

Public Company Accounting Oversight Board
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21 July 2011

- **Release No. 2011-003**
- **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**

Dear Sir,

Thank you for giving us the opportunity to comment on your Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards. This concept release (release) raises some important issues concerning the auditor's role with respect to audited financial statements. I have already commented on similar issues that were raised in the International Auditing and Assurance Standards Board's consultation paper "Enhancing the Value of Auditor Reporting: Exploring Options for Change".¹ For completeness I would suggest that you could also consider those comments in addition to these presented here.

In general I support improving the relevance and usability of the auditor's report. I would caution that we must clearly delineate the auditor's role and responsibilities in this context. For example it would be unacceptable under current responsibility structures and expectations if the auditor were to take on a governance role with respect to an entity it is

¹ See IAASB consultation paper Enhancing the Value of Auditor Reporting: Exploring Options for Change, available at <http://www.ifac.org/Guidance/EXD-Details.php?EDID=0163>.

auditing. That is not, nor should it be, the job of the auditor, who is independent from the audited entity. It would also not be appropriate for the auditor to take on an ongoing oversight, or pseudo-regulatory role regarding the entity. Such responsibilities lie elsewhere. Despite this, the release is rich in ideas and possibilities, many of which would certainly benefit users of audited financial statements (users). I have some specific comments, which I will address in answer to your specific questions.

Answers to specific questions raised by the PCAOB

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?

Yes. Such initiative should address the legitimate concerns of users outlined in the release, and from the results of your staff's outreach activities.

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?

The communicative value of auditor reporting could be substantially improved by altering and optimising the layout of the report. For example, the auditor's opinion should be prominent, and the majority of backup or supporting material should be presented in appendices. The auditor's report should also include greater disclosure of the tasks and procedures carried out in performing the audit, and that this should be included preferably in an appendix to the report. Users would then be able to better appreciate the completeness of the auditor's investigative work, and would therefore give greater credence to the auditor's views and opinions. I think that this would also help to manage users' expectations about the role and duties of the auditor in this context. Finally I would suggest that the auditor's report should including a clearer statement about the auditor's responsibilities regarding other information outside the financial statements. This would help to better manage users' expectations about the auditor's role and responsibilities here, and the extent of the auditor's duties pertaining to such other information

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?

Possibly. This depends on the “matters” in question. The auditor’s role and responsibilities must be clearly delineated, otherwise the auditor risks taking on a governance or ongoing oversight role with respect to the entity.

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 is clear and sufficient to indicate that the entity has fairly presented its financial statements.

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.

As a minimum, I would suggest that expanded use of emphasis paragraphs, where relevant, could provide more meaningful and complete information to users, by highlighting significant matters that could help to manage users’ expectations regarding the auditor’s report and opinions therein.

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.

This depends on the information and to what it relates. Opinions on consistency or completeness of information, rather than just disseminating information, should ideally be provided by an independent auditor.

5. Should the Board consider an AD&A as an alternative for providing additional information in the auditor’s report?

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

In general I support an expanded auditor commentary such as an AD&A. Such commentary should only be provided when necessary to aid understanding. In this sense it should not become boilerplate over time. At the end of the day, the auditor’s report should be

Please note that the comments expressed herein are solely my personal views

informative and useful as a whole, rather than just section-by-section, and any commentary that aids users' understanding in this regard should be beneficial.

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?

I would suggest that an AD&A should comment primarily on the audit. Open commentary on the financial statements would otherwise need to be structured within a clear delineation of the auditor's role and responsibilities, in order to manage the expectations of users.

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)?

The AD&A should comment on material issues in order to better manage the expectations of users regarding the audit and risks thereon. The illustrative report on page 16 of the release provides a good framework.

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")?

Please see my responses to your questions 5.b and 6.

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

A standard framework would be useful in order to better delineate the role and responsibilities of auditors and to better manage the expectations of users.

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?

I support expanded auditor commentary on the entity's internal controls, including any significant internal control deficiencies identified during the audit. I am not convinced of the

need or appropriateness of expanding the auditor's responsibilities to include commentary on general business risks, strategic risks etc.

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

This is difficult. However, I would recommend that the auditor should only comment on material issues, highlighting in particular difficult or contentious issues. This should reduce the use of boilerplate language.

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?

This is a risk. It is critical that the auditor should not take on a governance role with respect to the entity, nor should the auditor discuss matters that the entity has not disclosed in the financial statements. However, the auditor is also a professional with a public interest role. I would only expect to see such inconsistent or competing information in very difficult or extreme circumstances, when such disclosure could possibly better manage the expectations of users regarding the audit.

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?

Possibly. See also my responses to your questions 2.c and 5.

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.

In answer to this and your questions 15, 16 and 17, please see my responses to your questions 2.c and 5.

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

I would support an auditor's opinion on the consistency and completeness of information outside the financial statements, and their relation to the audited financial statements. However, auditor assurance on "other information outside the financial statements" is too

broad and vague an objective, and negates a clear delineation of the auditor's role and responsibilities, especially as the nature and contents of such "other information" changes over time.

In principle I support auditor assurance on the MD&A. The illustration on page 24 of the release provides a starting point for further discussion.

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?

I agree that these clarifications are appropriate, and would help to delineate roles and responsibilities regarding the audit.

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.

Yes. They should help to better manage the expectations of users. The results of your staff's outreach activities support this view.

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

One of management's and the auditor's most important responsibilities is to communicate with investors and users in a clear and straightforward manner. Anything which helps in this regard is worthy of further consideration.

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?

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All of these considerations are important. Changing the content or form, or extending the scope of the audit report, must be considered in total, rather than piecemeal, along with a global, cumulative, credible and coherent analysis of the potential benefits and costs at the end of the process.

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?

This is a business case, and users, preparers and others should be convinced that the additional and incremental benefits derived from such changes would outweigh the initial and ongoing costs of the changes and additional burdens thereafter.

Yours faithfully

C.R.B.

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