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

Rulemaking Docket No. 34

Board Members:

I write to comment on your concept release on “Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements.” To put my comments in context, I spent 26 years in public accounting, ten years as an accounting standard setter, and have been an accounting faculty member for 14 years. Also, I am now or formerly have been chairman of the audit committee of five large, publicly-held companies. My comments are influenced by all those experiences, but particularly by the more recent ones as an audit committee chairman. However, these comments are personal and should not be attributed to any other entity.

As the concept release notes, the form and content of the auditor’s report has been the subject of much debate over the past 75 years or so. During my 50 year professional career, in each case where the issue was thoroughly and thoughtfully debated, the result has been modest, incremental improvement. One such case was the Cohen Commission hearings in the 1970’s in which I participated. I have followed this topic with interest since that time.

As noted early in the concept release, “The objective of this concept release is to discuss several alternatives for changing the auditor’s reporting model that could increase its transparency and relevance to financial statement users, while not

compromising audit quality.” However, on page 6 of the release the PCAOB states that it wishes, “To obtain insight into the changes that investors and others are seeking to the auditor’s report ...” As noted throughout the release, some investors continue to request all sorts of changes to the auditor’s report. However, it is my impression that a large majority of the “others” referred to by the PCAOB (e.g., corporate officers, auditors, audit committee members) are not seeking changes as they believe they would be counterproductive for the reasons cited in the release and otherwise. I trust that the PCAOB will take into consideration all of the various views on this important topic and I’m pleased to provide mine in this letter.

OVERVIEW

The auditor’s report provides assurance to those who read it that the accompanying financial statements have been fairly presented in accordance with generally accepted accounting principles. Those audited financial statements are most often included in annual reports to shareholders or Forms 10-K. The assurance provided to users of those reports is an important element in the efficient operation of our capital markets but it should be recognized that this is far from the only form of assurance that users receive. For example, they also rely on audit committees of the board of directors they elect and in most cases companies have internal audit functions that help provide assurance.

Further, the annual report is only one form of financial communication with shareholders and other users. Equally important are the quarterly reports on Form 10-Q that are of increasing length and detail. While auditors are required to review such quarterly information, their reports are seldom made public. So any assurance that shareholders receive from the auditors thereon is implicit rather than explicit.

Financial management of public companies (with oversight by the CEO) is responsible for the accuracy of financial reporting – hence the certifications required of the CFO and CEO on both annual and quarterly financial information. These people spend full time designing the systems, collecting the data, researching the difficult accounting judgments, etc. that are necessary to develop information that is summarized in quarterly and annual reports. As noted, internal auditors and audit committees can provide some level of assurance that these activities are functioning properly but their efforts (particularly the audit committee) are limited by the relatively small amount of time they spend as compared to the original activities.

The same is true to a large extent for the independent auditor. While he or she must design the audit to provide reasonable assurance that no material misstatements are present in the financial statements, because of cost/benefit considerations the amount of the auditor's work is a tiny fraction of the original finance work. I certainly don't intend to denigrate the purpose of the audit as I believe this independent assurance does add considerably to the integrity of our capital markets. But I also think it's important to keep in mind what's reasonable for management and auditors to bring to this process. When I speak to auditors about this matter, I analogize to the Motion Picture Academy Awards (Oscars) and describe their role as qualifying for the "Supporting Role" category while management is in the "Leading Role."

Another important point to keep in mind is that the financial statements subject to the auditor's procedures are historical in nature, providing information as of a point in time or for a period then ended. After the recent financial crisis some critics expressed concern that earlier financial statements and audit reports did not disclose to users that "things were going to get a lot worse in the near future," and that led them to argue for some of the changes suggested in the PCAOB concept release. However, neither GAAP financial statements nor GAAS auditor reports are intended to predict the future, with the possible exception of the "going concern" concept. Some companies do provide earnings guidance, "warnings" about forthcoming business difficulties, and certain other disclosures about future expectations – but those matters are outside of the financial statements and subject to significant caveats about their reliability.

I am also concerned that the concept release does not seem to take into consideration the realities of today's public markets wherein large, sophisticated institutional investors (who own a high percentage of U.S. public equity) already have reasonable access to companies in order to ask questions about the financial statements. On the other hand, the very small "mom and pop" type investors for the most part likely wouldn't know what to do with many of the types of greatly expanded information from auditors suggested in the concept release.

The above is by way of background to explain my concern that too many of the suggestions for changes in the auditor's report would fall into one or the other of the following categories:

New disclosures that should more appropriately be considered by the SEC or FASB as part of management's reporting and should not be separately reported by the auditor

New disclosures of audit procedures that would add bulk to the auditor's report but would be confusing and not helpful to most users

Thus, I strongly believe that suggestions for change that fall into the above categories should not be adopted by the PCAOB. In summary, my belief is that only the following changes would improve the current form and content of the auditor's report:

Incorporate the substance of AU 550 so as to inform investors and other readers of the report of the extent of the auditor's responsibility for the other information in 10-Ks, etc.

Add words to clarify that the auditor is required to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement whether caused by error or fraud.

While the many other suggestions to change the auditor's report are well intentioned, I do not support them in general and have provided reasons for the most important ones in the remainder of this letter. As an audit committee chairman, I'm particularly concerned that many of the suggestions could make the committee's oversight of the audit and communications with the external auditors more difficult without providing the promised benefits to ordinary investors.

It may be possible that certain of the "transparency" concerns of users raised in the concept release can be addressed by enhancement of Management's Discussion & Analysis or other non-financial statement sections of SEC filings. It is also possible that reports from Audit Committees, which are presently only included in proxy statements, could be included in Forms 10-K and their content could be improved. I would be pleased to provide further thoughts on these matters, particularly with respect to enhanced Audit Committee reports, when appropriate.

RESPECTING THE ROLES OF THE AUDITOR AND THE CLIENT

AU Section 508.09 currently states that, "The (auditor's) report may be addressed to the company whose financial statements are being audited or to its board of

directors or stockholders.” While I haven’t done research on this, my limited experience is that for large, public companies, the report is generally addressed to the board of directors and the stockholders. It’s interesting that the literature doesn’t require this at present and the PCAOB might consider doing so as part of this project.

However, my real point in mentioning the addressing of the report is to note that the board of directors acts as representatives of the shareholders through the audit committee and in general. Thus, it seems to me that some of the things that the PCAOB says that investors wish to have included in or attached to auditor’s reports more properly belong in the category of communications between independent auditors and audit committees. The most obvious example of this would be the required communications between the two groups, which sometimes run into dozens of pages as noted in the concept release. Based on my experience in dealing with these communications over the past ten years a written report made available annually or quarterly to all shareholders would not provide sufficient context for it to be generally useful to most investors. It would have to be completely re-programmed for purposes of reasonable external communication, thus undermining its principal purpose as an effective tool to facilitate auditor/audit committee dialogue.

Some of the other matters that the release suggests could be included in the auditor’s report are:

Risks identified by the auditor (including factors evaluated in determining which risks are significant)

Audit procedures responsive to the identified risks, why they were considered responsive, and what the results of the procedures were

Independence matters discussed with the audit committee

Critical accounting estimates communicated to the audit committee and assumptions underlying the estimates (and how the estimates are susceptible to change)

Critical accounting policies, including significant unusual transactions that were communicated to the audit committee (including ones that management doesn’t consider critical)

Permissible alternative accounting treatments and the treatment preferred by the auditor

Difficult or contentious issues, including “close calls”

Material matters where disclosures could be enhanced or different accounting could have been applied

Some of these are already required to be communicated to the audit committee, as noted, and all of the others could be as well if audit committees felt such information was useful and could be provided in a reasonable manner and at a reasonable cost. In fact, the PCAOB has just such a subject on its agenda and presumably will be considering in the next few months whether to move forward with its proposal to expand the list of items auditors are required to communicate to audit committees. I provided comments on that proposal in my letter dated April 23, 2010 and suggested the Board not broaden the required disclosures as much as it proposed.

But disclosing this information to shareholders and other users of financial statements is an entirely different matter. If information such as the above and certain other matters covered in the concept release is sufficiently useful to investors and other users of public company financial statements and can be provided at a reasonable cost, then appropriate standard setters (SEC, FASB) should consider requiring companies to make such disclosures. The disclosure system should not be “back doored” through a PCAOB process that requires auditors to provide information that the issuers did not provide and possibly don’t even agree with.

Also, some of the information requested by investors (e.g., with respect to critical accounting policies and estimates) is already provided by companies but apparently certain investors don’t trust what they now receive. According to the concept release, “Some investors indicated that one of the primary reasons that they are looking to the auditor for more information, rather than management or the audit committee, is that the auditor is an independent third party.” Or the investors believed they would receive “... more relevant insight into the financial statements, through the eyes of the auditor...” Again, asking auditors to do the initial reporting of certain information because investors don’t trust registrants seems to reverse the normal “company reports and auditor attests” relationship.

While the auditor is required to be independent and should adopt a skeptical mindset when evaluating management judgments and estimates, as noted earlier in this letter the auditor will often have less information available to him and will often spend less time in reaching an opinion on the issues in question. The time and resources needed to support the initial representations for financial statement matters are management's and, therefore, those representations logically should come from management not from the auditor.

I think it would be a dangerous precedent for the PCAOB to begin requiring auditors publicly to disclose company information that hasn't already been provided by the company. This is a fundamental change in the issuer/auditor relationship and surely raises legal issues about which party is actually accepting responsibility for all of the audited financial statement information in an SEC filing.

POTENTIAL ALTERNATIVES FOR CHANGES TO THE AUDITOR'S REPORT

Auditor's Discussion and Analysis

My first comment with respect to the notion of an AD&A is that I don't think people can truly appreciate this proposal without a fully developed illustration. The illustration on pages 15-18 is pretty meaningless in that it does not include realistic examples of what companies would actually have to report. For a reasonable size company, I could envision this illustration going on for 20 pages or more (for one of my current public company boards it takes about nine pages in our annual report to just list the critical accounting policies and estimates and that's without letting the auditors express their views on alternatives, etc.). I strongly urge the PCAOB to field test the notion of an AD&A by asking a few companies and their auditors to prepare illustrations that could then be shared with the public on a no names basis before the end of the official comment period. Otherwise, the comments you receive on this matter will not be fully informed.

I also have a general concern about the notion of "an adaptable report that he or she can tailor to a company's specific risks, facts, and circumstances." This would likely lead to an administrative nightmare in trying to wrap up the audit given that each report would be "custom made" and would likely have to be cleared with a firm's national office accounting and auditing technical experts and perhaps even legal staff. Also, assuming that the AD&A included matters that the company would otherwise report, such as the auditor's views on significant estimates, those

matters would require extensive discussion and negotiation with company finance and legal staff at a time when meeting SEC deadlines is quite challenging. Rather than spending time on procedures that really matter, audit partners would find themselves haggling over wording issues that could serve as an unnecessary distraction. This factor alone should persuade the PCAOB not to advance the notion of an AD&A as Board members should already know that too much partner time is involved in pinning down minor details of financial statement footnotes and other matters that take away from involvement in more important audit tasks.

I will not comment on each of the possible items that could be included in an AD&A. But, for example, with respect to critical accounting policies and estimates, this matter is properly covered in the current communications between auditors and audit committees. Investors should be able to assume that a company's disclosures adequately address these matters or else the auditor would have insisted on changes. See my later comments on improved reporting on non-financial sections of the SEC filings also.

The concept release suggests that investors would like the auditor to give his own reasons why accounting policies are considered critical, including those that management doesn't consider critical. The release goes on to say that investors would like the auditor to discuss situations where alternative treatments are available and say which approach the auditor preferred, including situations where the auditor believe alternative disclosures could have been applied. This would seem to require that each large firm develop a preferred alternative for every accounting policy and apply it uniformly for all of their clients or at least industry by industry. It would also mean that any particular company could easily have a large number of accounting policies for which alternatives are available, which would be confusing to say the least.

In general, requiring an AD&A is a bad idea.

It could require auditors to disclose information not already being disclosed by companies, which is contrary to the normal auditor/client relationship

The resulting reports would be very long, would probably lack comparability with other companies, and would likely not be in a format that easily improves communications with users

The process of arriving at the content of such a report would be highly inefficient and damaging to auditor/issuer relationships

The suggested contents are better left to communications between auditors and audit committees or possible future improvements in company disclosures

Required and Expanded Use of Emphasis Paragraphs

I believe that emphasis paragraphs can be useful in certain relatively limited circumstances and for one of my current boards (Fannie Mae) the auditors include an emphasis paragraph to describe the controlling relationship of the Federal government and the dependence of the entity on the government's continuing support. However, I do not support a requirement to require and expand the use of emphasis paragraphs in all audit reports.

In discussing this possible expansion of the auditor's report the concept release seems to suggest that it could help investors identify the most significant matters and where they are disclosed in the financial statements. If there is a need for such a "road map" to the financial statements (I'm not sure there is – perhaps this should be studied separately by the SEC or another group), it would be far better for the company to provide it, with appropriate review by the auditor.

Another suggestion for the emphasis paragraphs is for the auditor to explain the procedures performed with respect to relevant areas of the audit. As noted more generally earlier, this seems more appropriate as a communication between the auditor and the audit committee. Also, I think that most shareholders and other readers would be confused rather than informed by the addition of several paragraphs describing detailed audit procedures. They simply don't have the background to properly evaluate the appropriateness of particular audit procedures.

The use of added emphasis paragraphs to explain audit procedures for relevant areas of the audit sounds like the old "long-form audit report" that was still used to a limited extent when I entered the accounting profession half a century ago. Back then I believe it was an alternative to the short-form report and my memory as a young staff member is that our firm issued very few such reports. While I didn't try to research whether the current literature would permit auditors to issue a long-form report, it seems that the long-form report fell out of use for good reasons and there's no reason to bring it back.

Auditor Assurance on Other Information Outside the Financial Statements

I support limited auditor “assurance” on other information outside the financial statements. By that I mean that I believe the standard auditor’s report would be enhanced by incorporating the substance of AU 550 so as to inform investors and other readers of the report of the extent of the auditor’s responsibility for the other information in 10-Ks, etc. The auditor presently reports this to the audit committee and this is one matter that can be added to the external report that would aid communications with investors with little or no change in procedures.

Reading the non-financial statement information and considering whether it is materially consistent with the audited financial statements seems sufficient to me and an attest engagement on MD&A or all of the non-financial statement data in an SEC filing would usually not pass a reasonable cost-benefit test. As noted in the concept release, the literature has provided guidelines for attestations of MD&A for many years yet it’s my understanding that there have been very few, if any, of these engagements. So companies don’t see the usefulness and investors haven’t made a sufficient case to compel companies to incur the cost.

I feel the same way about earnings releases. An auditor generally indicates the progress in performing the year-end audit or quarterly review at the time of the release and, accordingly, provides limited verbal assurance on the press release information, subject to completion of the work in process. An attest engagement would almost surely slow down the release of that information to the market. While it is at a minimum quite embarrassing to have to revise a preliminary earnings release, on balance the current system seems to be working adequately and I see no reason to change it. Those who are overly concerned about the reliability of information that might be released too soon can simply take more time to complete the regular audit or review process before announcing to the public.

Clarification of the Standard Auditor’s Report

Reasonable assurance – Expanding the report to say that “reasonable assurance means a high level of assurance, but not absolute assurance” seems like just adding words to say the same thing.

Auditor’s responsibility for fraud – I do agree that modest wording changes to the standard auditor’s report should be made to clarify this responsibility. This can be done by simply modifying the language in the second paragraph of the standard report that now states, “Those standards require that we plan and perform the audit

to obtain reasonable assurance about whether the financial statements are free of material misstatement” by adding the words “whether caused by error or fraud.”

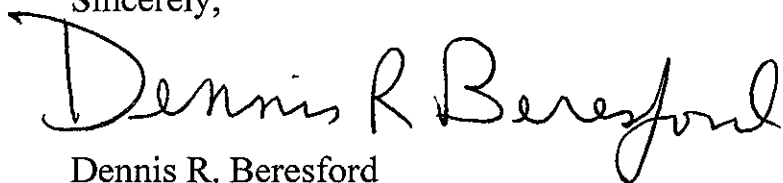
Auditor’s responsibility for financial statement disclosures – I am fairly ambivalent about this matter. The disclosures certainly are part of the “package” that is being examined by the auditors. However, when the audit report describes what the various financial statements fairly present (financial position, results of operations, cash flows) it’s hard to see how the footnotes represent a different category – aren’t they just integral to the rest of the financial statements? On balance, this seems like one of those “leave well enough alone” type of matters although it wouldn’t really bother me either way.

Auditor’s responsibility for information outside the financial statements – See my comments above about providing auditor negative assurance on non-financial statement data in 10-Ks, etc.

Auditor independence – As noted in the concept release, the title of the report includes the auditor’s implicit representation of independence. Further, auditors are required to communicate about this matter with audit committees on a regular basis. This is sufficient.

Thank you for the opportunity to comment on this important topic. I would be pleased to provide further comments if you have any questions about my letter.

Sincerely,

A handwritten signature in black ink that reads "Dennis R. Beresford". The signature is written in a cursive, flowing style with a large initial 'D'.

Dennis R. Beresford
Ernst & Young Executive Professor of Accounting