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

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

Dear Board Members and Staff:

Mayer Hoffman McCann P.C. ("MHM") welcomes the opportunity to comment on the *Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards* (the "Concept Release").

MHM supports the Board's efforts to improve the relevance and contents of auditors' reports. We appreciate the Board's responsiveness to requests from the investment community for additional information from auditors. However, we are concerned that many of the concepts proposed would substantially revise the basic financial reporting relationship whereby management provides the needed information and the auditor provides an independent opinion on the fairness of the information provided.

MHM is also concerned that if The Public Company Accounting Oversight Board ("PCAOB" or the "Board") moves forward with the proposals in the Concept Release, there will be significant unintended consequences. Those unintended consequences include, but are not limited to:

- Confusion of the responsibilities of management and the auditor
- Contradictory and confusing messages to readers of audit reports
- Significantly increased litigation exposure for audit firms
- Significantly increased costs of audits to registrants
- Probable boilerplate language in audit reports
- Contraction of the number of firms competing for audits of registrants
- Potential effects on global competitiveness of U.S. capital markets

As a general comment, we have noticed that the Concept Release uses the term auditor in its singular form and seems to be directed toward an individual auditor. Of course this is rarely the case in audits of public companies, most of which are conducted by substantial firms consisting of many auditors and including quality control systems, consultation policies, risk management policies and national office oversight. It appears that these features have not been considered in the Concept Release which may be the cause of our expected unintended consequences. Additionally, the concept of "joint audits" whereby the audit would be conducted by multiple firms is currently being considered in Europe.

We will explain our concerns with each of these consequences and then address the proposals in the Concept Release.

### *Confusion of the responsibilities of management and the auditor*

The efficiency of our capital markets depends upon public trust in the financial information provided by the entities seeking that capital. That public trust results from adequate disclosure of financial information by management that is examined by independent auditors. Many of the proposals in the Concept Release would require the auditor to provide significant additional disclosures about the audit and consequently about the entity. Presumably the parties requesting these disclosures expect the auditor to provide them without respect to the views and opinions of management. That is both inconsistent with the traditional role of the auditor and unreasonable in light of the relative familiarity of the parties with the entity.

The persons in financial reporting oversight roles in public companies are responsible for the completeness and accuracy of financial reporting in their filings with the Securities and Exchange Commission ("SEC"). These individuals spend full time designing the systems; collecting the data; researching, consulting and solving complex accounting and disclosure issues, and summarizing the information that is ultimately presented in the SEC filings. Additionally, their efforts are overseen and reviewed by the Audit Committee and the Board of Directors of the entity. In contrast, in forming an opinion on the financial statements, the auditor only spends a fraction of the time that management spends in producing the financial statements and developing the disclosures.

Therefore, if additional disclosures are necessary and can be provided at a reasonable cost, they should be provided by management in conformity with requirements and standards issued by the SEC and/or the Financial Accounting Standards Board ("FASB").

The current reporting system should not be subverted through "back door" requirements by the PCAOB for auditors to provide information that is not required to be provided by management and with which they may not agree.

The concept that management discloses and auditors opine should be maintained.

### *Contradictory and confusing messages to readers of audit reports*

As noted in the Concept Release "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.'" Of course, in actuality for SEC registrants, the only acceptable alternative is to "pass" since the SEC will not accept a qualified opinion. If the financial statements do not "pass" the auditor does not issue a report and the registrant does not file the financial statements. While this model is very simplistic, it is also very easily understood.

The Concept Release asks whether or not the pass/fail model should be retained. MHM believes that it should. This model is a direct affirmation of the auditor's assurance as to the fair presentation of the financial statements. Further, we believe that it should be left intact. A number of years ago auditors were allowed to issue "subject to" opinions. In this form of opinion the auditor could issue a clean opinion subject to the resolution of certain uncertainties. The profession subsequently determined that this type of opinion was not useful to readers of the opinion and that the auditor should issue either a clean or modified opinion depending on how management accounted for or disclosed the uncertainties. MHM believes that was an improvement to the auditor's reporting model that required the auditor to take more responsibility for the type of opinion rendered.

Many of the proposals in the Concept Release would require the auditor to supplement the audit report with additional information related to:

- Difficult or contentious issues including “close calls”
- Material matters where disclosures could be enhanced or different accounting methods could be applied
- Permissible alternative accounting treatments and which one is preferred by the auditor
- Critical accounting policies and critical accounting estimates discussed with the audit committee
- Significant risks identified by the auditor and the audit procedures performed in response to those risks.

MHM believes that much of this additional information would contradict the auditor’s opinion on the financial statements; could be viewed to be a piecemeal opinion, and would produce confusion rather than clarity as to the responsibility the auditor is taking for the opinion.

### *Significantly increased litigation exposure for audit firms*

The Concept Release refers to “...changes that investors and others are seeking to the auditor’s report ...” MHM acknowledges that investors have long requested that auditors provide additional insight into the audit process. We are also aware that the PCAOB has recently established an Investor Advisory Group and that this group recommended that the Board undertake this initiative. We understand that large sophisticated institutional investors and analysts may understand the types of additional disclosures that are being requested of auditors. These sophisticated investors and analysts already have substantial access to companies and receive substantial information on which to base their investment decisions. We therefore feel that the sophisticated investors and analysts are primarily attempting to reduce the inherent risks associated with their profession by increasing the risks of the auditing profession. We also feel that individual investors, which make up the bulk of the investing public, would only be confused by the additional disclosures as noted above.

MHM is seriously concerned that the segment that will benefit the most from the proposed revisions to the auditor’s report is the plaintiff’s bar.

In addition to the matters noted above, the auditing profession is being asked to publicly disclose all of the areas of weakness in an audit. These disclosures include:

- Difficult or contentious issues including “close calls”
- Significant risks identified by the auditor and the audit procedures performed in response to those risks.
- The results of audit procedures performed on audit risk areas or areas requiring significant auditor judgment
- Material matters where disclosures could be enhanced or different accounting methods could be applied
- Areas in which there were difficulties encountered in performing the related audit procedures

With hindsight after a financial problem for a company, these types of disclosures by the auditor will provide a blueprint for the lawsuit against the auditor. This is tantamount to purchasing a gun and ammunition; loading the gun, and handing it to your assassin.

### ***Significantly increased costs of audits to registrants***

Section IV. A. of the Concept Release includes the following statement. *“Since many of the alternatives presented in this concept release focus on auditor reporting and do not require additional audit procedures by the auditor in forming the opinion on the financial statements, some expressed a view that the auditor’s incremental efforts and cost to report such information should be minimal.”* The section then goes on to discuss a few reasons that this may not be the case.

MHM would point to the previous section of our comments and emphasize the fact that it may be impossible to do enough work to manage the litigation risk associated with the requested additional disclosures. Accordingly, we find it totally improbable that any CPA firm would allow individual line partners to provide the types of disclosures requested, particularly in a free-writing format, without an extensive review by regional and national quality control and risk management personnel. It would also, in many cases, probably require review by the firm’s legal counsel as well.

Our Firm’s experience in negotiating the wording of management letters and communications with audit committees, which are currently not public documents, indicates that significant amounts of time would be required to formulate additional disclosures in audit reports which would be available to the public. As noted in the Concept Release, this discussion and debate among the auditor, management and the audit committee will require additional time which will place significant additional pressure on preparers’ ability to meet public reporting deadlines.

It is totally inconceivable that the proposals included in the Concept release would not result in substantial increases in the costs of audits and in the time required to complete the audit and issue the auditor’s report.

### ***Probable boilerplate language in audit reports***

MHM believes that in response to the significantly increased litigation risks and the accompanying significant increased costs of the audit, most firms will develop standardized forms for the new audit reports. It is impractical to think that any national firm will allow a line partner in a remote location to jeopardize the capital of the firm. Consequently, standardized or “boilerplate” reports will quickly be developed.

### ***Contraction of the number of firms competing for audits of registrants***

We also believe that in response to the significantly increased litigation risks, many firms which each perform a relatively few number of public company audits will decide that the rewards no longer justify the risks associated with these engagements. This will of course increase the concentration of firms willing to accept these risks and reduce the competition for audits of registrants. This may also serve to increase the cost of audits of public companies.

### ***Potential effects on global competitiveness of U.S. capital markets***

MHM believes the PCAOB should thoroughly assess the potential effects of the proposed regulation and the additional cost of compliance on the effects on the U.S. Capital Markets. Numerous graduate studies have concluded that the Sarbanes Oxley legislation has driven both foreign and domestic companies from the U.S. Capital Markets since its introduction in 2002. This factor was also noted by Treasury Secretary Paulson’s Committee on Capital Markets Regulation which cited the role of Sarbanes Oxley in the decline of U.S. dominance in investment banking. The Board should consider that foreign registrants are either exiting or by passing entirely the U.S. capital markets and should reconcile this fact pattern with the SEC’s desire that the U.S. capital markets remain an attractive destination of capital formation for foreign entities.

The Board should also consider that Sarbanes Oxley has been a frequent target of competing foreign capital formation centers. Given the global competition in capital markets, and that many of these companies are based in emerging growth markets, the Board should bear this in mind to ensure that individual investors which comprise a significant segment of the U.S. markets are being denied an opportunity to these high growth opportunities due to increased regulatory burden.

We fear that the increased cost of regulatory compliance that we have seen with Sarbanes Oxley would only continue under this proposal.

### **Potential Alternatives for Changes to the Auditor's Report**

#### ***Auditor's Discussion and Analysis***

The first alternative to the current form of the auditor's report presented in the Concept Release is a supplemental narrative report described as an Auditor's Discussion and Analysis ("AD&A"). The intent of an AD&A would be to provide the auditor with the ability to discuss in a narrative format his or her views regarding significant matters and to provide investors and other financial statement users with a view of the audit and the financial statements "through the auditor's eyes."

MHM is strongly opposed to an AD&A.

We are concerned that all of the unintended consequences previously discussed are embodied in an AD&A.

- Auditors should not disclose information not previously disclosed by the management of their client. This is contrary to the normal relationship where management discloses and the auditor opines.
- An unqualified audit opinion supplemented with an AD&A that includes information about audit risk, audit procedures and results, management's judgments and estimates, accounting policies and practices, difficult or contentious issues including "close calls" and areas where the auditor would have preferred that management had chosen different accounting policies or enhanced disclosures seems to be contradictory at best.
- An unqualified audit opinion supplemented with an AD&A that includes the suggested information will be confusing to the vast majority of readers of the report and users of financial statements.
- An unqualified audit opinion supplemented with an AD&A that includes the suggested information will require extensive interaction between auditors, management, audit committees and both parties legal counsel and will discourage cooperation and encourage animosity among the parties.
- An unqualified audit opinion supplemented with an AD&A that includes the suggested information will significantly increase the cost of audits due to the required extensive review by regional and national quality control and risk management personnel as well as the firms' legal counsel.
- An unqualified audit opinion supplemented with an AD&A that includes the suggested information will provide a blueprint to the plaintiff's bar for claims against the auditor in any subsequent legal actions.
- An unqualified audit opinion supplemented with an AD&A that includes the suggested information will result in boilerplate language that does little to provide additional information to investors due the firms' desire to maintain reasonable costs and to protect them from increased legal liability.

MHM believes requiring an AD&A to be a bad idea that should not be considered as an alternative for future changes to the auditor's report.

### *Required and expanded use of emphasis paragraphs*

Emphasis paragraphs are extremely useful in limited circumstances. They provide the auditor with a mechanism to point to certain disclosures within the financial statements providing information the auditor feels is particularly important to users of the statements. They might also allow the auditor to emphasize a matter that was particularly crucial in forming the auditor's opinion on the financial statements. Emphasis paragraphs are not required but are a tool that the auditor may use when judgment calls for it.

Expanded use of emphasis paragraphs might be useful with additional guidance as to when they would be beneficial. They are an effective means of directing the reader's attention to areas within the financial statements that the auditor feels are significant.

MHM does not support required and expanded use of emphasis paragraphs.

- Emphasis paragraphs should not be mandated in all audit reports. The vast majority of audit report will probably never need an emphasis paragraph.
- Required and expanded use of emphasis paragraphs, particularly including key audit procedures pertaining to the matters identified may be seen as contradictory to an unqualified opinion and result in confusion on the part of the readers of the auditor's report.
- Required and expanded use of emphasis paragraphs will require extensive interaction between auditors, management, audit committees and both parties legal counsel and will discourage cooperation and encourage animosity among the parties.
- Required and expanded use of emphasis paragraphs will significantly increase the cost of audits due to the required extensive review by regional and national quality control and risk management personnel as well as the firms' legal counsel.
- Required and expanded use of emphasis paragraphs will provide a blueprint to the plaintiff's bar for claims against the auditor in any subsequent legal actions.
- Required and expanded use of emphasis paragraphs will result in boilerplate language that does little to provide additional information to investors due the firms' desire to maintain reasonable costs and to protect them from increased legal liability.

If, in all cases, investors need a "road map" to the more significant matters included in the financial statements it should be provided by the company with appropriate review by the auditor.

### *Auditor assurance on other information outside the financial statements*

MHM agrees that an auditor providing assurance on information outside of the financial statements could improve the quality, completeness, and reliability of such information, providing investors and other users of financial statements with a higher level of confidence in information about the company that is provided by management.

As noted in the Concept Release, current standards (AT sec. 201, *Agreed-Upon Procedures Engagements* and AT sec. 701, *Management's Discussion and Analysis*) provide companies the ability to retain auditors to provide assurance on information outside the financial statements. However, auditors rarely perform these services since there is no SEC requirement for companies to engage auditors to perform these procedures.

If auditors are to be required to perform these types of engagements, the SEC should require registrants to engage auditors to provide the assurance needed. The requirement should not be "back-doored" by the

PCAOB with a requirement for auditors to perform without a requirement for the company to engage us for the service.

Additionally, if the service is to be required, the SEC must realize that it will take additional time and a determination will be needed regarding the timing of the service in relation to current filing deadlines.

MHM could also support clarifying the current auditor's report to disclose our responsibility to read the information outside the financial statements and consider whether it is materially consistent with the audited financial statements.

### *Clarification of language in the standard auditor's report*

MHM agrees that in certain cases clarification of the language in the current auditor's report might enhance the reader's understanding of what the report is trying to convey. While we agree this might help in some areas, we do not think it is necessary for each of the terms suggested in the Concept Release as follows:

- Reasonable Assurance – It seems that adding language to the effect that “reasonable assurance is a high level of assurance, but not absolute assurance” would merely be additional words without a real improvement to clarity.
- Auditor's Responsibility for Fraud – We would not object to adding the phrase “whether caused by error or fraud” to the statement regarding our responsibility to obtain reasonable assurance about whether the financial statements are free of material misstatement.
- Auditor's Responsibility for Financial Statement Disclosures – Although we realize that the notes to the financial statements are not specifically mentioned in the auditor's report, we find it hard to believe that any knowledgeable reader would not consider them covered by the report when the footer on each of the statements mentioned in the report states that the notes are an integral part of the statement. However, we are not opposed to adding the notes to the financial statements to the list of items examined.
- Management's Responsibility for the Preparation of the Financial Statements – We suggest that the PCAOB incorporate the wording used by the AICPA's Auditing Standards Board in its clarified standard on auditor's reports.
- Auditor's Responsibility for Information Outside the Financial Statements – See our comment above. We would not object to disclosing our responsibility for this information.
- Auditor Independence – Since the title of the standard auditor's report is "Report of Independent Registered Public Accounting Firm", we feel that further clarification within the body of the report would only be redundant.

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We appreciate the opportunity to provide comments on the Exposure Draft. Please contact Ernie Baugh (423-870-0511) if you have any questions.

Respectfully Submitted,

*Mayer Hoffman McCann P.C.*

MAYER HOFFMAN McCANN P.C.