

Jack C Parsons
Audit Committees/Interim CFO/Financial and Risk Management Consulting
Reston, VA 20194
jcparsns@gmail.com

February 29, 2012

Sent via email: comments@pcaobus.org

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

Rulemaking Docket No. 30

I appreciate the opportunity to provide comments on the PCAOB's Proposed Auditing Standard on Communications with Audit Committees.

During my career, I've been an audit partner with one of the major firms, a Professional Accounting Fellow at the SEC, CFO of several public companies, an executive with two startup entities, a financial consultant, and an investor. As a result, I've been in the role of auditor, regulator, preparer and user of financial statements. I had the opportunity to sit in on a recent Standing Advisory Group (SAG) meeting and, while listening to the dialogue among the members of the SAG, decided to provide my perspective on the various Board initiatives.

First, let me commend the Board for taking up the many important issues on its docket. Many of these issues have been discussed over a long period of time yet still remain unresolved. With respect to this proposed standard, I think we'd all agree that communication between the auditor and the audit committee is a critical component of the financial reporting system. It's clear that in order for the system to work effectively, there must be excellent and ongoing communication among management, the auditors, and the audit committee. The Sarbanes-Oxley Act of 2002 imposed additional requirements on the audit committee and, as a result, I believe the audit committees have become more effective during the past 10 years. In addition, we're all focusing more on the critical role played by the audit committee and, therefore, I'm very much in favor of doing what we can to ensure that the audit committee is fully informed of the issues that impact the company's financial reporting. Communication between the auditor and the audit committee is a key component of that communication.

Overview

I think the Board has done an excellent job getting this proposed standard to its current state through the initial release, the follow-up roundtable discussions, and this updated release. It's clear that a great deal of effort went into this very important project.

As someone who is actively seeking audit committee roles, this project is very important to me. As I read through the release, I did so from the perspective of what I'd view as critical information from the auditor in carrying out my audit committee duties. I was pleased that the Release covers many of these items.

One of the issues that I'm sure the Board and staff had to deal with was how much detail to get into as opposed to providing more general guidance to ensure an improvement in the quality of the information provided rather than simply an increase in quantity. In all of the various projects being addressed by the Board, the topic of additional boilerplate language comes up – none of us is interested in more wording that doesn't say anything of substance. I think we need to be cautious about creating such a system and be sure we're focused on efforts of trying to improve the quality of the information communicated by the auditor to the audit committee. I commend the Board for striking what appears to me to be a reasonable balance here.

Another cautionary point regards whether the communication should come from the auditor or management. When I think of communication from the auditor, I'd be looking for the auditor to inform me about their audit strategy and then to provide me with their opinions and perspectives on the financial statements and internal controls over financial reporting based on the results of their audit. The audit committee gets a substantial amount of information from management and it needs to know that the auditor has also looked at this information and has formed opinions on its accuracy and completeness. The auditor also has a perspective on what others in the company's industry are doing in certain key areas or whether there are any current discussions among the rulemaking bodies with respect to any topics, and can share that objective perspective with management and the audit committee. They can also inform the audit committee whether the policies and practices of the company are on the conservative side or are more aggressive than others. The Release addresses this to some extent with its comments on sharing with the audit committee whether the auditor sees a bias on the part of management in its various estimates. But it's this type of input that is very valuable for the audit committee to hear from the auditor. In some cases, it seems to me that the Release puts the initial communication burden on the auditor in areas where it seems that management should be the primary communicator, thus blurring to some extent the respective roles of the two.

I also find myself very concerned about the quality of financial reporting in these difficult economic times because of the additional burden that economic uncertainty places on each of management, the auditor and the audit committee in carrying out their respective roles. As I think through the various components of the balance sheet, in just about every area there are judgments that must be made about future sales, timing of cash flows, interest rates, etc that have a substantial impact on the reserves that are established and any impairment losses that should be recognized. As an audit committee member, I'd want to spend a considerable amount of time with management and the auditors reviewing each balance sheet account to ensure that reserves have been established after giving appropriate recognition to these factors. I'd also want to know what other companies are doing in these same areas. As we know, when times get tough, there's a tendency to write off as much as possible given the uncertainty, which then allows for better reported results when things improve. As an audit committee member, I'd want to be sure that all these areas were addressed by all of us in considerable detail and that appropriate documentation is prepared to support the decisions that were made.

Related to that, I believe that all three parties – management, audit committee and auditor -- should be involved together in all these discussions given the significant, yet different, role that each plays in ensuring that the financial reporting system works effectively. I understand the focus of this Release is on communication from the auditor to the audit committee, consistent with the role of the PCAOB, but in my experience all three parties participate in these discussions. I note some specific areas later in this letter where I think some revisions can be made to ensure that this is the expectation of the Release.

Separate from the issues discussed in this Release, I would encourage the Board to consider how best to ensure that the audit committee is informed when their company's audit has been selected for audit by the PCAOB inspections team and how best to communicate the findings. I'm not sure exactly how this happens today but clearly this is key information for the audit committee in evaluating the work of the auditor and assessing the scope of future audits. Further to this point, I know it would be helpful for all audit committee members to be aware of the issues the inspections teams are finding during their audits of other companies. The Board may want to find a way to summarize their findings in a manner that would be beneficial to all audit committee members.

Lastly, I found the trail in Appendix 4 from the original release to this updated release very helpful in understanding the conclusions reached by the Board. Comments were clearly considered and changes made in some cases and original positions retained in others. I was a bit surprised by the limited comment letters received from audit committee members given the significance of this release to them.

Specific Comments

In reading through the final Release and the trail in Appendix 4, and considering the expectations regarding communication from the auditor that I would have as an audit committee member, I would offer the following comments:

Appointment and Retention

Like other commenters, it seems to me that the responsibilities of the audit committee should also be addressed in the engagement letter, along with the responsibilities of the auditor and the responsibilities of management. We all recognize the important role the audit committee plays in the audit and so it seems appropriate for the Board to take this opportunity to recommend engagement letter wording that describes that important role, despite the fact that it may be described elsewhere. As stated earlier, I think the Board should take every opportunity, in this Release and others, to stress the importance of active participation and communication between all three critical parties: management, audit committee and auditor.

Obtaining Information and Communicating the Audit Strategy

As an audit committee member, I would expect to engage in a discussion with the auditor regarding the timing of audit procedures and the degree of reliance that the auditor will be placing on the company's system of internal controls. By that I mean, I would expect to understand how much work will be done at an interim date and how much will be done after year-end and to what extent the year-end substantive testing will be reduced because of the reliance on the system of internal controls. This discussion would also include a discussion of the

work done at each quarter and how that work impacts the annual work. Included in this discussion would be agreement on the dates the auditors will be at the Company and the intended earnings release dates and SEC reporting dates. Maybe the fix for this would be to simply add some words about timing and internal control reliance in paragraph 9 or 10.

Results of the Audit

Accounting Policies, Practices and Estimates

I would recommend that this section be clarified to make it clear that the auditor is not the primary party responsible for communicating accounting policies, practices and estimates. I see this as the role of management and I would look to the auditor to provide the audit committee with their view of the appropriateness of management's selection and any concerns they may have regarding bias on the part of management in this area. As an audit committee member, I would want to review each of the policies and practices described as significant or critical with the auditor and determine whether the list is complete and whether the auditor has any issues or concerns in this area. I think the Note in paragraph 12c helps a bit by indicating that management is likely to make these communications but it still suggests that the responsibility is the auditor's. While I agree that all the items listed should be discussed by the auditor with the audit committee, maybe the fix here would be to simply change the wording a bit so that for each item it states that the auditor should review with, and provide its views on, management's selection, application, changes, etc regarding these key policies and practices, and that the expectation is that these discussions will occur with all three parties present.

As I mentioned earlier, I view this area as critical for substantive discussions among the auditor, management and the audit committee given the uncertain economic times and the impact that uncertainty has on management's ability to make reasonable judgments and estimates regarding future events that drive the recognition of reserves, accruals and impairment losses.

Auditor's Evaluation of the Quality of the Company's Financial Reporting

I think this section much more clearly defines the role of the auditor in the communications with the audit committee than does the previous section, discussed above. All of these items are those that I would expect the audit committee would discuss at length with the auditor.

In addition to matters on which the auditor consulted outside the engagement team, I think it's important for there to be a discussion between management, the auditor and the audit committee regarding any third parties engaged for the purpose of determining FMV of various holdings – those engaged by the company, and those engaged by the auditor, the respective conclusions, and how those conclusions impacted the company's financial results.

Not sure if it should be in this section or elsewhere but the issue of period-end revenue events of significance should be an area of discussion. Often, transactions are entered into at the end of a period on terms that might not be offered earlier in the period and there may be questions of whether the company has fully delivered on its commitments in order to support revenue recognition. I would suspect that the topic of end-of-period items of significance is addressed in every audit committee meeting in which a discussion of earnings results occurs and the Board may want to consider including some reference to this in the Release.

Significant Unusual Transactions

As an audit committee member, I would certainly expect the auditor to bring to the committee's attention any significant transactions they encountered during the audit that struck them as unusual. I expect that's being done now, but it seems clearly worth including in this Release.

Another thought, perhaps worthy of mention in the Release, whether in this section or another, is the issue of related party transactions. Clearly the audit committee should be made aware of all such transactions.

Uncorrected and Corrected Misstatements

I think the point about how any uncorrected differences might impact future periods is an important one so all parties understand that decisions made in the current period have implications down the road. It's also important for the audit committee to understand how the auditor assesses materiality – quantitatively and qualitatively, including the very important issue of whether the uncorrected differences would have caused the company to miss earnings estimates that support its current stock price.

I think also with respect to paragraph 19, the audit committee should be made aware of significant adjusting journal entries recorded at the end of the period to correct any system issues, to reconcile accounts, or to adjust reserves or accruals.

Form and Documentation of Communications

To the extent possible, I think matters discussed with the audit committee should be in writing. I would expect that the topics to be discussed at the audit committee meeting would be identified in a meeting outline with supporting memos for some items; other items on the agenda may simply be discussed with the committee.

Timing

Certainly all communications should occur before issuance of the auditor's report; most should occur before the release of earnings; and some should occur before the commencement of fieldwork.

Appendix C – Matters Included in the Audit Engagement Letter

As mentioned above, I would recommend including the audit committee's responsibilities, consistent with the description provided for the auditor and for management.

Once again, I appreciate the opportunity to provide comments on this Release. Please contact me if you have any questions or require any further explanation of my comments.

Sincerely,

Jack C Parsons

