

September 30, 2011

Public Company Accounting Oversight Board
Office of the Secretary
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 034, *Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards*

Deloitte & Touche LLP appreciates the opportunity to respond to the request for comments from the Public Company Accounting Oversight Board (the “PCAOB” or the “Board”) on its *Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards* (the “Concept Release”) (PCAOB Release No. 2011-003 June 21, 2011, PCAOB Rulemaking Docket Matter No. 034). Our comments on the Concept Release address the following areas:

- I. Overall Comments*
- II. Recommendations for Changes to the Auditor’s Report*
- III. Concerns with an Auditor Discussion and Analysis*
- IV. Other Considerations*

I. OVERALL COMMENTS

We commend the PCAOB for undertaking to solicit views regarding potential changes to the auditor’s report in connection with the audit of financial statements. We particularly commend the PCAOB and Chief Auditor Martin Baumann and his staff for the unprecedented outreach that preceded the publication of the Concept Release. It is inevitable that, as the information needs of users of financial statements and the amount of information available to such users evolve, reporting (by auditors, management and the audit committee) would also evolve to meet those needs.

A Holistic Approach to Changes in Financial Reporting:

While we support the PCAOB’s project to consider revisions to the auditor’s report, we also strongly believe a holistic approach to improving financial reporting is necessary and warranted. The audit is only one piece of the financial reporting process. Reporting obligations on the part of the auditor should not be considered in isolation; changes to financial-related reporting and disclosures by management, the audit committee and auditors should all be considered together in order to achieve the best outcome for users. This holistic approach, and related coordination among regulators, will allow a more complete review of the allocation of responsibility among those who participate in the

financial reporting process. We understand, however, that all of these changes would not be within the mandate of the PCAOB, and we encourage communication with accounting standard setters and the Securities and Exchange Commission (“SEC”) in such an effort to improve the quality of financial reporting.

Objectives of Potential Changes to the Auditor’s Report:

We encourage and support an evolution in auditor reporting that results in responsible changes that improve the relevance and information value of what auditors produce and helps to achieve high quality financial reporting. As part of the process of developing such changes, it is important to clearly link any proposed changes with the objectives of the project. We believe the objectives are to (1) meet the needs of users and (2) enhance audit quality. As the PCAOB weighs the merits of any proposed changes, we request that the Board assess the extent to which each option can help achieve these objectives.

Principles for Changes:

We believe there are fundamental principles that the PCAOB should keep in mind when considering changes to the auditor’s report, as follows:

1. Any proposal that would increase the information gap or expectation gap or detract in any way from audit quality should not be considered.
2. The respective roles and responsibilities of the auditor, management and the audit committee should remain unchanged. Auditors should not be the original source of disclosure about an entity; the responsibilities of management and the audit committee should be preserved in this regard.
3. Any changes to the auditor’s report should avoid user confusion. Specifically, any revisions should not require users to sort through different or duplicative information provided by the auditor, management and the audit committee. This would not improve financial reporting.
4. Auditor reporting should focus on the objective rather than the subjective.
5. Changes should be market driven, add value, and be made with appropriate consideration of costs and benefits.

II. RECOMMENDATIONS FOR CHANGES TO THE AUDITOR’S REPORT

We have participated in many open discussions regarding potential changes to the auditor’s report, including those at PCAOB Standing Advisory Group meetings, the PCAOB’s roundtable, as well as dialogues undertaken by the profession through the Center for Audit Quality (“CAQ”). We have also observed other open PCAOB meetings on this topic, including the PCAOB’s Investor Advisory Group (“IAG”) meetings and public Board meetings. Throughout these discussions the common themes have been the following:

- More information about and a better understanding of management’s estimates and judgments and areas involving significant measurement uncertainty would be useful;

- There is a lack of understanding regarding what an audit is and how it is performed; and
- There is a lack of awareness of the audit committee's responsibilities.

We support effective and responsible changes to the auditor's reporting model that address these common themes and will be most helpful to users, while at the same time meeting the principles identified in the "Overall Comments" section above. The approaches which we believe might be most effective are:

- 1) Including an additional paragraph in the auditor's report that references those footnotes in the financial statements which the auditor has determined are the most important to a user's understanding of the financial statements. In most cases, these will include the footnotes in which the entity identifies and discusses significant management estimates and judgments, as well as areas of significant measurement uncertainty;
- 2) Requiring the auditor to provide assurance on the portion of Management's Discussion and Analysis ("MD&A") related to critical accounting estimates;
- 3) Providing more information in the auditor's report, in a form prescribed for all audits, about what an audit is and the responsibilities of the auditor, management and the audit committee. This could be achieved by clarifying certain terms and adding some specific information regarding responsibilities.

These approaches, which are further discussed below, are designed to meet the needs of users, without imposing the unintended consequences and significant costs of other options, including requiring an Auditor's Discussion & Analysis ("AD&A") also discussed further below.

Additional Paragraph Referencing the Footnotes:

We support including an additional paragraph to the auditor's report which would reference those footnotes to the financial statements which the auditor has determined are most important to a user's understanding of the financial statements. As noted above, in most cases, these will include the footnotes in which the entity has identified and discussed its significant management judgments and estimates, and areas with significant measurement uncertainty. The objective of the paragraph would be to highlight matters that are in the financial statements. It would not describe audit procedures performed (refer to discussion in section III below) related to those financial statement disclosures.

We believe that this alternative would not blur the line of responsibility between the auditor and management (management is still the provider of information); however, it will often focus users on more important aspects of the entity's financial statements. We also believe that an increase in focus on these footnotes will improve management's disclosures in these areas.

We recognize that the PCAOB currently has standards with respect to emphasis of a matter paragraphs; however, a new standard would need to be promulgated by the PCAOB with an appropriate framework and guidance in order to make the above recommendation regarding an additional paragraph operational. In addition, we believe that the wording of the additional paragraph should be prescribed by the PCAOB (through the new audit standard), in part, to provide consistency

in disclosure from audit to audit, and so that a user does not incorrectly assume that the auditor has provided additional assurance on the referenced footnotes.

Assurance on MD&A Related to Critical Accounting Estimates:

For several reasons, we support the auditor providing assurance on the portion of MD&A in which management discusses the entity's critical accounting estimates. Such an alternative is consistent with the principles outlined in the "Overall Comments" section above, including the fact that providing assurance on this portion of MD&A would not blur the line between auditor and management responsibility. Also, it may have the effect of enhancing management's disclosures in this area as auditors engage in increased dialogue with management on the content of the disclosures.

Additional benefits of auditors providing such assurance include:

- It would be responsive to what has been heard from investors regarding further information on management's significant estimates;
- It would avoid many of the unintended consequences associated with AD&A; and
- Although, to some extent, this will increase the costs and burdens associated with the audit process, it will focus on a particularly important aspect of MD&A from a financial reporting perspective, and avoid the undue cost and burden of auditing MD&A in its entirety.

In order for the auditor to provide assurance on the critical accounting estimates that are disclosed in MD&A, the SEC will need to first develop applicable disclosure and reporting rules, and the PCAOB will need to develop an auditing standard on how the auditor would provide such assurance.

Additional Information on What Is an Audit:

On a broad level, we support clarifying what an audit is and how it is performed. This can be achieved through supplementing the current form of the auditor's report and can be implemented in a cost-effective and practical manner. Specifically, similar to the CAQ¹, we support the following detailed recommendations for clarifying what an audit is and how it is performed:

1. Provide additional standard information on what an audit is, including an explanation of technical terms such as reasonable assurance, materiality and material misstatement. This standardized wording should include an explicit statement that the footnotes are an integral part of the financial statements that are covered by the audit report.
2. Clarify the auditor's responsibility. This could be achieved by adding descriptions of the auditor's responsibility with respect to:
 - a. *Other information in documents containing audited financial statements.* We believe that some users of financial statements place undue reliance on other information in documents containing the audited financial statements because they are of the belief that, because such information is included with the financial statements, it has been audited.

¹ CAQ letter to the PCAOB, June 28, 2011.

- b. *Being independent under all relevant standards.* In addition to the title that the auditor's report is performed by an independent audit firm, we believe the report could include a specific statement that the auditor is independent under all relevant independence standards.
 - c. *Using professional judgment in making risk assessments and selecting audit procedures.* We believe it is important to clarify the role of professional judgment within an audit, to inform users that procedures selected and performed go beyond simple adherence to a checklist, and may vary from audit to audit.
 - d. *Planning and performing the audit to obtain reasonable assurance about whether the financial statements taken as a whole are free of material misstatement "whether due to error or fraud."*
 - e. *Situations in which a conclusion is reached that the financial statements are not in accordance with GAAP or in situations where the audit scope has been limited.*
3. Provide expanded discussion on the responsibilities of management and the audit committee for financial statements and the Form 10-K.²
 4. Where applicable, describe the accounting firm network structure, the responsibility of the member firm signing the audit report, and the level of participation by other member firms in the audits.

The forgoing changes could be implemented by including additional standardized language, prescribed by the PCAOB, either:

- As an appendix to the report;
- Within the audit report itself; or
- Through a link in the audit report to a document provided by a third party (e.g., the PCAOB; the CAQ).

The PCAOB prescribed language would be used by all auditors for all reports for audits of public companies.

III. CONCERNS WITH AN AUDITOR DISCUSSION AND ANALYSIS

Introduction:

We believe there are several significant obstacles to an AD&A that would result in problematic, unintended consequences. First, it would result in auditors disclosing original information about the entity, causing a departure from the foundational concept that the auditor should give assurance on information provided by management. Such a change will likely result in unnecessary challenges with

² The SEC may also consider revising its rules concerning the form and content of an audit committee report and requiring the audit committee report to be included with the 10-K, rather than in the proxy statement. Depending on the form and content of the audit committee report, the SEC and the PCAOB might consider requiring the auditor to provide assurance on the accuracy and completeness of that report.

respect to aspects of the audit such as confidentiality, independence and auditor-management-audit committee communications, ultimately imposing significant burdens on the auditor and the entity. Additionally, it would be extremely difficult for the PCAOB to establish standards that would provide for the requisite consistency, and thus comparability, in AD&A from audit report to audit report. There is a significant risk that the AD&A would result in inconsistent or competing information coming from the auditor and management, resulting in unnecessary additional disclosure in Form 10-Ks, and likely causing user confusion. These issues are discussed further below.

AD&A is Inconsistent with Our Basic Precepts for Any Change:

The idea of an AD&A as set forth in the Concept Release is contrary to the principles outlined in the “Overall Comments” section above in several important respects:

- Auditor becomes the original source of information. The auditor, through the AD&A, would become a source of original disclosure about the entity and its financial reporting, thereby blurring the role of the auditor and management. The role of the auditor is to provide assurance, not information about the entity. It is the role of management to provide that information. The AD&A proposal in the Concept Release does not recognize the extent to which the AD&A proposal would involve the auditor becoming an original source of entity information and the impact such a change would have on the roles of the auditor, management, and the audit committee.

If the auditor becomes a provider of original information, the following issues would have to be addressed:

- *Uncertainties regarding the responsibilities of the auditor and management.* Where would the line be drawn between the responsibility of auditor and management for financial information about the entity, if entity information is initially disclosed by the auditor? There would likely be significant confusion on the part of readers of the financial statements who may believe the auditor is responsible for the financial statements -- and not management or the audit committee. Currently there is a clear distinction between the reporting and disclosure responsibilities of the auditor and of management, respectively.
- *Impact on the responsibilities of the audit committee.* How would AD&A impact the role and responsibilities of the audit committee? Would the audit committee believe they are less responsible for financial reporting?
- *Coordination and consistency with other regulatory requirements.* How would auditor requirements under PCAOB standards be reconciled with requirements for disclosure by issuers -- now governed by the SEC and the Financial Accounting Standards Board?
- *Potential auditor independence issues.* SEC rules state that the auditor is not independent if the auditor acts as an employee of an audit client or performs any decision making, supervisory, or ongoing monitoring function for the audit client. Further, PCAOB independence rules preclude the auditor from preparing source documents or reporting on behalf of management. Writing an AD&A, determining which matters to include in the AD&A, and obtaining sufficient information about the

matters to be included arguably puts the auditor in the position of performing impermissible management functions, including preparing source documents, decision making, monitoring, or reporting on behalf of management.

- *Confidentiality issues.* Will confidentiality issues arise if the auditor is disclosing entity information not disclosed by management?
- Reduction in audit quality. Requiring AD&A has the potential of reducing audit quality. Auditor disclosure of original information about the entity could erode the robustness of discussions between the auditor and management and/or the audit committee and disrupt what should be a free flow of information among them. For example, management and the audit committee may be reluctant to candidly share with the auditor information with respect to the entity because of a concern that what is shared will be considered for inclusion in the AD&A. A level of distrust may develop as management and the audit committee are concerned about what the auditor is going to discuss in the AD&A.

Additionally, establishing and maintaining a system of quality control to ensure a reasonable level of consistency in AD&A across firms and the profession would be a challenge. Consistency in content and presentation is important so that reports are comparable for users. Efforts to ensure consistency in the AD&A within a particular firm which would likely include the need for national office review of all AD&As, and would tax audit firm national office/quality control resources at the time they would be focusing on audit quality and reporting matters.

Also, AD&A might detract auditors from effective completion of the audit. The ability of the auditor to prepare a tailored narrative and complete the necessary reviews within current SEC filing deadlines will be challenging. Once the auditor has completed the AD&A, management will want to review it for accuracy and completeness and will reconcile the AD&A to financial statements, MD&A and other entity disclosures. This will take significant time during a period that is already compressed. Creating this additional burden on management and the auditor will create added pressures and could keep auditors from focusing on other audit procedures.

Further, a public discussion in AD&A regarding the audit procedures performed with respect to areas of significant risk has the potential to lessen the value and effectiveness of the audit procedures performed. Such discussion of particular audit procedures may better equip management to anticipate the procedures that will be performed going forward, potentially reducing audit effectiveness and quality to the detriment of users. (See further discussion below regarding disclosing audit procedures.)

- Creation of user confusion. Requiring an AD&A could easily create user confusion due to competing, duplicative, potentially inconsistent, and lengthy information contributed by both management and the auditor. Discussing matters in AD&A such as (1) difficult or contentious issues, (2) close calls, and (3) matters that are in technical compliance with the applicable financial reporting framework but could be enhanced through additional disclosure, would undermine the auditor's opinion reached on the financial statements as a whole. Further, the ability to appropriately distill, into a few sentences, the hundreds of hours spent auditing a complex area will be difficult, and cannot conceivably convey the audit effort, including all

the procedures performed, evidence gathered and judgments made, relating to a particular area.

Additionally, when the auditor's views on complex items such as judgments, estimates, accounting policies and practices, difficult or contentious issues or close calls, are communicated with the audit committee, the audit committee has been provided with an appropriate context for these complex matters through:

- Live interaction with the auditor;
- Follow-up and two-way discussions with the auditor to review the information presented;
- Extensive background knowledge derived from their responsibility to oversee the financial reporting process.

This dialogue works quite well in practice as a means of discussing issues, assessments and conclusions. Such a dialogue cannot be meaningfully conveyed by way of AD&A reporting.

- Introduction of subjectivity and lack of comparability of reports. An AD&A would be a very subjective presentation by the auditor. As discussed earlier, achieving comparability of reports including subjective information, both within firms and across firms, would be a formidable challenge, and it is unclear how a firm would design and implement an effective system of quality control to achieve appropriate consistency regarding the reporting of such information, without having multiple layers of review at levels above the engagement team. Comparability between reports on different entities, including those in similar industries, would be sacrificed without consistent auditor reporting, potentially confusing the marketplace. For instance, one audit partner's subjective view regarding the inclusion or exclusion of a "close call" or "preferable accounting treatment" may differ from that of another, which could result in unintended consequences for an issuer in comparison to its peers.

Ultimately, the expectations of those who support an AD&A will not be realized in practice, as consistency, comparability, and the legal environment will prevent the auditor from providing unique, narrative discussions regarding the public companies they audit.

Discussing Audit Procedures is Inappropriate:

In addition to being contradictory to the principles we presented in the "Overall Comments" section above, we do not support discussing risks, judgments and procedures specific to the audit performed within the audit report for the following reasons:

- It would be difficult to understand this information without further context derived from dialogue with the auditor;
- Succinct descriptions would not adequately describe significant and often complex audit judgments and procedures;
- It would reduce the element of unpredictability of audit procedures, which is required by PCAOB Auditing Standard No. 13, paragraph 5(c);³ and

³ PCAOB Auditing Standard No. 13, states the following: "*Incorporating elements of unpredictability in the selection of audit procedures to be performed.* As part of the auditor's response to the assessed risks of material

- More thorough descriptions could contribute to disclosure overload and detract from the ability to provide useful information to users.

User Support for an AD&A is Uncertain at Best:

The surveys⁴ that have been referenced by proponents of AD&A do not support the more significant change that an AD&A would impose on the auditor reporting model, and, based on the input provided to date, there does not appear to be a mandate for such a change. For example:

- Consider information from the informal IAG survey as follows:
 - Respondents were asked to react to the following statement “The audit report as currently written, provides valuable information and is integral to understanding the financial statements.” The results did not show support for drastic change: 55% of the respondents said either “strongly agree”, “agree”, or “neither agree or disagree.”⁵
 - Respondents were also asked to react to the following statement: “The audit report (either in an AD&A or elsewhere) should include a narrative summary of the various items that the auditor communicated, both orally and in writing, to the entity’s audit committee (relating, for example, to significant accounting policies, management’s judgments and estimates, and significant audit adjustments) as required under existing PCAOB regulations.” The results did not show overwhelming support for such a narrative, with 44% stating they “strongly disagree,” “disagree,” or “neither agree nor disagree.”⁶
- Consider the following from the CFA’s informal survey regarding the auditor’s report:
 - When asked “What additional information, if any, would you like to see in the auditor’s report,” none of the respondents said they wanted the auditor to provide information about audit risks, audit procedures and results, discussion of critical accounting policies, significant unusual transactions, or “close calls” and other matters the Concept Release is suggesting be included in a potential AD&A.⁷
- Consider the following statements made at the PCAOB’s roundtable on September 15, 2011:
 - Mr. Peter Nachtwey, Chief Financial Officer, Legg Mason, Inc., when speaking about the potential concept of an AD&A stated the following: “...when I go talk to the guys that run our funds and run our affiliates, and these are very, very seasoned guys and

misstatement, including the assessed risks of material misstatement due to fraud (“fraud risks”), the auditor should incorporate an element of unpredictability in the selection of auditing procedures to be performed from year to year.”

⁴ The surveys put forth by some to support the creation of the AD&A have not been comprehensive in terms of outreach or in response rates. The survey conducted by members of the PCAOB IAG in March 2011 resulted in 73 responses from at least 330 individuals surveyed. Additionally, the survey conducted by the CFA Institute in March 2010 resulted in 106 responses from approximately 500 individuals surveyed; however, it is not clear how many of the CFA survey respondents are from the United States. The related report explains that 27% of those surveyed were from Europe, the Middle East, and Africa, and 19% were from Asia Pacific. The remaining 54% surveyed are from the Americas; the CFA does not specifically provide a figure for those surveyed in the United States, but it would seem to be less than 54% of those surveyed.

⁵ IAG Survey presented at the March 2011 IAG meeting, page 1.

⁶ Ibid, page 7.

⁷ CFA Institute Independent Auditor’s Report Survey Results, March 2010, page 20.

gals who've been around for decades, they are not clamoring for a change in the auditor's report."⁸

- Mr. Alan Beller, Partner, Cleary Gottlieb Steen & Hamilton LLP and former Director of the Division of Corporation Finance of the SEC, when also speaking about AD&A stated, "It actually will be less productive than some of the more modest suggestions that have been made around the table."⁹

Based on the foregoing, we strongly oppose the concept of the auditor providing an AD&A. The options we have suggested in section II above would better meet the needs of users, without imposing the unintended consequences and significant costs of requiring an AD&A.

IV. OTHER CONSIDERATIONS

If the PCAOB moves forward with its consideration of possible changes to the auditor's report, it should first perform a cost/benefit analysis, including consideration of the practical challenges related to the time, effort and resources required to implement any new requirements and complete them within the current SEC Form 10-K filing deadlines. The analysis should also include a comparison of the costs and benefits of instituting any required changes to the auditor's report versus requiring issuers to provide additional disclosure.

Additionally, like the CAQ, we believe the concerns articulated by the PCAOB in the Concept Release with respect to the potential for increased litigation risk are warranted, particularly if the Board proceeds with the AD&A alternative and such an approach is adopted. Auditor liability has been discussed in many forums over many decades, and it is an important issue for consideration as potential changes to the auditor's reporting model are evaluated.

Finally, as part of the process to develop proposed standards for changing the auditor's reporting model, we recommend that the PCAOB:

- Contemplate whether the changes make sense in the context of audits of employee benefit plans (EBP) of public companies, the financial statements of which are filed with the SEC through an 11-K. We do not believe users of EBP financial statements are requesting or in need of an expanded auditor's reporting model. Further, the alternatives the PCAOB is considering for audit reports on financial statement audits of public companies would not be meaningful in the context of reporting on EBP financial statement audits. As a result, the PCAOB may decide that the changes proposed and adopted may not apply in the context of an EBP audit report.
- Consider how any changes to the auditor's report would be managed to educate investors and other users.

⁸ PCAOB unofficial transcript of the September 15, 2011 roundtable, page 97.

⁹ Ibid, page 122.

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We would welcome an opportunity to further discuss these matters with the Board and the staff. If you have any questions or would like to discuss these matters further, please contact John Fogarty at (203) 761-3227 or Bob Kueppers at (212) 492-4241. We thank you for your consideration of these matters.

Very truly yours,

/s/ Deloitte & Touche LLP

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