

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.**

Deloitte & Touche LLP (“D&T”) is pleased to respond to the request for comments from the Public Company Accounting Oversight Board (the “PCAOB” or the “Board”) on its *Proposed Auditing Standards — 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 *Related Amendments to PCAOB Standards* (the “proposed amendments”) (collectively, “the proposal”); PCAOB Release No. 2013-005; and PCAOB Rulemaking Docket Matter No. 034 (August 13, 2013).

## OVERALL COMMENTS

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We support the Board’s efforts to increase the informational value, usefulness, and relevance of the auditor’s report. The more information of value that auditors are able to provide to the users of financial statements, the greater the value and relevance audits will have to the capital markets. Additional transparency regarding the audit also stands to enhance investor confidence in the rigor of the independent audit process.

The proposed changes to the auditor’s report would represent the most significant expansion of tailored information provided about a financial statement audit by auditors to the user community in the profession’s history. We are supportive of the objectives of the Board’s proposal, and offer certain constructive suggestions in this letter geared toward ensuring that the final standards the Board adopts:

- Add value to users of financial statements;
- Narrow the expectation gap between what users of financial statements might expect from a financial statement audit and the actual objective of a financial statement audit, which is the expression of an opinion regarding the financial statements taken as a whole based on having obtained reasonable assurance about whether the financial statements are free of material misstatement; and
- Enhance clarity regarding the responsibilities of the auditor, management, and the audit committee.

Consistent with the above objectives, we are supportive of the following changes to the auditor's report:

- Identifying and commenting upon those matters that are critical to a user's understanding of the audited financial statements;
- Providing transparency regarding the auditor's responsibilities for other information included within the Form 10-K;
- Including a statement that the auditor is required to be independent with respect to the company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the PCAOB and the U.S. Securities and Exchange Commission (SEC);
- Including additional standardized language regarding the auditor's responsibilities with respect to the detection of error or fraud and performing procedures to assess the risks of material misstatement; and
- Clarifying that an audit encompasses the financial statements and the related notes.

In addition to considering the changes included in the Board's proposal, we considered whether there are additional matters that could be addressed in the auditor's report to improve its value to investors. We believe a discussion about materiality would further enhance the utility of the report (see further discussion in the "Proposed Auditor Reporting Standard" section below).

We believe, however, that there are certain implementation and other issues that will need to be deliberated and resolved in order to ensure the objectives of the proposals are achieved. While some of these issues are complex and challenging, the potential benefits of the proposals are significant; accordingly, such issues should not stand in the way of moving forward. It is incumbent upon us, along with other interested stakeholders, to engage constructively with the Board and find reasonable solutions. A brief summary of the most significant issues we have identified is as follows (we offer further thoughts on each later in this letter):

**Critical Audit Matters (CAMs).** We agree that sharing information with investors and other financial statement users about the challenging aspects, from an audit perspective, of the company's financial statements would be useful. We recognize that application of the proposed standard could at times put auditors in the position of communicating original information that has not been disclosed by the company. Some constituents have expressed concerns that certain auditor disclosures may potentially be at odds with the long-standing, historical reporting model of management being responsible for the company's financial statements and disclosures and the auditor attesting to that information. We share these concerns. These perspectives raise the question as to whether additional companion disclosure requirements should be imposed upon companies in light of required CAM reporting, which would of course necessitate action by the SEC or accounting standard setters.

Given the broad implications of the issue of auditors communicating original information, we believe it is important that all stakeholders (e.g., audit committees, preparers, regulators, auditors and others, including those in non-U.S. jurisdictions who are affected by PCAOB standards), be actively involved in comprehensive discussions about such a significant change. We understand that the PCAOB plans to hold roundtable discussions during 2014 to solicit the views of stakeholders, and we look forward to participating constructively in a dialogue with the PCAOB, SEC, Financial Accounting Standards Board (FASB), and other interested parties.

We offer further observations on CAMs and suggest additional practical alternatives for consideration in the “Proposed Auditor Reporting Standard” section below.

**Auditor Responsibility with Respect to Other Information.** Investors would benefit from a transparent discussion of the auditor’s involvement with certain financial information contained in the Form 10-K outside the basic financial statements and footnotes. In addition, when other information outside the financial statements is both within the competence of the auditor and closely associated with procedures performed by the auditor during the audit of the financial statements (and if applicable, audit of internal control), we believe this information may lend itself to additional auditor involvement, with an accompanying disclosure in the auditor’s report outlining the procedures performed by the auditor. However, certain other information contained in the Form 10-K is not necessarily within the auditor’s competence, and is not closely associated with procedures performed during the audit. We believe it is important to ensure that auditor performance requirements are clear, and that any statement made in the audit report about other information does not create an expectations gap as to the nature of the auditor’s involvement with respect to such information, especially non-financial information and financial information not closely associated with procedures performed in connection with the audit. We discuss additional observations and potential alternatives in the “Proposed Other Information Standard” section below.

We commend the Board’s outreach with the International Auditing and Assurance Standards Board (IAASB), which has also issued a proposal to modify the auditor’s reporting model under the International Standards on Auditing. We believe it would be beneficial for the auditor’s reporting model under PCAOB standards and IAASB standards to be aligned to the greatest extent possible, in order to provide a consistent basis for enhancing users’ understanding of the audit process and the results of the audit and avoid unnecessary confusion. We encourage the PCAOB to continue to work with the IAASB as the two related proposals are finalized.

Some level of incremental costs will of course result from the application of the proposals. We believe the suggestions we offer in this letter will help manage costs for audits of companies of all sizes. In order to ensure that the benefits of the proposals outweigh the incremental costs, we encourage the PCAOB to carefully assess the costs associated with the various aspects of the proposals, particularly those aspects related to other information, by conducting appropriate research and outreach (including field testing where useful).

## **PROPOSED AUDITOR REPORTING STANDARD**

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As articulated in the “Overall Comments” section of this letter, we support many of the PCAOB’s proposed changes to the auditor’s report. In order to provide meaningful feedback to the Board during the comment process and as requested by the Board, we conducted limited field testing (including interaction with financial management) of the proposed auditor reporting standard. The results of that field testing are summarized in Exhibit 1. In light of our field testing and our analysis of the proposal, we have identified several adjustments that could be made that would address certain implementation challenges we identified. We further describe our observations and recommendations to the proposed auditor reporting standard below.

*Determination of Critical Audit Matters.* In order to provide useful information to users of financial statements, we agree that CAMs should highlight the most significant, complex, subjective areas of the audit. Our field testing results demonstrated a wide range in the number of CAMs reported for individual audits, suggesting that applying the proposed definition of CAMs and the related factors to consider in identifying CAMs as stated in paragraph 9 of the proposed auditor reporting standard, could result in a large number of potential CAMs being identified and ultimately a large number being reported. Inclusion of a large number of CAMs in the auditor's report would potentially obscure the most relevant information (including possibly the overall pass/fail opinion still valued by investors), making the auditor's report less useful to investors. This would be contrary to the PCAOB's objectives in proposing this standard. Our field testing results also indicated that all CAMs identified were matters already communicated to the audit committee in accordance with extant PCAOB standards, including PCAOB Auditing Standard 16, *Communications with Audit Committees* (PCAOB AS 16). Our suggestions herein are intended to address these implementation issues and reduce the associated costs.

We recommend the PCAOB limit the population of *potential* CAMs to only those matters that were discussed with the audit committee under existing auditing standards. Current PCAOB standards addressing required communications with audit committees are thorough and result in the auditor discussing a variety of matters with the audit committee. Therefore, we believe starting with the population of matters communicated to the audit committee would improve the efficiency of the process of determining potential CAMs, and would still be an effective approach. Not all matters communicated to the audit committee during the course of an audit rise to the level of a CAM; however, in practical terms, auditors would not put themselves in the position of disclosing CAMs that had not already been discussed with the audit committee.

Further, the level of interaction, including the extent of discussion with the audit committee about a particular matter, could be highlighted as an additional consideration for the auditor when concluding which matters rise to the level of a CAM (i.e., in addition to the factors outlined in paragraph 9 of the proposed auditor reporting standard).

These suggested changes to the proposed auditor reporting standard will simplify the methodology for determining CAMs and should have the effect of appropriately limiting the number of CAMs so as to render the auditor's report more useful to users.

*Auditor Disclosure of Original Information.* Our field testing confirmed that CAM reporting under the proposal could result in (1) original information<sup>1</sup> about the company being communicated in the auditor's report, (2) disclosure of matters that, while requiring significant audit effort, were ultimately concluded to be immaterial to the company's financial statements and internal control, or (3) disclosure of information that the SEC or the FASB previously concluded need not be disclosed by a company. For example:

- **Going Concern:** If issues calling into question an entity's ability to continue as a going concern are overcome based on management's plans for dealing with the issues, and the auditor ultimately concurs with this conclusion after performing extensive auditing procedures and applying significant professional judgment, this matter may still be considered a CAM and thus require disclosure. This challenge would be substantially alleviated if the FASB moves forward with its

proposal to require company disclosure of going concern uncertainties even when substantial doubt is not present.

- **Significant Deficiency:** If determining whether an identified control deficiency is a significant deficiency or a material weakness takes a significant amount of audit effort, results in modification of the planned substantive testing and is the subject of significant dialogue with the audit committee, and even if ultimately the company and the auditor conclude it is a significant deficiency and not a material weakness, this matter may still be considered a CAM under the proposed auditor reporting standard. This may result in disclosure by the auditor of the control issues, with no parallel disclosure obligation for the company under SEC rules.
- **Potential Illegal Act:** If the auditor encounters a potential illegal act, directs significant audit effort to the situation, and encounters challenges in gathering sufficient audit evidence but ultimately concludes, after extensive interaction with counsel, that an illegal act has not occurred, this matter may nonetheless be considered a CAM under the proposed auditor reporting standard; however, it is not clear that disclosure in the auditor's report of such a matter was intended by the proposed standard.

Some constituents have questioned whether additional information would be of value to users if matters determined to be CAMs relate to items determined not to rise to a level of required management disclosure under current regulatory requirements and accounting frameworks. We recommend stating (in the definition of CAM and in paragraph 9 of the proposed auditor reporting standard) that matters relating to amounts and disclosures that are ultimately determined not to be material to the financial statements (including footnote disclosures) or the company's internal control over financial reporting may not constitute CAMs, even if significant audit effort and professional judgment might have been required to reach such a conclusion. As supported by our field testing, it is important that the final standard explicitly state that the auditor uses both materiality and professional judgment in determining the CAMs to be communicated in the auditor's report.

*Describing CAMs in the Auditor's Report.* We support the requirements in paragraph 11 of the proposed auditor reporting standard for communication of CAMs in the auditor's report. We also agree with the Board that the auditor's communication of CAMs in the auditor's report should be presented using language and a format that is clear, concise, and understandable to users of financial statements.

We note that the release accompanying the Board's proposal states that "communicating critical audit matters in the auditor's report... would not require the auditor to describe the audit procedures related to critical audit matters"<sup>2</sup> but that the auditor would not be precluded from doing so. Further, paragraph 11 of the proposal does not address the auditor providing a description of the audit procedures related to each CAM. However, the illustrative examples of CAM reporting provided in Appendix 5 go beyond the stated requirements in the proposed auditor reporting standard and include a discussion of audit procedures performed (e.g., use of specialists, consultation with national office, among others). We believe it is important for the final standard to be clear as to whether the auditor is expected to describe the audit procedures performed, rather than relying upon examples and discussion in the accompanying release to set out this expectation. Further, we do not believe optionality would be appropriate as significant implementation challenges would result, including how the auditor would determine when to incorporate a discussion of audit procedures and to what extent they should be described.

If the Board intends for the auditor to include audit procedures performed in the CAM discussion in the auditor's report we offer the following observations:

- We recognize and support the objective that the Board is attempting to achieve, and believe users would in fact benefit from an appreciation of the rigor that underlies the audit of the identified CAMs. There are, however, significant challenges to accomplishing this objective—particularly on complex, large multinational audit engagements.
- Describing auditing procedures performed in the reporting of CAMs in complex audit engagements could make the auditor's report quite lengthy. In practice, written auditor communications to audit committees that include a description of some audit procedures in significant audit areas can be extensive, notwithstanding the opportunity the auditor has to supplement the written summary with dialogue at an audit committee meeting; no such opportunity for dialogue exists for a communication included in the auditor's report.
- In many cases, audit evidence with respect to material assertions is obtained through a combination of a large number of procedures. Because of the significant complex audit judgments and procedures that would be performed in connection with most (if not all) CAMs, it would be difficult to adequately describe even the significant procedures performed regarding a specific CAM in a concise manner. An overly brief description of two or three out of perhaps dozens of audit procedures would run the risk of decreasing confidence in the rigor of the audit, as it may imply that the auditor's procedures were much less in scope than was actually the case.
  - For example, our firm's practice aid for auditing goodwill, which is in excess of 80 pages, contains extensive auditing procedures for our practitioners to consider and apply. Auditing a discounted cash flow forecast prepared to support a goodwill impairment assessment involves significant procedures applied to a dozen or more unique variables. While incomplete, examples of the audit procedures applied would often include a review of external analyst reports, a retrospective review of the accuracy of the company's prior forecasts, in-depth analysis of future product portfolio and marketing plans, testing capital expenditure and working capital needs in relation to the future product portfolio, a review of the company's debt and equity structure, a review of the recent trends in the company's market capitalization, and consideration of competitor market multiples. During the course of performing these procedures, the auditor would often make use of internal specialists, external specialists, and other consultation resources of the firm. All of these procedures, in addition to several others, are essential in the aggregate to providing the auditor with the necessary level of evidence. An auditor could attempt to prepare such a summary for the report, but we believe it would often be quite lengthy.

If the intent of the Board is to require the auditor in all cases, to include a discussion of auditing procedures in the CAM discussion in the auditor's report, we suggest that the final auditor reporting standard include the following:

- A clear statement that for each CAM included in the auditor's report, the auditor should include a succinct description of the auditor's response to the financial statement risk associated with the CAM.
- An acknowledgement that the auditor applies professional judgment in determining which procedures to describe and how to describe them.

- A requirement for an explicit statement to be added to the auditor’s report which states that the procedures described are not the totality of all procedures performed on any particular CAM.

*Documentation of Matters Not Concluded to Be CAMs.* Paragraph 14 of the proposed auditor reporting standard requires audit documentation to explain the basis of the auditor’s determination that “non-reported audit matters addressed in the audit that would appear to meet the definition of a critical audit matter were not critical audit matters.” While we support documenting those matters determined to be CAMs, we suggest that the Board modify the requirement in paragraph 14 to exclude the documentation of audit matters ultimately determined not to be CAMs.

As suggested previously, we believe the PCAOB should limit the population of *potential* CAMs to only those matters communicated to the audit committee under existing auditing standards. Under this approach, the auditor performance requirement would be directed towards identifying which of those matters (i.e., the potential CAMs) are to be included in the auditor’s report as truly the most critical matters encountered during the audit. Accordingly, we believe it would be more appropriate for audit documentation to be focused on why matters are of such importance that they are included in the auditor’s report (i.e., how the determination of actual CAMs was made from the population of matters communicated to the audit committee, as opposed to documenting why potential CAMs were determined not to be CAMs). Certain documentation would already be in place as a result of communicating matters to the audit committee, and as a result, extensive incremental documentation should not be required or necessary. Placing undue emphasis on documenting matters ultimately not concluded to be CAMs may have the unintended consequence of causing auditors to tend towards identifying too many CAMs, thereby reducing the usefulness of the CAM reporting. If the broad range of sources to be considered for identifying potential CAMs as proposed in paragraph 8 of the proposed auditor reporting standard is retained, for a complex audit engagement, this could lead to a very large population of potential CAMs; accordingly, the process to document why potential matters are not CAMs could become very lengthy and of limited value.

*CAMs and Continued Use of Emphasis of Matter Paragraphs.* The proposed auditor reporting standard does not address the interaction between an audit matter that is determined to be a CAM and where, under paragraph 16 of the proposed auditor reporting standard, the matter also requires an explanatory paragraph to emphasize the matter. We observe that the examples provided in paragraph 16 of the proposed auditor reporting standard would in many cases also likely qualify as CAMs. However, on page A5-49 in Appendix 5 of the proposal, it states “[t]he proposed requirement to communicate critical audit matters does not alter the auditor’s ability to add an explanatory paragraph to the auditor’s report to emphasize a matter in the financial statements. The auditor’s communication of a critical audit matter may provide more information about the auditing aspect of the matter emphasized in the auditor’s report.”

We believe it would be confusing to have two disclosures included in the auditor’s report addressing the same matter. Accordingly, we recommend that the Board clarify in the proposed auditor reporting standard that, if a matter would constitute a CAM and require an explanatory paragraph, the discussion in the auditor’s report would be integrated so as to avoid duplication and repetitiveness.

*Additional Implementation Considerations.* As the Board finalizes its standards, it should consider various additional implementation matters, including:

- The real concern that CAM reporting over time may become boilerplate, which may result from marketplace pressure and auditing firms attempting to create standardization throughout their practices. If this were to happen, the Board’s objective of providing unique information to investors would be compromised. In order to guard against this, we recommend clear language in the proposed auditor reporting standard indicating that CAM discussions in the auditor’s report are intended to be tailored to the unique circumstances of each individual audit engagement.
- The likely increased pressure on senior audit resources (as well as on management and the audit committee) during the reporting phase of the audit as the identification of CAMs is finalized and related disclosures are drafted, and the implications on the timing of completing the audit and meeting SEC filing deadlines. In order to minimize the likelihood of problematic delays, the PCAOB should provide guidance in the proposed auditor reporting standard that it would be appropriate for auditors to communicate likely CAMs (along with draft report wording) to the audit committee when they are identified throughout the audit cycle, keeping in mind the requirements of PCAOB AS 16.26 to communicate matters to the audit committee on a timely basis.

*Reporting Period of CAMs.* We agree with the requirement in paragraph 10 of the proposed auditor reporting standard that CAM communications should pertain to the audit of the current period’s financial statements. To provide further clarity for auditors, we also recommend that the Board include a statement in paragraph 10 of the proposed auditor reporting standard that each year the auditor is expected to take a fresh look at the CAMs and should not maintain a “rolling inventory” of CAMs that would need to be re-evaluated each year by the auditor with justification for why CAMs in prior periods may not be CAMs in the current period. We believe this is particularly important to avoid any tendency towards boilerplate disclosure.

*Implications of Proposed Standard on the Reissuance of Auditor’s Report.* If the identification of CAMs is later questioned through a firm’s internal inspection process or a regulatory review process and it is determined that a CAM was omitted from the auditor’s report, the Board should consider how such a circumstance will affect the auditor’s report and if revisions to the auditor’s report will be required (including the presumed corresponding need for the company to amend its Form 10-K to include the revised report). If the auditor concludes that the omitted CAM is not significant in relation to the audit report taken as a whole, we do not believe there would be a need to revise and reissue audit reports and file amended Form 10-Ks. Rather, the auditor would consider any subsequently identified CAMs in connection with the next year’s audit to the extent that the CAM remains applicable in the subsequent year. Therefore, we recommend that the PCAOB (1) specifically allow in the standard for auditor judgment to be exercised in applying PCAOB AU 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor’s Report*, (PCAOB AU 561) and determining whether reissuance of the auditor’s report in question is necessary and (2) should further acknowledge that reissuances are not expected to occur frequently.

*Auditor Tenure.* As indicated in our comment letters to the PCAOB dated December 8, 2011 and April 20, 2012 in response to PCAOB Release No. 2011-006, *Concept Release on Auditor Independence and Audit Firm Rotation*, we performed a comprehensive review of available evidence with respect to the effect of auditor tenure on audit quality, and respectfully believe no nexus exists. Many stakeholders have expressed similar observations. While auditor tenure is a matter of fact, we do have some concern

that an auditing standard requiring its inclusion in the auditor's report suggests or implies that tenure has a direct effect on the conduct and quality of the audit, and may lead to ill-founded conclusions regarding auditor independence.

We recognize, however, that some constituents have expressed an interest in disclosure of auditor tenure. If the Board concludes that tenure should be disclosed, we believe there are opportunities to do so in a manner that may alleviate the unintended consequences described above. For example, the Board may consider requiring that tenure information for each company audit engagement be included in a registered firm's annual PCAOB Form 2, rather than in the auditor's report. Registered public accounting firms are currently required to provide to the PCAOB a list of entities audited in an annual PCAOB Form 2, which is publicly available on the PCAOB's website; adding firm tenure to Form 2 would represent another factual disclosure, providing information on a firm's entire audit portfolio in one location. Alternatively, as audit committees are responsible for oversight of external auditors, the audit committee report may also be an appropriate location for disclosure of auditor tenure, if it is determined to be relevant to its oversight. Based on a recent study, 32% of Fortune 100 companies already disclose auditor tenure in the audit committee report or elsewhere in the proxy statement.<sup>3</sup> Recognizing that the PCAOB does not have oversight authority with respect to audit committees and, therefore, does not have the ability to change the proxy or other rules governing required audit committee disclosures, the PCAOB may consider a rule such that if a registrant's audit committee has not disclosed auditor tenure in its most recently issued audit committee report or proxy statement, then the auditor would be required to disclose tenure information either in Form 2 or the auditor's report.

*Discussion of Materiality.* As discussed previously, we believe users of the auditor's report would benefit from a better understanding of the concept of materiality and how it is used by the auditor in the conduct of the audit engagement, including in the evaluation of overall financial statement presentation. We would, therefore, be supportive of including such a discussion in the auditor's report, proposed language for which is as follows:

The concept of materiality is applied by the auditor in planning and performing the audit and in evaluating the effect of any misstatements on our audit and on the financial statements. The determination of materiality is a matter of professional judgment in light of the particular circumstances, and is affected by the auditor's assessment of what amounts would influence the judgment of a reasonable investor. The determination of materiality requires the consideration of both quantitative and qualitative considerations. As a result, there is not one specific quantitative threshold that is used in determining materiality; rather, a combination of quantitative and qualitative factors is considered. \$[XXX] was the materiality used in conducting the audit of the consolidated financial statements as of December 31, 20xx and for the year then ended and, when combined with qualitative considerations, was used in concluding whether such financial statements were presented fairly, in all material respects, in conformity with the applicable financial reporting framework.

## **PROPOSED OTHER INFORMATION STANDARD**

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As articulated in the "Overall Comments" section of this letter, we support enhanced auditor association with other information that accompanies the financial statements we have audited. In the proposed other

information standard, however, we observe that the language in the auditor's report (which provides an overall conclusion and, therefore, implies assurance on the entirety of other information) does not appear to align with the performance requirement (i.e., to evaluate the information based upon the evidence obtained during the audit). We believe there are two alternatives that would address this issue, and we support the PCAOB pursuing either alternative. If the Board's desire is to add auditor reporting to today's performance requirement (thereby maintaining current auditor practices), the proposed wording of the report will need to be modified so as to not suggest a greater level of assurance than that which can be obtained based on the procedures that are performed. On the other hand, if the Board's desire is for the auditor to provide assurance on some or all of the other information, additional performance requirements would be necessary as some of the other information currently is not addressed by the procedures the auditor performs as part of the financial statement audit or, if applicable, the audit of internal control. Below we discuss additional observations regarding each approach.

**Maintaining Current Auditor Practices.** If the Board prefers to maintain current practices with respect to other information, we offer the following observations and suggestions.

*Definition of "Other Information."* The Board has proposed that the definition of "other information" specifically include exhibits to the financial statements and information incorporated by reference in the annual report, including the proxy statement which may be filed up to 120 days after the year-end encompassed by the Form 10-K. For practical reasons, we recommend that the current definition<sup>4</sup> of "other information" be maintained (i.e., "other information" should be defined as the information included in documents containing audited financial statements and the auditor's report thereon). In addition, doing so will avoid the PCAOB having to amend PCAOB AU 561, which addresses a subsequently discovered issue relating to the financial statements that the auditor has reported on, but does not address issues in the other information (such as a subsequently filed proxy statement) included in a document accompanying the audited financial statements.

*Objective of the Auditor in the Context of Other Information.* Paragraph 2 of the proposed other information standard states that the objective of the auditor is to "evaluate whether the other information contains (1) a material inconsistency with amounts or information, or the manner of their presentation, in the audited financial statements ('material inconsistency'); (2) a material misstatement of fact; or (3) both and, if so, to respond appropriately; and when issuing an auditor's report, to communicate in the auditor's report the auditor's responsibilities for other information and whether, based on relevant audit evidence obtained and conclusions reached during the audit, the other information contains a material inconsistency, a material misstatement of fact, or both." If the PCAOB intends to maintain current auditor practice, we recommend the proposed other information standard be revised to reflect that the auditor's objective is to read the other information and identify material inconsistencies with the financial statements based on knowledge gained during the audit of the financial statements (and, if applicable, audit of internal control). "Evaluate" is used throughout the PCAOB's auditing standards in the context of procedures that are performed to obtain reasonable assurance. Inclusion of the word "evaluate" in the proposed objective and in the auditor's report, therefore, implies a higher level of assurance than is present in existing practice and, as such, may cause confusion. In addition, extant PCAOB standards<sup>5</sup> incorporate an important distinction between the responsibilities of the auditor to identify a material inconsistency and a material misstatement of fact, highlighting that while reading the other information to identify material inconsistencies, the auditor may identify matters that may be material misstatements of fact. The extant standard acknowledges that the auditor may not have the expertise to assess the validity of a

statement included in other information, that there may be no standard by which to assess its presentation, and that there may be valid differences of judgment or opinion. This distinction is important to preserve because, unlike identifying a material inconsistency with the financial statements, the auditor may have no basis (and may also lack the expertise) to identify a potential or actual material misstatement of fact in the other information.

*Reporting on Other Information in the Auditor's Report.* Under current practice, auditor reporting on other information occurs most frequently when providing a traditional “comfort letter” to underwriters. When an auditor provides a comfort letter, there is no ambiguity about the procedures that have been performed on individual amounts or disclosures. There is also no ambiguity regarding those amounts or disclosures for which the auditor has performed no procedures and, therefore, provides no “comfort” or level of assurance. Without some form of clarity in the auditor’s report as to the nature and extent of the auditor’s procedures and how those procedures might vary for the different types of other information, investors or users may assume the auditor has done more, which has the potential to exacerbate the expectations gap that currently exists regarding the auditor’s association with other information. We believe providing clear language in the auditor’s report regarding the auditor’s responsibilities will mitigate this risk and suggest the following language for the auditor’s report to describe what exists under current practice:

In addition to auditing the Company’s financial statements in accordance with the standards of the PCAOB, we have a responsibility to read other information included in the annual report on [SEC Exchange Act form type] filed with the SEC that contains both the December 31, 20X2 financial statements and our audit report on those financial statements, and based on relevant audit evidence obtained and conclusions reached during the audit of the financial statements [and internal control over financial reporting], consider 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. Our responsibility with respect to other information does not extend beyond the procedures we performed on the financial statements identified in our report. Therefore, certain elements of other information were not subject to any procedures beyond reading because the audit evidence obtained and conclusions reached during our audit of the financial statements [and internal control over financial reporting] were not relevant to such other information. We did not audit the other information and do not express an opinion on the other information. Based on our reading of the other information and our consideration of the other information in light of relevant audit evidence obtained and conclusions reached during the audit of the financial statements [and internal control over financial reporting], nothing came to our attention that caused us to believe that the other information included a material inconsistency with the financial statements.

**Expanding Auditor Involvement with Other Information.** Expanding the auditor’s involvement to include the entirety of the other information (as currently defined in the proposed standard) is also an option. We believe expanded auditor involvement with many elements of other information would add value to investors and other users of companies’ Form 10-K filings. Depending on the extent to which auditor involvement is expanded, significant additional costs could also result. If the intent of the Board is to expand the auditor’s involvement with other information and to provide some form of assurance on it through expanded auditor reporting, we believe explicit performance requirements for the auditor will

be necessary, particularly in the context of qualitative other information, and other information not directly related to the financial statements. As the proposed other information standard is currently drafted, the auditor is to use information already obtained in the conduct of the audit and not perform additional procedures to evaluate the other information. As a result, it is likely that the auditor will have limited or no basis for evaluating certain non-financial data or other qualitative statements included in the other information. There are numerous examples of such other information; some examples include certain backlog information, the number of patents owned by the company, market share data by country, square footage of company facilities, and qualitative assertions regarding the reliability of individual products. The explicit performance standards needed to address these and other types of other information should consider, among others:

- How to evaluate qualitative statements or assertions;
- How to assess the materiality of non-financial data;
- What procedures are necessary when a potential material misstatement of the other information exists;
- Reporting requirements to ensure that users understand the scope and nature of the auditor's procedures and the level of assurance being provided on the other information;
- Audit documentation requirements.

We would be pleased to work with the PCAOB staff to create a workable model for expanded auditor involvement with other information.

*Attestation on Management's Discussion and Analysis (MD&A)*. Another option the PCAOB could pursue for expanding the auditor's involvement in other information would be to suggest that audit committees consider attestation engagements regarding MD&A, or a portion thereof (e.g., critical accounting policies). The Board may wish to consider outreach with audit committees and the investor community, and engaging in discussions with the SEC regarding such engagements. We observe that current PCAOB Attestation Standard 701, *Management's Discussion and Analysis*, (PCAOB AT 701) provides guidance for the auditor to attest to MD&A. The benefit of pursuing this alternative is that standards already exist for the auditor to perform such an engagement and the current standard permits either a review or an examination of MD&A (i.e., provides for an engagement based on varying levels of assurance). Further, the information contained within MD&A generally is both within the competence of the auditor and closely associated with procedures performed by the auditor during the audit of the financial statements. However, we note very few instances in which an auditor has been engaged to provide this level of assurance.

An examination report under PCAOB AT 701 would result in a report from the auditor on whether "the presentation includes, in all material respects, the required elements of the rules and regulations adopted by the SEC; the historical financial amounts included therein have been accurately derived, in all material respects, from the Company's financial statements; the underlying information, determinations, estimates, and assumptions of the Company provide reasonable basis for the disclosures contained therein." We believe such an examination report may also meet the objectives of the Board with respect to the auditor's involvement with other information.

## OTHER MATTERS

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### **Applicability to Audits of Brokers and Dealers.**

*Identification and Communication of CAMs.* As discussed in Appendix 5 of the proposal, there are no issuers among the 4,230 brokers and dealers that filed annual audited financial statements with the SEC and only 9% are subsidiaries of issuers. Of the remaining brokers and dealers, approximately 90% are owned by an individual or an entity that owns more than 50%, and approximately 75% have five or fewer owners. Additionally, almost 45% of brokers and dealers file statements of financial condition separately from the balance of the financial statements to obtain confidential treatment of their filings, including the full set of financial statements. For these brokers and dealers, only the auditor's report on the statement of financial condition would be available to the public, and the auditor's report on the full set of financial statements would be confidential and not available to the public. While applying the CAM requirements to audits of financial statements of audits of brokers and dealers would be possible, given (1) the closely held nature of many broker dealers, (2) the fact that in 45% of cases, only limited financial information is available publicly, and (3) what appears in most cases to be a limited number of users of their financial statements, we do not believe that there would be corresponding value to investors of CAM reporting in the same way as for issuers. Accordingly, we do not believe that the requirements relating to identification and communication of CAMs should apply to audits of financial statements of brokers and dealers.

*Auditor Responsibilities for Other information.* We believe the SEC's amendments to Rule 17a-5 provide users of financial statements of brokers and dealers with sufficient information and already require reporting by the auditor on various aspects of other information, such that additional reporting would not be necessary. Auditor reporting includes, as pointed out in Footnote 101 in Appendix 6 of the proposal, reporting on supporting schedules required by Rule 17a-5 in accordance with Auditing Standard 17, *Auditing Supplemental Information Accompanying Audited Financial Statements and Related Amendments to PCAOB Standards* (which was issued subsequent to the PCAOB's other information proposal). Therefore, we do not believe the proposed other information standard should apply to audits of financial statements of brokers and dealers. In addition, the language that would be required by the proposed auditor reporting standard regarding responsibilities with respect to other information should also not be required in the context of brokers and dealers.

### **Applicability to Investment Companies.**

*Identification and Communication of CAMs.* Appendix 5, page A5-61 of the proposal discusses the Board's consideration of comments to their concept release by investment companies. These commenters expressed the view that additional auditor reporting requirements should not apply to investment companies and that "financial statements [are] inherently less complex than operating companies' financial statements and ... that the limited nature of an investment company's operations entails fewer estimates and judgments." We agree with the views expressed by these commenters and believe that the requirements to identify and communicate CAMs in the auditor's report should not apply to audits of investment companies. Registered investment companies typically have an operating company or investment advisor, and sometimes hundreds of registered investment companies can exist under that operating company. Due to the similar nature of the financial statements of registered investment companies, if auditors of investment companies were required to identify and report on

CAMs in the auditor's report, the CAMs identified would become standardized across the numerous funds and from one complex to the next and likely from one year to the next as strategies of investment companies do not change significantly; thereby resulting in the disclosures providing little if any benefit to investors. As such, the Board's objectives in reporting CAMs (i.e., to provide unique insights regarding the audit and related financial statements) will not be achieved.

*Auditor Tenure.* If the Board does decide to require disclosure of auditor tenure in the auditor's report or in PCAOB Form 2, there are some unique implementation challenges that would arise when applying this requirement to auditor's reports on financial statements of investment companies. As such, if ultimately required to be included in either the auditor's report or in its Form 2, we believe auditor tenure should only relate to the relationship with the investment company complex as a whole and not to the relationship with each investment company. Investment companies are created frequently under an investment company complex, and typically the auditor is the auditor of multiple related investment companies within the same operating environment. Reporting auditor tenure at the investment company level would have little meaning, as these entities may be frequently formed and merged or liquidated. For example, as currently proposed, if a particular audit firm has been the auditor of an investment company complex for ten years and this investment company complex created five new investment companies in the current year, the firm would report only a one-year tenure at the investment company level for the five new funds. To report different tenure periods at the operating company and investment fund levels would be confusing and/or misleading to investors. Therefore, if the Board ultimately requires disclosure of auditor tenure, we suggest that it only be required for the relationship at the investment company complex level.

### **Applicability to Emerging Growth Companies and Initial Public Offerings.**

In the proposal, the Board is soliciting feedback on the applicability of the proposals to emerging growth companies (EGCs). We do not believe there is a basis for exempting audits of EGCs from the requirements of the final standards as we believe investors of these companies would benefit from the additional information communicated in the auditor's report in the same way that investors of larger companies would. While some level of incremental costs will of course result from the application of the proposals, we believe the suggestions we offer in this letter would help manage costs for audits of companies of all sizes. With respect to the requirement to communicate CAMs in the auditor's report, we believe the final auditor reporting standard should clarify whether CAMs are required to be reported in the context of IPOs.

### **Increase in Auditor Liability.**

The proposals represent an important step to ensure the auditor's report includes information that is responsive to the needs of users and remains relevant and valuable to the functioning of our capital markets. As a result, concerns over auditor liability should not stand in the way of moving forward. Rather, auditor liability concerns should be recognized and managed as the Board proceeds.

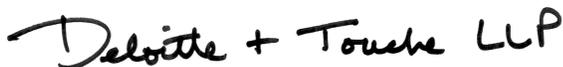
We believe that the proposed standards, if adopted, do present the potential for increased litigation. The PCAOB recognizes in the proposal that new statements will be made in the auditor's reports that could potentially raise new liability. The proposed new auditor statements — both with respect to CAMs and other information — could engender claims under Section 10(b) of the Exchange Act, Section 11 of the

Securities Act of 1933, and various state laws. For example, if the proposed auditor reporting standard is adopted, auditors will be subject to challenge based on the selection of matters considered to be CAMs and those that they do not consider to be CAMs. Plaintiffs will also invariably challenge the sufficiency of the auditor's evaluation of and disclosure about other information. Also of concern is the possible effect that disclosing CAMs may have on undermining efforts by Congress, which imposed the stringent pleading standards of the Private Securities Litigation Reform Act of 1995 (PSLRA), to curtail non-meritorious claims against auditors and avoid the costs and burdens associated with them. Plaintiffs will use descriptions of an auditor's procedures in its CAM disclosures to try to plead around the strict requirements of the PSLRA and federal jurisprudence that has interpreted it. The modifications suggested elsewhere in this comment letter may help mitigate some of the concerns relating to the effect of the proposed standards on an increase in litigation.

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D&T appreciates the opportunity to provide our perspectives on these important topics. Our comments are intended to assist the PCAOB in analyzing the relevant issues and potential effects of the proposals. We encourage the PCAOB to engage in active and transparent dialogue with commenters as the proposed standards are evaluated and changes are considered. If you have any questions or would like to discuss these issues further, please contact Joseph Ucuzoglu at 202-879-3109, William Platt at 203-761-3755, or Megan Zietsman at 203-761-3142.

Very truly yours,



Deloitte & Touche LLP

cc: James R. Doty, PCAOB Chairman  
Lewis H. Ferguson, PCAOB Member  
Jeanette M. Franzel, PCAOB Member  
Jay D. Hanson, PCAOB Member  
Steven B. Harris, PCAOB Member  
Martin F. Baumann, PCAOB Chief Auditor and Director of Professional Standards  
Mary Jo White, SEC Chairman  
Luis A. Aguilar, SEC Commissioner  
Daniel M. Gallagher, SEC Commissioner  
Kara M. Stein, SEC Commissioner  
Michael S. Piwowar, SEC Commissioner  
Paul A. Beswick, SEC Chief Accountant  
Brian T. Croteau, SEC Deputy Chief Accountant  
Russell G. Golden, FASB Chairman

## EXHIBIT 1 — Summary Results of Field Testing

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In order to provide meaningful feedback to the Board during the comment process and as requested by the Board, we conducted limited field testing (including interaction with financial management) of aspects of identifying and communicating CAMs. We conducted field testing with nine engagement teams each of which was responsible for a separate audit; the applicable companies had revenues ranging from approximately \$500 million to more than \$50 billion. The field testing included, among other steps, identifying potential CAMs based on the guidance in paragraphs 7- 9 of the proposed auditor reporting standard. The determination of the final CAMs was made based on the consideration of the factors included in paragraph 9 along with additional factors we have recommended in the body of our letter. Summary results of our field testing are provided below:

<b>Summary</b>	
<b>Identification of CAMs</b>	
Range of potential CAMs identified	12 – 120
Average # of potential CAMs identified	40
Range of final CAMs identified	1 – 12
Average # of final CAMs identified	4
<b>Characteristics of CAMs</b>	
% of final CAMs identified that were matters the engagement team had already discussed with the audit committee	100%
% of final CAMs that are also included in at least one of the following: the discussion of risk factors in the 10-K, the discussion of critical accounting policies in the company’s MD&A, and the footnotes to the financial statements	82%

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<sup>1</sup> The PCAOB may need to consider whether providing original information regarding a company may implicate non-U.S. privacy and confidentiality laws and regulations, as well as accountants’ professional obligations. For example, it appears that several countries impose strict confidentiality requirements on accountants not to reveal information about their work. In several countries, a violation of these confidentiality provisions also constitutes a criminal offense.

<sup>2</sup> See page A5-36 of the proposal.

<sup>3</sup> *Audit Committee Reporting to Shareholders: Going Beyond the Minimum*, Ernst & Young, February 2013, p. 2.

<sup>4</sup> See PCAOB AU 550, *Other Information in Documents Containing Audited Financial Statements*.

<sup>5</sup> *Ibid*, paragraphs 5 and 6.