



December 11, 2013

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

Re: PCAOB Release No. 2013-005, Rulemaking Docket Matter No. 34

*Proposed Auditing Standards - The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion; The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report (collectively referred to as "proposed standards")*

We are writing on behalf of the Emerging Standards Committee (ESC) of the Kentucky Society of Certified Public Accountants (KyCPA). The KyCPA is the sole professional organization representing CPAs in the Commonwealth of Kentucky. Its 5,100 members are engaged in business communities throughout the Commonwealth and have a comprehensive grassroots view of the needs of businesses, ranging from large public companies to small owner-managed businesses. KyCPA's ESC consists of a group of KyCPA members organized to monitor the activities of accounting and auditing standard setters, as well as government authorities, with the objective of participating in the standards-setting process by providing thoughtful comment on developing issues.

We appreciate the opportunity to comment on the PCAOB's proposed standards on auditor reporting. Our comments for your consideration are as follows:

### **Overall Comments**

We are supportive of the PCAOB's efforts to improve audit quality that will increase investor confidence and understanding of the audit process including the responsibilities of the auditor. However, we have serious concerns regarding the effectiveness, excessive cost and operability of the current proposal as discussed in our comments below. We believe it would be in the best interest of the Board to perform extensive real world field testing of the key elements in this proposal. Such an action would help identify the more costly and less beneficial elements within the proposal. Accordingly, we suggest this proposal be tabled or deferred until further research is completed. Further, the SEC should be involved during this research and study phase because some of the information being proposed relates to the Company and may not be otherwise disclosed. Accordingly, the SEC's involvement is important and they may wish to have Company management address certain Company matters mentioned by the auditors. Investor confusion would not represent an improvement in current practice.

## **The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion**

The proposed standards implement significant changes with respect to the existing auditor's report in three main areas: a) addition of a critical audit matters section, b) addition of new elements to the auditor's report, and c) enhancement of certain standardized language in the auditor's report. We highlight our concerns regarding each of these areas below.

### *Critical Audit Matters (CAMs)*

We believe CAMs, as currently defined, will create confusion with respect to audit quality. Acknowledging there are varying levels of sophistication among financial statement users, the additional information provided may inappropriately skew investors' perceptions of audit quality and assurance provided, as well as create additional risk for auditors as a result of this confusion. For example, if more CAMs are disclosed, an investor may incorrectly assume a lesser quality audit was performed (e.g. more issues) when in fact the opposite could be true. In another example, one audit team may disclose they consulted their national office on a CAM, but another audit team of another company in a similar industry with the same CAM may not. Given there could be valid reasons that one team did and another did not consult, an investor may inappropriately conclude a different level of audit quality among the audit teams. Further, there would be no process for investors to have their questions addressed or clarification provided. However, we believe that certain improvements, clarifications and illustrations can assist in establishing a standard that is more operational. We believe the following comments highlight the most important issues that must be addressed.

- Determination of CAMs – We believe the current definition of a CAM in the proposed standards is flawed. Specifically, we believe the sources of a CAM (completion document, engagement quality review matters, and audit committee communications) and factors as noted in paragraph 9 of the proposed standards are too broad. We believe the starting point to determine a CAM should be the required communications pursuant to AS 16. The ultimate CAMs determined should represent only material items that involved significant interaction with the Audit Committee. If the current "catch all" approach is implemented, we fear this will significantly impair the robust two-way communication with the Audit Committee, which is critical to an effective audit.

Further, we believe the requirement in paragraph 14 to document why a matter is not a CAM is not operational and subjects the auditor to unreasonable second guessing. A more practical approach would be to document the determination of which matters communicated pursuant to AS 16 were CAMs.

- Communication of CAMs – We have serious concerns regarding the communication requirements of CAMs. If the expectation is to communicate any items noted in paragraph 9, this would put the auditor in a precarious position as he/she may be communicating information not previously disclosed by the company. Examples of this would include deficiencies that are not material weaknesses, consultations outside the engagement team, and quantitative or qualitative information regarding corrected or uncorrected misstatements.

This issue must be addressed; auditors should not be allowed to serve as the original communicator of company information except in extraordinary circumstances. This is a matter that should be appropriately addressed by the SEC and not the PCAOB only.

The proposed standards provide the auditor the option, but not the requirement, to describe audit procedures related to CAMs. This will create diversity in practice and potential expectation gaps with investors. We suggest the description of audit procedures related to a CAM either be required or precluded. If it is required, we believe that further clarification and illustrations should be provided. We recommend a framework that is concise and focused on the financial statement assertions and factors that resulted in the determination of the CAM.

- Perceived assurance – Auditing standards require an audit be planned and performed to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to fraud or error (based on the financial statements as a whole). The audit report should clarify that the auditor is not reporting on individual accounts or assertions related to each CAM, but on the financial statements taken as a whole. Without clarification, an investor may inappropriately assume the auditor is providing assurance on individual accounts or assertions related to each CAM.
- Conformity with the IAASB Proposal – We strongly suggest that the PCAOB work with the IAASB to conform their effective dates and their proposals from a content perspective. The proposals regarding CAM (PCAOB) and Key Audit Matters (IAASB) are similar but not identical. This could result in different reporting depending on which standard is applicable, creating confusion with investors when evaluating U.S. vs. non-U.S. registered companies in similar industries that are under different standards.
- Litigation risk – We believe the proposed standards will absolutely result in additional auditor litigation risk. We understand this is not the Board's top priority, but the cause should not be flawed standards that cause investor confusion and increase the expectation gap.

#### *New Elements*

We agree with the proposed standards regarding new elements to the auditor's report with one exception. We believe that the auditor's tenure disclosure requirement should be removed. This does not appear to be relevant to the audit report and could result in inappropriate correlations between audit quality and auditor tenure. Acknowledging this is information certain investors have requested, we suggest this information be included in Form 2 reporting to the PCAOB or in the audit committee report of a company's annual proxy statement.

#### *Standardized Language*

We agree with the proposed standards regarding standardized language in the auditor's report.

**The Auditor's Responsibility Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report**

While there needs to be additional clarity and disclosure of the auditor's responsibility regarding other information, we do not believe the proposed standards as currently written are operational and we believe they will create significant incremental effort and costs. Further, the proposed standards as currently written may create significant gaps between the assurance investors will believe they are receiving versus what the assurance auditors will actually provide. The following comments highlight the most important issues that must be addressed and will help minimize confusion, cost and undue risk.

*Auditor's Responsibilities/Scope*

- The change in wording from "read and consider" under AU 550 to "read and evaluate" under the proposed standards appears to significantly increase the responsibility of the auditor. The term "evaluate" appears to infer a higher level of assurance. This will also create an expectation gap with investors who may assume auditors are providing a level of assurance similar to the audited financial statements. We recommend the wording and expectation be more consistent with AU 550. We also recommend adding clarification and examples of what procedures are expected to be performed by the auditor on other information.
- The proposed standards extend the auditors responsibility to include relevant audit evidence obtained during the audit, which is an expansion beyond the audited financial statements as currently described in AU 550. This appears to be unreasonably broad and cost-prohibitive. Specifically, it is unrealistic to expect the person performing the review of other information to know and remember all information that may reside in the audit work papers, especially if it is a multi-location or group audit.
- The proposed standard appears to increase auditor responsibility with respect to information not directly related to the financial statements. AU 550 only requires the performance of additional procedures if the auditor becomes aware of a potential material misstatement of fact. The increase in responsibility does not appear to be operational and we recommend reverting to the AU 550 requirement.
- The requirement to extend the other information procedures to information incorporated by reference and the proxy statement is cost prohibitive and not operational. We find it difficult to reconcile the cost/benefit regarding information incorporated by reference. Either this information would have already been considered as part of the audit or it is unlikely to be highly correlated to information in the financial statements. Further, it is impossible to perform these procedures on most proxy statements as they are not typically filed until after the auditor has issued their opinion.

*Reporting in the Auditor's Report*

We recommend that the audit report be revised to clearly state what procedures are performed on the other information and clearly state that the other information has not been audited.

**Other Matters**

*Cost and Resources*

We believe the implementation of the proposed standards, even if revised as we have suggested, will result in significant additional audit effort and costs (including ultimate costs to the investors). Further, the requirements in the currently proposed standards will likely cause significant resource constraints. Specifically, the effort required regarding CAMs will likely absorb critical capacity from the most senior members of the audit team in the late stages of the audit. We strongly suggest the PCAOB consider performing real world case studies to obtain better insights as to the actual effort and costs that will be required to implement the proposed standards.

*Scope of the Proposed Standards*

We believe that the proposed standards regarding CAMs are unnecessary for audits of benefit plans and we recommend these entities be exempted from CAM requirements. The potential CAMs for benefit plans would be very similar and these entities are inherently less complex. The effort and cost required would outweigh the benefit.

Similar to our comment on benefit plans as noted above, we believe the Board should justify why auditors of smaller reporting companies and non-accelerated filers should be required to comply with these proposed standards from a cost/benefit perspective. Specifically, the U.S. Congress and many others have grown increasingly concerned with administrative costs and related issues for smaller and emerging public companies. The JOBS Act is an example of addressing these issues. We believe this proposed standard is very costly and contrary to these initiatives.

Thank you very much for considering our thoughts.

Sincerely,



Glenn Bradley, CPA, Chair  
On behalf of the Emerging Standards Committee  
Kentucky Society of CPAs