Edison Electric INSTITUTE

American Gas Association

August 12, 2016

Phoebe W. Brown, Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

**File Reference: PCAOB Rulemaking Docket Matter No. 034**

Dear Ms. Brown:

The Edison Electric Institute (EEI) and American Gas Association (AGA) respectfully submit our comments on the Public Company Accounting Oversight Board's (Board) reproposed auditing standard – *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* ("reproposed standard"), PCAOB Rulemaking Docket Matter No. 034.

EEI is the association that represents all U.S. investor-owned electric companies. EEI members provide electricity for 220 million Americans, operate in all 50 states and the District of Columbia, and directly and indirectly create jobs for more than one million Americans. With more than $100 billion in annual capital expenditures, the electric power industry is responsible for millions of additional jobs. EEI has dozens of international electric companies as International Members and hundreds of industry suppliers and related organizations as Associate Members. Organized in 1933, EEI provides public policy leadership, strategic business intelligence, and essential conferences and forums.

AGA, founded in 1918, represents 202 local energy companies that deliver clean natural gas throughout the U.S. There are more than 70 million residential, commercial and industrial natural gas customers in the U.S., of which almost 93 percent – more than 65 million customers – receive their gas from AGA members. AGA is an advocate for natural gas utility companies and their customers and provides a broad range of programs and services for member natural gas pipelines, marketers, gatherers, international gas companies and industry associates. Today, natural gas meets almost one-fourth of the energy needs in the U.S.

EEI and AGA appreciate the Board's efforts to enhance the form and content of the auditor's report to make it more relevant and informative to investors and other financial statement users. We agree that financial statement users should have access to timely, accurate, objective and relevant information for purposes of making investment decisions.

We understand the Board has taken into consideration the comments and additional feedback received from the original 2013 proposal and modified the definition of what would be included as critical audit matters ("CAMs"), including limiting the sources of potential CAMs, and adding a materiality component. However, we continue to have significant concerns with certain aspects of the reproposed standard, specifically, the disclosure of CAMs and auditor tenure in the auditor's report, as described in our response below.

We are aware that some regulators outside the U.S. are also considering or have made changes to the independent auditor's report. Should the PCAOB proceed with some version of this reproposal, we urge the Board to adopt a more principles-based approach to the definition of a CAM, similar to the IAASB. The IAASB defines Key Audit Matters "as those matters that, in the auditor's professional judgment, were of most significance to the audit of the financial statements in the current period. Key audit matters are selected from matters communicated with those charged with governance."

Notwithstanding these considerations, we continue to believe that it is inappropriate to include such a disclosure in the auditor's report for the reasons we describe in detail below.

**Critical Audit Matters**

The reproposed standard states that it is intended to respond to investor requests for additional information about the financial statement audit by increasing the relevance and usefulness of the auditor's report, without imposing requirements beyond the auditor's expertise or mandate. However, we believe that CAM disclosure would result in the imposition of requirements beyond the auditor's mandate as the independent auditor in that it would require the auditor to become a primary source of a company's financial information.

The reproposal asserts that the current form of the auditor's report does little to address the information asymmetry between investors and auditors brought on by the increased complexity of financial reporting. While we respect the Board's efforts to reduce this information asymmetry, we believe that it is inappropriate to address this concern through mandating disclosures by the auditor. Accordingly, as discussed further below, we do not believe that the disclosure of CAMs in the auditor's report provides investors with useful and relevant information on which to make investment decisions. In addition, we do not believe it is the role of the auditor to determine or highlight specific areas of the financial statements for increased investor focus.

*The Role of the Auditor*

The auditor's role is to express an opinion on the financial statements taken as a whole, which assists an investor's decision by stating whether the financial statements are in conformity with GAAP. The auditor's principal considerations that led to the determination that a matter is a CAM, and how the CAM was addressed in the audit, would only provide the reader insight into the *audit process*, not insight into the quality of the financial statements and, therefore, would provide little benefit to investors in making their decisions.

Regardless of the language included in the proposed auditor's report, inclusion of CAMs could be interpreted by some as the auditor expressing reservations in their report, or providing a "piecemeal" opinion. This could undermine the value of the auditor's opinion concerning whether the financial statements are presented in accordance with GAAP.

*The Role of the Audit Committee*

If CAMs are required to be disclosed in the auditor's report, the auditor may become the source of original and confidential information, which would diminish both the governance role of the audit committee as well as management's responsibility for the company's disclosure of financial information. We believe the audit committee is uniquely qualified to ensure that a company's various risks and issues have been adequately addressed during the audit and disclosed in a company's periodic filings, as considered necessary, because it has access to the full Board of Directors, company management and the auditors. The role of the auditor is to verify that the audit committee has adequately performed this responsibility.

*Purpose of the Financial Statements and the Auditor's Report*

GAAP and SEC rules have been designed to help companies determine what information should be provided to financial statement readers. These rules already require disclosure of critical accounting estimates, assumptions, risks and uncertainties, as well as an issuer's significant accounting policies. Given the volume of disclosures required for complex or subjective areas of accounting, we believe that financial statement users can already determine for themselves which areas are likely to be subject to a higher level of audit scrutiny.

In addition, we do not believe that directing a financial statement user's attention to specific areas of the financial statements and related note disclosures adds value. All disclosures in the financial statements and notes are included because they are material to the financial statements. It is the responsibility of the investor to review a company's periodic filing in its entirety. Providing a "roadmap" to direct financial statement users' attention to specific areas of the filing undermines the relevance of other areas that are not referred to in the auditor's report. Those areas may contain the same level of investment risk as a CAM but may not be required to be disclosed as such in the auditor's report.

*FASB and SEC Procedures Govern Financial Report Disclosures*

If stakeholders believe that better "roadmaps" are needed to guide investors to high risk areas in the financial statements, the most appropriate means for doing so is for the FASB and the SEC to provide guidance through their respective disclosure projects. The FASB and the SEC continue to update and refine disclosure requirements, and the issue of information asymmetry between a company and its investors should be addressed through those projects, which are intended to improve the effectiveness of information provided to investors.

The FASB's Disclosure Framework initiative is designed to assist investors in determining which financial statement items are significant to the company by allowing companies to provide disclosures that focus on those areas that are most relevant and important and eliminating those disclosures that are of less significance, thereby reducing "disclosure overload." The SEC's Disclosure Effectiveness initiative is seeking feedback on whether the current business and financial requirements in Regulation S-K provide useful information to readers and whether specific disclosure requirements in Regulation S-X could be changed or eliminated to avoid redundancy with GAAP and improve disclosure effectiveness.

Guidance provided through these FASB and SEC disclosure projects, rather than through an unprecedented expansion of the independent auditor's report, will ensure that users' attention is directed to areas of investment risk, *not audit risk*, as those risks by definition may not be the same.

*Supporting Research*

Section VI. C. 1. a. of the proposal notes that *"Overall, the results from research analyzing whether the information provided in expanded auditor reporting is useful to investors are limited. Collectively the results are ambiguous as to whether the expanded auditors' reports have provided investors with new information beyond what is contained in the financial statements."* Because the current research is inconclusive, we recommend that the Board obtain more thorough and conclusive evidence that CAMs provide investors with additional information that could influence investment decisions before including these additional auditor disclosure requirements in a final standard.

**Auditor Tenure**

We do not believe that the proposal adequately substantiates why auditor tenure information is important and useful to financial statement readers. Without a clear understanding of that importance and usefulness, we believe readers may misinterpret the information. Specifically, and as discussed further below, we believe that the inclusion of auditor tenure in the auditor's report could lead to incorrect and even erroneous inferences about possible correlations between auditor tenure, auditor independence, and audit quality. If the Board believes that information on auditor tenure is important and relevant to readers, we believe that the Board should provide additional, more conclusive research and information as to what readers should infer from a shorter or longer tenure, in order to avoid misinterpretation of the data.

For example, does longer auditor tenure indicate that the independence of the auditor or the quality of the audit performed might be compromised or of lower quality than those performed by an auditor with a shorter auditor tenure? Or might it indicate that the auditor has more experience with and insight into the complexities of the company it is auditing? Likewise, should investors consider not ratifying the appointment of an auditor if that auditor has a longer tenure? Or conversely, should investors be more likely to ratify an auditor with a longer tenure?

*Tenure and Audit Quality*

We believe that the disclosure of auditor tenure in the auditor's report could lead to readers making erroneous conclusions about the correlation between audit quality and auditor tenure. As stated in the reproposed standard, academic research on the relationship between auditor tenure and audit quality has produced inconsistent conclusions. Many readers of the auditor's report and financial statements are likely unaware of the range and potentially conflicting implications of these research conclusions.

Contrary to the presumption that long auditor tenure leads to reduced audit quality, some research shows that audit engagements with short-term auditor tenure are relatively *riskier* and that audit quality is *improved* when auditors have time to gain expertise in the company under audit and in the related industry. Therefore, we believe it is inappropriate to imply that there is a correlation between shorter tenure and improved audit quality, which could lead to incorrect inferences about that correlation. This, in turn, could result in investor inquiries or requests that are an inefficient use of management and audit committee time. It could also lead to faulty investor decisions based upon a presumed correlation that is not accurate.

*Tenure and Auditor Independence*

We also believe that the disclosure of auditor tenure in the auditor's report could incorrectly imply that there is a relevant relationship between auditor independence and auditor tenure. The feedback received on the Board's Release No. 2011-006 *Concept Release on Auditor Independence and Audit Firm Rotation* indicated that constituents did not agree that requiring audit firm rotation would lead to an increase in audit quality. We believe that required audit partner rotation sufficiently addresses any potential independence issues, and implying that there is a link between auditor independence and audit firm tenure is inconsistent with the feedback received on Release No. 2011-006.

In addition, we believe that there may actually be a higher risk that a new audit firm has not acquired the level of expertise and knowledge necessary in specialized industries to provide an audit of at least the same quality as a longer-tenured audit firm. Therefore, even if one assumes that a new audit firm may have a higher degree of independence, audit quality may be lower as a result of an auditor change.

*Cost-Benefit Analysis*

The release does not provide definitive research as to the benefit of this information to readers, other than to provide an example that information on auditor tenure could be used in "*understanding the audit committee's oversight of the auditor or in deciding whether to ratify the appointment of the auditor.*" The Board also indicates that one of the benefits of the proposal is reduced search costs related to readers searching for auditor tenure information.

However, the Board has not provided any information showing that significant costs are currently being incurred by users seeking this information. Our industry would be disadvantaged if readers began to correlate a longer audit tenure with reduced audit quality or reduced auditor independence because many of the audit committees of companies in our industry believe that the quality of our audits and audit firms are top-notch and, therefore, have not changed auditors in many years.

We believe that there are a limited number of audit firms with strong knowledge, experience and expertise in our specialized industry, and therefore changing auditors could result in ratification of a new auditor that would require significantly higher costs and effort to assure that it had the necessary expertise to provide a high-quality audit. As such, if our investors made incorrect assumptions about tenure and quality, and accordingly did not vote to ratify the appointment of the existing auditor simply because of a longer tenure, the risk of a lower-quality audit being performed would be higher, and significant additional costs of changing auditors would be incurred, thereby not justifying any perceived benefits.

If the Board decides to require disclosure of auditor tenure, we strongly believe such information should be included outside of the auditor's report to avoid misconceptions about the relationship between tenure and quality, and tenure and independence. For example, the Board could consider including this information in Form AP or in a consistent location within the proxy statement. The proxy statement may be more appropriate if research indicates that one of the main uses of this information would be to help investors decide whether to ratify the appointment of the auditor.

**Conclusion**

As discussed above, we do not support the inclusion of CAMs or auditor tenure in the auditor's report. We urge the Board to reconsider these proposals. We believe that auditor reporting of CAMs could decrease the relevance of the audit report and diminish the role of the audit committee. We also believe that disclosure of auditor tenure is unnecessary and, because of inconclusive and contradictory evidence about correlations with audit quality and independence, could result in misinterpretation by readers. If such disclosure is required, we believe it should be required elsewhere, such as within Form AP or the annual proxy statement.

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EEI and AGA appreciate the opportunity to provide our input on the reproposed standard. We would be pleased to discuss our comments and to provide any additional information that you may find helpful.

Very truly yours,

/s/ Richard F. McMahon, Jr.
Richard F. McMahon, Jr.
Vice President

/s/ Patrick J. Migliaccio
Patrick J. Migliaccio
Senior Vice President & Chief Financial Officer
Chairman of the American Gas Association Accounting Advisory Council