



December 11, 2013

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Public Company Accounting Oversight Board
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Re: PCAOB Rulemaking Docket Matter No. 034 – Proposed Auditing Standards on 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; and Related Amendments to PCAOB Standards

Dear Board Members and Staff:

Grant Thornton LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board’s (“PCAOB” or “Board”) proposed auditing standards and amendments, *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 and Related Amendments to PCAOB Standards*, and we respectfully submit our comments and recommendations thereon.

Overall, we support the Board’s efforts to enhance the relevancy and transparency of the auditor’s report. We agree that retaining and also expanding beyond the “pass/fail” reporting model, will benefit investors and other users of financial statements and related financial information. As the PCAOB considers moving to a less-structured report in order to enhance relevancy and transparency, we believe global consistency is of critical importance. We strongly encourage the Board’s collaboration with other standard-setters, such as the International Auditing and Assurance Standards Board (“IAASB”) to align, to the extent practicable, the reporting requirements in order to minimize differences in definitions and application and, therefore, maximize the benefit to users of auditor’s reports worldwide.

We are participating in the Center for Audit Quality’s coordinated field-testing efforts of certain elements of the proposal. We believe this effort will provide important feedback on the operationality and cost elements of the proposal, and accordingly, we strongly encourage the PCAOB to consider the results of the field testing prior to finalizing the proposed new and revised standards. We also note that this analysis could be particularly important for smaller listed entities. We agree with the Board’s expectation that the adoption of the proposals will increase the

time necessary to complete an audit and the costs related thereto, predominantly related to critical audit matters and other information.

Critical audit matters

We agree with the objectives of increasing the relevance and usefulness of the auditor's report. Providing more insight into critical audit matters ("CAMs"), the audit matters that were of most significance to the audit, should provide investors and other users of the financial statements with information that could be useful in evaluating the underlying financial statements.

We have identified suggestions for improvement with respect to the proposal's scope, filtering mechanisms, and form of communication. These suggestions are intended to address concerns we have as to how the proposal aligns with current audit processes and documentation protocols. For example, the proposal could better leverage the process and work performed under other auditing standards, such as Auditing Standard No. 16, *Audit Committee Communications* ("AS 16").

Additionally, we agree that tailoring CAMs to the specific facts and circumstances of each engagement is important in providing meaningful information to investors. However, we note that this may create challenges to investors who attempt to compare reports even within the same industry because risk assessment and audit issues are very unique to each issuer. To illustrate this point, consider two companies in the same industry where one auditor may report difficulties on one issuer while another auditor may not report anything on the other issuer. We understand the flip-side to this risk is that such disclosures will become boilerplate. We recommend that the Board continue to evaluate these potential challenges through further outreach and post-implementation review separate from the inspections process.

Scope and definition of a CAM

We believe that the proposed scope under which CAMs are determined (documented in the engagement completion document, reviewed by the engagement quality reviewer, and/or communicated to the audit committee) creates redundancy and inefficiencies when considering the current audit process. We believe that audit teams effectively identified matters that are most significant to the audit in developing their communications to the audit committee under AS 16. Our view is that the audit team will have already filtered through the engagement completion document and work reviewed by the engagement quality reviewer in order to develop those significant matters that will be communicated to the audit committee. Therefore, requiring reconsideration of the matters defined in the proposal would significantly increase time and costs with little benefit to CAM identification. Accordingly, we believe the more appropriate starting point for identification of CAMs is to consider the matters included in audit committee communications.

When comparative financial information is presented, we agree with limiting the CAMs to the most recent financial period. We believe the most recent financial period is likely the most relevant to users of the financial statements and may enhance understandability and transparency. Further, limiting the CAMs to the most recent financial period may avert unnecessary complexities in auditor reporting. Other than in the initial year of implementation, we believe that

financial statement users may have access to the prior period's auditor's report should they wish to consider CAMs related to such period.

Factors in determining a CAM

We are supportive of the factors considered in determining CAMs listed in the proposed standard and believe these will assist the auditor in assessing matters, based on the audit procedures performed, to adequately identify CAMs. However, we believe that the current proposal would be improved by providing more direct linkage of the factors to significant matters disclosed in the financial statements. The examples provided and related discussions in the Release focus on those types of matters (for example, complex fair value measures). As currently drafted, situations where the auditor spent considerable effort in developing an audit plan over say a multi-location audit may appear to meet the CAM factors for consideration, but disclosing those efforts may not provide actionable information to the users of the financial statements as the auditor considerations would not be presented in the context of an impact on the financial statements. In relating matters directly to the financial statements, we would also encourage consideration as to materiality, which we believe is a significant factor when considering practical application of the standard, but is currently implicit in the requirements. Therefore, we strongly encourage the Board to revise paragraph nine of the proposed standard to include a more direct link to the financial statements – the auditor would consider matters that are material to the financial statements as well as those involving the most difficult, subjective or complex auditor judgments; posed the most difficulty to the auditor in obtaining sufficient appropriate audit evidence; and/or posed the most difficulty to the auditor in forming an opinion on the financial statements.

Communication

We generally support the proposed language that would precede CAMs in the auditor's report, when considered with the relevant comments throughout this letter. However, we note that there is no reference to auditor judgment, and we believe it is important to specifically communicate that the determination of CAMs is based on the auditor's professional judgment. Adding language to this effect will better align the proposal with other standard setters as well as the Board's risk assessment standards.

Further, paragraph 11b requires that the auditor describe the considerations that led the auditor to determine that the matter is a CAM. We recommend the Board consider revising this requirement so the auditor considers the "primary" considerations that led to the determination of a CAM. As currently proposed, an auditor may repeat all of the factors in paragraph nine, which we do not believe is the Board's intention. If the requirement is revised to focus on the primary considerations, the auditor can better communicate what were the most relevant factors that led to the conclusion that a matter is a CAM.

We appreciate the Board providing various examples of CAMs and the opportunity to comment on those examples. We are generally supportive of the examples, however, we have significant concerns with respect to disclosing information about the company (internal control deficiencies and proposed adjustments) that should be the purview of management to consider for disclosure. Absent disclosure by the entity, we do not believe the auditor should be in the position of needing to or being expected to disclose such information.

We believe that the current proposal and related examples imply that certain information may be reported by the auditors and not disclosed by management. Such disclosures by the auditor would blur the auditor's responsibilities with those of management. We also believe that unintended consequences could arise if the auditor were to communicate matters that are not otherwise required to be disclosed, such as significant deficiencies in internal control, since this could create confusion and inconsistencies with current SEC reporting requirements. Such disclosure by the auditor could also result in negative consequences to the issuer given the context in which those disclosures might be made and the fact that the issuer did not make the disclosures themselves. Application guidance provided in paragraph A37 of the IAASB's Proposed International Standard on Auditing ("ISA") 701, *Communicating Key Audit Matters in the Independent Auditor's Report* states:

"It is appropriate for the auditor to seek to avoid the description of key audit matters inappropriately providing original information about the entity that is the responsibility of the entity's management and those charged with governance unless, in the auditor's judgment, the additional information that the auditor may provide is critical to the auditor's description of the key audit matter and providing such information is not prohibited by law or regulation. In such circumstances, the auditor may encourage management or those charged with governance to make relevant disclosures in the financial statements that include such other information, so that reference can be made to those disclosures within the description of the key audit matters in the auditor's report, rather than the auditor providing original information."

We believe this is important application guidance that we recommend the Board consider adding to their proposed standard related to CAM. As noted above, we believe alignment in the auditor reporting standards is important for investors and other stakeholders. Adopting this guidance will better align the requirements with the proposed ISA and clarify that auditor reporting should be limited to only audit-related matters and should not include information that management is responsible for disclosing.

We also note that the examples include references to the procedures the auditor performed with respect to the CAM. As proposed, there is currently no guidance or framework for the auditor to consider how and what to describe with respect to the audit response to a CAM. While we recognize that CAMs are intended to make the auditor's report more informative and useful, it is essential for investors to better understand the concepts of auditing in order to fully benefit from this additional information regarding audit procedures performed and to be able to use the information as intended by the proposed standard. In recent years, investors have adapted to new and emerging accounting information, but accounting topics (and changes thereto) do not equate to auditing topics, and there would be a significant learning curve for many investors who do not understand audit fundamentals and objectives.

We do support providing the auditor the option to include audit procedures in the explanation of each CAM if, in the auditor's judgment, conveying those procedures provides a better understanding regarding the significance of the matter. However, we strongly recommend the Board continue to perform outreach in this area prior to concluding on whether to promote or require such disclosures.

Finally, we note that the reporting of CAMs will likely present additional auditor litigation risk surrounding what matters were selected, how they were described, and even the order in which they are presented in the auditor's report. Such risks may not be limited to the legal liability of the auditor but may also heighten the audited company's litigation risk. However, we believe revisions to the proposal based on certain of our recommendations may mitigate this risk.

Documentation

We support the effort to align the documentation requirement under the proposal with current auditing standards. However, as noted previously, we believe that it is important to clarify within the proposal that the determination of and response to CAMs are a matter of auditor judgment. Further, the current proposal requires the auditor to document why the auditor concluded that a matter potentially meeting the definition of a CAM was not ultimately communicated as a CAM. This type of documentation is inappropriate and will add unnecessary time and costs to the audit. We believe that this requirement is inconsistent with current auditing standards and auditor protocols regarding documenting the results of procedures performed and evidence obtained to support the auditor's opinion. Documenting what the auditor considered but did not act on is not operational, and we do not believe it improves audit quality.

Also, the proposed standard appears somewhat inconsistent with the additional discussion on this topic provided in Appendix 5, *Additional Discussion Related to the Proposed Auditor Reporting Standard* ("Appendix 5") of the proposal, which notes:

"In fulfilling the documentation requirements under the proposed auditor reporting standard, the auditor would not be expected to provide an explanation for each matter documented in the engagement completion document, reviewed by the engagement quality reviewer or communicated to the audit committee."

We are concerned that, as currently drafted, the proposal will result in a significant amount of time and effort relating to fulfilling the documentation requirements, particularly at the end of the audit when available time is often minimal. Consequently, we are concerned with the potential impact on audit quality, as such requirements would strain resources and could potentially impact the communications between the auditor and engagement quality reviewer and/or the audit committee.

Auditor's responsibility regarding other information

We support providing greater transparency into the auditor's responsibility and procedures related to other information, which we believe will be beneficial to users of the financial statements. We agree with the Board's view that investors and other users of the financial statements will benefit from understanding the auditor's responsibilities for information that accompanies the auditor's report and financial statements. We do note that some of the suggested changes in the proposal seem to indicate that the Board is remedying a deficiency in current practice, rather than bringing transparency to the existing process. We think this is most evident in the Board's discussion in Appendix 6, *Additional Discussion Related to the Proposed Other Information Standard* of the release as to the upgrading of the auditor's responsibility from "read" to "evaluate." We are not aware of

previous concerns articulated by the Board or PCAOB staff with respect to the auditor's responsibilities and execution under current standards.

Objectives and scope

We believe that certain clarifications to the objectives may enable the auditor to meet such objectives. We recommend clarifying the objectives to refer directly to the financial statements as well as adding language allowing for the auditor to consider the materiality of the other information, in order to focus the auditor's efforts in areas where potential misstatements of fact or material inconsistencies may be more likely to occur.

We have suggested certain revisions to the proposal related to clarifying the scope of the auditor's responsibilities and the auditor's ability to use judgment in determining the level of effort to expend on certain information. For example, we believe it would be appropriate to allow the auditor to determine the extent of work necessary on certain aspects of other information. Also, we are not clear as to the Board's intent with respect to the exhibits filed with the company's annual report and whether previously filed exhibits are also subject to the same approach with respect to evaluating the information and performing procedures. While such clarification is not currently included in AU 550, *Other Information in Documents Containing Audited Financial Statements*, we believe current practice would include a pragmatic approach to the need for or level of review of certain other information included in the exhibits, for example. Accordingly, we recommend the Board clarify the scope of other information that would be subject to this standard as well as provide for auditor judgment in determining the nature and extent of the procedures performed related to the other information. We are also concerned as to the implications of extending the auditor's responsibility to information filed subsequent to the issuance of the company's Form 10-K, specifically the definitive proxy statement or any subsequent amendments to the annual report. As currently written, the auditor is responsible for evaluating information that is not available as of the report date. We believe this requirement could result in significant operational issues. We recommend the Board reconsider the impact subsequent filings may have on auditors fulfilling their responsibilities under this standard and the interaction with other standards, such as those related to report dating, predecessor/successor auditor changes, etc.

We also believe the Board should clarify in the standard that it does not intend for another company's financial statements to be considered "other information" for purposes of this standard (for example, in cases where financial statements of an acquired entity are included in a registrant's Form 10-K). These financial statements should not be considered within the scope of the proposed standard given that they are not the company's information and were subjected to a separate audit.

Evaluating the other information

As noted above, the proposed standard elevates the level of auditor responsibility, which we believe is unnecessary. The benefits of this change to investors will not be commensurate with the costs associated with expanding the auditor's responsibilities related to other information. By increasing the requirement from "read and consider" to "evaluate and conclude," the burden to identify misstatements of fact is now higher, but there is no reference in the second objective of

the standard with respect to the evidence obtained. We strongly encourage the Board to consider retaining the current performance requirements in AU 550 .

We do have concerns regarding the proposed responsibilities for information not directly related to the financial statements. As currently written, we believe this may be interpreted inconsistently and potentially drive excessive work by audit teams attempting to compare audit evidence with aspects of such information. We believe that the evaluation of other information not directly related to the financial statements as described in paragraph 4c of the proposal should be separate from the responsibility for information directly related to the financial statements. Consistent with current practice, we believe the auditor's responsibility should be limited to reading and considering the other information not directly related to the financial statements based on the auditor's understanding gained during the audit.

We also note that the proposal does not specify that the auditor would communicate the date through which the other information subjected to the auditor's evaluation was available. We believe this should be included especially when considering potential issues related to report dating and subsequently filed other information.

Responding to material inconsistencies or misstatements

We support the proposed responses to potential material inconsistencies or material misstatements of fact as set forth in the proposal. We do note that it is unclear whether the Board's reference in the proposal to AU 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*, implies that the audit report should be amended or dual dated in instances where the auditor identifies a material inconsistency or misstatement of fact within a company's subsequent filing, such as a definitive proxy statement. Additionally, is the report on other information affected by subsequent matters? We believe further clarification of the intent of the Board with respect to such events is necessary.

Reporting in the auditor's report

We support flexibility with respect to the order of items to be reported within the auditor's report; however, we believe that reporting on other information should not be included prior to the description of management's (and the audit committee's) or the auditor's responsibilities, both of which refer to the audit of the financial statements. Reporting on other information should be clearly separated and included at the end of the auditor's report on the audited financial statements.

We believe it is important to consider the users' perception of the proposed paragraph to be added to the report and the conclusion provided in that paragraph. We believe that providing a conclusion on other information in the report would likely result in an increase in the expectation gap for investors and other users as to the level of work performed on the other information. We strongly recommend the Board consider revising the reporting requirements to focus on the materials the auditor was responsible for, and a general description of the performance requirements without providing a conclusion.

We suggest the Board consider clarifying scenarios as it relates to the auditor's reporting responsibilities. For example, if the auditor identifies a material misstatement of fact with respect to a matter that does not affect the financial statements and management will not revise the disclosure, would the auditor be expected to report this misstatement in the auditor's report? Would the auditor include it but specifically state that the material misstatement does not impact the financial statements? Since the scope of information currently encompasses all other information, all of the various scenarios that may arise should be considered by the Board prior to finalizing the proposal.

Finally, with respect to the impact on predecessor auditors, we do agree with the Board's proposed changes with respect to the predecessor's responsibilities. We note that AU 508.71 discusses representations from management and the successor auditor that the predecessor should obtain. We suggest the Board consider expanding the nature of the representations to include matters that come to the attention of the successor auditor that might have a material effect on the predecessor's conclusion with respect to previously reported other information, in addition to the financial statements reported on by the predecessor auditor.

Basic elements of the auditor's report

Addressees

We are supportive of the addressees of the auditor's report including both shareholders and the board of directors or its equivalent in order to gain more consistency in practice. We believe that addressing the report to the shareholders is supportive and consistent with the objective of the audit, which is to enhance public confidence. However, we do not believe the addressees should extend beyond the shareholders and the board of directors or equivalent. The primary users of the financial statements that are considered when planning and executing an audit are "reasonable investors" as described in Auditing Standard No. 11, *Considerations of Materiality in Planning and Performing an Audit*. Including other parties beyond these may misalign the addressees of the auditor's report and the primary users considered in an audit.

Auditor's responsibilities and nature of an audit

We further support the clarifications and proposed additions to the report language surrounding the auditor's responsibilities as well as the nature of the audit. We believe such information may be helpful to investors and other users of the financial statements. We also recommend that the Board consider aligning those requirements, where appropriate, with the IAASB proposal, which we believe would be beneficial to financial statement users. In particular, we recommend adding the following:

- Definition of "reasonable assurance"
- The auditor's responsibility related to obtaining an understanding of internal control relevant to the audit (financial statement only audit)
- The auditor's responsibility to communicate with the audit committee

Auditor tenure

We recognize that greater transparency regarding tenure may be important to some users of the financial statements, but we believe the auditor's report is not the appropriate place to convey this

information. If included in the auditor's report, the information could be misinterpreted as having a correlation to audit quality, as highlighted in the PCAOB's release, where there is no definitive empirical evidence that such a correlation exists.

The Board refers to rules adopted by the United Kingdom ("UK") Financial Reporting Council in Appendix 5 that require UK-listed companies to provide information on the length of auditor tenure in a separate section of the annual report. In this case, the listed company provides this information, not the auditors. We believe it would be more appropriate if this information were reported by a company's audit committee through the proxy statement or other means. If the responsibility to disclose this information must lie with the auditor, we would be supportive of the Board requiring the tenure information to be included in audit firms' annual report on Form 2. Since an audit firm's Form 2 is available to the public, we believe this is a more reasonable method for conveying this information without risking it being misinterpreted.

Form of the auditor's unqualified report

We believe retaining the pass/fail model is important, particularly with the introduction of CAMs. Maintaining the pass/fail model will make it clear that the auditor's opinion is on the financial statements taken as a whole and not on specific elements. As indicated above, we support not mandating the ordering of sections in the auditor's report in order to allow flexibility. However, we are concerned about the proposed standard's use of headings. Currently, headings are required for only certain sections of the auditor's report. The proposed use of headings may imply to users of the financial statements that certain sections are more important than others or should be weighed differently when evaluating the auditor's report taken as a whole. We recommend requiring headings for all sections, which is consistent with other standard setters. We believe this would better align the intended use of the auditor's report with how it is read and used by investors.

Explanatory language within the auditor's report

We agree with retaining the concept of explanatory paragraphs to emphasize a matter regarding the financial statements. We note that the proposed definition of CAM is included in Appendix A to the proposed auditor reporting standard. We suggest the Board consider adding a definition of an "emphasis of matter paragraph" to clearly differentiate the expected use of those paragraphs from CAM. .

With respect to placement, we support the flexibility afforded by the proposal that permits auditor's to place emphasis of matter paragraphs within the auditor's report based on the nature of the information and the auditor's judgment as to its relative significance. This flexibility is consistent with not mandating the ordering of the various sections of the auditor's report.

Other considerations

Scope

We recommend that the two proposed standards be applicable to issuers, including emerging growth companies (thus entities filing Regulation 305 or 309 statements would not be subject to these provisions), with an exception for Form 11-K filers. While we understand that certain industries, such as investment companies, include entities that are not complex and reporting and

disclosures are straightforward (such as a mutual fund that invests in highly rated securities with little complexity or valuation uncertainty), we would find it difficult to “draw a line” as to when CAM would be required for an entity or type of entity based on those scoping characteristics.

We believe that employee benefits plans are designed for a specific purpose and as a result would likely have either no CAMs identified, or similar, potentially boiler-plate CAM descriptions. Employee benefit plans are inherently less complex and entail fewer estimates and judgments, and CAMs for these entities would likely include auditing hard-to-value investments, which require extensive fair value disclosures. Further, plans have a limited amount of other information that would be filed with the SEC. Since each plan also files an AICPA report with the Department of Labor, scoping plans out of the proposed standards would avoid different forms of the auditor’s report for the same entity.

With respect to broker-dealers, we believe the standards should apply to broker-dealers that are issuers, consistent with our views above. We are aware of situations where a broker-dealer can request confidentiality with respect to certain statements included in a filing. In those circumstances, the auditor’s responsibilities for reporting CAM may conflict with the reduced financial statement presentation. We recommend further discussion on this matter and consideration as to whether CAM, in those circumstances, would be limited for consideration to the matters related to the publicly available financial information.

Consideration of other independent auditors

It is currently unclear how these proposed standards would interact with AU 543, *Part of Audit Performed by Other Independent Auditors*. We believe that further guidance is needed with respect to applying the proposed standards to audits where multiple auditors are involved, such as in scenarios where a principal auditor makes reference to another auditor’s report.

Considerations related to securities act documents

We agree with the Board’s deliberate approach as it relates to expanding the scope of the proposed standard or incorporating elements of the performance and reporting of the proposed standard to AU 711 *Filings Under Federal Securities Statutes*. Current practice for most securities offerings that include capital-raising often include an underwriter who will require that the company’s auditor provide a comfort letter related to the financial statements and other financial information included in the filing. The interplay between the responsibilities and legal liability of the underwriter and that of the auditor under the federal securities laws is complex. Providing more transparency as to the auditor’s responsibilities for other information included in those filings without also including the responsibilities of the other parties (such as underwriters and attorneys) may be confusing and result in inappropriate conclusions by the readers of those filings.

Cost considerations

As described above, we agree that initial costs will be incurred by firms in order to update firm policies and methodologies, and there will be ongoing costs in order to apply the requirements of the two proposed standards. We note that certain of our suggestions are intended to address efficiencies as well as maintain effectiveness of executing on the objectives set forth in the proposal.

Some of the additional cost considerations will include incurring additional time identifying and drafting CAMs, evaluating other information, documenting procedures and conclusions reached on CAMs and other information, and discussing these matters at length with the audit committee. Audit firm quality control procedures will likely include national office involvement. This increased time will also be incurred by the more expensive team members since the proposed standards provide minimal opportunity to leverage this work.

As noted above, we are in the process of performing field testing in conjunction with the Center for Audit Quality, which will help us determine an estimate of the increase in hours and costs. While we currently do not have empirical evidence to provide to the Board, we believe that the increase in cost and time will be due to considering the sensitivity of company information and interrelationship with company disclosures in the financial statements and other information, and the additional discussions that will need to take place with management, those charged with governance, and possibly the company's and auditor's legal counsel. We do expect that the increased time will impose pressure on meeting an issuer's filing deadline and also create pressures on audit quality. The costs to be incurred by the auditor will also pressure firms to raise the cost of the audit.

Lastly, we support and recognize the importance of a post-implementation review separate from the Board's inspection process that includes an evaluation of the direct and indirect effects on financial markets, regulatory scrutiny, and litigation matters. It is inevitable that auditor judgments across and within firms will differ with respect to determining and describing CAMs and, as a result, there will be variations in practice. In addition, we believe that users of financial statements would utilize and apply the additional information to be included in the auditor's report in diverse ways to suit their specific needs. Accordingly, monitoring the effects of the new auditor's reporting model and whether it is not only being applied appropriately by auditors but also has met user expectations will be essential to achieving the objectives of the proposed standards.

If you have any questions about our response, or wish to further discuss our comments, please contact Jeff Burgess, National Managing Partner of Professional Standards, at Jeff.Burgess@us.gt.com or at (704) 632-3940.

Sincerely,

Grant Thornton LLP