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Response to Release No. 2013-005
Auditor's report on an audit of financial statement
when the auditor expresses an unqualified opinion
PCAOB Rulemaking Docket Matter No. 034

I am commenting on the above proposed standard (the "Proposal"), which I believe it should not be adopted as it would add no information for users of financial statements and cost issuers money.

I am concerned by the increasing cost of disclosures required by the various legislative and regulatory bodies affecting financial reporting. A major issue facing the United States is operating efficiency and cost control so we maintain our international competitiveness. Congress has attempted to address some of this issue with the JOBS Act.

These issues have bothered me for some time. I have had the following articles published in the New York State Society of Certified Public Accountants monthly magazine The CPA Journal:

Have We Created Financial Statement Overload? – November 2007
PCAOB Proposal for Greater Disclosure from Auditors – January 2012
The Effects of Regulatory Overload – February 2013.

In line with my comments in my articles, I believe that the Proposal creates significant additional costs. In the description of the Proposal, the costs of the disclosure are not treated in detail and the benefits are not quantified or even justified in a material way. I believe that the Proposal should not be adopted as the benefits do not justify the costs.

I am not commenting on the proposal relating to "other information in certain documents containing…the audit report" as I do not believe that that proposed standard creates costs beyond those created by AU 550, although I am not sure that the proposed standard improves AU550.

Costs

First the costs. The Proposal refers to them in a few places with no specificity. I believe that the additional costs relating to this proposal include the following:

- Training maybe 100,000 auditors on the requirement and how to apply it;
- Training the same number of members of management in the same issues;
- Training possibly fewer attorneys in the requirements and their implication;
- Current auditing practice would entail requiring all Registered auditors to create a section in all audit programs with instructions for field auditors to complete and sign off;
- The time on each audit for the staff to complete the applicable portion of the audit program;
- Staff and partner time parsing the issues to determine which belong in and out of the auditor's report;
- Documenting the areas where the decision was not to include the item in the auditor's report;
- Discussions with management as to what issues, why the auditor included them in the report, negotiation with management of the inclusion or exclusion of items;
- Three-way discussion among management, and auditors and counsel as to the disclosures, including writing the disclosure and working details with management and counsel; and
- Cost of paper and postage.

I have left out the cost of having anyone closely reading the entire Form 10-K having to read additional pages and maybe wonder why an item is in the MD&A but not the auditors' report.

These costs are not insignificant. Assuming annually 12 hours of accountants' time, five hours of attorneys' time, one hour each for three members of the audit committee and ten hours of management time at an average of $200 per hour it is $6,000 per registrant per year. For the 10,000 public companies, that comes to $60,000,000 burden, per year, on the US economy for a proposal that there is no evidence that it will have a value. On page A5-41 the Proposal briefly differentiates between one time and ongoing costs. I suggest that one-time costs are a misnomer as manuals have to be continuously updated and employee turnover means new employees have to be continuously trained.

In response to your questions 21 through 23 of Appendix A5 I am unable to determine the relationship between costs and size of companies and I believe that audit fees will rise to cover the additional auditor time.

Benefits

Of the 78 pages in Appendix A, the benefits are glossed over in three paragraphs. I note that the benefits start based on academic research and are all, I believe, (1) modified with the words "should" or "could" and (2) unclearly defined as to a specific benefit. For example the sentence "the communication of critical audit matters could help to alleviate the information asymmetry that exists between company management and investors" on page A5-23, does not:

- Indicate why the reduction in the "information asymmetry" is good,
- Give an evaluation of the present "information asymmetry" and whether the extent it could be reduced is significant, or
- Any support that the proposal would in fact reduce the "information asymmetry".

There other examples of similar thinking. The three paragraphs describing the logic of the proposal on pages A5-22 and A5-23 use the words "should", "can" "may" and "could" twelve times. No sentence I read seems to say "the proposal does definitely help this issue". As none of the benefits, if existent, seem definite, are the changes worth the cost?

Three examples are given in the Proposal: Allowance for Sales Returns, Valuation of Deferred Tax Assets and Recurring Fair Value Measurements. They raise the following questions:

- Does the proposed addition say anything more than the proposed footnote and the required reference from MD&A as to critical accounting policies?
- Is a reader of the financial statements helped to know that I consulted with my national office, another partner in my office, or in my case another CPA who may have experience in the matter?
- Would these examples reduce the "information asymmetry"? If so, how?
- I am unconvinced that these are difficult matters, e.g. it appears to me that for example one it is clear that the registrant should not record sales until ultimate sale is known under 605-15-5.

Duplicative disclosure of matters

The issue of whether the information being proposed to be required in the Auditor's Report adds additional information to that which is already being disclosed is not addressed. The three examples in Appendix A start with a detailed footnote with the auditor add little, if anything, to the discussion in the footnotes. I agree that with the length of published reports on public companies (see <u>Have we Created Financial Statement Overload?</u> suppra.) it would be useful to have a place to go to find significant items. The SEC's approach is to add more and more disclosure, much of it repetitive. A far more useful approach is to determine what disclosures are significant and those of little or no use should be discarded.

Disclosure of matters that would otherwise not be disclosed

I have been unable to think of an example where an item would be disclosed by the auditors but is not otherwise required to be disclosed. It would be useful to have an example of such an item. If there is none, I believe that the lack of such an example is evidence that additional disclosure is not useful.

Question 27 refers to the issue of an item that would be in the auditors' report that would not otherwise be disclosed. I have racked my brain but been unable to think of one. Would the Proposal require the following disclosure:

> We, the auditors, determined that the difficulty of finding invoices to support inventory costs was a critical audit matter. The inventory clerk had quit just before the audit and the new staff had difficulty locating the invoices. As a result the completion of the audit was delayed a week and the auditor's fee was increased by $3,000. All invoices were ultimately located and the inventory found to be appropriately priced. We obtained the approval of audit committee for the additional fee involved.

For me to think that the Proposal will be an improvement over current reporting, it would need to indicate that both (a) additional matters would be disclosed and (b) such disclosure would be both useful and justify the additional costs.

Does anybody read this stuff?

As I wrote in my article, Have We Created Financial Statement Overload?, the length of financial statement and other annual reporting requirements turns off reasonable readers. While I have been told that some professional analysts read every word, I sincerely doubt it. Who can read every word of all 400 pages of one company's annual report and proxy statement?

My favorite example of over disclosure is the current rules on executive compensation in the proxy statements. The disclosure in a great reform went from a comprehensible page to many pages with tables and a description of the compensation committee's process. Do you know anyone, but attorneys, who have actually read the detailed disclosures; I do not.

The additional disclosures requested in your Proposal would make the matter of length worse.

What is necessary

In many areas of our society, the concept that "less is more" has produced improvements. We have made financial statements unreadable as the volume is just overwhelming. I have been told that security professionals actually read them all; the ones I have spoken to try to pick and choose so they do not waste a lot of time. My article in The CPA Journal "Have we Created Financial Statement Overload" (November 2007) lists a number of suggestions, none earth-shaking, to reduce disclosure. I believe that is the direction in which we should be going.

Other changes to the Auditor's report

Other than the inclusion of Critical Audit matters the proposal adds about 21 lines to audit reports for the approximately 10,000 reporting companies. I do not believe that the cost of adding the 210,000 lines of type annually justifies the improvement. I have always believed that a pass/fail model should be succinct. I recommend "We have performed an audit in accordance with professional auditing standards and believe that the accompanying financial statements are in accordance with prescribed standards." It could have made it shorter. I appreciate that courts might take an approach different from mine.

Very truly yours,

Arthur J. Radin