



August 18, 2017

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: File No. PCAOB-2017-01

Dear Mr. Fields:

We appreciate the opportunity to comment on the **Securities and Exchange Commission’s (“SEC” or “the Commission”) Notice of Filing of Proposed Rules on *The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion, and Departures from Unqualified Opinions and Other Reporting Circumstances, and Related Amendments to Auditing Standards*** (collectively the **“final PCAOB standard” or “PCAOB adopting release”**).

We have provided feedback to the Public Company Accounting Oversight Board (“PCAOB” or “the Board”) at all stages of consultation throughout the six-year development process. As we have expressed **previously, we support changes to the auditor’s report that** are responsive to the feedback provided by users, while also maintaining or improving audit quality. Our August 2016 comment letter to the PCAOB noted our support for the changes the PCAOB made from its original proposal, particularly with respect to the reporting of critical audit matters (“CAMs”). We believe such changes will result in an approach to communicating CAMs that is more consistent with the role of an auditor and help to mitigate certain unintended consequences of expanded auditor reporting.

In our view, the adoption and implementation of the final PCAOB standard could mark the beginning of **an evolution of the content of the auditor’s report. Accordingly, continued dialogue and feedback with stakeholders** will be important to monitoring whether **the PCAOB’s standard setting has achieved its** intended objectives and to identifying further actions that may be necessary or appropriate. Such stakeholder engagement will allow the PCAOB and others, as necessary, to make mid-course adjustments and longer-term **continued improvements to the auditor’s report, in particular as corporate reporting** continues to evolve.

Our primary observations on the final PCAOB standard are organized into the following topical areas:

- Request for SEC action to promote effective implementation of CAM reporting
- Monitoring the implementation of CAM reporting
- Applicability of CAMs
- Communication of auditor tenure
- Determination of auditor tenure



Request for SEC action to promote effective implementation of CAM reporting

We support the PCAOB's efforts to make the auditor's report more responsive to the interests of financial statement users. We also appreciate the PCAOB's efforts to consider prior comments about the scope of CAMs and the related potential unintended consequences. However, we remain concerned that the final PCAOB standard may undermine the new audit report's utility by exposing auditors to increased and unwarranted risk of meritless litigation under the federal securities laws. Accordingly, we ask that the SEC expeditiously undertake rulemaking, without delaying adoption of the standard, to promote robust implementation and execution by auditors under the standard by proportionally addressing the new litigation risks related to the identification and discussion of CAMs in the auditor's report.

As we noted in our previous comment letters to the PCAOB, discussion of CAMs is likely to result in an increased potential for meritless claims under the securities laws by expanding the number and variety of statements that will be attributed to the auditor. Because CAMs, by definition, will involve "challenging, subjective, or complex auditor judgment," even a good-faith discussion of these matters will give rise to greater litigation risk. As a practical matter, reasonable auditors may differ in how they resolve a "judgment call," and those good-faith judgments may end up being the subject of inappropriate, hindsight-based claims under the securities laws. The new standard is likely to result in more spurious lawsuits being brought, fewer meritless cases being properly dismissed at an appropriately early stage, and more unwarranted settlements needing to be reached—all of which would divert resources and focus from audit quality and robust implementation of the standard.

The PCAOB stated that it did not adopt additional proposed changes to address this risk due to concerns that such changes would also have the effect of reducing "the number and content of required communications of critical audit matters," and "the informativeness of auditor communication of critical audit matters."¹ We acknowledge the PCAOB's decision not to alter the standard, but we believe action is necessary to address the potential for increased and unwarranted litigation risk. To that end, we ask the SEC to adopt complementary rules clarifying when an auditor's additional statements pursuant to the standard may give rise to liability under the federal securities laws. Given the complex and subjective professional judgments involved in the identification and description of CAMs, such a rule should require an auditor to have actual knowledge that a misstatement or omission relating to CAMs is false or misleading (i.e., the auditor did not believe its CAM statements) in order for certain liability provisions of the federal securities laws to apply. This would also promote vigorous implementation and execution of the standard by encouraging auditors to focus fully on drafting useful, informative CAM disclosures based on their best judgment without being distracted by concerns about unwarranted litigation.

This proposal is narrowly tailored to leave the PCAOB's new reporting model fully intact, and strikes an appropriate balance between preserving a remedy in the case of wrongful conduct, while avoiding an unwarranted expansion of costly, meritless litigation. Our request is also consistent with remarks made by the Commission's new Chairman relating to effective rulemaking ("situations where a rule's effects may

¹ PCAOB Release No. 2017-001 at 42.



not be consistent with expectations”) and assessing the real costs of new rules (“recogniz[ing the] practical costs that are sure to arise”).²

This proposal seeks to proportionally address a consequence of the standard on which there is widespread agreement.³ It does so in a way that is consistent with the objectives of the rulemaking, allowing for a reduction in the practical “costs” of the standard without taking away from (and even potentially adding to) its anticipated benefits. The requested rule could be modeled after the approach to forward-looking statements under the Private Securities Litigation Reform Act of 1995 (“PSLRA”), which encouraged company management to provide their best estimates of future performance by allowing management to make forward-looking statements without fear of being sued simply because the future turned out somewhat differently. There, a fraud claim relating to forward-looking statements will proceed only if, among other things, the forward-looking statements were not accompanied by meaningful cautionary language and the plaintiff pleads facts demonstrating the statements were made with actual knowledge that they were false or misleading. This serves as a critical screening function for meritless claims—while ensuring that an appropriate remedy remains given the nature of the statements. As was the case with forward-looking statements, CAMs will serve the interest of increasing the information available to financial statement users, but the nature of the statements warrants an approach that addresses the risk of unwarranted, increased litigation costs.

The federal securities laws and related case law contemplate an auditor’s report as we know it today. Given the significant expansion of that report required by the new standard, we believe it is reasonable for the SEC to engage in the concomitant rulemaking proposed here concerning CAM statements. The SEC could approach such rulemaking through the National Securities Markets Improvement Act of 1996, which gives the SEC general exemptive authority under the Securities Act of 1933 (“Securities Act”) (*see* 15 U.S.C. § 77z-3) and the Securities Exchange Act of 1934 (“Exchange Act”) (*see* 15 U.S.C. § 78mm(a)(1)),⁴ and through the PSLRA’s grant to the SEC of the power to create exemptions to liability under the Securities Act and the Exchange Act.⁵ The legislative history of the PSLRA emphasizes Congress’s expectation that the SEC would expand such protections from liability where appropriate.⁶ The SEC, through rulemaking,

² SEC Chairman Jay Clayton, *Remarks at the Economic Club of New York* (July 11, 2017).

³ *See, e.g.*, PCAOB Release No. 2017-001 at 40, 44 and 94.

⁴ *See also* Merritt B. Fox, *Securities Class Actions Against Foreign Issuers*, 64 *Stan. L. Rev.* 1173, 1267 (2012) (“The SEC has broad powers of exemption from the impact of both statutory provisions and its own rules.”) (citing Section 36 of the Exchange Act, 15 U.S.C. § 78mm(a)(1)); *see generally* *Schiller v. Tower Semiconductor Ltd.*, 449 F.3d 286, 292 n.5 (2d Cir. 2006) (describing 15 U.S.C. § 78mm(a)(1) as a “general exemptive authority provision”).

⁵ *See* 15 U.S.C. § 77z-2(g) (“Commission may, by rule or regulation, provide exemptions from or under any provision of this subchapter”); 15 U.S.C. § 78u-5(g) (“Commission may, by rule or regulation, provide exemptions from or under any provision of this chapter”). *See also, e.g.*, Disclosure of Accounting Policies for Derivative Financial Instruments, S.E.C. Release No. 48, 63 S.E.C. Docket 1851 (Jan. 31, 1997) (deeming certain information relating to Item 305 disclosures “forward looking statements” within scope of PSLRA safe harbor).

⁶ “The Committee intends for its statutory safe harbor provisions to serve as a starting point and fully expects the SEC to continue its rulemaking proceedings in this area. The SEC should, as appropriate, promulgate rules



could establish exemptions under the Securities Act and Exchange Act for good-faith statements made by auditors pursuant to the final PCAOB standard. We include possible language for such a concept for the SEC's consideration as an appendix to this letter.

We appreciate the PCAOB's efforts to "appropriately address[] commenters' concerns regarding liability in a manner compatible with the objectives of this rulemaking, and in view of the rulemaking's anticipated benefits."⁷ And we acknowledge, as the PCAOB has stated, that the rulemaking we are proposing here would have been beyond the PCAOB's authority.⁸ Therefore, we request the SEC exercise its rulemaking authority to address this important issue.

Monitoring the implementation of CAM reporting

The communication of CAMs will be a significant change in practice. Some commenters have said that CAMs will add to the total mix of information available, providing insights relevant in analyzing and pricing risks in capital valuation and allocation, among other things. Other stakeholders have questioned the extent of potential usefulness of the information and expressed concerns about the unintended consequences of auditors communicating CAMs, including the risk that auditors may be placed in an inappropriate position of providing original information about a company. It is therefore essential that the SEC and PCAOB closely monitor the implementation of the standard to assure both that the communication of CAMs achieves the expected benefits and that potential unintended consequences are minimized.

The auditing profession has a significant role to play in contributing to the monitoring process, in particular through engagement with management and audit committees, as well as engaging on the implementation with the broader investment community on a profession-wide basis. We stand ready to work with the SEC and PCAOB to provide feedback on implementation experiences. The standard's phased implementation will allow the SEC and PCAOB to consider initial feedback on implementation and take appropriate steps to support the more widespread implementation, including issuing guidance or highlighting PCAOB or SEC staff views on the success of the first phase of implementation of CAMs. We also recommend that the PCAOB commit to undertake a formal post-implementation review after the final standard is implemented as well as a timeline for doing so.

Applicability of CAMs

The PCAOB adopting release acknowledges there are situations when an auditor may be required by law or regulation, or voluntarily agrees, to perform an audit engagement in accordance with PCAOB standards for a company whose audit is not subject to PCAOB oversight. For example, SEC rules permit audits under

or regulations to expand the statutory safe harbor by providing additional exemptions from liability or extending its coverage to additional types of information." See H.R. Rep. No. 104-369, at 46 (1995) (Conf. Rep.), 1995 USCCAN 745.

⁷ PCAOB Release No. 2017-001 at 43-44.

⁸ PCAOB Release No. 2017-001 at 43 n.72.



PCAOB standards in connection with offerings under Regulation A and Regulation Crowdfunding. The PCAOB adopting release clarifies that, in these situations, certain elements of the auditor's report required under the final standard, such as the use of "registered public accounting firm" in the title or the statement regarding independence requirements, may not apply, and suggests that additional guidance for these situations will be provided.⁹

We believe additional guidance from the PCAOB and SEC in the near future would be helpful. Specifically, since voluntary filers are not explicitly scoped out from the requirements to communicate CAMs, it is necessary for the PCAOB and SEC to clarify whether CAMs would be required to be communicated in other audits performed under PCAOB standards, as well as in circumstances in which reference is made to both PCAOB and AICPA standards. In our view, auditors of these entities should not be required to communicate CAMs, but instead could be permitted to do so voluntarily.

Communication of auditor tenure

We wish to reiterate our concerns about communicating auditor tenure in the auditor's report, particularly in light of the PCAOB's explanation for its policy decision in its adopting release. As acknowledged in the PCAOB's May 2016 reproposal, research continues to be divided on the relationship between audit quality and auditor tenure. The adopting release expressly disclaims any relationship between an auditor's tenure and either audit quality or auditor independence.¹⁰ Accordingly, we believe including auditor tenure in the auditor's report may create the false impression that such a relationship exists and give undue prominence to this information. Moreover, the responsibility for hiring and dismissing the auditor rests with the audit committee, not the auditor.

We acknowledge and support the PCAOB's objective of making information about auditor tenure more readily accessible in a consistent location and reducing search costs for this information. In our view, requiring this disclosure in Form AP (i.e., in one searchable location), where other information about participants in the audit is already required to be disclosed would accomplish the PCAOB's stated objective. Furthermore, the PCAOB's approach to allowing the tenure disclosure to be included anywhere within the auditor's report could increase the chances of misunderstanding the intended purpose of the disclosure (e.g., it may suggest unintended meaning if the disclosure is included in the Opinion or the Basis for Opinion sections of the report) and its policy choice is at odds with the PCAOB's own stated objective. Board Member Franzel highlighted similar concerns at the PCAOB's open meeting to adopt the standard and stated that she would "support an analysis of alternatives for the best party to make the disclosure and the mechanism for doing so."¹¹ Her statement makes it clear that such an analysis was not performed and considered by the PCAOB prior to the decision to adopt the new requirement. Accordingly, while we are supportive of disclosure of auditor tenure information, we do not believe that it should be required to be included in the auditor's report, particularly without proper analysis and justification.

⁹ PCAOB Release No. 2017-001 at 60-61.

¹⁰ PCAOB Release No. 2017-001 at 47, 95-96.

¹¹ *Statement on Adoption of an Auditing Standard on the Auditor's Report* (June 1, 2017).



Determination of auditor tenure

Both the reproposal and the adopting release contemplate that auditor tenure would be calculated taking into account audit firm or company mergers, acquisitions, or changes in ownership structure. The adopting release also highlights the PCAOB's belief that the disclosure of tenure should reflect the entire relationship between the company and the auditor, including the tenure of predecessor accounting firms and engagement by predecessors of the company under audit. Determining auditor tenure by including relationships with "predecessor" and "successor" companies provides a useful framework for auditors – for example, we do not believe it would be necessary for auditors to expend effort to trace relationships with every entity that may have been acquired over the years. Rather, a focus on predecessor and successor companies is a better reflection of the entire relationship with a company.

The final standard also includes a note providing that, if the auditor is uncertain as to the year the auditor became the company's auditor, the auditor should so state and provide the earliest year of which the auditor has knowledge. We appreciate what we view as the PCAOB's acknowledgement that, in certain cases, it may be difficult to precisely determine the length of the relationship. This may be the case, for example, when a firm has audited an entity long before it became a public company or when a company went public prior to 1994 (i.e., prior to when information on changes in auditors generally is publicly available through EDGAR).

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We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions. Please contact Leonard L. Combs (██████████) regarding our submission.

Sincerely,

PricewaterhouseCoopers LLP



Appendix -- Proposed Concept for Rulemaking

The Commission could adopt a rule as follows:

The provisions of Section 11 of the Securities Act, 15 U.S.C. § 77k, and the provisions of Section 10(b) of the Exchange Act, 15 U.S.C. § 78j, and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5, shall not apply with respect to any statement or omission by an auditor that pertains to the discussion of critical audit matters under AS 3101.11, *et seq.*, unless the statement or omission—

(1) if made by a natural person, was made with actual knowledge by that person that the statement or omission was false or misleading at the time it was made; or

(2) if made by a business entity, was—

(a) made by or with the approval of the partner or executive officer charged with responsibility for the audit, and

(b) made or approved by such partner or officer with actual knowledge that the statement or omission was false or misleading at the time it was made.