



1800 Gateway Drive, Ste 200
San Mateo CA 94404-4072
(800) 922-5272
www.calcpa.org

September 27, 2011

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

Submitted via email to: comments@pcaobus.org

Re: PCAOB Release No. 2011-003
Concept Release on Possible Revisions to PCAOB Standards
Related to Reports on Audited Financial Statements

The Accounting Principles and Auditing Standards Committee (the "Committee" or "We") of the California Society of Certified Public Accountants ("CalCPA") is grateful for the opportunity to comment on the Concept Release referred to above. The Committee is the senior technical accounting and auditing committee of CalCPA. CalCPA has approximately 35,000 members. The Committee is comprised of 43 members, of whom 56% are from local or regional firms, 21% are from large multi-office firms, 12% are sole practitioners in public practice, 9% are in academia and 2% are in an international firm.

We have provided our comments in response to the questions set forth in the Concept Release within the main body of this letter. However, we wanted to present certain overall comments which reflect the tone of the Committee's views.

The Committee supports the Board's proposal to clarify certain basic elements of the auditor's report because to do so would not expand audit scope and would retain the current "pass/fail" model. The Committee does not support any of the other alternatives proposed by the Board in this Release as they ultimately seek to place the auditor into a role that cannot be fulfilled, and that can best be met by the entity's management. It should not be the auditor's role to function as a financial analyst and attempt to predict the future prospects of the entity under audit.

Many of the Board's proposals presume that auditors know as much (or more) about an entity as management of the company. This is worst exemplified in the discussion of an "Auditor's Discussion and Analysis." Auditor's knowledge of a company comes from four basic sources: Industry knowledge, what management tells them voluntarily, what management tells them in response to questions, and what auditors discover through audit procedures. The totality of this knowledge does not, and cannot, equal what management knows from dealing with the business day-to-day. Quite often, if management in good faith does not think the auditor needs

knowledge of something and the auditor does not ask about it or find it, the auditor will not know about it, and in this case if the auditor prepares an AD&A, it will likely be deficient.

PCAOB Concept Release: Audit Report. Staff Questions

History and Outreach

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?

The Committee does not oppose an initiative to consider improvements to the auditor's reporting model. However, a clear distinction needs to be made between improvements in the report based on the existing scope of services and expansion of reporting based on an expanded scope of services. The Committee supports a better articulation of the overall audit process and certain significant findings. The Committee does not support the expansion of audit services and reporting on them.

Auditors should not be asked to report on the "quality" of an entity's financial statement. That quality is impacted by mandated accounting principles, which some believe underlie some complaints about the quality of financial statements. Auditors cannot be reasonably asked to critique mandatory accounting principles. Other aspects of "quality" are very subjective and what is good quality for some may be poor quality for others. There are bound to be inconsistencies among companies and even auditors within the same firm as to what is good vs. poor quality. What is needed is a clear disclosure of accounting principles followed, so users can draw their own conclusion about quality.

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 Committee believes that clarification of the auditor's report, as highlighted in the PCAOB Concept Release, merit further study. The Committee further recommends this study be done in conjunction with the AICPA to avoid establishing different reporting standards for public and non-public entities.

A number of things can be better articulated, including reasonable assurance, responsibility for fraud, clarification of management's responsibility and auditor's lack of responsibility for preparation of the financial statements, responsibility for information outside the financial statements, and the meaning of independence. All of this can be done with no expansion of audit scope.

Another area for study is determining how to effectively communicate the fact the audit process is by definition predominately about the past. The exception is where the future is so clear that the auditor adds going concern language. One might argue that financial statements should contain more forward looking content; perhaps, but that is not the auditor's issue, that is a financial framework issue, which makes it a management disclosure issue. Should forward looking information be made obligatory in the notes, the auditing profession will have to come to grips with the question of what is, AND what is not auditable.

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?

The Committee says "no", unless it is to report on information derived from the financial statements or prepared from records used to prepare the financial statements. Management has the responsibility for providing interpretation and analysis of historical and other business data, and this requires far more intimate knowledge of the entity, its business and its industry than an auditor has or is likely to be able to achieve.

The Committee is concerned that some of the responses described in the results of the staff's outreach activities demonstrate a complete lack of understanding of the role of the auditor, and worse, a desire to have the auditor perform analyses that should be performed by investors and analysts. Some responses seem to be based on the premise that the auditor has extensive knowledge of risks concerning the financial statements and the entity's business; the auditor clearly has some knowledge, but management is in the best position to assess and disclose risks, and is already required to do so in "risk factors." The Committee sees no point in having the auditor, with incomplete knowledge; attempt to provide information that is already within the purview of management's disclosure obligation.

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. It is the auditor's basic role, and is expected by users.

b. If not, why not, and what changes are needed?

See the Committee's response to Question 2.a. No change needed or desirable regarding the overall "pass/fail model."

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.

Please refer to the Committee's response to Question 1.b., above.

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.

Additional information that may be provided should be provided by management. Management would have the information. The audit committee best serves in an independent oversight role, and does not have the same access to information that management has; further, if the audit committee is cast in the role of providing information, it can be perceived as losing its independence. Similarly, the auditor's role is independent verification. The auditor does not have the same access to information that management has and if the auditor is cast in the role of providing information, it can be perceived as losing its independence.

4. Some changes to the standard auditor's report could result in the need for amendments to the report on internal control over financial reporting, as required by Auditing Standard No. 5. If amendments were made to the auditor's report on internal control over financial reporting, what should they be, and why are they necessary?

Most of the focus on internal controls has been oriented toward the financial statements. Internal controls and processes around information outside the financial statements may have differences from those related to the financial statements, but there are likely significant similarities. Differences will need to be identified before consideration can be given to the need for amendments to audit and reporting standards.

Potential Alternatives for Changes to the Auditor's Report

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

No.

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

The Committee does not support an AD&A.

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?

It should comment on neither.

c. Which types of information in an AD&A would be most relevant and useful in making investment decisions? How would such information be used?

Any information relevant and useful to making investment decisions should be furnished by management. The auditor's role is one of verification; expansion beyond this would jeopardize the auditor's independence and confuse the auditor's role with that of a financial analyst.

d. If you do not support an AD&A as an alternative, explain why.

The Committee opposes any AD&A. Auditors cannot achieve the level of knowledge of the audited entity that management has, and is, therefore, not in a position to report its own analysis of the entity's affairs. Commentary on audit procedures is not appropriate; the totality and interdependence of audit procedures is difficult, if not impossible, to communicate in a brief report and little constructive purpose is served in explaining procedures that, no matter how comprehensive, are likely to be "second-guessed" by parties less knowledgeable.

e. Are there alternatives other than an AD&A where the auditor could comment on the audit, the company's financial statements, or both? What are they?

Any commentary should be included in the auditor's report. See the Committee's response to Question 1.b., above.

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)?

There should not be an AD&A.

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")?

There should not be an AD&A. The matters that might be discussed, per the PCAOB Release, should be covered by management in the financial statements, and perhaps in the MD&A as well. Better accounting standards may be needed as to what needs to be included, and to the extent required in the financial statements, audit standards should have a clear statement of the auditor's responsibility for auditing that data and reporting if the auditor concludes it is materially deficient.

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

No. An AD&A should not be required.

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?

The discussion of these items is management's responsibility. The auditor's role is independent verification, based upon an objective evaluation of an entity's past performance, measured against a meaningful financial framework. The current audit framework is not meant to support providing an overall assessment of the "quality of the financial statements". The auditor does not have the same access to information that management has and is not able to perform the comprehensive analysis that is required for this risk analysis. Some of these risks are considered by the auditor in setting audit scope and procedures, but this is a far different context than providing such information to investors. Further, if the auditor is cast in the role of providing information and analysis of this type, it can be perceived as losing its independence.

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

An AD&A should not be required. "Boilerplate" language is one risk, as auditors would likely find it necessary to heavily caveat the scope and conclusions of any such analysis.

11. What are the potential benefits and shortcomings of implementing an AD&A?

See the Committee's responses to Questions 5.d., 7, and 9. and 10. above.

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?

While the Committee rejects the use of an AD&A for auditors, the Committee would expect that any differences between management's and the auditor's information would normally be resolved before either side finalizes their views, just as it is now with presentation and disclosures in financial statements. The difficulty with an AD&A is that the knowledge bases of management and the auditor are different and the information is subjective, so it may be impossible to resolve differences between the AD&A and other information provided by management. Further, a complete discussion could lead the auditor to make statements which, in effect, second guess or criticize management's decisions; differences such as that may not be resolvable, and may reflect lack of business knowledge and perspective by the auditors, rather than a basis for differences with management. As for different or competing information in the financial statements

themselves, the Committee would expect these to be resolved in most cases, since if the differences are not resolved, they would likely lead to a reporting exception by the auditor, and management usually seeks to avoid that.

Required and Expanded Use of Emphasis Paragraphs

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?

The Committee does not support the “required” use of emphasis paragraphs in the audit report. The types of information proposed to be included in an emphasis paragraph are best left to management and be presented in the notes to the financial statements. Management, not the auditor, should have the responsibility of identifying significant risks, estimates and uncertainties about the accounting information. The accounting standards should deal with any such requirements.

14. Should the Board consider a requirement to include areas of emphasis in each audit report, together with related key audit procedures?

No. The totality and interdependence of audit procedures is difficult, if not impossible, to communicate in a brief report and little constructive purpose is served in explaining procedures that, no matter how comprehensive, are likely to be “second-guessed” by parties less knowledgeable.

a. If you support required and expanded emphasis paragraphs as an alternative, provide an explanation as to why.

The Committee does not support the required use of emphasis paragraphs for the reasons set forth in our response to Question 13

b. If you do not support required and expanded emphasis paragraphs as an alternative, provide an explanation as to why.

Please refer to the Committee’s response to Questions 13. and 14. above.

15. What specific information should required and expanded emphasis paragraphs include regarding the audit or the company's financial statements? What other matters should be required to be included in emphasis paragraphs?

Please refer to the Committee’s responses to Questions 13. and 14 above.

16. What is the appropriate content and level of detail regarding the matters presented in required emphasis paragraphs?

Please refer to the Committee’s responses to Questions 13. and 14 above.

17. How can boilerplate language be avoided in required emphasis paragraphs while providing consistency among such audit reports?

Please refer to the Committee's responses to Questions 13. and 14 above.

18. What are the potential benefits and shortcomings of implementing required and expanded emphasis paragraphs?

Please refer to the Committee's responses to Questions 13. and 14 above.

Auditor Assurance on Other Information Outside the Financial Statements

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

The Committee believes there may be aspects of "other information" on which auditors could provide assurance. However, The Committee questions whether the auditor should be placed in a role that *requires* him to provide assurance, directly or indirectly, that the information is complete or complies with applicable rules and regulations. Some of this requires legal perspective beyond the scope of the auditor's expertise. Some requires knowledge and perspective that management gains from running the business and that the auditor, as an independent outsider, cannot achieve. The current attest procedures to express an opinion on MD&A at AT sec. 701.05 et seq. in part require this, which may explain why auditors seldom report on the MD&A in practice.

a. If you support auditor assurance on other information outside the financial statements as an alternative, provide an explanation as to why.

The Committee does not support providing any assurance on a required basis.

b. On what information should the auditor provide assurance (e.g., MD&A, earnings releases, non-GAAP information, or other matters)? Provide an explanation as to why.

None. See the Committee's response to Questions 19. and 19.a.

c. What level of assurance would be most appropriate for the auditor to provide on information outside the financial statements?

None.

d. If the auditor were to provide assurance on a portion or portions of the MD&A, what portion or portions would be most appropriate and why?

Information derived directly from the financial statements or accounting records underlying that information that is subject to audit procedures employed in the audit of the financial statements.

e. Would auditor reporting on a portion or portions of the MD&A affect the nature of MD&A disclosures? If so, how?

If the reporting is limited to information derived directly from the financial statements or accounting records underlying that information that are subject to audit procedures employed in the audit of the financial statements, there should be no effect. However, if the information reported on includes other less objective and interpretative information, it may lead to a reduction of the amount of such information included because it may be difficult or expensive, or impossible for the auditor to audit it; this result would be undesirable.

f. Are the requirements in the Board's attestation standard, AT sec. 701, sufficient to provide the appropriate level of auditor assurance on other information outside the financial statements? If not, what other requirements should be considered?

AT 701 was written to deal specifically with the MD&A. The entire attestation standard would need to be re-examined under the Board's proposed expansion of reporting. If the Board moves in this direction, we suggest a comprehensive examination be done to determine why so few reports are currently rendered in practice under AT 701.

g. If you do not support auditor assurance on other information outside the financial statements, provide an explanation as to why.

Please refer to the Committee's responses to Questions 19, 19.a. and 19.e.

20. What are the potential benefits and shortcomings of implementing auditor assurance on other information outside the financial statements?

A potential benefit may be some enhanced reliability of the information. However, for the reasons stated in the Committee's response to Questions 19. and 19.a. the shortcomings outweigh this small benefit.

Clarification of the Standard Auditor's Report

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?

The Committee supports the Board's proposal for clarifications. However, they are likely to lead to more boilerplate.

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. It is apparent that, after years of trying to communicate the meaning of the auditor's report, users still do not understand it.

c. What other clarifications or improvements to the auditor's reporting model can be made to better communicate the nature of an audit and the auditor's responsibilities?

The suggestions in the PCAOB Release are sufficient.

d. What are the implications to the scope of the audit, or the auditor's responsibilities, resulting from the foregoing clarifications?

Within the current scope of the auditor's responsibility, there would be no effect since the auditor would merely be articulating what he is doing now.

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

See the Committee's response to Questions 1.b. and 21.b. However, the Committee sees little merit in trying to clarify the auditor's responsibility for financial statement disclosures; we believe it is well understood that the note disclosures are part of the financial statements, and it is not necessary to say more.

Questions Related to all Alternatives

23. This concept release presents several alternatives intended to improve auditor communication to the users of financial statements through the auditor's reporting model. Which alternative is most appropriate and why?

The Committee supports the suggestion to consider clarifying the current auditor's report, and does not support the other suggested alternatives for the reasons previously set forth herein.

24. Would a combination of the alternatives, or certain elements of the alternatives, be more effective in improving auditor communication than any one of the alternatives alone? What are those combinations of alternatives or elements?

See the Committee's response to Question 23.

25. What alternatives not mentioned in this concept release should the Board consider?

None. However, the Committee believes that many of the issues set forth in this Release can be better solved by asking the accounting standard setters to address these issues, and by making changes to the current financial reporting model.

26. Each of the alternatives presented might require the development of an auditor reporting framework and criteria. What recommendations should the Board consider in developing such auditor reporting framework and related criteria for each of the alternatives?

The Committee's suggestions presented in our response to Question 1.b. may be relatively easy to implement with additional reporting requirements, without significant changes to the auditor reporting framework beyond the additional requirements themselves.

The Committee has no comments on the other alternatives in the Release, as we do not support them.

27. Would financial statement users perceive any of these alternatives as providing a qualified or piecemeal opinion? If so, what steps could the Board take to mitigate the risk of this perception?

The Committee's suggestions presented in our response to Question 1.b. are unlikely to cause any confusion. The clarification of the auditor's standard report would not be directed to any specific financial data, so would not cause any misperception.

28. Do any of the alternatives better convey to the users of the financial statements the auditor's role in the performance of an audit? Why or why not? Are there other recommendations that could better convey this role?

The alternatives in the PCAOB Release item III.D. "Clarification of the Standard Auditor's Report" are sufficiently comprehensive. The Committee has no other recommendations.

29. What effect would the various alternatives have on audit quality? What is the basis for your view?

The answer to this is very dependent on the clarity of any standards written to implement the alternatives. Limiting changes to clarifications, as the Committee suggests in our response to Question 1.b. would likely have no negative effects on audit quality.

30. Should changes to the auditor's reporting model considered by the Board apply equally to all audit reports filed with the SEC, including those filed in connection with the financial statements of public companies, investment companies, investment advisers, brokers and dealers, and others? What would be the effects of applying the alternatives discussed in the concept release to the audit reports for such entities? If audit reports

related to certain entities should be excluded from one or more of the alternatives, please explain the basis for such exclusion.

Yes. the Committee sees little basis for differentiation.

Considerations Related to Changing the Auditor's Report

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, and 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?

See the Committee's response to Question 3. above. It is important to maintain the separate roles of management, the audit committee and the auditors. Any incursion of the audit committee or auditors into functions of management will create confusion for all and compromise the independence and effectiveness of the audit committee and the auditors.

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?

No. Please see the Committee's response to Question 29. above.

c. Are there any other considerations related to changing the auditor's report that this concept release has not addressed? If so, what are these considerations?

The Committee strongly recommends the Board evaluate the cost benefit relationship of implementing any of the alternatives except for the audit report clarification process, which the Committee supports, as any expansion of the auditor's overall reporting responsibilities are likely to drive smaller registered auditing firms away from public company work. This will further restrict choices among a dwindling supply of qualified firms.

d. What requirements and other measures could the PCAOB or others put into place to address the potential effects of these considerations?

The AD&A and auditor reporting on information outside the financial statements are fraught with potential litigation exposure for the auditor. A "safe harbor" is not likely to provide adequate insulation, assuming one would even be acceptable to all.

32. The concept release discusses the potential effects that providing additional information in the auditor's report could have on relationships among the auditor, management, and the audit committee. If the auditor were to include in the auditor's report information regarding the company's financial statements, what potential effects could that have on the interaction among the auditor, management, and the audit committee?

Please see the Committee's responses to Questions 9 and 12. It could create an adversarial relationship between the auditor and management, and that would seriously impair communications between management and the auditor.

The Committee would be glad to discuss our comments further should you have any questions or require additional information.

Very truly yours,

A handwritten signature in black ink that reads "Howard Sibel". The signature is written in a cursive style with a large, prominent 'H' and 'S'.

Howard Sibelman, Chair
Accounting Principles and Auditing Standards Committee
California Society of Certified Public Accountants