Statement of
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Public Meeting on the Auditor's Reporting Model of the
Public Company Accounting Oversight Board
April 3, 2014

I am pleased to be invited to participate in the public meeting on the Auditor's Reporting Model. I believe you are aware that I am a partner of Willkie Farr & Gallagher LLP and also serve as Chair of the Financial Reporting Committee of the New York City Bar Association.

I have been asked to address the Board's proposed audit standard dealing with "other information," that is, the standard proposed in the August 13, 2013 PCAOB Release (No. 2013-005) entitled, "The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report." The main feature of the proposed standard would be the expansion of an auditor's reporting from the financial statements underlying the audit report to the "other information" included in certain documents containing the audit report, the best example probably being a Form 10-K. The bar association's Financial Reporting Committee earlier submitted a letter on this subject, and for convenience it is attached.

In this written statement, I would propose to make two observations with regard to the proposed standard. The first is an overall observation building upon the main point of the bar association letter. The second is the subject on which the Board has specifically asked me to comment: the application of the proposed standard as to the procedures to evaluate other information and the proposed reporting in the audit report.

Overall Observation

To begin, I certainly credit the Board's efforts to improve the usefulness and reliability of financial reporting. I appreciate that this is an extraordinarily difficult undertaking and one that does not always earn unanimous praise. The Board is to be commended for its continuing efforts.

Having said that, I must report that I am not in favor of the Board's proposal to expand the auditor's reporting to other information. In a nutshell, my concern is that it may be counterproductive and result in disclosure that is less useful for investors.

To first put this in context, my own experience does not support the existence of a problem of material inconsistency between the financial statements underlying an audit report and the disclosures contained elsewhere in the pertinent document. I have been handling financial reporting issues and disputes for more than thirty years, and I cannot recall an instance in which such an inconsistency was the issue. Beyond my own experience, this concern was the topic of discussion of the bar association's Financial Reporting Committee, a group that includes counsel for preparers, users, and auditors, including plaintiffs' counsel and counsel for D&O insurers. It was our collective sense that, of the many things that have given rise to financial reporting problems, material inconsistencies between audited results and other information were not among them.

A different and more prevalent concern, rather, involves an apparent trend in which financial reporting appears to be increasingly driven by the goal of regulatory compliance rather than the goal of effective communication. My concern is that this trend would be furthered by the proposed standard.

Here is the reason. I routinely hear, as I am sure many do, of concerns that 10-Ks have gotten too long, overly dense with minutiae, more tedious to review, and in some respects

less understandable. I am reminded of the Stern School of Business professor who complained that "disclosure rules have turned financial disclosures into data dumps" and that, in his estimate, "less than 10% . . . of a modern financial disclosure has any value to an investor . . . ."[1] A similar concern has recently been expressed by SEC Chair Mary Jo White who spoke on the problem of "information overload" which she characterized as "a phenomenon in which ever-increasing amounts of disclosure make it difficult for investors to focus on the information that is material and most relevant to their decision-making as investors in our financial markets."[2]

As an attorney frequently involved in litigation defense, I can understand all too well how well-intentioned regulatory requirements can lead to such counterproductive results. The main problem is that it is exceedingly difficult for regulatory requirements to mandate effective communication. We have all seen this in action. At its core the problem is the completely laudable reaction of companies, when faced with a new regulatory requirement, to try to comply. One of the safest approaches to compliance is to provide data in a format that is objectively correct and verifiable, a process that may involve many levels of review by executives and professionals all understandably pursuing the complementary objectives of rule compliance and risk minimization. Once a given company's process of developing compliant disclosure is complete, there is an understandable inclination to want to stick with it – year after year. Over time, companies may seek to conform their own approach to perceived "best practices" of disclosure in the industry, with the consequence that public disclosure becomes less useful in differentiating among industry participants or, for that matter, from differentiating a given company from itself in prior years. We all know how this ends. A regulatory requirement

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1 http://aswathdamodaran.blogspot.com/2012/10/the-disclosure-dilemma-why-more.html

2 www.SEC.gov/News/Speech/Detail/Speech/1370539864016

that was intended to encourage effective communication evolves into data recitation and boilerplate.

An antidote to such a result would be management candor unconstrained beyond a desire to communicate effectively and to speak the truth. A perennial favorite (and, I must confess, my own) is the annual shareholder letter of Warren Buffett. One can come away from the annual shareholder letter with a sense of what Berkshire Hathaway is doing, the significant achievements and setbacks over the course of the year, the style and culture of management, and challenges going forward. More than that, the shareholder letters are actually interesting to read, a singular achievement given that Warren Buffett's main businesses – insurance, railroads and utilities – are fairly boring.

The question I ask in evaluating the consequences of the Board's "other information" standard is: In which direction would it take financial reporting? Would it contribute to the type of candor and communication illustrated by Warren Buffett? Or would it take us further in the direction of data-driven compliance and boilerplate? As I think through the foreseeable reactions, I am dismayed to report that I believe it would be the latter. One reason is the environment in which the auditor's evaluation of such other information would need to take place. An audit these days takes place in an environment of accelerated deadlines, increased demands for documentation, and the omnipresent stress that naturally accompanies an unforgiving deadline. In such a context, the last thing management of a public company will want is an issue arising out of the auditor's evaluation of other information – particularly information that, by its nature, is less susceptible to objective verification, such as trends, uncertainties, judgments, challenges, and other non-data driven aspects of the business. A logical reaction by management would be to seek to minimize information or observations the

objective verifiability of which may create a risk of auditor recalcitrance. Moreover, once a particular type of disclosure had been approved by an auditor in one year, the natural incentive would be to minimize changes in years subsequent. A foreseeable consequence, therefore, is that Form 10-K disclosure would be driven further in the direction of recitation of objectively verifiable data and boilerplate at the expense of the sort of meaningful communication that can help investors see what is really going on.

I understand that, even under the standards as they exist today, some of the big accounting firms make it their practice to read other information and to consider the content. And, of course, existing PCAOB standards call upon the auditor to read other information and to consider whether the other information is materially inconsistent with information in the financial statements. However, a requirement of explicit auditor evaluation of, and reporting on, such information may be expected to result in a perception of greater accountability and therefore less willingness to defer to the judgment of management. In any event, management concern may result in elimination or minimization of otherwise useful subjective analysis.

Application of the Standard

That takes me to the issue on which the Board has asked me to comment in particular: the proposed procedures to evaluate the other information and the proposed reporting in the audit report. I am aware, based on comment letters submitted to the Board and general discussion, of significant concern regarding the standard's proposed application. I must report that I share that concern. Unfortunately, I am not of the view that the concern can be sufficiently mitigated through refinement of the applicable language of the standard or of the audit report. Rather, I am afraid it is inherent in the expansion of the scope of an auditor's reporting to other information.

Let me explain. The proposed standard contemplates that the audit report will explicitly speak to the substance of other information and, in particular, the subjects of its material inconsistency with the financial statements and its truthfulness. A very real concern is that such an expansion would have the practical effect, both as a matter of substance and appearance, of making the auditor fully accountable for other information. One reason is the terminology used by the standard which speaks in terms of an "evaluation" of the information which, to my way of thinking, suggests a level of assurance comparable to that attained as a result of normal audit testing. True, those highly knowledgeable of PCAOB audit standards would be able to find distinctions between normal audit procedures and those of the proposed standard. But, for non-experts, that would be slicing it pretty thin.

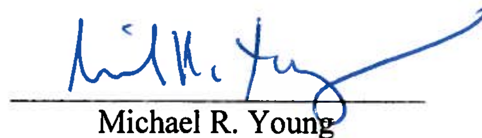
For that matter, my overall experience with audit standards is that they are more likely to receive expansive interpretations than narrow ones, and such expansive interpretations applied to this standard could readily further a perception that the auditor had full responsibility for other information, quantitative and qualitative. To illustrate, the standard directs the auditor to evaluate for consistency with the financial statements "any qualitative statement" providing "greater detail" about information in the financial statements. But I am immediately drawn to ask: What qualitative statement about the business would not, in one sense or another, provide "greater detail" about information in the financial statements? Here, again, I accept that, with effort, distinctions could be drawn. But little in my experience suggests that such distinctions would carry meaningful weight. More likely would be the perception, which is consistent with the main thrust of the standard, that the auditor will evaluate other information and report on its truthfulness.

It is arguably true that, to some extent, this result could be mitigated through modification of the precise terms of the proposed standard and audit report. But the critical point here is that full auditor accountability for other information should be assumed, even if such concepts as "evaluation" were modified, simply by virtue of the expansion of the scope of the audit report to other information to begin with. My own experience is that an auditor who has spoken about the quality of information is almost inevitably called upon to justify the audit report if the information turns out to be false. And, when a falsity is uncovered, no amount of insistence of conformity to a professional standard satisfactorily mitigates the appearance of professional failure.

In any event, legitimate concern about increased accountability would foreseeably cause all participants in the disclosure process to adopt an approach that places a premium on risk minimization even at the expense of effective communication. I thus come full circle to the initial observation described above.

Conclusion

I understand, and am sympathetic to, the frustration of investors who seek to get behind much of the financial reporting taking place today to get better insight into the genuine drivers of business activity. My concern is that the proposed standard would not take financial reporting in that direction.



Michael R. Young

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March 20, 2014

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December 9, 2013

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

Re: *PCAOB Rulemaking Docket Matter No. 034*

Dear Ms. Brown:

On behalf of the Committee on Financial Reporting of the Association of the Bar of the City of New York, I respectfully submit this letter regarding the proposed auditing standard entitled "The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report" (PCAOB Release No. 2013-005 – August 13, 2013). This letter is also supported by the Bar Association's Committee on Securities Regulation.

By way of introduction, the Committee on Financial Reporting consists of attorneys representing different roles and perspectives within the financial reporting community, including preparers, users, and auditors. An important objective of the Committee is to enhance the integrity of financial reporting systems in order to foster the objectivity, understandability, and reliability of financial reports. The Committee seeks to improve financial reporting integrity through the

enhancement of the rules and regulations of financial reporting as well as the culture in which those rules and regulations are called upon to function.

We very much share the Board's objective of improving the usefulness of financial reporting and appreciate the Board's efforts to that end. And we certainly share the Board's view that information reported in audited financial statements, and "other information" included in documents containing the audited financial statements, should not be inconsistent. However, we are concerned that the proposed audit standard may prove to be counterproductive. In summary, we are concerned that a consequence of the proposed standard, insofar as it would subject "other information" to explicit auditor reporting, may be that such "other information" becomes less useful.

The basis for our concern centers on the fact that auditor processes are more effectively directed to the evaluation of objective, rather than subjective, information. It is true, of course, that much "other information" is objectively verifiable and therefore susceptible to effective auditor evaluation. Much other information, however, is significantly less so. That is particularly the case as to aspects of information regarding trends, strategy, challenges, risks, and other more judgmental aspects of business activity.

We do not understand how an auditor's normal processes would allow it to effectively evaluate and report on such information. We are concerned that, instead, a requirement of auditor evaluation and reporting may result in an inclination by preparers to facilitate auditor approval through increased emphasis upon objectively verifiable information. From the perspective of users, such an inclination would be unfortunate insofar as a commonly expressed frustration with business disclosure today involves its presentation in the form of disaggregated numerical detail at the expense of broader discussion that explains how the data fits with the company's performance and prospects.

Our concerns are exacerbated by the logistics of the modern day audit environment. Today's audit takes place in an environment of increased expectations, increased demands for documentation, and accelerated deadlines. We can readily foresee scenarios in which the difficulties of auditor evaluation of subjective information would create a risk of delay ultimately resulting in, again, an inclination by preparers to favor data that can be more readily verified.

Nor are we familiar with an underlying problem that would justify these consequences. We understand the desire of the investment community for greater transparency into management decision-making and company prospects. But we do not believe this proposed standard addresses that. Rather, the standard seems directed to an entirely different issue: the potential for inconsistency between audited financial statements and other information. But that is an issue that, at least in our experience, rarely if ever comes up. In our experience, the much more frequent complaint involves the difficulties and tediousness of review of disaggregated detail.

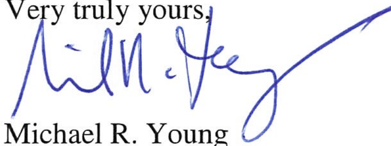
In terms of cost-benefit analysis, therefore, our own judgment would suggest that the costs greatly outweigh the benefits. We see little if any benefit to the standard. The costs would include not only higher audit fees but higher internal costs associated with auditor involvement

in the substance of information, which is already extensively reviewed by multiple departments within the reporting entity, beyond the scope of the auditor's normal systems for evaluation.

At root, we are of the view that transparency in "other information" is best served by giving management the opportunity to describe its business activity as management sees fit constrained by the obligations to tell the truth and otherwise to fulfill legal requirements. If management does not fulfill these obligations, legal means of redress and corrective mechanisms of corporate governance already exist. The installation of an additional layer of evaluation and reporting, and with it the risk of increased emphasis upon disaggregated detail at the expense of more subjective analysis and discussion, strikes us as counterproductive. We would therefore respectfully submit that this proposed standard should not be adopted.

We thank the Board for the opportunity to submit these comments and congratulate the Board on its continuing efforts to enhance the systems of financial reporting.

Very truly yours,



Michael R. Young

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The content of this letter does not necessarily reflect the views of any institution or organization with whom a member of the Committee on Financial Reporting is affiliated.