

December 11, 2013

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,  
Proposed Auditing Standards—*The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses and 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*

Office of the Secretary:

Crowe Horwath LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board’s Proposed Auditing Standards—*The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses and 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* (Proposed Standards or Proposed Amendments, as applicable).

We support the Board’s efforts to improve audit quality by enhancing existing auditing standards, and to provide additional information to investors for decision-making. Further, we agree with the Board’s decision to retain the current “pass/fail” model for the auditor’s report as the current report provides objective information with clarity. We also encourage the Board to ensure that the Proposed Standards do not increase the expectation gap between auditors and users of financial statements. We are pleased to provide our observations regarding areas where we believe the Proposed Standards and Proposed Amendments could be modified to provide more clarity for investors and other users, and to address other matters.

**Proposed Standard, *The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion***

**Alternative Approach**

We are providing for the Board’s consideration an alternative approach for reporting critical audit matters. We believe it is the role of management to provide information regarding the issuer’s financial reporting to financial statement users, and it is the role of the audit committee to provide oversight of the financial reporting process. The auditor’s role is to provide assurance on information provided by management. To alleviate the auditor from reporting original information, including critical audit matters that, under the Proposed Standard, might be included in the auditor’s report, and to avoid a time-consuming process of determining the content of the auditor’s report, generally occurring at a time of year that is critical to completion of audit engagements, we suggest that appropriate rulemaking require disclosure of critical audit matters by an issuer’s audit committee, rather than the auditor. As part of the audit committee’s role in corporate governance and oversight of the financial reporting process, and following discussions with the audit committee by the issuer’s auditor under PCAOB Auditing Standard No. 16, *Communications with Audit Committees* (AS 16), the audit committee is in a position to understand and report on critical audit matters. The auditor would then be able to report on the critical accounting matters disclosed by the

issuer's audit committee, and maintain the fundamental role of providing assurance on such information. If the audit committee is responsible for disclosing the critical audit matters, the auditor's report could indicate that the auditor read the critical audit matters disclosed by the audit committee, and report on whether there were any inconsistencies in the matters reported, as compared to the auditor's communications with the audit committee. Under this alternative approach, the audit committee's report of critical audit matters would best be included in the issuer's annual report. We acknowledge that this alternative approach would require rule-making by the Securities and Exchange Commission as it relates to audit committee reporting of critical audit matters.

The following comments represent our observations on the Proposed Standard without consideration of the alternative approach above.

## **Critical Audit Matters**

### **Definitional Clarity and Unintended Consequences**

Appendix A of the Proposed Standard defines critical audit matters as those matters the auditor addressed during the audit of the financial statements that (1) involved the most difficult, subjective, or complex auditor judgments; (2) posed the most difficulty to the auditor in obtaining sufficient appropriate evidence; or (3) posed the most difficulty to the auditor in forming an opinion on the financial statements. Further, Paragraph 8 of the Proposed Standard states that critical audit matters ordinarily are matters of such importance that they are included in the matters required to be documented in the engagement completion document, reviewed by the engagement quality reviewer, communicated to the audit committee, or any combination of the three. We believe that the definition of critical audit matters is not sufficiently clear; given the three possible sources and that the matters to consider in the determination of critical audit matters in the Proposed Standard will lead to several unintended consequences:

- The subjectivity inherent in the Proposed Standard will result in inconsistencies in practice and the lack of comparability of auditors' reports. Based on auditor judgment, two different audit firms, or two separate engagement teams within the same audit firm, may identify and report different critical audit matters for a similar engagement. We believe that financial statement users prefer a clearly conveyed auditor's report with a concise and useful message. We also believe that introducing inconsistency and lack of comparability of auditors' reports could result in unintended assumptions by the users of the financial statements regarding the issuer's quality of accounting based on the number of critical audit matters in an issuer's auditor's report, or the inclusion or lack of specific critical audit matters in an issuer's audit report, compared to audit reports of other issuers. Users of the audit report may shift their focus from the auditor's conclusion that the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework, a clear and concise conclusion, to inconsistencies in the number and type of critical audit matters within the auditors' reports.
- The lack of a clear definition of a critical audit matter increases auditor liability concerns. As a result, auditors' reports might include matters that do not meet the intent of the Proposed Standard in an effort to reduce auditor liability risk for the lack of sufficient disclosures. An auditor's report that provides other than important user information may not be understood by a user of the financial statements, and the relative importance of the information provided will be unclear.
- The lack of a clear definition of a critical audit matter will lead to a significant amount of documentation of matters that might appear to meet the definition of a critical audit matter but were ultimately determined to not be critical audit matters. Paragraph 14 of the Proposed Standard requires the auditor to document the basis for the determination that unreported audit matters that may appear to meet the definition of a critical audit matter were not critical audit matters. The matters and factors to consider in the determination of critical audit matters in paragraph 8 and paragraph 9 of the Proposed Standard are subjective judgments with no clear boundaries. As a result, we believe a significant number of audit matters will

“appear to meet” the definition of a critical audit matter. It is not uncommon for a significant number of matters to be documented in the engagement completion form, reviewed by the engagement quality reviewer, or communicated to the audit committee. As a result, we believe the documentation of unreported audit matters will be of significant length and may likely exceed the documentation of critical audit matters that are disclosed in the auditor’s report.

- Critical audit matters in the draft auditor’s report will be reviewed by the issuer’s audit committee, management, and their legal counsel. The additional time necessary to review the draft auditor’s report will occur in a very critical and compressed period of time. Without clarity of the definition of a critical audit matter, we believe the additional time needed to review the draft disclosures in the auditor’s report and resolve observations will be further magnified and create challenges for issuers to meet the current requirements for a timely filing. Further, documentation of items that were not deemed critical audit matters will not improve audit quality, but instead it will strain the auditors’ ability to focus on other responsibilities during the critical wrap up stages of the audit.

To help avoid the unintended consequences noted above, we believe the definition of a critical audit matter in the Proposed Standard should be based on and limited to the existing communication requirements of AS 16. AS 16 includes materiality thresholds for required communications, which would also assist in determination of matters that are critical audit matters. We also recommend removing the requirement for the auditor to document the basis for the determination that unreported audit matters that may appear to meet the definition of a critical audit matter from the Proposed Standard.

#### Specific Critical Audit Matters and Examples

Paragraph 11 of the Proposed Standard requires the auditor’s report to (1) identify the critical audit matter; (2) describe the considerations that led the auditor to determine that the matter is a critical audit matter; and (3) refer to the relevant financial statement accounts and disclosures that relate to the critical audit matter. The illustrative examples on pages A5-65 to A5-78 of the Proposed Standard include disclosures in excess of the requirements in the Proposed Standard. The additional disclosures in the illustrative examples, as noted below, raise several concerns.

- We do not believe that the auditor’s report should contain commentary on the issuer’s business and the anticipation of future events. We believe management is best suited to address their business and future plans, and to provide the most relevant information for investors; whereas the auditor’s role is to provide independent assurance on the information that is disclosed by management.
- The examples include disclosures of audit procedures performed in response to a critical audit matter. Disclosure of audit procedures may not be clearly understood by a user, and put the user in the role of determining the sufficiency of the auditor’s procedures in responding to critical audit matters. The disclosure of audit procedures will also result in increasing the length of the auditor’s report, shifting the focus of the report from auditor conclusions on the issuer’s financial statements to audit procedures that will be difficult for users to understand and determine their importance. The disclosure of audit procedures may also become boilerplate disclosures, further diminishing the value of the information to the users of the financial statements. In addition, we believe the disclosure of audit procedures could decrease audit quality by providing information on audit strategies and by reducing the element of unpredictability in the audit. As a result, we do not believe the auditor’s report should discuss the audit procedures in response to critical audit matters.
- We do not believe that the auditor’s report should disclose consultations with the auditor’s national office or the use of specialists. Auditor interactions with the national office, audit firm specialists, or specialists engaged by the issuer, are routine considerations that occur during the audit process that are intended to provide assurance on the overall form and presentation of the financial statements, including any related audit affects. Specific reference to consultations or use of specialists in the auditor’s report may appear to offer an inappropriate high level of assurance on these matters.

- We do not believe that the auditor's report should disclose internal control deficiencies that do not meet the definition of a material weakness. An internal control deficiency, or a combination of deficiencies, that is less severe than a material weakness, by definition, does not reach a threshold of a reasonable possibility that a material misstatement of the issuer's financial statements will not be prevented or detected on a timely basis. As a result, disclosure of internal control deficiencies that do not meet the definition of a material weakness is not of high importance to the user of the financial statements, and may result in confusion regarding the effectiveness of the issuer's overall system of internal controls. Further, disclosure of non-material weaknesses could result in disclosing original information about an issuer's processes or accounting systems. As previously noted, we believe the issuer should have the primary responsibility for disclosing original information.
- We do not believe that the auditor's report should disclose corrected and uncorrected financial statement misstatements. According to a January 2008 U.S. Government Accountability Office report, as referenced in an Appendix to the Proposed Standard, the sense of confidence in audited financial statements is key to the efficient functioning of markets. We believe the disclosure of corrected and uncorrected financial statement misstatements may add unfounded uncertainty that more misstatements may exist in the financial statements, or imply that the financial statements are not presented fairly, in all material respects, resulting in reduced confidence in the financial statements. Similar to the above observation, disclosure of these types of matters could also result in reporting original information in the auditors' report.

As a result of the above observations and to avoid the implication that such additional disclosures in the auditor's report are required, or become de facto required in practice, we recommend that the examples provided in the Appendices include only the disclosures required by the Proposed Standard.

#### Prior Period Critical Audit Matters

Paragraph 10 of the Proposed Standard requires the auditor to communicate the critical audit matters related to the audit of the current period's financial statements. Paragraph 10 further indicates that the auditor "should consider" communicating critical audit matters relating to prior periods when certain criteria are met. The additional discussion on page A5-34 states that when a predecessor auditor reissues an audit report, the communication of critical audit matters for the prior period need not be repeated. The language in the Proposed Standard and related discussion are not clear regarding the predecessor auditor's reporting responsibilities. We suggest modifying the Proposed Standard to clarify the requirement to communicate critical audit matters related to prior period's financial statements. Further, we suggest expanding the Proposed Standard to clarify a predecessor auditor's responsibilities when a predecessor auditor did not previously report an audit matter (since it did not meet the criteria) as a critical audit matter, however, based on subsequent events, the predecessor auditor's conclusion as to the need to report a matter as a critical audit matter may have changed. We believe guidance to explain the predecessor's reporting responsibilities in this situation would be helpful.

#### Basic Elements of the Auditor's Report

Paragraph 6b of the Proposed Standard specifies that the addressees in the auditor's report could include others besides shareholders and the board of directors. We recommend modifying the Proposed Standard to remove others from the entities to which the auditor's report may be addressed due to potential litigation risk.

Paragraph 6i of the Proposed Standard requires the auditor's report to include a statement containing the year the auditor began serving consecutively as the issuer's auditor. We believe an unintended consequence of including auditor tenure in the auditor's report is the implication of a correlation between auditor tenure and audit quality. The PCAOB's previous Concept Release on Auditor Independence and Audit Firm Rotation acknowledges that there is not a demonstrated relationship between an auditor's objectivity and professional skepticism and the tenure of the audit engagement. Further, the Proposed Standard does not suggest conclusive evidence of a relationship between audit quality and auditor tenure. Accordingly, we believe that auditor tenure should not be included in the auditor's report. We

suggest it is more appropriate to disclose auditor tenure in the definitive proxy statement or in the registered public accounting firm's Annual Report Form 2 with the Public Company Accounting Oversight Board.

**Proposed Standard, The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report**

Definition of Other Information

Paragraph 1 of the Proposed Standard defines Other Information to include information in an annual report, other than the financial statements and auditor's report. Other Information is also defined to include information incorporated by reference, proxy statements filed within 120 days after the end of the fiscal year and, based on the circumstances, Other Information in amended annual reports. The suggested additions to the auditor's report regarding Other Information do not define the Other Information that is subject to the Proposed Standard. As a result, the scope of Other Information subject to the auditor's procedures may not be clear to users of the financial statements, resulting in an expectation gap between auditors and users. Further, unlike the requirements of AU 550, auditors would be required to evaluate Other Information to determine if a material misstatement of fact exists, even though such Other Information may be only tangentially related to the financial statements, resulting in significant additional time and cost by auditors. This tangential relationship between the financial statements and certain Other Information is particularly relevant to many documents incorporated into the annual report by reference. We suggest retaining the AU 550 requirement that the auditor consider Other Information only for the purpose of considering its consistency with the financial statements. This would allow users of the financial statements to understand that the Other Information that is subject to the auditor's procedures is limited to the Other Information that the auditor would consider when determining whether such information, or the manner of its presentation, is materially inconsistent with information, or the manner of its presentation, appearing in the financial statements.

Regarding the applicability of the Proposed Standard to Other Information that is not available prior to the issuance of the auditor's report, we do not believe that it is appropriate for the auditor to conclude in the auditor's report on information that is not available at the time the auditor's report is issued. Providing assurance on information after the auditor's report is issued presents practical and logistical concerns that would make this aspect of the Proposed Standard inoperable. We believe the Proposed Standard should reflect limiting the auditor's procedures to information that is only available at the time the auditor's report is issued.

Further, Paragraph 11 of the Proposed Standard indicates that when Other Information is not available prior to the issuance of the auditor's report, and the Other Information is not appropriately revised after the auditor has communicated a material inconsistency, material misstatement of fact, or both, to the audit committee, the auditor should apply the procedures in AU 561. The audit procedures required by AU 561 are only required if the new information that may affect the auditor's report existed at the date of the auditor's report, therefore the Other Information in this situation would not be available at the date of the auditor's report. If information not available prior to the issuance of the auditor's report is not excluded from the Proposed Standard, as recommended above, we recommend clarifying in the Proposed Standard the audit procedures that are required.

Auditor's Responsibilities

Paragraph 3 indicates that the auditor must evaluate whether Other Information contains a material inconsistency, a material misstatement of fact, or both. The level of materiality to be applied for this requirement is not clear based on the Proposed Standard. For an audit of the financial statements and internal control over financial reporting, federal security laws interpret a misstatement to be material if there is "a substantial likelihood that the ...fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." We believe that application of this interpretation of materiality to the wide variety of both financial and non-financial Other Information included in an annual report may be inconsistently applied and interpreted. Clarification in the Proposed

Standard of the auditor's application of materiality when evaluating whether Other Information contains a material inconsistency, a material misstatement of fact, or both, is suggested.

Paragraph 4 of the Proposed Standard includes the required procedures that an auditor should perform with respect to Other Information in an annual report. These procedures include evaluating Other Information not directly related to the financial statements as compared to relevant audit evidence obtained and conclusions reached during the audit. We suggest retaining the auditor's procedures in AU 550 with respect to Other Information for the following reasons:

- We believe an expectation gap with users of the auditor's report is possible due to introducing the term "evaluate", which is a previously unused term to express the level of assurance. We believe that users will interpret "evaluate" as a level of assurance that is beyond the "read and consider" language in current standard AU 550, and that significant additional procedures will be performed by auditors in response. Further, because users are not knowledgeable of the audit evidence obtained and conclusions reached during an audit, users' understanding of the extent of the auditor's procedures regarding Other Information may be inconsistent. Also, because the additional language that is proposed to be added to the auditor's report does not clarify the auditor's procedures, an expectation gap with users may result. Examples of Other Information that would be particularly susceptible to misunderstanding of the auditor's procedures include:
  - Forecasted information;
  - Assertions regarding the effectiveness of management's business plans;
  - Management's assertion regarding its internal controls when the auditor has not performed an audit of internal controls; and
  - Disclosed business risks, and the completeness of this information.
- Paragraph 4's requirement for auditors to read and evaluate Other Information based on relevant audit evidence obtained and conclusions reached during the audit will be difficult to implement. Consideration of every item of audit evidence in an audit file would often involve thousands of pages of audit file documentation, including copies of documents provided to the auditor by issuers. Also, many individual conclusions are reached in the conduct of an audit. To evaluate Other Information as compared to all relevant audit evidence obtained and conclusions reached could be viewed by auditors to involve detailed review and consideration of audit file documentation at the time of the auditor's evaluation of Other Information. Further, due to the significance of additional time and cost associated with auditors evaluating Other Information in this manner, issuers may consider this additional time and cost as they make judgments about the inclusion of Other Information in their annual reports, which could result in certain information that would be valuable to users not being disclosed.
- The following text from page A6-5 of the Appendix indicates that the auditor is not precluded from applying additional procedures beyond those described in the Proposed Standard:

*"The proposed other information standard does not preclude the auditor from applying the procedures in the standard to such other documents. Also, the proposed other information standard does not preclude the auditor from applying additional procedures not described in the proposed other information standard to the other information."*

This paragraph suggests to auditors that to "evaluate" Other Information in an annual report, additional procedures may be appropriate. Due to the lack of definition of the term "evaluate", as discussed above, the expectation gap between auditors and users regarding the scope of their procedures, and the additional risk of liability that auditors may incur as a result; significant additional effort by auditors is anticipated as compared to the work performed currently under AU 550. Further, we believe the text above provides an open ended obligation on auditors to consider whether to do more, which is in conflict with the introductory section on page 21, which does not require the auditor to perform other procedures or obtain additional information not directly related to the financial statement audit.

Paragraph 5 of the Proposed Standard indicates that if the auditor identifies a potential material inconsistency, a potential misstatement of fact, or both, the auditor should discuss the matter with management, and perform additional procedures, as necessary, to determine whether there is a material inconsistency, a material misstatement of fact, or both. We believe this requirement to consider performing additional procedures, as necessary, may cause auditors to perform unnecessary and time-consuming procedures. For example, the auditor may read in Other Information that the issuer is the leading provider of a product. Based on issuer-provided documents regarding revenue streams included in the audit file, the issuer's market positioning is discussed, but it is unclear whether the disclosure that the issuer is the leading provider of a product is correct or not. Paragraph 5 could lead the auditor to both discuss this matter with management, as well as perform additional procedures to make a determination. We consider the additional procedures in this example to be unnecessary and costly. Similar to our above concern with paragraph 4, we note that Paragraph 5 is inconsistent with page 21 of the introductory section to the Proposed Standards, which reads:

*“The auditor's evaluation would be based on relevant audit evidence obtained and conclusions reached during the audit. The auditor would not be required to perform procedures to obtain additional evidence regarding other information not directly related to the financial statements that was not required to be obtained during the audit.”*

While we agree with the concept outlined in the above paragraph, we believe it will not be clear to users what Other Information was subject to procedures and what information was not, since a user will not know whether the auditor obtained evidence during the course of the audit.

AU No. 3, *Audit Documentation*, requires audit documentation to be prepared in sufficient detail to provide a clear understanding of its purpose, source, and the conclusions reached. Also, the documentation is to be appropriately organized to provide a clear link to the significant findings or issues. Additional guidance within the Proposed Standard is suggested regarding the nature and extent of auditor documentation required, particularly considering the “evaluate” level of engagement involved, and the significance of Other Information, including information incorporated by reference, that would be subject to an auditor's evaluation procedures.

## **Other Observations**

### **Scope**

The Board has requested comment on the applicability of the Proposed Standards to Broker-Dealer, Investment Company and Benefit Plan audit engagements. Due to the unique characteristics of these companies, as indicated in Appendices A5 and A6 of the Proposed Standards (i.e. filing requirements; ownership structure; degree of complexity; user needs; sufficiency of other information available), we do not believe that application of the Proposed Standards to audits of these companies would provide investors or other financial statements users with sufficient additional relevant information to justify the additional cost of such information. If broker-dealer, investment company and benefit plan audit engagements are not excluded from the scope of the Proposed Standards, we recommend providing additional guidance to assist auditors of these companies in applying the Proposed Standards, given their unique characteristics and differences from issuer entities.

### **Reports of Subsidiaries**

We observe that many subsidiaries of issuers also present separate only subsidiary financial statements for a variety of reasons, and those financial statements also require the independent auditor to issue a report on such financial statements. These financial statements are normally not included in any public filings; however, the audit report often reflects that the audit was conducted in accordance with PCAOB standards. We believe critical audit matters and other information would not apply in these situations and recommend providing reporting illustrations for these situations.

Reference to City and State in Auditor's Report

Paragraph 6r of the Proposed Auditor Reporting Standard includes a requirement to include the city and state or country from which the auditor's report has been issued. Due to the participation in many audit engagements of audit personnel from various cities and countries, we suggest providing guidance in the Proposed Standard on the determination of the city and state or country that should be included in the auditor's report.

Reference to Accounting Standard

Page A3-18 refers to FASB Statement No. 107. We suggest the use of FASB Codification references.

Reference to Financial Statements

We suggest updating the text on page A5-10 to include in the listing of financial statements the Statement of Other Comprehensive Income and to include such statement in the illustrative examples.

**Field Testing and Cost/Benefit Considerations**

We anticipate that substantial additional work by auditors, audit committees and management will be necessary to implement and comply with the Proposed Standards. As a result, we encourage the Board to perform field testing to fully understand the costs and other implications of the Proposed Standards. Further, we encourage the Board to perform a thorough cost/benefit analysis to determine that the benefits will meaningfully exceed the initial and annual costs to comply with the Proposed Standards.

**Effective Date of the Proposed Standards**

The proposed effective date of these standards is for audits of financial statements for fiscal years beginning on or after December 15, 2015. Based on the significance of the implementation effort required by issuer companies and their audit firms in response to these Proposed Standards, including developing appropriate methodologies and training, we suggest that the Board re-assess the proposed effective date at the time the proposals are approved by the SEC, and re-establish the effective date to be at least one year after approval. We also suggest a further delay in the effective date for audits of smaller reporting companies.

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Crowe Horwath LLP supports the Board's efforts to improve its auditing standards for the benefit of investors and other stakeholders. We appreciate the opportunity to comment on the Proposed Standards and Proposed Amendments, and would be pleased to respond to any questions regarding the comments we have provided. Should you have any questions please contact Clarence Ebersole at (317)706-2636 or James Dolinar at (630)574-1649.

Sincerely,

*Crowe Horwath LLP*

Crowe Horwath LLP