration.

Best regards,

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