

(6) The Exchange or FINRA, on behalf of the Exchange, or both, will communicate as needed regarding trading in the Shares with other markets and other entities that are members of the ISG, and the Exchange or FINRA, on behalf of the Exchange, or both, may obtain trading information regarding trading in the Shares from such markets and other entities. In addition, the Exchange may obtain information regarding trading in the Shares from markets and other entities that are members of ISG or with which the Exchange has in place a comprehensive surveillance sharing agreement.<sup>28</sup>

(7) Prior to the commencement of trading, the Exchange will inform its ETP Holders in an Information Bulletin of the special characteristics and risks associated with trading the Shares. Specifically, the Information Bulletin will discuss the following: (1) The procedures for purchases and redemptions of Shares in creation units (including noting that Shares are not individually redeemable); (2) NYSE Arca Rule 9.2–E(a), which imposes a duty of due diligence on its ETP Holders to learn the essential facts relating to every customer prior to trading the Shares; (3) how information regarding the IIV is disseminated; (4) the requirement that ETP Holders deliver a prospectus to investors purchasing newly issued Shares prior to or concurrently with the confirmation of a transaction; (5) the possibility that trading spreads and the resulting premium or discount on the Shares may widen as a result of reduced liquidity of gold trading during the Core and Late Trading Sessions after the close of the major world gold markets; and (6) trading information.<sup>29</sup>

(8) All statements and representations made in this filing regarding (a) the description of the portfolio or reference assets, (b) limitations on portfolio holdings or reference assets, or (c) the applicability of Exchange listing rules specified in this rule filing shall constitute continued listing requirements for listing the Shares of the Trust on the Exchange.<sup>30</sup>

(9) The issuer has represented to the Exchange that it will advise the Exchange of any failure by the Trust to comply with the continued listing requirements and, pursuant to its obligations under Section 19(g)(1) of the Act, the Exchange will monitor for compliance with the continued listing

requirements. If the Trust is not in compliance with the applicable listing requirements, the Exchange will commence delisting procedures under NYSE Arca Rule 5.5(m).<sup>31</sup>

This approval order is based on all of the Exchange's representations—including those set forth above and in Amendment No. 1—and the Exchange's description of the Trust.

For the foregoing reasons, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with Section 6(b)(5) of the Act<sup>32</sup> and the rules and regulations thereunder applicable to a national securities exchange.

#### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Exchange Act,<sup>33</sup> that the proposed rule change (SR–NYSEArca–2017–98), as modified by Amendment No. 1 be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>34</sup>

**Eduardo A. Aleman,**  
Assistant Secretary.

[FR Doc. 2017–23371 Filed 10–26–17; 8:45 am]

**BILLING CODE 8011–01–P**

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–81916; File No. PCAOB–2017–01]

### Public Company Accounting Oversight Board; Order Granting Approval 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

October 23, 2017.

#### I. Introduction

On July 19, 2017, the Public Company Accounting Oversight Board (the “Board” or the “PCAOB”) filed with the Securities and Exchange Commission (the “Commission”), pursuant to Section 107(b)<sup>1</sup> of the Sarbanes-Oxley Act of 2002 (the “Sarbanes-Oxley Act”) and Section 19(b)<sup>2</sup> of the Securities Exchange Act of 1934 (the “Exchange

Act”), a proposal to adopt AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* and related amendments to other auditing standards (collectively, the “Proposed Rules”).<sup>3</sup> The Proposed Rules were published for comment in the **Federal Register** on July 28, 2017.<sup>4</sup> At the time the notice was issued, the Commission extended to October 26, 2017 the date by which the Commission should take action on the Proposed Rules.<sup>5</sup> The Commission received approximately 50 comment letters in response to the notice.<sup>6</sup> This order approves the Proposed Rules, which we find to be consistent with the requirements of the Sarbanes-Oxley Act and the securities laws and necessary or appropriate in the public interest or for the protection of investors.

#### II. Description of the Proposed Rules

On June 1, 2017, the Board adopted AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, which replaces portions of AS 3101, *Reports on Audited Financial Statements*, and re-designates the remaining portions of AS 3101 as AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*. The Proposed Rules will require that the auditor provide new information about the audit that is intended to make the auditor's report

<sup>3</sup> The Board originally issued a concept release on these matters in 2011. See *Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards*, PCAOB Release No. 2011–003 (June 21, 2011) (“PCAOB Concept Release”), available at [https://pcaobus.org/Rulemaking/Docket034/Concept\\_Release.pdf](https://pcaobus.org/Rulemaking/Docket034/Concept_Release.pdf). In 2013, the Board issued a proposed rule. See *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; and Related Amendments to PCAOB Standards*, PCAOB Release No. 2013–005 (August 13, 2013) (“PCAOB Proposal”), available at [https://pcaobus.org/Rulemaking/Docket034/Release\\_2013-005\\_ARM.pdf](https://pcaobus.org/Rulemaking/Docket034/Release_2013-005_ARM.pdf). The Board issued a re-proposal in 2016. See *Proposed Auditing Standard—The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards*, PCAOB Release No. 2016–003 (May 11, 2016) (“PCAOB Re-proposal”), available at <https://pcaobus.org/Rulemaking/Docket034/Release-2016-003-ARM.pdf>.

<sup>4</sup> See Release No. 34–81187 (July 21, 2017), 82 FR 35396 (July 28, 2017) available at <https://www.sec.gov/rules/pcaob/2017/34-81187.pdf>.

<sup>5</sup> See *id.*

<sup>6</sup> Copies of the comment letters received on the Commission order noticing the Proposed Rules are available on the Commission's Web site at <https://www.sec.gov/comments/pcaob-2017-01/pcaob201701.htm>.

responsible for FINRA's performance under this regulatory services agreement. See *id.*

<sup>28</sup> See *id.*

<sup>29</sup> See *id.*

<sup>30</sup> See *id.*

<sup>31</sup> See *id.*

<sup>32</sup> 15 U.S.C. 78f(b)(5).

<sup>33</sup> 15 U.S.C. 78s(b)(2).

<sup>34</sup> 17 CFR 200.30–3(a)(12).

<sup>1</sup> 15 U.S.C. 7217(b).

<sup>2</sup> 15 U.S.C. 78s(b).

more informative and relevant to investors and other financial statement users, as discussed further below.

#### A. Changes to PCAOB Standards

The Proposed Rules retain the pass/fail opinion of the existing auditor's report but make significant changes to the existing auditor's report, including the following:

- Critical audit matters (“CAMs”). The Proposed Rules require the auditor to communicate in the auditor's report any CAMs arising from the current period's audit or state that the auditor determined that there are no CAMs.
  - A CAM is defined as any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that:
    - (1) Relates to accounts or disclosures that are material to the financial statements; and
    - (2) involved especially challenging, subjective, or complex auditor judgment.
      - In determining whether a matter involved especially challenging, subjective, or complex auditor judgment, the auditor should take into account, alone or in combination, the following factors, as well as other factors specific to the audit:
        - The auditor's assessment of the risks of material misstatement, including significant risks;
        - The degree of auditor judgment related to areas in the financial statements that involved the application of significant judgment or estimation by management, including estimates with significant measurement uncertainty;
        - The nature and timing of significant unusual transactions and the extent of audit effort and judgment related to these transactions;
        - The degree of auditor subjectivity in applying audit procedures to address the matter or in evaluating the results of those procedures;
        - The nature and extent of audit effort required to address the matter, including the extent of specialized skill or knowledge needed or the nature of consultations outside the engagement team regarding the matter; and
        - The nature of audit evidence obtained regarding the matter.
- The communication of each CAM within the auditor's report includes:
  - Identifying the CAM;
  - Describing the principal considerations that led the auditor to determine that the matter is a CAM;
  - Describing how the CAM was addressed in the audit; and
  - Referring to the relevant financial statement accounts or disclosures.

- For each matter arising from the audit of the financial statements that (a) was communicated or required to be communicated to the audit committee, and (b) relates to accounts or disclosures that are material to the financial statements, the auditor must document whether or not the matter was determined to be a CAM (*i.e.*, involved especially challenging, subjective, or complex auditor judgment) and the basis for such determination.

- Additional Changes to the Auditor's Report. The Proposed Rules also include a number of other changes to the auditor's report that are primarily intended to clarify the auditor's role and responsibilities related to the audit of the financial statements, provide additional information about the auditor, and make the auditor's report easier to read. These include:

- Auditor tenure—a statement disclosing the year in which the auditor began serving consecutively as the company's auditor;
- Independence—a statement regarding the requirement for the auditor to be independent;
- Addressee—the auditor's report will be addressed to the company's shareholders and board of directors or equivalents (additional addressees are also permitted);
- Amendments to basic elements—certain standardized language in the auditor's report has been changed, including adding the phrase “whether due to error or fraud,” when describing the auditor's responsibility under PCAOB standards to obtain reasonable assurance about whether the financial statements are free of material misstatement; and
- Standardized form of the auditor's report—the opinion will appear in the first section of the auditor's report, and section titles have been added to guide the reader.

The amendments to other PCAOB standards include:

- AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances* to (1) require the communication of CAMs in certain circumstances; (2) revise certain terminology to align with AS 3101 of the Proposed Rules; and (3) amend the illustrative reports for the basic elements of AS 3101 of the Proposed Rules and the required order of certain sections of the auditor's report;
- AS 1220, *Engagement Quality Review* to require the engagement quality reviewer to evaluate the engagement team's determination, communication, and documentation of CAMs;

- AS 1301, *Communications with Audit Committees* to require the auditor to provide to and discuss with the audit committee a draft of the auditor's report;

- AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* to conform the example auditor's report with the example auditor's report on the financial statements in AS 3101 of the Proposed Rules;

- AS 2820, *Evaluating Consistency of Financial Statements* to include the existing reporting requirements and illustrative explanatory language related to a change in accounting principle or a restatement that is currently in AS 3105; and

- AS 4105, *Reviews of Interim Financial Information* to include the basic elements of AS 3101 of the Proposed Rules, where applicable.

#### B. Applicability

##### Critical Audit Matters

Under the Proposed Rules, communication of CAMs in the auditor's report is not required for audits of emerging growth companies (“EGCs”);<sup>7</sup> brokers and dealers reporting under Exchange Act Rule 17a-5;<sup>8</sup> investment companies other than business development companies (“BDCs”); and employee stock purchase, savings, and similar plans.

##### Additional Changes to the Auditor's Report

The additional changes to the auditor's report contained in the Proposed Rules apply for all audits performed under PCAOB standards, including audits of EGCs, as discussed in Section IV below.

#### C. Effective Date

The Proposed Rules would be effective as follows:

- a. All paragraphs of the Proposed Rules, except the paragraphs related to CAMs in AS 3101 of the Proposed Rules (paragraphs .11 through .17) and amendments related to those paragraphs: All audits of fiscal years ending on or after December 15, 2017; and
- b. All paragraphs related to CAMs in AS 3101 of the Proposed Rules

<sup>7</sup> The term “emerging growth company” is defined in Section 3(a)(80) of the Exchange Act (15 U.S.C. 78c(a)(80)). See also *Inflation Adjustments and Other Technical Amendments Under Titles I and III of the JOBS Act*, SEC Rel. 33-10332 (Mar. 31, 2017), 82 FR 17545 (Apr. 12, 2017), available at <https://www.sec.gov/rules/final/2017/33-10332.pdf>.

<sup>8</sup> If the broker or dealer is an issuer, the requirement to communicate CAMs would apply.

(paragraphs .11 through .17) and amendments related to those paragraphs:

- For audits of large accelerated filers: Fiscal years ending on or after June 30, 2019; and
- For audits of all other companies to which the requirements apply: Fiscal years ending on or after December 15, 2020.

### III. Comment Letters

The Commission's comment period on the Proposed Rules ended on August 18, 2017. The Commission received approximately 50 comment letters from investors and investor associations, accounting firms, issuers and issuer organizations, and others.<sup>9</sup> Most commenters generally supported the Board's objective to improve the auditor's report to make it more informative and relevant to financial statement users. Commenters' views varied on the nature and extent of specific changes, particularly those related to CAMs. Investors and investor associations were supportive of the Proposed Rules, including communication of CAMs, and encouraged adoption without delay. Larger accounting firms were generally supportive but raised certain practical concerns and asked for guidance during the implementation phase, a safe-harbor related to CAMs, or post-implementation reviews. A number of other commenters raised questions and concerns about the Proposed Rules and their application and recommended the Commission not approve the Proposed Rules in their current form. These concerns generally relate to: (1) Usefulness of the information in CAMs; (2) the auditor's role as the potential source of original information about the company in CAMs; (3) the potential impact of CAMs on the role of the audit committee and the communication among the audit committee, management, and the auditor; (4) the potential liability impact of CAMs; (5) the economic analysis of CAMs; (6) practicability matters related to CAMs; (7) disclosure of auditor tenure in the auditor's report; (8) the effective dates of the Proposed Rules; and (9) implementation efforts.

As background, for several years, the Board has been considering changes to the auditor's report, throughout which the Board has, in various settings and formats, considered commenters' concerns on such changes. In June 2011, the Board issued the PCAOB Concept Release to solicit comment on a number of potential changes to the auditor's

report. The Board also held a public roundtable in September 2011 to obtain additional insight on the alternatives presented in the PCAOB Concept Release.

After considering the results of its outreach and comments on the PCAOB Concept Release, in August 2013, the Board issued the PCAOB Proposal that included, among other things, new requirements for auditors to communicate CAMs, as well as additional changes to the auditor's report. In April 2014, the Board held a public meeting to obtain further input on the PCAOB Proposal from a diverse group of investors and other financial statement users, preparers, audit committee members, auditors, and others.

In May 2016, the Board issued the PCAOB Re-proposal that modified the PCAOB Proposal in several respects in response to feedback received. In particular, the PCAOB Re-proposal modified the source, definition, and communication requirements for CAMs.

Throughout the rulemaking process, the Board received comments from investors and investor associations that consistently stressed the importance and value to them of additional communication from the auditor. In particular, commenters indicated that tailored, audit-specific information from the auditor's point of view would reduce information asymmetries and make the auditor's report more relevant and useful, a view which also was shared by at least one of the larger accounting firms. Based on these comments and its own analysis, the Board concluded that requiring auditors to provide more information about the audit through the communication of CAMs will benefit investors and other market participants.

As further explained below, the Board also made changes in the Proposed Rules to address the significant comments received on the PCAOB Proposal and the PCAOB Re-proposal. In particular, the Board sought to balance the potential benefits of CAM communications with the concerns expressed by some commenters about potential consequences, including: The auditor's role as the potential source of original information about the company; the potential impact of CAMs on the role of the audit committee and communication among the audit committee, management, and the auditor; and the potential liability impact of CAMs. To balance among these competing factors, the Board, among other things, limited the source of CAMs to matters communicated or required to be communicated to the

audit committee, added a materiality component to the definition of a CAM, and narrowed the definition of a CAM to only those matters that involved especially challenging, subjective, or complex auditor judgment. In its release accompanying the Proposed Rules, the Board acknowledged that a variety of claims can be raised related to the statements in the auditor's report and that litigation is inherently uncertain. The Board also stated that it will monitor the Proposed Rules after implementation for any unintended consequences.

The Sarbanes-Oxley Act requires us to determine whether the Proposed Rules are consistent with the requirements of the Sarbanes-Oxley Act and the securities laws or are necessary or appropriate in the public interest or for the protection of investors.<sup>10</sup> In making this determination, we have considered the comments received by the Commission as well as the feedback received and modifications made by the PCAOB throughout its rulemaking process. The discussion below addresses the significant points raised in the comment letters received by the Commission, which were generally consistent with the comments the PCAOB received during its deliberations.

#### A. Usefulness of the Information in CAMs

A number of commenters provided feedback related to the potential usefulness of CAMs. Comments from investors and investor associations consistently indicated they would find CAM communications to be beneficial in understanding the audit.<sup>11</sup> One commenter stated that CAMs will provide tailored, audit-specific information directly from the auditor's point of view and should provide insights that will add to the mix of information that could be used in investors' capital allocation and voting

<sup>10</sup> See Section 107(b)(3) of the Sarbanes-Oxley Act. The Sarbanes-Oxley Act also specifies that the provisions of Section 19(b) of the Exchange Act shall govern the proposed rules of the Board. See Section 107(b)(4) of the Sarbanes-Oxley Act. Section 19 of the Exchange Act covers the registration, responsibilities, and oversight of self-regulatory organizations. Under the procedures prescribed by the Sarbanes-Oxley Act and Section 19(b)(2) of the Exchange Act, the Commission must either approve or disapprove, or institute proceedings to determine whether the proposed rules of the Board should be disapproved; and these procedures do not expressly permit the Commission to amend or supplement the proposed rules of the Board.

<sup>11</sup> See e.g., Letter from Council of Institutional Investors, August 8, 2017 ("CII Letter"); Letter from Hermes Investment Management, August 18, 2017 ("Hermes Letter"); Letter from CFA Institute, August 24, 2017 ("CFA Institute Letter").

<sup>9</sup> See *supra* footnote 6.

decisions.<sup>12</sup> This commenter also stated a belief that CAMs will benefit investors, particularly institutional investors, in engaging with management and the audit committee and in voting on the ratification of the auditor.<sup>13</sup> Another commenter noted that CAMs will reduce the information asymmetry between investors and auditors, which in turn should reduce the information asymmetry between investors and management about the company's financial performance.<sup>14</sup> One commenter noted that, from its perspective as a long-term investor, the communication of CAMs would provide an augmented basis from which investors can more fully understand challenging, subjective, or complex auditor judgment.<sup>15</sup> Another commenter stated that, through CAMs, investors would have more information from which to make investment decisions.<sup>16</sup> The same commenter noted that, as it indicated in comment letters to the PCAOB, the inclusion of CAMs would enhance transparency, relevance, reliability, and credibility in audits.<sup>17</sup> Another commenter, noting that the Board has balanced the differing perspectives of various stakeholders, indicated that investors desire robust information within the auditor's report *beyond* the requirements in the Proposed Rules.<sup>18</sup>

In commenting on the Proposed Rules, one large accounting firm acknowledged that many financial statement users have expressed dissatisfaction with the current reporting by auditors.<sup>19</sup> This same commenter also stated that the enhanced transparency of the audit process benefits all stakeholders and promotes the important role of independent auditors in serving the public interest.<sup>20</sup> Another large accounting firm generally agreed with the views of investors and investor associations that communication of CAMs will enhance the value and relevance of audits to the capital markets.<sup>21</sup>

We agree with these commenters and the Board that communicating CAMs to investors will reduce information asymmetries. In particular, we are persuaded that the communication of CAMs, as structured in the Proposed Rules, will add to the total mix of information available to investors by eliciting more information about the audit itself—information that is uniquely within the perspective of the auditor and, thus, not otherwise available to investors and other financial statement users. In so doing, we believe the communication of CAMs could enhance the value and relevance of audits to the capital markets and be useful to investors and other financial statement users in assessing a company's financial reporting and making capital allocation and voting decisions. We are, therefore, of the view that the requirement to communicate CAMs, as structured in the Proposed Rules, is consistent with the Sarbanes-Oxley Act and the securities laws and is necessary or appropriate in the public interest or for the protection of investors.

We recognize that some commenters questioned the usefulness of CAMs, including asserting that the communications will not provide meaningful information, likely will duplicate management disclosures, or will use standardized language (some commenters referred to this as "boilerplate").<sup>22</sup> A few commenters expressed concern that CAMs could also provide information that conflicts with management disclosures, which some argued would be confusing to investors.<sup>23</sup> Some commenters indicated CAMs will force issuers to make reactive disclosures because they will not want auditors to be the source of information about the company that would not otherwise have been disclosed (which commenters referred to as "original information"), which they argued could increase costs and reduce disclosure effectiveness.<sup>24</sup> Some

commenters expressed concern that auditors may communicate an overabundance of CAMs to reduce litigation risk, as CAMs may be seen as a shield from litigation.<sup>25</sup>

Similar concerns were raised in the PCAOB's rulemaking process. In response to these concerns, the Board stated in the release accompanying the Proposed Rules that the requirements in the Proposed Rules "aim to provide investors with the auditor's unique perspective on the areas of the audit that involved the auditor's especially challenging, subjective, or complex judgments. Limiting critical audit matters to these areas should mitigate the extent to which expanded auditor reporting could become standardized. Focusing on auditor judgment should limit the extent to which expanded auditor reporting could become duplicative of management's reporting."

We acknowledge the risks identified by commenters that CAMs will not provide meaningful incremental information, either because the information is duplicative of what is already provided by the issuer, or because auditors will communicate numerous or boilerplate CAMs. With respect to the duplication risk, the requirement for CAM communications focuses on the auditor's perspective, not the issuer's. Specifically, as discussed above in Section II.A, "Changes to PCAOB Standards," the auditor must identify the CAM, describe the principal considerations that led the auditor to determine that the matter is a CAM, describe how the CAM was addressed in the audit, and refer to the relevant financial statement accounts or disclosures. With the exception of the reference to the relevant portions of the financial statements, those required communications are not expected to overlap with the Commission's required issuer disclosures, which generally do not focus on the audit. Also, the required reference to the relevant financial statement accounts or disclosures provides context for the CAM-related communications but does not necessarily duplicate those disclosures.

With respect to the risk that auditors would communicate unnecessary CAMs or boilerplate CAMs, we acknowledge that our own experience with the disclosure by companies of risk factors under Item 503(c) of Regulation S-K<sup>26</sup> illustrates the potential challenges of disclosure practices. The Commission and SEC staff have issued numerous releases and other guidance seeking to

<sup>22</sup> See e.g., Letter from Aetna Inc. et al., August 18, 2017 ("Aetna Letter"); Letter from Quest Diagnostics Inc., August 15, 2017 ("Quest Letter"); Letter from Northrop Grumman Corporation, August 18, 2017 ("Northrop Grumman Letter"); Letter from New York City Bar, August 18, 2017 ("New York City Bar Letter"); Letter from Davis Polk & Wardell LLP, August 18, 2017 ("Davis Polk Letter"); Letter from Robert N. Waxman, August 19, 2017 ("Robert Waxman Letter").

<sup>23</sup> See e.g., Aetna Letter; Letter from Society for Corporate Governance, August 18, 2017 ("Society for Corporate Governance Letter").

<sup>24</sup> See e.g., Society for Corporate Governance Letter; Letter from Sullivan & Cromwell LLP, August 18, 2017 ("Sullivan & Cromwell Letter"). We discuss commenters' concerns regarding the auditor's role as the potential source of original information in section III.B below.

<sup>25</sup> See e.g., Davis Polk Letter; Quest Letter.

<sup>26</sup> 17 CFR 229.503(c).

<sup>12</sup> See CII Letter.

<sup>13</sup> See *id.*

<sup>14</sup> See Letter from J. Robert Brown Jr., et. al., August 21, 2017 ("J. Robert Brown Jr. Letter").

<sup>15</sup> See Letter from California State Teachers' Retirement System, August 23, 2017.

<sup>16</sup> See Letter from California Public Employees' Retirement System, August 18, 2017 ("CalPERS Letter").

<sup>17</sup> See *id.*

<sup>18</sup> See CFA Institute Letter.

<sup>19</sup> See Letter from Ernst & Young LLP, August 18, 2017 ("EY Letter").

<sup>20</sup> See *id.*

<sup>21</sup> See Letter from Deloitte & Touche LLP, August 18, 2017 ("Deloitte Letter").

induce registrants to focus on clear discussions of the “most significant factors,” rather than numerous boilerplate risk factors.<sup>27</sup>

We believe that some of these concerns are lessened by the way that the Board has defined CAMs. Specifically, as it relates to the concern of auditors reporting an overabundance of CAMs, we note that, under the Proposed Rules, a matter must meet each element of the definition of a CAM. In our view, the inclusion of a materiality component in the definition; narrowing the source of potential CAMs to matters communicated or required to be communicated to the audit committee; limiting CAMs to those areas that involved especially challenging, subjective, or complex auditor judgment; and refining the factors to take into account in determining whether a matter involved especially challenging, subjective, or complex auditor judgment should all act to mitigate the risk of auditors reporting too many CAMs.

Similarly, we believe that the focus on auditor judgment in the definition of CAMs, along with the requirement to disclose *why* a matter is a CAM and how it was addressed, should mitigate the extent to which expanded auditor reporting could become standardized. Moreover, we believe these concerns must be balanced against the additional insights into the audit that we believe would be gained from the reporting of CAMs.

Having considered the public comments, we are persuaded that the reporting of CAMs, as structured in the Proposed Rules will be beneficial. The communication of CAMs should not be numerous and boilerplate and will provide additional information about the audit—and from the auditor’s own unique perspective—that will be useful to investors and other financial statement users in assessing a company’s financial reporting and making capital allocation and voting decisions.

#### *B. The Auditor’s Role as the Potential Source of Original Information About the Company*

A number of commenters expressed concern with the auditor potentially disclosing original information, including potentially immaterial or confidential information.<sup>28</sup> Some of

these commenters asserted that this runs counter to the U.S. regulatory framework, or confuses the role of the auditor.<sup>29</sup> Further, at least one commenter questioned whether the PCAOB has the regulatory authority to require such disclosure.<sup>30</sup> Conversely, as stated in the Board’s release accompanying the Proposed Rules, “[i]nvestor commenters, including the auditor’s report working group of the Investor Advisory Group, argued that there should not be any limitation on the auditor providing original information and that [the PCAOB Re-proposal] went too far in constraining the auditor from providing original information in response to concerns expressed by other commenters. . . .” Furthermore, as discussed above, investors and investor associations have indicated that there is a benefit in receiving information about the audit directly from the auditor’s point of view.<sup>31</sup>

Similar concerns regarding the auditor being the source of original information about the company were raised in response to the PCAOB Concept Release, PCAOB Proposal, and PCAOB Re-proposal. The Board acknowledged these concerns and made certain modifications in the Proposed Rules in an effort to balance investor interests in expanded auditor reporting and the concerns of other stakeholders, primarily issuers and issuer organizations and audit committees, related to the costs, benefits, and potential unintended consequences associated with communicating CAMs. For example, the Board added a materiality component in the definition of a CAM “to respond to investor requests for informative and relevant auditor’s reports while, at the same time, addressing other commenters’ concerns regarding auditor communication of immaterial information that management is not required to disclose under the applicable financial reporting framework and SEC reporting requirements.” Further, in an effort to

clarify the requirements, the Board stated in the release accompanying the Proposed Rules, among other things, that “while auditor reporting of original information is not prohibited, it is limited to areas uniquely within the perspective of the auditor: describing the principal considerations that led the auditor to determine that the matter is a critical audit matter and how the matter was addressed in the audit.” AS 3101 of the Proposed Rules includes the following note to the same effect, “When describing critical audit matters in the auditor’s report, the auditor is not expected to provide information about the company that has not been made publicly available by the company unless such information is necessary to describe the principal considerations that led the auditor to determine that a matter is a critical audit matter or how the matter was addressed in the audit.”<sup>32</sup>

With respect to whether mandating such disclosure would run counter to the U.S. regulatory framework or exceed the Board’s authority, the Board observed in the release accompanying the Proposed Rules that there is no PCAOB standard, SEC rule, or other financial reporting requirement prohibiting auditor reporting of information that management has not previously disclosed.<sup>33</sup> Moreover, in the release accompanying the Proposed Rules, the Board stated its belief that requiring expanded auditor reporting to make the auditor’s report more relevant and informative as prescribed in the Proposed Rules is consistent with the statutory mandate of the PCAOB.<sup>34</sup>

We agree with commenters that, in general, the preparation and disclosure of information about an issuer should be the primary responsibility of the issuer, and that the auditor’s role, by contrast, is to audit the issuer’s financial statements and to provide a report thereon. That said, we disagree with those commenters who expressed an

<sup>32</sup> See Note 2 to Paragraph 14 of AS 3101 within the Proposed Rules.

<sup>33</sup> In the release accompanying the Proposed Rules, the Board states, “there are areas under current law and auditing standards that require auditor reporting that goes beyond attesting to the compliance of management disclosures (e.g., substantial doubt about a company’s ability to continue as a going concern or illegal acts).” See also Cleary Gottlieb Letter (acknowledging that no legal prohibition prevents the auditor from communicating original information).

<sup>34</sup> The mission of the PCAOB, as provided in Section 101(a) of the Sarbanes-Oxley Act, is “to oversee the audit of companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports.” (emphasis added).

Letter from Eli Lilly and Company, August 15, 2017 (“Eli Lilly Letter”); Letter from Regions Financial Corporation, August 17, 2017 (“Regions Letter”); Sullivan & Cromwell Letter; Letter from American Tower Corporation, et al., August 18, 2017 (“American Tower Letter”); New York City Bar Letter; Davis Polk Letter; Letter from Financial Executives International, August 18, 2017 (“FEI Letter”); Robert Waxman Letter; Letter from Cleary Gottlieb Steen & Hamilton LLP, August 24, 2017 (“Cleary Gottlieb Letter”).

<sup>29</sup> See e.g., CCMC Letter; Quest Letter.

<sup>30</sup> See e.g., CCMC Letter.

<sup>31</sup> See e.g., CII Letter; Letter from The Capital Group Companies Inc., August 15, 2017 (“Capital Group Letter”).

<sup>27</sup> See e.g., Plain English Disclosure, Release No. 33-7497 (Jan. 28, 1998), 63 FR 6370 (Feb. 6, 1998), available at <https://www.sec.gov/rules/final/33-7497.txt>.

<sup>28</sup> See e.g., Letter from Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, August 11, 2017 (“CCMC Letter”); Quest Letter;

absolute view of the relative roles and responsibilities of the issuer and the auditor. Nothing prohibits exceptions to this general principle, and indeed, existing requirements contemplate a role for the auditor in disclosing original information.<sup>35</sup> Until recently, for example, the auditor's role in preparing the "going concern" explanatory paragraph contemplated that the auditor would be required to provide original information. Pursuant to Section 101(a) of Sarbanes-Oxley Act, part of the Board's mission is "to further the public interest in the preparation of informative, accurate, and independent audit reports." Providing investors and other users of financial statements with the unique perspective of the auditor regarding CAMs can give them valuable insight about the audit. This furthers the underlying purpose of the auditor's report itself—to provide investors and other users with information to use in evaluating a company's financial statements and make informed investment decisions—and is consistent with the U.S. regulatory framework.

Nor do we believe that CAMs, particularly as currently proposed, will displace the financial reporting responsibilities of management. Instead, we believe the communication of CAMs should add to the total mix of information available to investors by eliciting more information about the audit itself, which is uniquely within the perspective of the auditor, irrespective of the financial reporting responsibilities of management. Requiring communication of information about the audit, from the auditor's perspective, as the Proposed Rules require, should limit the extent to which original information would be provided by the auditor. Moreover, to the extent original information would need to be communicated in a CAM, we anticipate that the auditor, management, and the audit committee will engage in a dialogue about that communication.

While we acknowledge the important concerns raised by several commenters in this area and intend to closely monitor the implementation of the Proposed Rules, as discussed further below, we believe that the requirements for communicating CAMs in the auditor's report are reasonably designed to ameliorate these concerns and are within the Board's authority. As a result, we believe that the Proposed Rules are consistent with the Sarbanes-Oxley Act and the securities laws and are necessary or appropriate in the public interest or for the protection of investors. We address more specific

concerns on this matter in the following paragraphs.

#### 1. Definition of CAM

As discussed in Section II.A, "Changes to PCAOB Standards" above, under the Proposed Rules, a CAM is defined as any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) Relates to accounts or disclosures that are material to the financial statements, and (2) involved especially challenging, subjective, or complex auditor judgment.

Some commenters questioned the scope of the definition of CAMs, which states that a CAM "relates to" accounts or disclosures that are material to the financial statements, rather than specifying that a CAM itself has to be material to the financial statements.<sup>36</sup> Commenters also questioned whether there is sufficient clarity on how to apply this requirement.<sup>37</sup>

The commenters that raised questions about the scope of the CAM definition principally explained their concerns by discussing specific examples that might result in the auditor disclosing original information about the company as it relates to the identification of a CAM or immaterial information that is not otherwise required to be disclosed by the financial reporting framework or SEC regulations. Specifically, commenters questioned whether significant deficiencies, illegal acts, and remote loss contingencies should be identified as CAMs. The same questions were posed to the Board in response to the PCAOB Re-proposal. In the release accompanying the Proposed Rules, the Board directly addressed each of the examples by providing guidance that: (1) The determination that there is a significant deficiency in internal control over financial reporting, in and of itself, cannot be a CAM; (2) a potential illegal act, if an appropriate determination had been made that no disclosure of it was required in the financial statements, would not meet the definition of a CAM; and (3) a potential loss contingency that was communicated to the audit committee, but that was determined to be remote and was not recorded in the financial statements or otherwise disclosed under the applicable financial reporting framework, would not meet the definition of a CAM.

Other than the specific examples described above, no other examples raising concerns with the definition of

a CAM have been brought to the attention of the PCAOB or the Commission. We recognize that some commenters suggested an alternative approach to materiality, but we agree with the balance struck by the PCAOB between the benefits of communicating CAMs and the possibility of the auditor providing information that has not previously been disclosed by the company. Under the Proposed Rules, communication of original information should be limited to rare circumstances, as we further discuss in section III.B.2 below, and relate only to the discussion of the principal considerations as to why a matter was a CAM or how the auditor addressed the CAM. Moreover, we believe this approach is consistent with the Board's statutory mandate under Section 101(a) of the Sarbanes-Oxley Act to further the public interest in the preparation of informative, accurate, and independent audit reports. Requiring the communication of CAMs will provide additional information about the audit from the auditor's own unique perspective that investors have indicated, and which we have found, could reduce information asymmetries and be useful to investors, in assessing a company's financial reporting and making capital allocation and voting decisions.<sup>38</sup>

Commenters also suggested that their alternative approach to materiality would be easier to apply in determining which matters to communicate as CAMs. However, given the clarifications provided by the Board, we believe commenters' concerns regarding the scope of the CAM definition have been adequately addressed and that the Proposed Rules' materiality component, which specifies that a CAM "relates to" accounts or disclosures that are material to the financial statements, will be both workable and effective in assisting an auditor in determining which matters to communicate as a CAM. Indeed, we note that the accounting firms that would be responsible for implementing the Proposed Rules, while calling for active PCAOB and SEC monitoring both pre- and post-implementation, did not raise additional concerns in their comment letters to the Commission regarding any lack of clarity within the definition of a CAM under the Proposed Rules.<sup>39</sup>

<sup>38</sup> See e.g., J. Robert Brown Jr. Letter; CII Letter; Letter from Colorado Public Employees' Retirement Association, August 18, 2017 ("Colorado PERA Letter").

<sup>39</sup> See e.g., Letter from BDO USA LLP, August 15, 2017 ("BDO Letter"); Letter from PricewaterhouseCoopers LLP, August 18, 2017 ("PwC Letter"); Deloitte Letter; EY Letter.

<sup>35</sup> See *supra* footnote 33.

<sup>36</sup> See e.g., CCMC Letter; American Tower Letter; Eli Lilly Letter; New York City Bar Letter.

<sup>37</sup> See e.g., CCMC Letter; Eli Lilly Letter.

## 2. Disclosure of ‘Why’ a Matter Is a CAM and How It Was Addressed

As discussed in section II.A, “Changes to PCAOB Standards,” above, under the Proposed Rules, the communication of each CAM includes: (1) Identifying the CAM; (2) describing the principal considerations that led the auditor to determine that the matter is a CAM; (3) describing how the CAM was addressed in the audit; and (4) referring to the relevant financial statement accounts or disclosures that relate to a CAM.

Some commenters, while acknowledging that much of the discussion in CAMs will focus on the audit itself, expressed concerns that the description as to *why*<sup>40</sup> a matter was designated as a CAM could frequently include information not otherwise required to be disclosed by a company.<sup>41</sup> The example cited most frequently in comment letters as a concern was a significant deficiency in internal control over financial reporting (or control deficiencies, generally). At least one commenter suggested removing the requirements to describe (1) the principal considerations that led the auditor to determine that the matter is a CAM, *and* (2) how the matter was addressed in the audit.<sup>42</sup>

By contrast, comments from investors and investor associations indicated a desire for information directly from the auditor’s point of view.<sup>43</sup> One commenter specifically stated that CAMs will make the auditor’s report more relevant and useful to investors and other readers by providing tailored, audit specific information.<sup>44</sup> This same commenter noted that CAMs should provide insights that could be used in investors’ capital allocation decisions by, for instance, enabling comparison of certain aspects of the audit across companies and over time.<sup>45</sup>

Regarding the requirement to describe the principal considerations that led to the identification of a CAM (*i.e.*, the “why”), the release accompanying the Proposed Rules states: “If auditors can adequately convey to investors the principal considerations and how the auditor addressed the matter without including previously undisclosed information, it is expected that they

will. However, the standard provides that even when management has not disclosed information, the auditor is not constrained from providing such information if it is necessary to describe the principal considerations that led the auditor to determine that a matter is a critical audit matter or how the matter was addressed in the audit.” With regard to the specific control deficiency point raised by commenters, in the release accompanying the Proposed Rules, the Board concluded that the determination that there is a significant deficiency, in and of itself, cannot be a CAM, as it does not relate to an account or disclosure that is material to the financial statements as no disclosure of the determination is required. As a result, even though it might involve especially challenging, subjective, or complex auditor judgment, this determination would not be a CAM.

Further, should the auditor deem it necessary to discuss control-related matters that do not rise to the level of a material weakness within the communication of a CAM (*e.g.*, a significant deficiency was a principal consideration for determining that a matter was a CAM), the Board stated that the auditor could “describe the relevant control-related issues in a broader context of the critical audit matter without using the term significant deficiency.”

Regarding the requirement to describe *how* the matter was addressed in the audit, the Board indicated in the release accompanying the Proposed Rules that including this information would be “consistent with the Board’s objective of providing more information about the audit and, if developed with an appropriate focus on the intended audience, should be of interest to users.” The Board also indicated that this information should be specific to the circumstances of the audit and avoid standardized language.

We agree with the Board and certain commenters that the “why” and the “how” elements of the CAM will provide investors with relevant information from the auditor’s perspective that could assist them in understanding the audit, thereby reducing information asymmetries. We believe that, by providing insight into the audit, the “why” and the “how” elements will provide additional transparency to investors, which in turn will enhance investor confidence in the audit. We therefore believe this requirement is consistent with the Board’s statutory mandate to “protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent

audit reports.” In our view, the importance of this information to investors justifies the possibility that the auditor would provide information about a company that is not otherwise required to be disclosed by the company.

Further, we are not persuaded that the description of principal considerations will frequently lead to communication of original information, as commenters suggested. We believe that situations where auditors would be required to provide information about the company that management has not already made public would be exceptions, arising only in limited circumstances, and not a pervasive occurrence. With respect to providing original information about control deficiencies in particular, we similarly believe these situations would be rare. The especially challenging, subjective, or complex auditor judgment in these cases is typically limited to the determination as to whether a control deficiency is a significant deficiency or material weakness. The other judgment to consider when a control deficiency exists is whether and how the auditor might need to adjust the original audit plan (*i.e.*, the audit response). The concerns expressed by commenters related to disclosing original information about control deficiencies are primarily related to scenarios where the company and auditor have concluded a material weakness in internal control over financial reporting does not exist but the deficiency is a principal consideration for determining that a matter is a CAM. The audit response to a deficiency that is not a material weakness is typically less extensive because the auditor has already concluded that a reasonable possibility of material misstatement due to the control deficiency does not exist. For example, the audit response might be more of the same procedures being performed without changing the nature of the procedures. In those instances, typically, judgments about the audit response would not be a principal consideration of why something is a CAM and therefore would not need to be reported.

## 3. Client Confidentiality—Professional Obligations and State Laws

At least one commenter stated that auditors may have a requirement to maintain client confidentiality under certain states’ laws or professional obligations that could conflict with the Proposed Rules, if the Proposed Rules required the auditor to communicate original information about the

<sup>40</sup> Commenters indicated the second communication requirement “describing the principal considerations that led the auditor to determine that the matter is a CAM” is effectively a requirement to communicate ‘why’ a matter is a CAM.

<sup>41</sup> See *e.g.*, Sullivan & Cromwell Letter.

<sup>42</sup> See *e.g.*, Cleary Gottlieb Letter.

<sup>43</sup> See *e.g.*, CII Letter; Capital Group Letter.

<sup>44</sup> See CII Letter.

<sup>45</sup> See CII Letter.

company.<sup>46</sup> In the release accompanying the Proposed Rules, the Board noted that auditor's obligations under PCAOB standards arise under federal law and regulations and professional or state law duties of client confidentiality should not apply to, or should be preempted by, the obligation to communicate CAMs.

We agree that the communications called for by the Proposed Rules should not be precluded by existing state legal or professional obligations as to client confidentiality in light of, among other things, existing exceptions for disclosure where required by applicable law. For example, the AICPA Code of Professional Conduct articulates the professional duties of a member CPA in public practice regarding confidential client information and stipulates that "[a] member in public practice shall not disclose any confidential client information without the specific consent of the client."<sup>47</sup> However, the Code goes on to state that "[t]his rule shall not be construed . . . to prohibit a member's compliance with applicable laws and government regulations."<sup>48</sup> While we are sensitive to the importance of client confidentiality, and do not believe it should be overridden lightly, we believe that the benefits of requiring communication to investors of CAMs—within the confines of the Proposed Rules—justify the potential that some information that otherwise would be considered a client confidence will be made public.<sup>49</sup>

### *C. The Potential Impact of CAMs on the Role of the Audit Committee and the Communication Among the Audit Committee, Management, and the Auditor*

Commenters provided mixed views on the potential impact of CAM reporting on the role of the audit committee and the communication among the audit committee, management, and the auditor. Some commenters indicated they believe the public reporting of CAMs will likely result in improved communications between auditors and audit committees.<sup>50</sup> At least one commenter suggested audit committees should have a particular interest in matters communicated by the auditor that are likely to be made public in the auditor's report and they will likely want to more fully understand any auditing matter that resulted in a CAM.<sup>51</sup>

Conversely, some commenters indicated they believe there is a risk that the requirement for auditors to communicate CAMs will result in "chilled" conversation among audit committees, management, and auditors.<sup>52</sup> Generally, these commenters expressed concern that the Proposed Rules could unintentionally discourage free and open communication between the auditor and management and between the auditor and audit committee. Further, some commenters expressed concern that the role of the audit committee will be undermined by the auditor's responsibilities under the Proposed Rules.<sup>53</sup>

Similar comments were received by the PCAOB in its rulemaking process. In the release accompanying the Proposed Rules, the Board explained that it believes there should not be a chilling effect or reduced communications to the audit committee because of the requirements included in AS 1301, *Communications with Audit Committees*. Any potential chilling effect would therefore relate only to matters that are not explicitly required to be communicated to the audit committee. However, the Board noted that given the broad requirements of AS 1301 (particularly paragraph .24), there may be few, if any, relevant communications affected by that possibility.

We acknowledge that there exists a risk that communications between the auditor and the audit committee could be chilled, if the auditor were to avoid raising certain issues to the audit committee's attention so as to not trigger the requirement to determine whether such issues are CAMs. However, we agree with the Board's conclusion that the existing requirements to communicate matters to the audit committee—an auditing standard that would be violated if matters were not communicated—limits the risk of chilling to matters not falling within the scope of AS 1301, but falling within the scope of a CAM. In this regard, we believe it would be highly unusual for a matter to meet the definition of a CAM and not be required to be communicated to the audit committee. To illustrate this point, the following are examples of matters that are required to be communicated to the audit committee based on the requirements in AS 1301:

- Significant risks identified during the auditor risk assessment procedures;<sup>54</sup>
- The nature and extent of specialized skill or knowledge needed to perform the planned audit procedures or evaluate the audit results related to a significant risk;<sup>55</sup>
- Critical accounting policies and practices;<sup>56</sup>
- Critical accounting estimates;<sup>57</sup>
- Significant unusual transactions;<sup>58</sup>
- Difficult or contentious matters for which the auditor consulted (outside of the engagement team);<sup>59</sup> and
- Other matters arising from the audit that are significant to the oversight of the company's financial reporting process.<sup>60</sup>

The Proposed Rules provide the following nonexclusive list of factors that auditors should take into account, alone or in combination, in determining whether a matter involved especially challenging, subjective, or complex auditor judgment for purposes of evaluating whether a matter falls within the definition of a CAM:

- The auditor's assessment of the risks of material misstatement, including significant risks;
- The degree of auditor judgment related to areas in the financial statements that involved the application of significant judgment or estimation by management, including estimates with significant measurement uncertainty;

<sup>46</sup> See e.g., CCMC Letter.

<sup>47</sup> AICPA Code of Professional Conduct 1.700.001.01.

<sup>48</sup> AICPA Code of Professional Conduct 1.700.001.02. See also, e.g., Rule 10–4 of the Uniform Accountancy Act Model Rules, which has been the basis for many state rules for professional conduct.

<sup>49</sup> One commenter stated that the PCAOB reaffirmed the propriety of confidentiality requirements imposed on auditors by other authorities within PCAOB Release No. 2008–001 which adopted Auditing Standard No. 6, *Evaluating Consistency of Financial Statements* (since reorganized as AS 2820) in which the Board stated that the revisions contained therein "did not reflect a decision that auditor confidentiality requirements imposed by other authorities were inappropriate." See CCMC Letter. However, by reaffirming the propriety of confidentiality requirements imposed on auditors by other authorities in PCAOB Release 2008–001, we believe the Board also effectively reaffirmed professional requirements such as the AICPA's confidential client information rule, which, as discussed above, expressly states that the rule does not prohibit a member's compliance with applicable laws and government regulations.

<sup>50</sup> See e.g., CII Letter; J. Robert Brown Jr. Letter.

<sup>51</sup> See e.g., J. Robert Brown Jr. Letter.

<sup>52</sup> See e.g., Letter from Bruce J. Nordstrom, August 11, 2017 ("Bruce J. Nordstrom Letter"); Northrop Grumman Letter; Sullivan & Cromwell Letter; Cleary Gottlieb Letter; Letter from Nasdaq, August 24, 2017.

<sup>53</sup> See e.g., Bruce J. Nordstrom Letter; Quest Letter; Aetna Letter.

<sup>54</sup> See AS 1301.9.

<sup>55</sup> See AS 1301.10a.

<sup>56</sup> See AS 1301.12b.

<sup>57</sup> See AS 1301.12c.

<sup>58</sup> See AS 1301.12d.

<sup>59</sup> See AS 1301.15.

<sup>60</sup> See AS 1301.24.



- The nature and timing of significant unusual transactions and the extent of audit effort and judgment related to these transactions;

- The degree of auditor subjectivity in applying audit procedures to address the matter or in evaluating the results of those procedures;

- The nature and extent of audit effort required to address the matter, including the extent of specialized skill or knowledge needed or the nature of consultations outside the engagement team regarding the matter; and

- The nature of audit evidence obtained regarding the matter.

Given the similarity of the two lists, we believe it would be difficult to identify an example of a matter that would meet the definition of a CAM that would not otherwise need to be communicated to the audit committee based on the requirements in AS 1301. Further, it is important to bear in mind that the mere communication of information from the auditor to the audit committee is not sufficient to meet the definition of CAM. The information communicated also would have to meet all other criteria in the definition of CAM, including that the matter involved especially challenging, subjective, or complex auditor judgment. Given auditors' existing responsibilities to discuss the matters described above with audit committees, we do not believe that the Proposed Rules are likely to chill these conversations.

As it relates to the risk that the role of the audit committee will be undermined, we emphasize that the Commission has a long history of promoting effective and independent audit committees.<sup>61</sup> We believe the requirement for every company listed on an exchange to have an independent audit committee<sup>62</sup> plays an important role in protecting the interests of investors by assisting the board of directors in fulfilling its responsibility to oversee the integrity of a company's accounting and financial reporting processes and both internal and external audits. Dialogue between audit committees and auditors provides real benefits to investors and the financial reporting process. The intent of the Proposed Rules is to supplement the role of the audit committee by providing information about the audit through the lens of the auditor. The Proposed Rules are unlikely to impact this relationship

<sup>61</sup> See e.g., *Possible Revisions to Audit Committee Disclosures*, Release No. 33-9862 (July 1, 2015), 80 FR 38995 (July 8, 2015) available at <https://www.sec.gov/rules/concept/2015/33-9862.pdf>.

<sup>62</sup> See Section 301 of the Sarbanes Oxley Act and Section 10A(m) of the Exchange Act.

or the dialogue between audit committees and auditors, and may even encourage audit committees to engage more extensively with auditors given that there will be disclosures by the auditor about those aspects of the audit that constitute CAMs.

#### *D. The Potential Liability Impact of CAMs*

Commenters provided mixed views related to potential liability impacts of the introduction of CAMs.<sup>63</sup> Some commenters expressed concern that the communication of CAMs may result in an increase of meritless claims under the securities laws by expanding the number and variety of statements that will be attributed to the auditor.<sup>64</sup> Some commenters also expressed concerns that the requirements for auditor reporting of CAMs will increase litigation risk for both auditors and companies.<sup>65</sup> However, other commenters expressed views that the communication of CAMs by the auditor may have the potential to decrease liability as it involves disclosure of risks and challenges, and accordingly, could effectively provide a defense for the auditor.<sup>66</sup>

These concerns were also raised by commenters during the PCAOB rulemaking process. As the Board acknowledged in the release accompanying the Proposed Rules, CAMs themselves would be new statements that could be the basis for asserted claims against auditors. The Board also noted in its release that information provided regarding CAMs could be used to impact other aspects of securities fraud claims, such as providing evidence to support pleadings against an issuer, an auditor, or both.

In response to these concerns, the Board limited and clarified the process for determining CAMs, including by narrowing the source of CAMs to matters communicated or required to be communicated to the audit committee, adding a materiality component to the

<sup>63</sup> Some commenters suggested the Commission undertake rulemaking to provide a safe harbor around auditor reporting of CAMs. See e.g., PwC Letter, CCMC Letter. The question before the Commission at this time, however, is whether the rules as proposed meet the statutory criteria for approval. Moreover, we believe it would be more appropriate to consider whether any potential rulemaking is warranted related to safe harbors after the Board and the Commission have the opportunity to observe how the Proposed Rules are implemented in practice.

<sup>64</sup> See e.g., Quest Letter; PwC Letter; Davis Polk Letter.

<sup>65</sup> See e.g., CCMC Letter; American Tower Letter; EY Letter.

<sup>66</sup> See e.g., CII Letter; Letter from The Value Alliance and Corporate Governance Alliance, August 18, 2017.

CAM definition, and refining the factors used to determine CAMs. We believe these modifications, as well as the CAM definition's focus on the auditor's judgment, should help mitigate potential liability concerns. For example, one of the concerns expressed by commenters regarding liability is the potential omission of CAMs within the auditor's report. By narrowing the potential matters that could be CAMs, clarifying the process for determining CAMs, and revising the definition of a CAM as discussed above, the Board has provided a framework for the auditor to evaluate and demonstrate whether a matter meets the definition of a CAM in accordance with the Proposed Rules.

We recognize, as the Board did, that mandating communication of CAMs will, by design, entail new statements in the auditor's report, thereby increasing the potential for litigation regarding such statements. However, the actual litigation impacts of these communications are difficult to predict. As the Board notes, in order to succeed, any claim based on these new statements would have to establish all of the elements of the relevant cause of action (e.g., when applicable, scienter, loss causation, and reliance). Moreover, as discussed above, CAMs could be used to defend as well as initiate litigation.

Nevertheless, we recognize reporting of CAMs likely will create an incremental risk of litigation and potential liability. To some degree, increased litigation risk is the by-product of any new reporting requirement and must be balanced against the perceived benefits of the required reporting. As discussed above, we are persuaded that the communication of CAMs, which can be provided only by auditors, will benefit investors and other financial statement users by providing insights into the audit—and from the auditor's own unique perspective—that can reduce information asymmetries and be used to assess a company's financial reporting and make capital allocation and voting decisions. In our view, these benefits justify any such potential incremental liability risk arising from the communication, especially in light of the steps taken by the Board to mitigate such risk, as discussed above. However, because of these risks and other concerns expressed by commenters, we expect the Board to monitor the Proposed Rules after implementation for any unintended consequences.

#### *E. Economic Analysis of CAMs*

Several commenters expressed concerns that the costs of the Proposed

Rules will exceed their benefits, or that the economic analysis performed by the Board did not sufficiently analyze the costs and benefits of the Proposed Rules.<sup>67</sup> Some commenters observed specifically that the Board's analysis lacked quantitative information.<sup>68</sup> Conversely, some commenters indicated they believe the potential costs are not likely to be significant relative to the potential benefits, for example because CAMs are based on matters already being discussed by the auditor and audit committee.<sup>69</sup> Further, to the extent that costs are incurred related to the Proposed Rules, commenters from the investor community stated that, as shareholders, they are willing to bear the additional costs of the Proposed Rules in exchange for enhanced information about the audit.<sup>70</sup>

The Board's evaluation of the potential costs and benefits of the Proposed Rules was informed by information sought and obtained from stakeholders. In the course of that analysis, the Board stated that "the potential benefits and costs of the [Proposed Rules] are inherently difficult to quantify, therefore the Board's economic discussion is primarily qualitative in nature." The Board also observed that commenters that raised concerns about the Proposed Rules' costs generally did not quantify those costs and that "[e]ven those [commenters] that, at an earlier stage of the rulemaking, conducted limited implementation testing of the proposal were unable to provide a quantified cost estimate." Moreover, as stated in the release accompanying the Proposed Rules, as related to comments provided to the Board, "[c]ommenters provided views on a wide range of issues pertinent to economic considerations, including potential benefits and costs, but did not provide empirical data or quantified estimates of the costs or other potential impacts of the standard." As a result, in lieu of providing a quantitative analysis, the Board engaged in a detailed qualitative assessment of the Proposed Rules' potential economic

impacts, including consideration of direct and indirect benefits, costs, and potential unintended consequences.

We disagree with commenters' assertions that the Board's analysis is defective for failing to adequately quantify the costs and benefits of the Proposed Rules. Analyzing the potential economic impacts, including the costs and benefits, of a proposed rule is a key way to develop regulatory changes that are well-reasoned, with potential costs that are warranted in light of the expected benefits. We believe that a high-quality qualitative analysis can allow for this type of evaluation, particularly in those cases where quantification is not feasible.<sup>71</sup>

We also agree with the Board that it would not have been feasible to quantify the potential costs and benefits of the Proposed Rules. While certain components of the total potential costs related to the Proposed Rules might be easier to estimate (e.g., the costs an auditor might incur to draft a CAM), several of the significant components of the total potential cost are inherently difficult to estimate. For example, under the Proposed Rules, the auditor would need to determine which matters are CAMs and have incremental discussions with the audit committee regarding the draft of the CAM communications. Given the audit-specific nature of such matters, it is difficult to predict how many hours would need to be involved in the analysis and communication process as this will vary based on a number of factors, including, for example, the complexity of the company and the number of CAMs.

In addition, there are potential costs that might be incurred by the company as a consequence of the implementation of the Proposed Rules. For example, besides the audit committee, other executives and legal counsel may be required to expend more time and effort in discussing and reviewing the auditor's report as a consequence of the Proposed Rules. Again, estimating these costs is difficult because these costs likely will vary among audit engagements depending on the circumstances.

Potential benefits from new auditor reporting requirements are also inherently difficult to quantify. For example, to quantify the direct benefit to investors of a more useful and informative auditor's report, one would require an estimate of how their investment or voting decisions would be

affected by CAMs and an estimate of the amount of profit from such decisions. Such estimates are either impossible or very difficult to calculate with reasonable reliability. In addition to the direct benefits, there may be indirect benefits from the new reporting requirements. For example, the communication of CAMs can provide some auditors, management, and audit committees with additional incentives to enhance audit quality. Enhanced audit quality ultimately can lead to a reduced cost of capital. However, at this time, it is impossible to predict the amount of reduction in cost of capital that would arise from the Proposed Rules.

Moreover, we agree with the Board's qualitative analysis of the possible economic consequences of the Proposed Rules. As they did before the Board, investors and investor associations have expressed strong support to the Commission for the Proposed Rules and stated that they expect the potential benefits to justify the potential costs.<sup>72</sup> As an example, one commenter stated the Proposed Rules will not require changes to the audit process and hence should not impose any significant incremental costs.<sup>73</sup> This same commenter further stated that, while incremental costs or auditor effort should be minimal, there are manifold benefits for investors.<sup>74</sup> Several commenters also informed the Commission that they believe that the information from the auditor's perspective that would be required by the Proposed Rules would be useful, for example, in forming voting and investment decisions.<sup>75</sup>

We believe these are important benefits. The Proposed Rules are consistent with the broader economic theory regarding the benefits from enhanced disclosures. More specifically, we believe that the Proposed Rules are likely to improve the information currently available to investors and facilitate their efforts to understand the financial statements. Importantly, the Proposed Rules will assist investors in identifying those matters that relate to the relevant financial statement accounts or disclosures that involved especially challenging, subjective, or complex auditor judgment. This will, in turn, provide investors with audit-specific information directly from the auditor's point of view and add to the

<sup>67</sup> See e.g., CCMC Letter; Society for Corporate Governance Letter; Davis Polk Letter.

<sup>68</sup> See e.g., Robert Waxman Letter; CCMC Letter; Davis Polk Letter.

<sup>69</sup> See e.g., CII Letter; Letter from Aberdeen Asset Management, August 11, 2017 ("Aberdeen Letter"); Hermes Letter; CFA Institute Letter.

<sup>70</sup> Compliance and implementation costs from the auditor's standpoint could be passed through to the company and consequently investors in the form of increased audit fees. Moreover, companies themselves (and consequently investors) could incur additional costs as a consequence of the Proposed Rules, for example by engaging additional resources such as legal counsel, and such costs would impact investors. See also e.g., CII Letter; Aberdeen Letter; Hermes Letter.

<sup>71</sup> Cf. *Nat'l Ass'n of Mfrs v. SEC*, 748 F.3d 359 (D.C. Cir. 2014) (acknowledging the reasonableness of the SEC's determination that it was unable to quantify benefits because it lacked the data necessary to do so).

<sup>72</sup> See e.g., CFA Institute Letter; CII Letter.

<sup>73</sup> See e.g., CFA Institute Letter.

<sup>74</sup> See *id.*

<sup>75</sup> See e.g., CII Letter; Letter from Public Citizen, August 18, 2017; CalPERS Letter; Hermes Letter; CFA Institute Letter.

total mix of information that could be used in their capital allocation and voting decisions. Further, investors will be able to observe reported CAMs for other companies. Within the right context, such information could be used by investors to improve their understanding of both the audit itself and the company's financial statements.

Moreover, the Proposed Rules may stimulate discussions between the auditor and the company regarding CAMs, and potentially increase professional skepticism by the auditor. The public nature of CAMs may also act to further enhance auditors' professional skepticism. An increase in skepticism may lead to an increase in audit quality and, as a consequence, result in lower cost of capital for companies.

Like the Board, we recognize that there are costs associated with complying with the Proposed Rules. The Board indicated that costs to auditors are most likely to arise from additional time to prepare and review auditor's reports, including discussions with management and audit committees, as well as potential legal costs for review of the information provided in the CAMs. In addition, auditors may choose to perform more audit procedures related to areas reported as CAMs (even though auditor performance requirements have not changed in those areas), with cost implications for both auditors and companies. For auditors, costs might represent both one-time costs and recurring costs. One-time costs could be incurred as a result of: (1) Updating accounting firm audit and quality control methodologies; and (2) developing and conducting training. Recurring costs could include: (1) Drafting descriptions of CAMs and related documentation; (2) additional reviews by senior members of engagement teams, engagement quality reviewers, and national office personnel; and (3) additional time as a result of discussions with management or the audit committee regarding CAMs.

Companies, including audit committees, will likely also incur both one-time and recurring costs. One-time costs could be incurred, for example, in educating audit committee members about the requirements of the new standard and in developing management and audit committee processes for the review of draft descriptions of CAMs and the related interaction with auditors. Recurring costs could include the costs associated with carrying out those processes,

potential legal costs,<sup>76</sup> as well as any increase in audit fees associated with new reporting requirements.

We recognize that there is some level of uncertainty as to the costs that will be incurred to comply with the Proposed Rules. However, as discussed above, the Board has taken steps to mitigate those costs, including by, as an example, limiting the source of CAMs to matters communicated or required to be communicated to the audit committee and by adding a materiality component to the definition of a CAM. At the same time, for the reasons explained above, we believe that the Proposed Rules will provide significant new benefits to investors and other financial statement users. Based on the economic analysis in the release accompanying the Proposed Rules and our own evaluation of comments received by both the Board and the Commission regarding the potential economic effects of the Proposed Rules, we are persuaded that there is a sufficient basis to conclude that the potential benefits of the Proposed Rules will justify the potential related costs, and therefore, that the Proposed Rules are necessary and appropriate in the public interest and for the protection of investors.

#### *F. Practicability Matters Related to CAMs*

Several commenters raised certain practical concerns with the Proposed Rules. We discuss each of these concerns in detail below.

##### 1. Timing

Some commenters expressed concerns that the requirement to communicate CAMs will impose additional burdens on auditors, audit committees, and preparers during an already time-constrained period as management finalizes its annual financial statements.<sup>77</sup> In the release accompanying the Proposed Rules, the PCAOB acknowledged that if drafting and reviewing of CAMs takes place towards the end of the audit, there will also be an opportunity cost associated with the time constraints on the parties involved.

We also acknowledge these concerns, but we expect most matters that will ultimately need to be communicated as CAMs will be identified throughout the audit and not just at the end of the audit. As a result, we believe much of the work can be completed prior to the time-constrained period at the end of

the financial reporting process. In those cases, we encourage auditors, audit committees, and preparers to coordinate and work together before the critical year-end financial reporting period so that, if other CAMs arise later in the audit, the burden can be lessened during the finalization of the audit.

##### 2. Inconsistent Application by Auditors

Some commenters also expressed concerns that the principles-based nature of the Proposed Rules as it pertains to both the identification and communication of CAMs could lead to inconsistent application by auditors.<sup>78</sup> In the release accompanying the Proposed Rules, the Board stated that the determination of CAMs is principles-based and the Proposed Rules do not specify any items that would always constitute CAMs as the auditor determines CAMs in the context of the specific audit.

We recognize commenters' concerns that the subjective requirements related to CAMs could lead to diversity in communications, but we agree with the Board that it is important for the CAM requirements, particularly the communication requirements, to be principles-based in order to meet the Board's objective of having CAM communications provide tailored, audit-specific information by the auditor within the auditor's report. We also believe the guidance provided by the Board in the release accompanying the Proposed Rules will assist auditors in implementing the Proposed Rules consistently.

##### 3. Lack of Examples

Some commenters noted that the PCAOB did not include the illustrative example CAMs from the PCAOB Re-proposal in the release accompanying the Proposed Rules, and they expressed concern that the removal of these examples will add to uncertainties and confusion for auditors in reporting CAMs.<sup>79</sup> As the PCAOB noted in the release accompanying the Proposed Rules, given the principles-based nature of the requirements for CAMs and the objective of providing tailored, audit-specific information, the examples in the PCAOB Re-proposal were intended to function as illustrations of how CAMs could be communicated, and not as templates for how CAMs should be communicated. In this regard, it is important to bear in mind that a number of commenters expressed concerns that

<sup>76</sup> See discussion in section III.D above, "The Potential Liability Impact of CAMs."

<sup>77</sup> See e.g., Society for Corporate Governance Letter; Letter from ArcBest, August 17, 2017.

<sup>78</sup> See e.g., CCMC Letter; Aetna Letter.

<sup>79</sup> See e.g., CCMC Letter; Robert Waxman Letter.

the CAMs will become boilerplate and will not be useful.<sup>80</sup>

We agree with the Board's objective of providing tailored, audit-specific information and believe it is important for auditors to develop CAM descriptions that comply with the Proposed Rules without conforming to an example provided by the Board. As a result, inclusion of examples may lead to more boilerplate descriptions of CAMs. In addition, the PCAOB does present certain examples in the release accompanying the Proposed Rules to provide guidance on how to identify and communicate CAMs. The release includes examples such as, whether the auditor's evaluation of the company's ability to continue as a going concern could also represent a CAM and whether a potential illegal act, if an appropriate determination had been made that no disclosure of it was required in the financial statements, would be a CAM. The Proposed Rules also include a note incorporating four examples of potential approaches to addressing the requirement to describe how the CAM was addressed in the audit.

#### *G. Disclosure of Auditor Tenure in the Auditor's Report*

Commenters provided mixed perspectives related to the disclosure of auditor tenure in the auditor's report. Some commenters did not support disclosure of auditor tenure in the auditor's report. These commenters indicated such disclosure may give undue prominence to the information, thereby giving an impression that a correlation exists between auditor tenure and independence or audit quality.<sup>81</sup> Some of these commenters suggested alternative locations for this information, such as the proxy statement, so that the information could be provided with context from the audit committee, or PCAOB Form AP.<sup>82</sup> At least one commenter did not support requiring the disclosure of auditor tenure as this commenter stated the audit committee is in the best position to evaluate the auditor's independence.<sup>83</sup> Other commenters, including investors and investor associations, supported the disclosure of auditor tenure, indicating the information is useful in matters such as proxy voting.<sup>84</sup>

<sup>80</sup> See e.g., Aetna Letter; Quest Letter; Davis Polk Letter.

<sup>81</sup> See e.g., CCMC Letter; PwC Letter; Deloitte Letter.

<sup>82</sup> See e.g., Davis Polk Letter; Regions Letter.

<sup>83</sup> See e.g., Bruce J. Nordstrom Letter.

<sup>84</sup> See e.g., Colorado PERA Letter; CFA Institute Letter.

As described in the release accompanying the Proposed Rules, issuers are not currently required to disclose auditor tenure, although some voluntarily choose to do so. Based on recent surveys,<sup>85</sup> and as noted in the release accompanying the Proposed Rules, there is a growing trend of voluntary disclosure of auditor tenure in the proxy statement, presumably reflecting audit committees' use of and investors' demand for such information. We believe it is important to note, for issuers that do not disclose auditor tenure voluntarily, investors themselves, in some circumstances, may be able to determine auditor tenure based on publicly available information. Further, we are aware that various third-party commercial databases provide auditor tenure information based on public records (e.g., the auditor's report in an issuer's annual report on Form 10-K). Institutional investors or professional analysts typically have access to such databases; however, retail investors typically do not. To the extent that these retail investors seek to obtain auditor tenure information, they would need to incur the cost to determine this information themselves.<sup>86</sup> Accordingly, we believe requiring this disclosure could lower information acquisition costs for such investors, which we find to be a compelling potential benefit in support of the requirement.

As it relates to the location of the disclosure, the PCAOB does not have the statutory authority to require disclosure in the proxy statement. While the Commission does have authority to amend the proxy rules, as discussed in the release accompanying the Proposed Rules, not all companies required to be audited under PCAOB standards are subject to the proxy rules (e.g., foreign private issuers). In addition, certain issuers that are not required to hold annual meetings of shareholders, such as most registered investment companies, generally will solicit proxies less frequently than other issuers. Also, as discussed in the release accompanying the Proposed Rules, the Board considered disclosure of auditor tenure in Form AP, which requires disclosure of the name of the engagement partner and of the names

<sup>85</sup> See e.g., Deloitte, Center for Board Effectiveness, *Audit Committee Disclosure in Proxy Statements—2017 Trend* (Aug. 2017), available at <https://www2.deloitte.com/content/dam/Deloitte/us/Documents/center-for-board-effectiveness/us-cbe-august-2017-on-the-boards-agenda.pdf>.

<sup>86</sup> Though institutional investors and professional analysts need to pay to get access to the databases, their marginal cost of acquiring this piece of information is likely much lower than that of retail investors because the database provider can spread the cost among the database's many subscribers.

and percentage of participation of other accounting firms in the audit for all issuer audits. However, Form AP was developed primarily to respond to commenter concerns about the potential liability consequences of naming persons in the auditor's report, the potential need to obtain consents from those named persons in connection with registered securities offerings, and the additional time needed to compile information about the other accounting firms. The Board's determination to create Form AP, rather than require disclosure of these items in the auditor's report, was a means to address these concerns.

We believe it is important to acknowledge that the disclosure of auditor tenure does not have the same potential liability or other consequences as disclosure of the name of the engagement partner or other accounting firms. We therefore agree with the Board that such an approach is unnecessary in the Proposed Rules. Overall, we believe it is appropriate for this disclosure to appear in the auditor's report because it will provide for a consistent location and decrease search costs with respect to information about auditor tenure.

#### *H. The Effective Dates of the Proposed Rules*

Some commenters suggested postponement or further consideration of the effective dates included in the Proposed Rules.<sup>87</sup> At least one commenter suggested postponement of the effective dates as companies and auditors will be dealing with the implementation of significant new GAAP standards, including those related to revenue, leases, and credit losses.<sup>88</sup> In the release accompanying the Proposed Rules, the Board took into consideration commenters' feedback and phased effective dates for CAMs, indicating this "may facilitate any post-implementation review of the impact of the final standard."

We believe the Board took a balanced approach to effective dates by adopting a reasonable phase-in schedule. For certain entities listed internationally, audit firms are already required to communicate information similar to CAMs. Given that the effective date for communication of CAMs for large accelerated filers is phased in first, larger firms will likely be able to observe practices developed by other firms within their global network in considering implementation questions.

<sup>87</sup> See e.g., CCMC Letter; FEI Letter; Eli Lilly Letter.

<sup>88</sup> See e.g., CCMC Letter.

As the Board discussed, the staggered approach to implementation may allow the Board to evaluate implementation by the first cohort of companies before applying the Proposed Rules to other companies. Also, the second cohort of auditors and companies will have more time to prepare, and will have the benefit of observing how the Proposed Rules have been implemented by the first cohort. The Commission itself, for many similar reasons, has used, at times, staggered implementation dates for new regulatory requirements.<sup>89</sup> With respect to the other changes to the auditor's report in the Proposed Rules that are not subject to a phase-in approach, those changes should not be a significant burden to implement as they involve relatively straightforward changes to the existing auditor's report. Accordingly, we believe the effective dates in the Proposed Rules are reasonable.

#### *I. Implementation Efforts*

Several commenters, including most notably audit firms, generally expressed support for the Proposed Rules while simultaneously expressing concern that unintended consequences may arise during implementation. These commenters stated that uncertainty surrounding the effects of the Proposed Rules would necessitate a post-implementation review.<sup>90</sup> Commenters called on the Commission and PCAOB to assist with implementation efforts should the Commission approve the Proposed Rules and encouraged the Board to take advantage of the proposed phased effective dates to undertake a post-implementation review of the impact of the final standard.<sup>91</sup> Some accounting firms have also stated their willingness to work with both the Commission and PCAOB to provide feedback on implementation experiences.<sup>92</sup> In the release accompanying the Proposed Rules, the Board stated that it "intends to monitor the results of implementation, including consideration of any unintended consequences."

The Commission acknowledges that the communication required of auditors by the Proposed Rules is a significant change in practice for auditors, companies, and audit committees.

Accordingly, it will be important to closely monitor the implementation of the Proposed Rules, including potentially issuing incremental implementation guidance (if needed), providing PCAOB staff to be available to respond to questions and challenges as they arise, and completing a post-implementation review as soon as reasonably possible, including some analysis between effective dates for CAMs. The Commission expects the PCAOB to take such steps.

#### **IV. Effect on Emerging Growth Companies**

Under the Proposed Rules, the requirement to communicate CAMs would not apply to the audits of EGCs, but all other provisions within the Proposed Rules would apply to such audits.<sup>93</sup> As described in section II.A, these include a number of changes to the auditor's report that are primarily intended to clarify the auditor's role and responsibilities related to the audit of the financial statements, provide additional information about the auditor's tenure, and make the auditor's report easier to read.

Section 103(a)(3)(C) of the Sarbanes-Oxley Act, as amended by Section 104 of the Jumpstart Our Business Startups Act, requires that any rules of the Board "requiring mandatory audit firm rotation or a supplement to the auditor's report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer (auditor discussion and analysis)" shall not apply to an audit of an EGC. The provisions of the Proposed Rules applicable to the audits of EGCs do not fall into this category.<sup>94</sup> Section 103(a)(3)(C) further provides that "[a]ny additional rules" adopted by the PCAOB after April 5, 2012, do not apply to audits of EGCs "unless the Commission determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation."

<sup>89</sup> See Paragraph .05b of AS 3101 within the Proposed Rules.

<sup>90</sup> While the precise scope of this category of rules under Section 103(a)(3)(C) is not entirely clear, we do not interpret this statutory language as precluding the application of Board rules requiring a certain format for the auditor's report or inclusion of additional factual information about auditor tenure, auditor independence and other requirements related to the audits of EGCs. In our view, this approach reflects an appropriate interpretation of the statutory language and is consistent with our understanding of the congressional purpose underlying this provision.

The provisions of the Proposed Rules applicable to the audits of EGCs fall within this category, and thus the Commission must make a determination under the statute about the applicability of these provisions to EGCs. Having considered those statutory factors, the Commission finds that applying these provisions to the audits of EGCs is necessary or appropriate in the public interest.

In proposing application of certain of the Proposed Rules to audits of all issuers, including EGCs, the PCAOB requested that the Commission make the determination required by Section 103(a)(3)(C). To facilitate the Commission's determination, the Board provided information identified by the Board's staff from public sources, including data and analysis of EGCs that sets forth its views as to why it believes certain of the Proposed Rules should apply to audits of EGCs.

To inform consideration of the application of auditing standards to audits of EGCs, the PCAOB staff has also published a white paper that provides general information about characteristics of EGCs.<sup>95</sup> The data on EGCs outlined in the white paper indicates that a majority of EGCs are smaller public companies that are generally new to the SEC reporting process. This suggests that there is less information available to investors regarding such companies relative to the broader population of public companies because, in general, investors are less informed about companies that are smaller and newer.

We expect that the changes to the auditor's report that would be applied to the audits of EGCs under the Proposed Rules, will: (1) Provide a consistent location and decrease search costs with respect to information about auditor tenure; (2) enhance users' understanding of the auditor's role; and (3) make the auditor's report easier to read and facilitate comparison across companies by making the format of the report more uniform. Given the relatively straightforward nature of the additional changes to the auditor's report, we expect that the costs associated with these changes will not be significant and will be primarily one-time, rather than recurring, costs. Overall, we expect the changes to increase the efficiency with which users are able to locate and understand the information presented in the auditor's report. We do not expect the changes to

<sup>95</sup> See *White Paper on Characteristics of Emerging Growth Companies* (Nov. 15, 2016), available at <https://pcaobus.org/EconomicAndRiskAnalysis/ORADocuments/White-Paper-Characteristics-Emerging-Growth-Companies-November-2016.pdf>.

<sup>89</sup> See e.g., *Shareholder Approval of Executive Compensation and Golden Parachute Compensation*, Release No. 33-9178 (Jan. 25, 2011), 76 FR 6010 (Feb. 2, 2011) available at <https://www.sec.gov/rules/final/2011/33-9178.pdf>.

<sup>90</sup> See e.g., BDO Letter; Letter from the Center for Audit Quality, August 18, 2017 ("CAQ Letter"); Deloitte Letter; EY Letter; PwC Letter.

<sup>91</sup> See *id.*

<sup>92</sup> See e.g., CAQ Letter; EY Letter; PwC Letter.

significantly impact competition or capital formation. As such, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation, we believe there is a sufficient basis for the Commission to determine that applying the Proposed Rules, other than the provisions related to CAMs, to the audits of EGCs is necessary or appropriate in the public interest.

## V. Conclusion

The Commission has carefully reviewed and considered the Proposed Rules, the information submitted therewith by the PCAOB, and the comment letters received. In connection with the PCAOB's filing and the Commission's review,

A. The Commission finds that the Proposed Rules are consistent with the requirements of the Sarbanes-Oxley Act and the securities laws and are necessary or appropriate in the public interest or for the protection of investors; and

B. Separately, the Commission finds that the application of the Proposed Rules to the audits of EGCs, which do not have a requirement to communicate CAMs, is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation.

*It is therefore ordered*, pursuant to Section 107 of the Sarbanes-Oxley Act and Section 19(b)(2) of the Exchange Act, that the Proposed Rules (File No. PCAOB-2017-01) be and hereby are approved.

By the Commission.

**Eduardo A. Aleman,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-81925; File No. SR-BatsBYX-2017-26]

### Self-Regulatory Organizations; Bats BYX Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Its Amended and Restated Certificate of Incorporation

October 23, 2017.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup>

notice is hereby given that on October 13, 2017, Bats BYX Exchange, Inc. (the "Exchange" or "BYX") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange seeks to amend its Amended and Restated Certificate of Incorporation. The text of the proposed rule change is provided below.

(additions are italicized; deletions are [bracketed])

\* \* \* \* \*

#### AMENDED AND RESTATED CERTIFICATE OF INCORPORATION of BATS BYX EXCHANGE, INC.

The name of the corporation is Bats BYX Exchange, Inc. The corporation filed its original Certificate of Incorporation with the Secretary of State of the State of Delaware on July 30, 2009 *under the name BATS Y-Exchange, Inc.* This Amended and Restated Certificate of Incorporation of the corporation, which restates and integrates and also further amends the provisions of the corporation's Certificate of Incorporation, was duly adopted in accordance with the provisions of Sections 242 and 245 of the General Corporation Law of the State of Delaware and by the written consent of its sole stockholder in accordance with Section 228 of the General Corporation Law of the State of Delaware. The [Amended and Restated] Certificate of Incorporation of the corporation is hereby amended, integrated and restated to read in its entirety as follows:

\* \* \* \* \*

The text of the proposed rule change is available at the Exchange's Web site at [www.bats.com](http://www.bats.com), at the principal office of the Exchange, and at the Commission's Public Reference Room.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The

Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant parts of such statements.

#### (A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

##### 1. Purpose

BYX recently amended its Certificate of Incorporation in connection with a corporate transaction (the "Transaction") involving, among other things, the recent acquisition of BYX, along with Bats BZX Exchange, Inc. ("Bats BZX"), Bats EDGX Exchange, Inc. ("Bats EDGX"), and Bats EDGA Exchange, Inc. ("Bats EDGA" and, together with Bats BYX, Bats EDGX, and Bats BZX, the "Bats Exchanges") by CBOE Holdings, Inc. ("CBOE Holdings"). CBOE Holdings is also the parent of Chicago Board Options Exchange, Incorporated ("CBOE") and C2 Options Exchange, Incorporated ("C2"). Particularly, the filing proposed, among other things, to amend and restate the certificate of incorporation of the Exchange based on certificates of incorporation of CBOE and C2.<sup>3</sup> The Exchange notes that in conforming the Exchange's Certificate to the certificates of CBOE and C2, it inadvertently (1) did not comply with a provision of Delaware law and (ii) referred to an inaccurate version of the Certificate in the introductory paragraph. The Exchange seeks to correct those errors.

Particularly, Section 245(c) of the Delaware General Corporation Law (DGCL) requires that a restated certificate of incorporation "shall state, either in its heading or in an introductory paragraph, the corporation's present name, and, if it has been changed, the name under which it was originally incorporated, and the date of filing of its original certificate of incorporation with the secretary of state." The Exchange notes that the conformed Certificate did not reference the name under which the corporation was originally incorporated (*i.e.*, "BATS Y-Exchange, Inc."). In order to comply with Section 245(c) of the DGCL, the Exchange proposes to amend its Certificate to add a reference to its original name.

The Exchange also notes that the last sentence of the introductory paragraph which provides that the current certificate is "amended, integrated and restated to read in its entirety as follows:" mistakenly references the new

<sup>3</sup> See Securities Exchange Act Release No. 81498 (August 30, 2017), 82 FR 42127 (September 6, 2017) (SR-BatsBYX-2017-19).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.