

September 29, 2011

Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington D.C. 2006-2803

RE: Response to the Public Company Accounting Oversight Board (PCAOB) – Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards (Ref Docket matter No. 34)

Members of the Board,

I appreciate the opportunity to submit comments to the Board with respect to the concept release addressing potential revisions to the external auditor's report on financial statements. To put my comments in context, I worked for ten years as an external auditor, 16 years as an internal auditor, and four years in other roles within a large publicly-held company. I have also had the privilege of being involved in a variety of standard setting and governance activities related to accounting and auditing over my career. These experiences have led me to have some clear views on the subject of this concept release. However, the comments in this letter are mine personally and should not be attributed to any organization or entity.

I believe the most of the potential changes outlined in the concept release are misguided and will not accomplish the intended result. They will create more of an expectations gap, create more confusion, and increase cost with little benefit. Below are my overall comments followed in an attachment with specific answers to some of the questions asked in the concept release.

1. The financial statements are management's communication to investors and other stakeholders. If there are gaps in the information being presented, management should be the source to fill those gaps. If more information is needed regarding treatment of judgmental accounting issues, significant risks, how changes in the economy will impact future financial performance, etc., the SEC should modify its financial statement requirements. The PCAOB should not use a "back door" mechanism of requirements on the external auditor to provide this information to the public.
2. The boards of directors and their audit committees are charged with representing the interest of the investor in financial reporting matters. Many of the potential changes in the concept release go around the audit committee and replace communication between the external auditors and the audit committee with communication between the external auditor and investors directly. If there has been a failure of audit committees to adequately represent investors, correct this deficiency. The PCAOB should not fundamentally change the nature of corporate governance structures.
3. Most of the potential changes in the concept release involve topics that are currently discussed between the audit committee and the external auditor. These communications are fundamentally different than what is possible through a published written report. Discussions in a meeting involve context of prior discussions, ability for dialogue over unclear points, knowledge of the competency of the persons in the discussion, and an ability for each party to ensure they are meeting the desired information needs of the other party. None of these are available in a written report. The somewhat subjective

nature of many of these communications needs the context of a setting like an audit committee meeting to be successful. Attempting to substitute this rich venue of discussion with a written report will only leave questions unanswered, requests unmet, and confusion for the readers.

4. If the intent of the potential changes outlined in the concept release is to provide the reader with an ability to judge the sufficiency of the audit work performed, this will be unsuccessful. An audit is a complex effort requiring deep understanding of the company, its financial reporting risks, and nature of available audit evidence. If quality of audit work is a concern, the response should improvements in audit standards and inspections performed by the PCAOB.
5. The potential changes outlined in the concept release have external auditors providing previously unreleased information about a company to the public. This puts the external auditor in the role of a principle information source to the public. In this role the external auditor loses as aspect of their independence from the company.
6. Much of the information that is suggested should be included in the external auditor's report is already addressed, at least in part, by management reports. The requests for the external auditor to opine on this information looks to be an attempt by investors to shift to the external auditors the hard work of understanding a business' financial statements. Investors should be expected to read financial statements, do the hard work to analyze them, and participate in the many avenues available to obtain additional information from the company instead of trying to shift this task on the external auditor.
7. An AD&A will be long and be interpreted as providing separate opinions on the elements addressed in the AD&A. While this may not be the intention of the concept release, I believe this will be the inevitable result. This will necessarily increase the legal risk assumed by the external auditor which will further increase their efforts and the length of the AD&A. In the end, costs will be very high to produce the AD&A.
8. The PCAOB should focus its efforts on establishing robust audit standards and enforcing compliance with them, rather than trying to force the eternal auditor into a role that is extremely unlikely to succeed in accomplishing what is expected.

Sincerely,



Douglas J. Anderson, CPA, CIA

## Attachment - Responses to Specific Questions

- 1. Many have suggested that the auditor's report, and in some cases, the auditor's role, should be expanded so that it is more relevant and useful to investors and other users of financial statements.**

- a. Should the board undertake a standard-setting initiative to consider improvements to the auditor's reporting model? Why or why not?**

No. None of the potential changes outlined in the concept release merit a major undertaking to revamp the auditor's reporting model. Minor adjustments can be made if necessary without a major project.

- b. In what ways, if any, could the standard auditor's report or other auditor reporting be improved to provide more relevant and useful information to investors and other users of financial statements?**

Additional guidance could be provided as to the appropriate circumstances for explanatory paragraphs in an auditor's report for highly unusual or material items.

- c. Should the board consider expanding the auditor's role to provide assurance on matters in addition to the financial statements? If so, in what other areas of financial reporting should auditors provide assurance? If not, why not?**

No. The external auditor's focus, training, competencies, and role relates to financial statements. Expanding to other matters pushes the external auditor into roles best addressed by management or others with the appropriate competencies.

- 2. The standard auditor's report on the financial statements contains an opinion about whether the financial statements present fairly, in all material respects, the financial condition, results of operations, and cash flows in conformity with the applicable financial reporting framework. This type of approach to the opinion is sometimes referred to as a "pass/fail model."**

- a. Should the auditor's report retain the pass/fail model? If so, why?**

Yes. This model removes the potential confusion over the final view of the external auditor. If a change was made to a purely subjective discussion, it could become very unclear what the external auditor believed.

- b. If not, why not, and what changes are needed?**

N/A

- c. If the pass/fail model were retained, are there changes to the report or supplemental reporting that would be beneficial? If so, describe such changes or supplemental reporting.**

Additional guidance on the use of explanatory paragraphs in the auditor's report to highlight material or unusual items included in the financial statements could be beneficial.

- 3. Some preparers and audit committee members have indicated that additional information about the company's financial statements should be provided by them, not the auditor. Who is most appropriate (e.g., management, the audit committee, or the auditor) to provide additional information regarding the company's financial statements to financial statement users? Provide an explanation as to why.**

Management has the responsibility to provide sufficient information to financial statement users to understand the financial position and performance of the company. If additional information is required by users, the SEC should amend their requirements for the content of financial statements as prepared by management.

- 4. Some changes to the standard auditor's report could result in the need for amendments to the report on internal control over financial reporting, as required by Auditing Standard No. 5. If amendments were made to the auditor's report on internal control over financial reporting, what should they be, and why are they necessary?**

No response

- 5. Should the board consider an AD&A as an alternative for providing additional information in the auditor's report?**

No. Management should be the primary provider of information about the financial position and performance of a company. The description of the AD&A leads to having the external auditor take a larger than appropriate role in providing original information to the reader. If information is needed about accounting positions and performance of the company, management should be required to provide that. If the concern is inadequate audit quality, this is best addressed through high quality audit standards and the PCAOB inspection process, not a written report from the external auditors.

- a. If you support an AD&A as an alternative, provide an explanation as to why.**

Do not support an AD&A

- b. Do you think an AD&A should comment on the audit, the company's financial statements or both? Provide an explanation as to why. Should the AD&A comment about any other information?**

Do not support an AD&A

- c. Which types of information in an AD&A would be most relevant and useful in making investment decisions? How would such information be used?**

Do not support an AD&A

- d. If you do not support an AD&A as an alternative, explain why.**

Answered above

- e. Are there alternatives other than an AD&A where the auditor could comment on the audit, the company's financial statements, or both? What are they?**

Answered above

- 6. What types of information should an AD&A include about the audit? What is the appropriate content and level of detail regarding these matters presented in an AD&A (i.e., audit risk, audit procedures and results, and auditor independence)?**

Do not support an AD&A

- 7. What types of information should an AD&A include about the auditor's views on the company's financial statements based on the audit? What is the appropriate content and level of detail regarding these matters presented in an AD&A (i.e., management's judgments and estimates, accounting policies and practices, and difficult or contentious issues, including "close calls")?**

Do not support an AD&A

- 8. Should a standard format be required for an AD&A? Why or why not?**

Do not support an AD&A

- 9. Some investors suggested that, in addition to audit risk, an AD&A should include a discussion of other risks, such as business risks, strategic risks, or operational risks. Discussion of risks other than audit risk would require an expansion of the auditor's current responsibilities. What are the potential benefits and shortcomings of including such risks in an AD&A?**

Do not support an AD&A, however, if one is included, it should focus only on areas of competency of the external auditors. Such competencies are in the realm of financial reporting, not generalized business and strategic risks. If investors desire an insurance policy against any and all potential negative consequences from their investment, they should look to an insurance company, not the external auditor.

**10. How can boilerplate language be avoided in an AD&A while providing consistency among such reports?**

In the current litigation environment of the United States, one of two outcomes is highly likely. Either the AD&A would be boilerplate, or an extensive rambling of information, some useful and much not useful.

**11. What are the potential benefits and shortcomings of implementing an AD&A?**

The shortcomings are numerous: (1) requiring external auditors to supplant management as the source of original information about a company's financial performance and position, (2) providing information in a method that ensures it would not be fully understood as the reader would not have context for the information in the report nor the ability to dialogue with the external auditor, (3) increasing costs of the audit significantly.

No benefits identified.

**12. What are your views regarding the potential for an AD&A to present inconsistent or competing information between the auditor and management? What effect will this have on management's financial statement presentation?**

Over time the AD&A would likely result in management saying less and the external auditor saying more. Inconsistencies would likely not be tolerated so the solution will be for management to stop providing information that is required to be provided by the external auditor.

**13. Would the types of matters described in the illustrative emphasis paragraphs be relevant and useful in making investment decisions? If so, how would they be used?**

None identified

**14. Should the board consider a requirement to include areas of emphasis in each audit report, together with related key audit procedures?**

**a. If you support required and expanded emphasis paragraphs as an alternative, provide an explanation as to why.**

Areas of emphasis paragraphs should be included in an external auditor's report when they add useful information for the reader. Requiring them for all audits, even when they provide no meaningful information, is inappropriate.

**b. If you do not support required and expanded emphasis paragraphs as an alternative, provide an explanation as to why.**

Additional audit guidance could be prepared outlining those situations where areas of emphasis paragraphs are useful and encourage their use in more situations than is current practice.

- 15. What specific information should required and expanded emphasis paragraphs include regarding the audit or the company's financial statements? What other matters should be required to be included in emphasis paragraphs?**

Requirement not supported

- 16. What is the appropriate content and level of detail regarding the matters presented in required emphasis paragraphs?**

Requirement not supported

- 17. How can boilerplate language be avoided in required emphasis paragraphs while providing consistency among such audit reports?**

Requirement not supported

- 18. What are the potential benefits and shortcomings of implementing required and expanded emphasis paragraphs?**

Discussed above

- 19. Should the board consider auditor assurance on other information outside the financial statements as an alternative for enhancing the auditor's reporting model?**

- a. If you support auditor assurance on other information outside the financial statements as an alternative, provide an explanation as to why. Subject to the caveat and suggestion above, assurance over other important components of information provided by management is a form of assurance commonly provided by the internal audit activity and a reasonable extension of financial statement auditors, to the extent it is cost justified and can be related to the financial statements and information considered in connection with the audit of the financial statements.**
- b. On what information should the auditor provide assurance (e.g., MD&A, earnings releases, non-GAAP information, or other matters)? Provide an explanation as to why.**

While question (a) above asserts expanding the external auditor's work over other information is a "reasonable extension", I disagree. The MD&A, earnings releases, press releases, non-GAAP information and others all involve subject matter that is either management judgment of future events or involves matters outside of the field of financial reporting. The external auditors do not currently

have the competency to adequately address these matters by providing assurance. Extension of their mandate into these areas would require extensive costs with no demonstrated benefit.

- c. What level of assurance would be most appropriate for the auditor to provide on information outside the financial statements?**

Proposal not supported

- d. If the auditor were to provide assurance on a portion or portions of the MD&A, what portion or portions would be most appropriate and why?**

Proposal not supported

- e. Would auditor reporting on a portion or portions of the MD&A affect the nature of MD&A disclosures? If so, how?**

If the auditor needed to provide assurance on the MD&A, management would limit their disclosures to historical, factual information.

- f. Are the requirements in the board's attestation standard, AT sec. 701, sufficient to provide the appropriate level of auditor assurance on other information outside the financial statements? If not, what other requirements should be considered? The cost of AT 701 form of assurance may exceed the benefits. We suggest a compromise position. As exists today, the auditor are required to read such disclosures, including MD&A, we suggest the auditor include a paragraph in the auditor's report that the auditor has read [add specific areas] and found such information and disclosures to be materially consistent with information the auditor learned as part of the audit of the financial statements. That is, have the auditor's report disclose what is essentially in effect today.**

Disclosing what the external auditor is doing today to comply with audit standards is acceptable. However, this assumes investors are unaware of this requirement and are not able to read the audit standards.

- g. If you do not support auditor assurance on other information outside the financial statements, provide an explanation as to why.**

Discussed above

- 20. What are the potential benefits and shortcomings of implementing auditor assurance on other information outside the financial statements?**

Discussed above



**21. The concept release presents suggestions on how to clarify the auditor's report in the following areas:**

- Reasonable assurance
- Auditor's responsibility for fraud
- Auditor's responsibility for financial statement disclosures
- Management's responsibility for the preparation of the financial statements
- Auditor's responsibility for information outside the financial statements
- Auditor independence

**a. Do you believe some or all of these clarifications are appropriate? If so, explain which of these clarifications is appropriate? How should the auditor's report be clarified?**

There is no harm in expanding the auditor's report for these items. However, none are changing the requirements on the external auditor, merely stating the current standard. It is unclear that investors do not understand these long-established audit standards and cannot learn about them with limited amount of effort.

**b. Would these potential clarifications serve to enhance the auditor's report and help readers understand the auditor's report and the auditor's responsibilities? Provide an explanation as to why or why not.**

See answer above

**c. What other clarifications or improvements to the auditor's reporting model can be made to better communicate the nature of an audit and the auditor's responsibilities?**

See answer above

**d. What are the implications to the scope of the audit, or the auditor's responsibilities, resulting from the foregoing clarifications?**

See answer above

**22. What are the potential benefits and shortcomings of providing clarifications of the language in the standard auditor's report?**

The benefits are speculative and assume investors currently do not know this information and cannot read the audit standards. The shortcomings, however, are nil.

**23. This concept release presents several alternatives intended to improve auditor communication to the users of financial statements through the auditor's reporting model. Which alternative is most appropriate and why?**

The best alternative is for the PCAOB to focus its efforts on producing high quality auditing standards and enforcing those standards.

- 24. Would a combination of the alternatives, or certain elements of the alternatives, be more effective in improving auditor communication than any one of the alternatives alone? What are those combinations of alternatives or elements?**

See answer for Q23 above

- 25. What alternatives not mentioned in this concept release should the board consider?**

See answer for Q23 above

- 26. Each of the alternatives presented might require the development of an auditor reporting framework and criteria. What recommendations should the board consider in developing such auditor reporting framework and related criteria for each of the alternatives?**

There would need to be a substantial level of effort to develop the framework and criteria. The PCAOB should not underestimate the extent of this effort or try to complete too quickly. Explicit consideration of costs and benefits of any specific proposals must be considered.

- 27. Would financial statement users perceive any of these alternatives as providing a qualified or piecemeal opinion? If so, what steps could the board take to mitigate the risk of this perception?**

No response

- 28. Do any of the alternatives better convey to the users of the financial statements the auditor's role in the performance of an audit? Why or why not? Are there other recommendations that could better convey this role?**

The external auditor's current role is already well defined in the audit standards.

- 29. What effect would the various alternatives have on audit quality? What is the basis for your view?**

Audit quality would likely diminish if the external auditor were to provide assurance on other financial material outside of the financial statements. This is because of the current lack of competency of the external auditors with this material. If the external auditor were to produce an AD&D, it is hard to conclude on the effect on audit quality. However, I suspect most external auditors would devote substantial resources to this effort that would likely result in acceptable audit quality, but extremely high cost.

- 30. Should changes to the auditor's reporting model considered by the board apply equally to all audit reports filed with the SEC, including those filed in connection with the financial statements of public companies, investment companies, investment advisers, brokers and dealers, and others? What would be the effects of applying the alternatives discussed in the concept release to the audit reports for such entities? If audit reports related to certain entities should be excluded from one or more of the alternatives, please explain the basis for such an exclusion.**

I am generally not in support of the potential changes proposed in the concept release. I don't believe my position would be different for different types of filers.

- 31. This concept release describes certain considerations related to changing the auditor's report, such as effects on audit effort, effects on the auditor's relationships, effects on audit committee governance, liability considerations, and confidentiality.**

- a. Are any of these considerations more important than others? If so, which ones and why?**

The most important impact is requiring the external auditors to take away from management primary responsibility for reporting certain aspects of financial information.

- b. If changes to the auditor's reporting model increased cost, do you believe the benefits of such changes justify the potential cost? Why or why not?**

The costs will increase significantly for marginal benefits. Before these initiatives move forward a much more robust cost benefit analysis would be required.

- c. Are there any other considerations related to changing the auditor's report that this concept release has not addressed? If so, what are these considerations?**

No

- d. What requirements and other measures could the PCAOB or others put into place to address the potential effects of these considerations?**

As most of the potential changes are not supported, no measures by the PCAOB would be necessary.

- 32. The concept release discusses the potential effects that providing additional information in the auditor's report could have on relationships among the auditor, management, and the audit committee. If the auditor were to include in**

**the auditor's report information regarding the company's financial statements, what potential effects could that have on the interaction among the auditor, management, and the audit committee?**

The nature of relationships between management, Audit Committee and the external auditors has certain inherent friction points. This is good and by design. However, the potential changes to the auditor's reporting model outlines in the concept release would substantially increase the pressure on these relationships, especially those between the external auditors and management. This increased pressure would substantially increase cost, potentially delay the reporting processes, and reduce the openness management may have with the external auditors. None of this improves the quality of financial reporting.