

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

By E-mail: comments@pcaob.org

September 30, 2011

494/541/584

Dear Sir(s),

**Re.: PCAOB Rulemaking Docket Matter No. 034
PCAOB Release No. 2011-003, June 21, 2011
Concept Release on Possible Revisions to PCAOB
Standards Related to Reports on Audited Financial Statements
And Related Amendments to PCAOB Standards**

We would like to thank you for the opportunity to provide the Public Company Auditor's Oversight Board (PCAOB) with our comments on the Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements And Related Amendments to PCAOB Standards (hereinafter referred to as the "release").

The Institut der Wirtschaftsprüfer in Deutschland [Institute of Public Auditors in Germany], is the professional body that represents public auditors in Germany. We are responding to this release not only because certain of our members are registered with the PCAOB and therefore may undertake engagements in which they are required to apply PCAOB Auditing Standards, but also because the issue of auditor reporting is currently subject to debate by a number of other parties worldwide, including the IAASB, IOSCO and the European Commission, and therefore the PCAOB's discussions on this matter are relevant in this context.

Given the questions about the value of auditing that have arisen in the aftermath of the financial crisis, we consider the initiative by the PCAOB to consult on the

Institut der Wirtschaftsprüfer
in Deutschland e.V.

Wirtschaftsprüferhaus
Tersteegenstraße 14
40474 Düsseldorf
Postfach 32 05 80
40420 Düsseldorf

TELEFONZENTRALE:
+49 (0)211 / 45 61 - 0

FAX GESCHÄFTSLEITUNG:
+49 (0)211 / 454 10 97

INTERNET:
www.idw.de

E-MAIL:
info@idw.de

BANKVERBINDUNG:
Deutsche Bank AG Düsseldorf
BLZ 300 700 10
Kto.-Nr. 7480 213

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
Dr. Klaus-Peter Feld, WP StB CPA;
Manfred Hamann, RA

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options for enhancing the value of auditor reporting to be timely and appropriate. We therefore commend the PCAOB for addressing this issue at this time. However, the discussion of the value of auditor reporting cannot be delinked from an exploration of the added value of audits, which relates not only to reporting, but also the scope of the audit. The release recognizes this – particularly when discussing expanding the scope of the audit to information not currently within the scope of the audit – but, in the context of the European Commission’s Green Paper on the role of the audit, further exploration of the scope of the audit beyond that in the paper is necessary.

We note that consultation with stakeholders on changes to auditor reporting is necessary because the issues relating to enhancing audit reporting and the scope of financial statement audits are foremost *political and legal* issues – not technical issues. Clearly, even political decision-making can only occur in the context of technical reality and therefore must be technically appropriate, but the questions about what, when, how (in a general sense) and to whom auditors should report given a particular audit scope, and whether the scope of audits should be enhanced, are public policy issues that require political resolution implemented by legal or regulatory means. **Such selection of public policies in relation to enhancing audit reporting ought to be decided on the basis of the public interest, which involves consideration of the costs and benefits to the public of potential policies, including the incidence of such costs and benefits among affected stakeholders.**

In this respect, we are concerned about suggestions that the auditor provide further “insights” into the audited entity or the audit. Without in any way suggesting that further exploration of audit reporting and audit scope issues to increase the added value of audits is not necessary – in our view, it is – we would like to note that some sophisticated investors, per se, always want more rather than less information, especially since potential (as opposed to existing) investors in entities perceive the provision of additional information as being virtually costless, and as not having an impact on the timing of communications. Hence, potential investors do not perceive that they are bearing the cost of additional information provided, which leads to a “free rider” syndrome among them. Once having obtained more information by means of regulation, such investors would still not be satisfied and then ask for even more, regardless of the cost. This is why it is important that **the selection of public policies in relation to audit reporting and scope needs to involve consideration of who all of the users of financial statements are and the actual demand for more information, as well as of the costs and benefits to the public (not just to certain investor groups) and the incidence of such costs and benefits.**

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It should also be recognized that the provision of additional information in audit reports, particularly, but not limited to, information obtained by extending the scope of the audit, involves greater work effort and hence the incurrence of additional cost by auditors, which must ultimately be borne by preparers and then indirectly by other stakeholders, including investors. Calls for more information under the assumption that this would not involve significant increases in cost are not serious propositions. Nevertheless, there may be cases where the provision of more information may involve the benefits of that information exceeding the cost of providing it. **It is therefore important that legislators and regulators perform serious cost-benefit analyses to determine the need for additional information prior to prescribing its provision.**

Current discussions in the International Accounting Standards Board (IASB) and in other bodies about reducing the extent and complexity of disclosures in financial reporting suggest that most investors, other than a comparatively small group of financial analysts in certain larger financial institutions and funds, are already subject to information overload from, and have difficulty understanding, the information already provided to them. In this context, the call for “more” information may need to be interpreted as a call for “better” information by less sophisticated investors, rather than for “more”. Furthermore, the provision of additional or better information may require more time, which may decrease its relevance to users. **It is therefore important for public policy decisions in relation to both financial and audit reporting to consider whether “better” information needs to be provided, rather than just “more”, and the impact of additional information provided by auditors on the timing of the communication of information and the ability of most investors to process that information and understand it given the increasing complexity of financial reporting.** However, as the nature and sophistication of investors that use financial statements and auditor reporting vary considerably, it will be challenging to have concise and clear auditor’s reports that meet certain investors’ desires for additional information without causing information overload for most investors.

Audits are complex services that are difficult for many investors to understand, even though audits play an important role in the economy and in financial markets. Given the nature of some of the suggestions in the paper for more information from auditors, it seems that many investors may not fully appreciate what an audit involves or what the role of the auditor currently is, which contributes to the expectations gap. Some of the demands for more information from auditors – in particular “soft” information, such as the suggested “auditor’s insights” – may in part be driven by the desire of investors to transfer investment risks from

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investors to other parties. Investors seek to minimize the risks arising from their investments without sacrificing returns, and ideally, would like “riskless” investments with high returns. To this effect, calls for more “soft” information from the auditor may in part reflect investors’ desires to unreasonably narrow the expectations gap, which in its extreme form would involve closing the expectations gap by having auditors provide information that in effect represents a “guarantee” (i.e., have the auditors provide their views on audited entities, but make the auditors fully liable for those views). However, despite government support of financial institutions in the last financial crisis, and Eurozone support for Eurozone countries with sovereign debt difficulties to prevent greater private sector participation in losses, it is still a fundamental principle of free enterprise that those making investment decisions ought to bear the risks of those decisions. Disregarding this principle leads to moral hazard in investment decisions, which in turn leads to the gross misallocation of capital in economies, with the attendant negative macroeconomic consequences. **It is therefore important that public policy decisions in relation to audit reporting (including other communications in relation to the audit) and scope consider the proper delineation of the roles and responsibilities of audit stakeholders, including management, those charged with governance, auditors, and investors, and the appropriate nature and extent of the risks that ought to be borne by each in those roles and responsibilities to facilitate the efficient and sustainable operation of capital markets.**

In this context, communication by auditors with those charged with governance, and, in particular, audit committees, represents an important factor in aiding those charged with governance in meeting their oversight responsibilities, including their oversight responsibilities over financial reporting and the audit. Reporting by auditors to investors plays an important role in conveying to investors the credibility that they can attribute to financial reporting by the entity. However, the role of those charged with governance is significantly different from that of investors, and therefore when making public policy decisions, legislators, audit regulators and auditing standards setters need to consider the appropriate nature and extent of information to be conveyed by the auditor to those charged with governance compared to investors. Just because information is made available by auditors to aid decision-making by those charged with governance, who are subject to confidentiality requirements, does not mean it is appropriate for all of that information to be made publicly available for investors. A requirement for auditors to provide additional information about their findings to the general public may even unduly impair the effectiveness of audit procedures. The obligation of an auditor to treat information obtained as part of an audit as

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confidential is an important prerequisite for management or other representatives of an entity to provide auditors with the information requested, even if it is regarded as highly sensitive or confidential. If new reporting requirements result in an auditor's obligation to disclose such confidential or sensitive audit evidence to the general public, this may undermine the willingness of management or others to provide auditors with information and thus endanger the effectiveness of an audit. **It is therefore critical that, when considering enhancements to the nature and extent of audit reporting to investors based on information that is made available by the auditors to those charged with governance, policymakers consider the nature and extent of that information that is important for investors without having auditors make public information that may unduly impair the operations of the entity or the effectiveness of the audit.**

At a technical level, public policy decision-making in relation to audit reporting and scope also needs to take into account that some of the "softer" information that some investors would like to have does not have the same quality of evidence available to support that information and therefore may not be as reliable as information currently subject to audit under PCAOB Auditing Standards. If an audit of some of the "softer" information is nevertheless desired by expanding the scope of an audit, **it needs to be recognized that the "reasonable assurance" obtained in these circumstances is less than that obtained for "harder" information for which there is better quality evidence available, that the nature of this part of the audit engagement may be different, and that therefore the audit opinion in relation to such information would also need to be different to convey to investors these differences. In some cases, even if it is considered valuable to have certain additional "softer" information provided by management, it may not always be useful to the public (i.e., it is a cost-benefit consideration) or possible (i.e., adequate evidence is generally not available to support an audit opinion in that respect) to have an audit of some of that information in every case.** Some jurisdictions (such as Germany) do have experience with the audit report extending to softer information, such as in the management report. However, it is important that additional "softer" information opined on in an auditor's report be clearly separated from the opinion on the financial statements and be supported by an introduction that describes the different nature and level of assurance associated with such "softer" information.

However, we note that the quality of an individual audit is not apparent from the auditor's report, which often leads to the value of the audit not being properly recognized, and at worst may lead to the audit being viewed as a commodity.

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Including more information pertinent to each individual audit within the auditor's report may be a means of customising audits for certain issues. **There is an opportunity for the PCAOB to consider improvements to commoditized audit reporting by customizing audit reports for individual audits.**

In summary, the principles upon which we base the responses to the questions posed in the paper are:

- The selection of public policies in relation to enhancing audit reporting and audit scope ought to be decided on the basis of the public interest (not just the interests of certain investor groups), which involves consideration of who all of the users of financial statements are as well as of the costs and benefits to the public of potential policies, including the incidence of such costs and benefits among affected stakeholders.
- It is important for public policy decisions in relation to audit reporting to consider whether “better” information needs to be provided, rather than just “more”, and the impact of additional information provided by auditors on the timing of the communication of information and the ability of most investors to process that information and understand it given the increasing complexity of financial reporting.
- It is important that legislators and regulators perform serious cost-benefit analyses to determine the need for additional information prior to prescribing its provision.
- Public policy decisions in relation to audit reporting (including other communications in relation to the audit) and audit scope must consider the proper delineation of the roles and responsibilities of management, those charged with governance (in particular, audit committees), auditors and investors, and the appropriate nature and extent of the risks that ought to be borne by each in those roles and responsibilities to facilitate the efficient and sustainable operation of capital markets. In this context, when considering enhancements to the nature and extent of audit reporting to investors based on information that is made available by the auditors to those charged with governance, it is critical that policymakers consider the nature and extent of that information that is important for these users without having auditors make public information that may unduly impair the operations of the entity or the effectiveness of the audit.
- When auditors opine on “softer” information, the nature of this part of the audit engagement may be different, and therefore the audit opinion in re-

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lation to such information would also need to be different; in some cases, there may be no net public benefit to having some “softer” information audited, or some “softer” information may not be auditable due to a general lack of adequate available evidence.

- There is an opportunity for the PCAOB to consider improvements to commoditized audit reporting by customizing audit reports for individual audits.

We do recognize that the release on auditor reporting, and its relationship to the scope of the audit, is an opportunity to seek to enhance the value of audits by considering whether better information can be provided in audit reports about the current audit, and to consider whether it may be appropriate to expand the scope of the audit. To this effect, we make some specific recommendations in the Appendix to this comment letter to the questions posed in the release. We based our responses in this Appendix to the questions posed in the release on the principles that we have described in this letter above.

Various parties are currently deliberating on audit reporting and the scope of the audit, including the International Auditing and Assurance Standards Board (IAASB) and the European Commission. We would encourage both the IAASB and the PCAOB to strive for consistency between their respective future standards in this regard. It is crucial that the PCAOB consult on auditor reporting, and in particular, the scope of the audit, with regulators in the world’s major jurisdictions – especially with the European Commission.

We hope that our views will be helpful to the PCAOB. If you have any questions relating to our comments in this letter, we would be pleased to be of further assistance.

Yours very truly,



Klaus-Peter Feld
Executive Director



Wolfgang P. Böhm
Director, International Affairs

Appendix

APPENDIX:

Responses to Questions Raised in the Release

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?**

We believe that the Board should undertake an initiative to consider improvements to auditor reporting because it is important that audit reports are valuable to users. However, the question arises whether it is appropriate to consider commencing a standards-setting initiative without having first examined the responses to the concept release. Because some matters in relation to form or wording of the report may be more easily resolved than matters that extend to the content of the report given the current scope of the audit, which in turn may be more easily resolved than matters that extend the scope of the audit, it may be appropriate to distil those responses to the concept release by issuing a series of discussion papers or a similar vehicles in which the PCAOB makes general proposals to improve auditor reporting based on those responses prior to developing detailed exposure drafts of standards about the noted different aspects of auditor reporting. Given the importance of these issues, it would be inappropriate to seek "quick fixes" without having undertaken a serious cost-benefit analysis for each type of change.

- 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?**

Without extending the scope of an audit, matters that might be addressed to improve the standard auditor's report relate to:

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- The format and structure of the report given its current content
- The wording of the report given its current content
- The provision of additional information about the audit given the current audit scope

Format and Structure of the Report Given Its Current Content

We believe that one of the main purposes of the auditor's report is to reduce the expectations gap by clarifying to users what the role and responsibilities of the auditor are. The fact that even some sophisticated users are not sufficiently well informed about matters addressed in such paragraphs lends support to this view. This is especially the case if the auditor's report were to be expanded to provide additional auditor commentary. In this case, there may even be a need to include further clarification of responsibilities so that users do not misperceive the role of the auditor.

One of the main issues in this respect is that the financial statements are management's financial statements – not the auditor's financial statements. Consequently, a description of management's responsibilities is crucial to contrast the responsibility of the auditor from that of management. Likewise, removing the description of what an audit involves would only serve to increase the expectations gap. We would therefore not support removing the paragraphs on the responsibilities of management or the auditor. We are less concerned about their positioning within the auditor's report, as long as there is a logical structure to the components of the report such that users are not confused by the report. However, we would not support repositioning these paragraphs to an appendix outside of the body of the report, which has been suggested by some commentators, because it diminishes the delineation of responsibilities between management and the auditors, which would serve to increase the expectations gap.

In respect of placement of the opinion paragraph, we tend towards the view that although it is a key element in the report, it does need to be understood in the right context. Moving the opinion right after the introductory paragraph, which has been suggested by some, also leads to the strange situation that in the case of modified opinions, the Basis for Modifications Paragraph would immediately precede the introductory paragraph. Where would emphasis and other matter paragraphs be placed so as to not indicate that they affect the opinion? Will users un-

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derstand the change, especially for reports with modified opinions or emphasis or other matters paragraphs? It is not clear whether placing the opinion paragraph (almost) first rather than (almost) last really adds anything to the readability or understandability of the report and it may cause other difficulties as noted: in such a case, it is probably better to stick with tradition on format and structure, rather than moving things around for changes sake.

On the whole, we believe that instruments such as emphasis and other matter paragraphs have worked well because they have not been overused. We believe that these paragraphs ought to be clearly distinguished from any other additional “auditor commentary” that might be provided in the report, if the PCAOB were to choose to include such an item in the report. Their current positioning within the report serves to improve clarity about their meaning.

While changes to the format and structure of the standard auditor’s report cause the least direct costs to auditors, such changes are not costless. The templates for auditor’s reports would need to be changed across the entire firms and their networks and for standards issued by national standards setters. Such changes also increase the likelihood of errors in the reports, which will likely cause greater quality control costs. We also note some other costs that may result from the changes proposed. In many cases, the benefits of changes, other than the suggestions we make below, are likely to be marginal at best. We therefore recommend that the PCAOB not make changes to the format and structure of the report simply for the sake of change, but consider the direct and indirect costs that we address together with the rather marginal benefits that arise from such changes.

Wording of the Report Given Its Current Content

Complexity of the standardized language used is also an issue that means that many users lacking specialized technical skills may find the text hard to understand. However, we note that the terminology often regarded as overly technical language (fair presentation, materiality, misstatement) in fact stems from financial reporting frameworks such as US GAAP (the first two) or from law (negligent or gross “misstatement”) and is not solely “auditor jargon”. To this extent, users’ misunderstanding of the auditor’s report due to the use of technical language is actually indicative of a lack of understanding by users of the applicable financial reporting framework and basic legal concepts underlying

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financial statements, which is not something that enhancing audit reporting would resolve. However, where pure “auditing jargon” (e.g., “reasonable assurance”) is used, further clarification, or use of plain language to the extent possible, may need to be considered.

Given user misconceptions about the inherent limitations of an audit and what the role of an audit is, the explanation of the auditor’s responsibilities ought to be enhanced by referring to these inherent limitations (which has the added benefit of helping to explain the meaning of “reasonable assurance”), and the third sentence of ISA 200.A1 or its equivalent ought to be added to clarify what an audit does not do.

The provision of additional information about the audit given current audit scope

The provision of additional information about the entity or the audit given the current audit scope appears appealing at first glance. However, there are limitations on the dissemination of entity information that represent a real barrier to some of the suggestions made by some users that the auditor provide more information about the entity and its financial statements. In many jurisdictions, management or those charged with governance have legal control over the information about an entity or its financial statements obtained from within the entity: it is the entity’s information and only management or those charged with governance have the legal right to determine which information from the entity may be made available to third parties unless such information is clearly required to be made available by law or regulation.

Even if management consents to the auditor providing additional information, data protection laws in the EU member states and other jurisdictions may hinder the provision of certain entity information. Hence, in these jurisdictions, auditors providing more information not provided by management or those charged with governance about the entity or its financial statements would likely be illegal without the introduction of specific laws or regulations to change this situation. The successful introduction of such laws or regulations is very unlikely because business and other enterprises would not be in favour of such legislation or regulation. This legal situation may also present a barrier to the auditor being able to provide information about the audit performed, including key areas of audit risk, because this information is often indistinguishable from information about the entity or its financial statements. It will therefore be very difficult for the PCAOB to promul-

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gate an effective standard requiring such disclosures by the auditor internationally without a provision for an exception due to law or regulation, which would essentially cause that requirement to be ineffective in many jurisdictions.

Legal considerations aside, having the auditor provide information about the entity or its financial statements is not in consonance with the role of auditors vs. management or those charged with governance. An audit is, by definition, an attestation engagement in which the auditor opines on information provided by management or those charged with governance; an audit is not a direct engagement (see current Exposure Draft of ISAE 3000), in which the practitioner performs the measurement or evaluation and reports the resulting subject matter information about the entity. Hence, by suggesting that auditors provide information about the entity or its financial statement directly, users are confusing the relative roles of auditors vs. management or those charged with governance.

This is not to say that some information that is clearly audit-related may not be useful to users, but the costs and benefits as a whole need to be considered, including the impact on information overload of users, as we note in the body of our comment letter. On this basis, consideration might be given to exploring as to whether the auditor's report might highlight a summary of significant risks of material misstatement identified during the audit that are identified as significant financial reporting issues in the financial statements by management. However, it would have to be clear from the report that any such information did not represent any form of piecemeal opinion on isolated aspects of financial statements – the auditor opines the financial statements as a whole – and not individual financial statement items.

- 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?**

We believe it to be appropriate for the PCAOB to consider expanding the auditor's role to provide assurance on matters in addition to the financial statements. However, as we pointed out, issues in relation to information overload for investors as well as the costs and benefits would need serious consideration.

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We would like to point out that this question goes beyond “audit reporting”, and actually deals with the scope of the audit of financial statements. Extension to scope are possible as long as there are suitable criteria (i.e., criteria against which the entity’s performance can be reliably measured or evaluated) for such areas such as prospective financial information, corporate governance, (sustainable) business models, risk management, and key performance indicators, an auditor cannot perform an audit on these matters without such criteria. A subjective assessment by the auditor would be inappropriate because it would neither be in line with AT sec. 101, nor sufficiently consistent to be of benefit to users.

Consequently, this question really represents a consultation for 1. the PCAOB to consider whether certain information accompanying the financial statements ought to be required, and to consider the suitable criteria for that information and the underlying subject matter, and 2. the PCAOB to consider the nature and extent of an auditor’s responsibilities for any such information accompanying the financial statements.

Two potential extensions of financial reporting and consequent potential extensions of audit scope include auditor involvement in prospective financial information and in information about business risks (as opposed to risk management), prepared by management. To the extent that prospective information were, in future, required to be disclosed in the financial statements or in information accompanying the financial statements, auditors are able to opine on whether the assumptions used by management are plausible in the circumstances, and whether the information has been appropriately prepared on the basis of those assumptions, but not on whether such forecasts will actually occur. However, if an audit engagement were to be extended to cover prospective financial information, care would be needed not to widen the expectations gap in view of the auditor’s limited ability to predict the future. For example, including statements by the auditor as to the future profitability and the sustainability of the entity’s business model in the auditor’s report would involve the danger of increasing the expectations gap as to the ability of the auditor to predict future events. Auditors are often loath to accept assurance engagements with respect to such information in some jurisdictions because of legitimate liability concerns: therefore, liability reform is a prerequisite for auditor involvement with prospective financial information. In our comment let-

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ter to the EU Commission dated December 8, 2010 in respect of the Green Paper on auditing, we also suggested that expanding financial reporting, specifically the management report (also called “management commentary” by IFRS or “annual report” in the Fourth and Seventh EU Directives), by requiring the inclusion of more prospective information – without requiring preparers to perform impracticable tasks, or prompting so-called self-fulfilling prophecies – might also contribute to a fair presentation of the entity’s actual economic situation. We also suggested that the scope of the audit in Europe include the management report, provided any legislation in this respect also includes appropriate limitation of auditor liability in this respect.

We comment in turn on the four examples of financial reporting and consequent potential audit scope extensions:

a) Corporate Governance Arrangements

We suspect that users’ expectations as to what information might be included in the auditor’s report in respect of corporate governance arrangements could vary widely, such that an expectations gap in this respect would be unavoidable. The differences in corporate governance frameworks and requirements world-wide mean that this is an area that does not lend itself to standards setting by the PCAOB.

b) Business Model, Including the Sustainability Thereof

An entity’s business model is one aspect that auditors will consider in obtaining the understanding of the entity required by PCAOB Auditing Standards. The auditor also considers the viability of an entity to continue as a going concern for a period of at least 12 months subsequent to the date of the financial statements. However, this is an area upon which auditors do not form an opinion specifically; rather it is considered as part of the opinion on the financial statements as a whole.

We are open to reasonable suggestions relating to legal requirements to have the auditor examine the impact of the entity’s business model on the economic development of its business and how related risks are disclosed in the financial statements or in accompanying information. Provided there are appropriate financial reporting requirements (suitable criteria) in this area, the auditor may be able to consider management’s assessment of the

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opportunities and risks that result from the applied business model and consider whether their presentation in the financial statements or in accompanying information is adequate.

c) Enterprise-Wide Risk Management

In some jurisdictions there may be legal requirements for certain entities to have systems to manage risk, whilst in others there may not be. However, PCAOB Auditing Standards do require the auditor to obtain an understanding of whether the entity has a risk assessment process and – in the absence of such a process – to hold certain discussions with management and consider whether it represents a significant deficiency in internal control.

In Germany the IDW has had such an auditing standard since 1999, as certain German entities are required pursuant to the German Aktiengesetz (Stock Corporation Act) to have in place a Risikofrüherkennungssystem (risk early recognition system), which, in respect of listed entities, the auditor is required to address within the audit of the financial statements. The auditor is required to evaluate whether the entity's management has complied with the legal requirement to establish this risk early recognition system in a suitable form and also whether that system is capable of fulfilling its role. The auditor is required to report internally (in the German long form audit report) thereon. Those entities that are not listed entities, but which have such a system because of their size or complexity, often elect to have the auditor cover this aspect on a voluntary basis.

Furthermore, under banking legislation, financial institutions are required to have the appropriateness (that is, the design and implementation, but not the operating effectiveness) of certain aspects of the institution's risk management system as required by banking legislation and regulation audited by their auditors as part of the financial statement audit.

The IDW also has a standard on assurance engagements in relation to parts of enterprise compliance management systems, which, however, is not a part of the financial statement audit.

We would like to point out that in all of these engagements, the subject matter is not the entire enterprise-wide risk management system. Due to the comprehensiveness of enterprise-wide risk

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management systems, extending an audit of financial statements to the entire enterprise risk management system would involve considerably greater cost. Consequently, if an audit were to be extended to risk management, cost-benefit considerations may involve considering the scope of such an engagement in relation to certain aspects of risk management.

d) Key Performance Indicators

As financial reporting becomes more complex, users seek greater simplicity by reverting to key performance indicators (KPIs). Many of these KPIs are so-called “non-GAAP measures” – that is, they are developed by specific enterprises or represent loose industry practice. Prerequisites for auditor involvement with KPIs are suitable criteria for the development of appropriate KPIs and for their disclosure. At the present time, such suitable criteria are not yet available. However, once such criteria are available, auditor involvement may be beneficial to users.

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?

We believe that many users continue to find the “binary opinion” (the pass/fail model) useful, and would therefore support its retention. We believe that the pass/fail model facilitates good audit reporting, and in this context accept that some standardization in wording is unavoidable.

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

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 noted in our response to a) above, we believe retention of the pass/fail model is appropriate, and therefore no changes are needed in this regard.

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However, as noted in our response to Question 1 b) above, we do believe that it may be worthwhile to consider supplemental reporting. In particular, consideration might be given to exploring as to whether the auditor's report might highlight a summary of significant risks of material misstatement identified during the audit that are identified as significant financial reporting issues in the financial statements by management. However, it would have to be clear from the report that any such information did not represent any form of piecemeal opinion on isolated aspects of financial statements – the auditor opines the financial statements as a whole – and not individual financial statement items.

- 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.**

We believe that management is the most appropriate party to provide additional information regarding the company's financial statements to financial statement users. Please note our detailed response to Question 1 b) above on *the provision of additional information about the audit given current audit scope* for an explanation as to why.

- 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?**

We have no comments on this issue at the present time.

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

We do not believe that the PCAOB ought to consider an AD&A as an alternative for providing additional information in the auditor's report.

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

We do not support an AD&A as an alternative.

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?

If an AD&A were to be provided, as noted in our response to Question 1 b) above on the provision of additional information about the audit given current audit scope, the AD&A should comment on the audit, but not on the financial statements because 1. of the legal issues involved in having the auditor originating information on the financial statements and 2. the fact that having the auditor originate information in the financial statements blurs the respective roles of management and the auditor.

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?

As noted, we believe that information about an entity that would be most relevant and useful in making investment decisions ought to be provided by the management of an entity. It is only appropriate that auditors provide more information about the audit – not the financial statements.

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

We do not support an AD&A as an alternative because only management should be originating information about the entity. As noted in our response to Question 1 b) above on the provision of additional information about the audit given current audit scope, it is difficult to distinguish the provision of information about the audit from the provision of information about the entity. The concept of an AD&A presumes that a considerable amount of auditor commentary is possible or desirable, which is not necessarily the case.

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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?

As noted in our response to Question 1 b) above on the provision of additional information about the audit given current audit scope, consideration might be given to exploring as to whether the auditor's report might highlight a summary of significant risks of material misstatement identified during the audit that are identified as significant financial reporting issues in the financial statements by management. This approach would not involve the provision of information by the auditor that did not originate with management. However, it would have to be clear from the report that any such information did not represent any form of piecemeal opinion on isolated aspects of financial statements – the auditor opines the financial statements as a whole – and not individual financial statement items.

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)?

As we pointed out above, we do not consider an AD&A to be an appropriate vehicle to improve auditor reporting. We believe that, at most, consideration might be given to exploring as to whether the auditor's report might highlight a summary of significant risks of material misstatement identified during the audit that are identified as significant financial reporting issues in the financial statements by management.

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")?

As noted above, the AD&A should not include the auditor's views on the company's financial statements based on the audit, but rather highlight a summary of significant risks of material misstatement identified during the audit that are identified as significant financial reporting issues in the fi-

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nancial statements by management. Therefore, there is not appropriate content or level of detail regarding the auditor's views on the financial statements – it is not clear what “the auditor's views” means in this context. What criteria are to be applied for such “views”?

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

Since we do not support the use of an AD&A, we would not support either a standard or non-standard format.

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?

We would like to point out that it is unclear what such a discussion of other risks would entail because such a discussion would need to be prepared on the basis of suitable criteria, which do not exist at the present time. If suitable criteria were developed, then applying these criteria to such a discussion would not be a part of the current audit scope, but would involve broadening the current audit scope (i.e., the expansion of the auditor's current responsibilities as noted). Having the auditor apply criteria to these matters means that the auditor is actually obtaining assurance on these matters. The PCAOB would need to consider the costs and benefits of extending the scope of the audit beyond the financial statements and internal control.

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

Without in any way favoring the introduction of an AD&A, in general, the way to avoid boilerplate language is to have auditors address matters that are specific to an individual audit. However, it should be noted that when matters are addressed that are specific to an individual audit, by definition the reports cannot be consistent in these matters. The advantage of such inconsistency is however a reduction in the commoditization of audits. This is why we would support exploring as to whether the auditor's report might

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highlight a summary of significant risks of material misstatement identified during the audit that are identified as significant financial reporting issues in the financial statements by management.

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

We see few, if any, potential benefits of implementing an AD&A because the shortcomings that we noted above would negate those benefits. These potential shortcomings include having auditors originate entity information (which may not be legally possible or blur the role of auditors and management), and extending the scope of the audit without having the criteria in place so that assurance can be obtained.

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?

We believe that having the AD&A present inconsistent or competing information between the auditor and management would serve to confuse investors, and would therefore not be desirable: we therefore would expect no such inconsistent or competing information to remain in the AD&A and the financial statements, as auditors and management would seek to minimize such inconsistent or competing information to prevent such confusion.

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?

We believe that the release appears to confuse the justification used in France with emphasis of matter paragraphs as conceived in PCAOB Auditing Standards and emphasis of matter and other matter paragraphs as conceived in the ISAs. The French justification is an altogether different concept.

As noted in our previous responses above, it would be inappropriate for auditors to provide information in the auditor's report that originates solely from the entity or its financial statements. It is management's responsibility

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to help users “navigate” through complex financial reporting. As a matter of principle, the auditor’s report should not be used to supplement financial reporting or mitigate poor financial reporting. However, emphasis of matter paragraphs remain a useful tool as long as their use remains exceptional. We therefore believe that increased use of emphasis of matter paragraphs blurs the distinction between the responsibilities of management and of the auditor, would inappropriately change the nature of those paragraphs and their impact, and therefore the costs of increasing the use of these paragraphs are greater than the benefits. Emphasis of matter paragraphs should be used in rare circumstances when the auditor believes there is a need to highlight a matter that is appropriately disclosed and presented in the financial statements that is fundamental to users’ understanding of those financial statements.

On this basis, we believe that the PCAOB should make a clear distinction between emphasis of matter paragraphs for exceptional circumstances, and ordinary additional “auditor commentary” that would be provided in every audit, as we suggest in our response to Question 1 b) above, which involves supplemental reporting as to whether the auditor’s report might highlight a summary of significant risks of material misstatement identified during the audit that are identified as significant financial reporting issues in the financial statements by management.

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

We do not believe that the PCAOB ought to consider a requirement to include areas of emphasis in each audit report in an emphasis of matter paragraph because, as we noted in our response to Question 13, emphasis of matter paragraphs should be used in rare circumstances to highlight matters that are appropriately disclosed and presented in the financial statements but that are fundamental to users’ understanding of the financial statements. This should be distinguished from an “auditor commentary” that is included in every audit report that highlights a summary of significant risks of material misstatement identified during the audit that are identified as significant financial reporting is-

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sues in the financial statements by management. In this case, it would not be appropriate to provide information on key audit procedures because the procedures would either need to be described at such a high level so as to not be useful for users, or be described in such detail that the report would lead to information overload.

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?

As noted above, we do not support requiring an expanded emphasis of matter paragraph on the audit; it should be distinguished from an “auditor commentary” that is included in every audit report that highlights a summary of significant risks of material misstatement identified during the audit that are identified as significant financial reporting issues in the financial statements by management.

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

In our view, the appropriate content and level of detail regarding an “auditor commentary” as noted above would be a *summary* of significant risks of material misstatement identified during the audit that are identified as significant financial reporting issues in the financial statements by management. As noted, such a commentary should be distinguished from an emphasis of matter paragraph.

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

In general, the way to avoid boilerplate language is to have auditors address matters that are specific to an individual audit. However, it should be noted that when matters are addressed that are specific to an individual audit, by definition the reports cannot be consistent in these matters. The advantage of such inconsistency is however a reduction in the commoditization of audits. This is why we would support exploring as to whether the auditor's report might highlight a summary of significant risks of material

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misstatement identified during the audit that are identified as significant financial reporting issues in the financial statements by management.

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

The primary advantages of implementing an auditor commentary that highlights a summary of significant risks of material misstatement identified during the audit that are identified as significant financial reporting issues in the financial statements by management is the fact that such reporting would reduce the commoditization of audits by having a part of the audit report customized for matters that are specific to a particular audit. Furthermore, by addressing only those matters that are identified as significant financial reporting issues in the financial statements by management, the auditor would not be originating any entity information. This would help users understand the significant audit risks related to significant reporting issues. The shortcoming of implementing such commentary as a required and expanded emphasis of matter paragraph is the elimination of an instrument that enables the auditor to emphasize, in rare circumstances, matters of fundamental importance for users' understanding of the financial statements that have been appropriately disclosed and presented in those 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?

We believe that the PCAOB ought to consider auditor assurance on other information outside of the financial statements in addition to enhancing the auditor's reporting model. However, when considering to extend the scope of the audit in this way, the PCAOB must perform serious cost-benefit analyses of the potential impact of such extensions to ensure that there are significant net benefits to the public.

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

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We support auditor assurance on other information outside of the financial statements, but not as an alternative to enhancing auditor reporting, but as an additional consideration that involves expanding the scope of the audit.

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.

Two potential extensions of financial reporting and consequent potential extensions of audit scope include auditor involvement in prospective financial information and in information about business risks (as opposed to risk management), prepared by management. To the extent that prospective information were, in future, required to be disclosed in the financial statements or in information accompanying the financial statements, auditors are able to opine on whether the assumptions used by management are plausible in the circumstances, and whether the information has been appropriately prepared on the basis of those assumptions, but not on whether such forecasts will actually occur. However, if an audit engagement were to be extended to cover prospective financial information, care would be needed not to widen the expectations gap in view of the auditor's limited ability to predict the future. For example, including statements by the auditor as to the future profitability and the sustainability of the entity's business model in the auditor's report would involve the danger of increasing the expectations gap as to the ability of the auditor to predict future events. Auditors are often loath to accept assurance engagements with respect to such information in some jurisdictions because of legitimate liability concerns: therefore, liability reform is a prerequisite for auditor involvement with prospective financial information. In our comment letter to the EU Commission dated December 8, 2010 in respect of the Green Paper on auditing, we also suggested that expanding financial reporting, specifically the management report (also called "management commentary" by IFRS or "annual report" in the Fourth and Seventh EU Directives), by requiring the inclusion of more prospective information – without requiring preparers to perform impracticable tasks, or prompting so-called self-fulfilling prophecies – might also contribute to a fair presentation of the entity's actual economic situation. We also suggested that the scope of the audit in Europe include the manage-

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ment report, provided any legislation in this respect also includes appropriate limitation of auditor liability in this respect.

We comment in turn on the four examples of financial reporting and consequent potential audit scope extensions:

a) Corporate Governance Arrangements

We suspect that users' expectations as to what information might be included in the auditor's report in respect of corporate governance arrangements could vary widely, such that an expectations gap in this respect would be unavoidable. The differences in corporate governance frameworks and requirements world-wide mean that this is an area that does not lend itself to standards setting by the PCAOB.

b) Business Model, Including the Sustainability Thereof

An entity's business model is one aspect that auditors will consider in obtaining the understanding of the entity required by PCAOB Auditing Standards. The auditor also considers the viability of an entity to continue as a going concern for a period of at least 12 months subsequent to the date of the financial statements. However, this is an area upon which auditors do not form an opinion specifically; rather it is considered as part of the opinion on the financial statements as a whole.

We are open to reasonable suggestions relating to legal requirements to have the auditor examine the impact of the entity's business model on the economic development of its business and how related risks are disclosed in the financial statements or in accompanying information. Provided there are appropriate financial reporting requirements (suitable criteria) in this area, the auditor may be able to consider management's assessment of the opportunities and risks that result from the applied business model and consider whether their presentation in the financial statements or in accompanying information is adequate.

c) Enterprise-Wide Risk Management

In some jurisdictions there may be legal requirements for certain entities to have systems to manage risk, whilst in others there may not be. However, PCAOB Auditing Standards do require the auditor to obtain an understanding of whether the entity has a risk

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assessment process and – in the absence of such a process – to hold certain discussions with management and consider whether it represents a significant deficiency in internal control.

In Germany the IDW has had such an auditing standard since 1999, as certain German entities are required pursuant to the German Aktiengesetz (Stock Corporation Act) to have in place a Risikofrüherkennungssystem (risk early recognition system), which, in respect of listed entities, the auditor is required to address within the audit of the financial statements. The auditor is required to evaluate whether the entity's management has complied with the legal requirement to establish this risk early recognition system in a suitable form and also whether that system is capable of fulfilling its role. The auditor is required to report internally (in the German long form audit report) thereon. Those entities that are not listed entities, but which have such a system because of their size or complexity, often elect to have the auditor cover this aspect on a voluntary basis.

Furthermore, under banking legislation, financial institutions are required to have the appropriateness (that is, the design and implementation, but not the operating effectiveness) of certain aspects of the institution's risk management system as required by banking legislation and regulation audited by their auditors as part of the financial statement audit.

The IDW also has a standard on assurance engagements in relation to parts of enterprise compliance management systems, which, however, is not a part of the financial statement audit.

We would like to point out that in all of these engagements, the subject matter is not the entire enterprise-wide risk management system. Due to the comprehensiveness of enterprise-wide risk management systems, extending an audit of financial statements to the entire enterprise risk management system would involve considerably greater cost. Consequently, if an audit were to be extended to risk management, cost-benefit considerations may involve considering the scope of such an engagement in relation to certain aspects of risk management.

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d) Key Performance Indicators

As financial reporting becomes more complex, users seek greater simplicity by reverting to key performance indicators (KPIs). Many of these KPIs are so-called “non-GAAP measures” – that is, they are developed by specific enterprises or represent loose industry practice. Prerequisites for auditor involvement with KPIs are suitable criteria for the development of appropriate KPIs and for their disclosure. At the present time, such suitable criteria are not yet available. However, once such criteria are available, auditor involvement may be beneficial to users.

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

Whether reasonable or limited assurance would be appropriate depends upon the needs of investors and consideration of the relative costs and benefits of reasonable vs. limited assurance to support the credibility of the information in question. As a matter of principle, users generally prefer reasonable assurance unless the cost is prohibitive relative to the benefits.

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?**

Those portions of the MD&A for which sufficient appropriate evidence is available can be subject to assurance procedures, whereas those for which no such evidence is available should not be subject to assurance.

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

We expect subjecting the MD&A to assurance procedures would have the effect of causing the MD&A to distinguish more clearly between those parts that can be subjected to assurance procedures because sufficient appropriate evidence is available and those parts that cannot be subject to assurance procedures because such evidence is not available.

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- 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?**

We believe that AT sec. 701 is outdated: it does not reflect the progress that has been made in the IAASB for extant ISAE 3000, which was issued at the end of 2003. Furthermore, considerable progress is being made in further improving ISAE 3000 (see IAASB Exposure Draft to ISAE 3000). For these reasons, we believe that AT sec. 701 is not sufficient to have auditors obtain the appropriate level of auditor assurance on other information outside the financial statements. In particular, ISAE 3000 clarifies that practitioners do not "provide assurance": they obtain assurance that they then convey in their report (i.e., the assurance conveyed may not be that which users attribute). We suggest that the PCAOB consider revising AT sec. 701 to update it.

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

Since we do support the PCAOB exploring auditor assurance on other information outside the financial statements, we need not provide an explanation to this question.

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

The benefits of implementing auditor assurance on other information is that investors would have greater comfort that this information is credible. The shortcomings would be the potential cost of such assurance. Consequently, it is critical that the PCAOB consult with all stakeholders (preparers, auditors, investors and those charged with governance) to enable the PCAOB to perform serious cost-benefit analyses of potential assurance on other information.

21. **The Concept Release presents suggestions on how to clarify the auditor's report in the following areas:**

- **Reasonable assurance**

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- **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?**
- 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.**

We will address each of the clarifications in turn:

Reasonable Assurance

We are not convinced that stating that reasonable assurance is “high but not absolute” really provides any help whatsoever for users of audit reports other than explaining that an audit is not a guarantee (i.e., “not absolute”). As we noted in our comment letters to the PCAOB on proposed AS-5 and AS-2 dated February 26, 2007 dated November 21, 2003, respectively, and to the SEC on May 17, 2004), and as is noted in the FEE Papers “Principles of Assurance” from 2003 and “Selected Issues in Relation to Financial Statement Audits” from 2007, the use of the word “high” begs the question of “high in relation to what”? Certainly not in relation to absolute, because the evidence available and that thereof obtainable by the auditor varies by assertion, and the level of assurance is only an expression of the strength (that is, the combination of quality and quantity) of the evidence obtained. Consequently, using the phrase “high, but not absolute” misleads users into believing that auditors are able to obtain the same level of assurance for all of the assertions in the financial statements, which is ludicrous. The fact that current PCAOB auditing standards state that reasonable assurance is a high level of assurance doesn't make it any more true than having a regulator or standards setter claim that the sky is green rather than blue. If the PCAOB were to address the issue of reasonable assurance, then it would only be appropriate to do so by explaining the

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inherent limitations of an audit (see the above-noted FEE paper from 2007) to users.

Auditor's responsibility for fraud

We agree that, like the auditor's report under ISA 700, reference should be made to obtaining "reasonable assurance about whether the financial statements are free of material misstatement, *whether due to fraud or error*". This would clarify the nature of the auditor's responsibility.

Auditor's responsibility for financial statement disclosures

It may be useful to clarify to users in the auditor's report that the financial statements include the related notes (see ISA 700).

Management's responsibility for the preparation of the financial statements

We believe that one of the main purposes of the auditor's report is to reduce the expectations gap by clarifying to users what the role and responsibilities of the auditor are. The fact that even some sophisticated users are not sufficiently well informed about matters addressed in such paragraphs lends support to this view. This is especially the case if the auditor's report were to be expanded to provide additional auditor commentary. In this case, there may even be a need to include further clarification of responsibilities so that users do not misperceive the role of the auditor.

One of the main issues in this respect is that the financial statements are management's financial statements – not the auditor's financial statements. Consequently, a description of management's responsibilities is crucial to contrast the responsibility of the auditor from that of management and we would therefore support its inclusion with wording similar to that in ISA 700. Likewise, removing the description of what an audit involves would only serve to increase the expectations gap. We would therefore not support removing the paragraphs on the responsibilities of management or the auditor.

Auditor's responsibility for information outside the financial statements

A statement of an auditor's responsibilities with respect to other information may be useful, provided it clarifies precisely the information for which the auditor has a particular responsibility and the nature and extent of that responsibility to prevent a widening of the expectations gap.

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In our view, the auditor should report only when there is something to report, rather than also reporting that there is nothing to report. The costs of such a change are likely to be minimal: there may be an added benefit to have users understand the auditor's responsibilities in this regard, as long as these are clearly stated to prevent a widening of the expectations gap.

Auditor independence

Reference to auditor independence may provide useful information to users, and therefore is worthy of further consideration.

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?

It may be useful to also include short statements on the following to better communicate the nature of an audit and an auditor's responsibilities:

- Given user misconceptions about the inherent limitations of an audit, the explanation of the auditor's responsibilities ought to be enhanced by referring to the inherent limitations of an audit (which has the added benefit of helping to explain the meaning of "reasonable assurance")
- Given user misconceptions about what the role of an audit is, the third sentence of ISA 200.A1 or its equivalent ought to be added to clarify what an audit does not do, since some users believe that audits cover these matters.

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

There should be no implications to the scope of the audit or the auditor's responsibilities because these explanations serve only to clarify the scope of the audit and the auditor's responsibilities to users.

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

The benefits of providing the clarification noted in our response to Question 22 are that users would have a better understanding of what the respective responsibilities of management and the auditors are, and have a

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better understanding of the nature of an audit. The only drawback is that the audit report would be somewhat more lengthy with some more standard wording. However, we believe that this cost is worth the added benefit.

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?**
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?**

In our view the most effective options that can be addressed by the PCAOB without needing to expand audit scope would be:

- Addressing user misconceptions about audits by enhancing the explanation of auditor responsibilities in the auditor's report by referring to inherent limitations (which has the added benefit of helping to explain the meaning of "reasonable assurance"), and adding the third sentence of ISA 200.A1 or its equivalent to clarify what an audit does not do.
- Including a statement of an auditor's responsibilities with respect to other information that clarifies precisely the information for which the auditor has a particular responsibility and the nature and extent of that responsibility to prevent a widening of the expectations gap.
- Consideration of providing auditor commentary that highlights a summary of significant risks of material misstatement that are identified as significant financial reporting issues in the financial statements by management.
- Furthermore, the PCAOB ought to consider strengthening auditor reporting to those charged with governance, which does not affect audit scope.

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25. What alternatives not mentioned in this Concept Release should the Board consider?

One matter that we have not addressed in the body of our letter or in the responses to the questions above is whether management ought to be required by financial reporting standards to provide an assessment of its use of the going concern assumption in every financial statement. Auditors' reports could then be required to include disclosure by the auditor of the auditor's consideration of management's use of the going concern assumption in the financial statements. However, as this is a financial reporting matter in the first instance, this issue would need further discussion with legislators, accounting regulators and financial reporting standards setters before being placed on an audit standards setting agenda.

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?

We agree that the development of an auditor reporting framework would be advantageous. However, we would like to point out that the development of an auditor reporting framework depends on the development of a conceptual framework for auditing, which as yet no standards setter has attempted. We therefore suggest that without such a conceptual framework for auditing, the PCAOB should first seek to be less ambitious by developing reporting criteria.

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?

We agree that users may perceive some or all of the alternatives as providing a qualified or piecemeal opinion. Consequently, it is critical that it be clear from the report that any such information did not represent any form of piecemeal opinion on isolated aspects of financial statements – the auditor opines the financial statements as a whole – and not individual financial statement items. Therefore, the PCAOB would need to consider wording in the report that clarifies the nature of any assertions made by the auditor in, for example, an auditor's commentary, by stating that these

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are not audit opinions, but conclusions reached in forming the audit opinion.

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?

We believe that the alternatives that we have provided in response to Question 24 would be best in conveying to users the auditor's role in the performance of an audit. The other alternatives proposed would either not convey the auditor's role or, in some cases, just expand the scope of the audit.

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

Since the various alternatives deal with the form, structure, wording and content of the report, or extending the scope of the audit, none of the alternatives ought to have an impact on the quality of the audit disregarding reporting. However, improved auditor reporting will increase audit quality in the eyes of users.

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 an exclusion.

In our view, the changes to the reporting model as we suggest ought to be considered for financial statements of public companies. We do not comment on whether the changed reporting model is appropriate for investment companies, investment advisors, brokers and dealers, and others. We expect the effect of applying our suggestions to the audit of public companies would lead to users valuing the audit more than previously.

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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?

In our view, all of these considerations need to be balanced – that is audit effort, and hence cost, needs to be balanced with the expected benefits of increased communication or expansion of audit scope. Likewise, liability considerations are important when considering expanding audit scope beyond the financial statements to other information – particularly when that other information is “soft” in character or lacks evidence. It is also critical not to blur the distinction between the roles of management and those of the auditor when seeking to convey entity information to users, which may violate legal confidentiality requirements in some jurisdictions. It is also important not to confuse information needed by users with that needed by audit committees in their governance role.

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?

Changes to the standardized wording of the auditor's report are not costless, but if done judiciously the cost of those changes can generally be easily justified by the benefits. With respect to expanding auditor reporting as we suggested, or to expand the scope of the audit, we believe that the PCAOB must engage in a rigorous cost-benefit analysis to ensure that the benefits of proposed changes exceed the cost.

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?

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

We are not aware of any other considerations that we have not already mentioned in our responses to the other Questions.

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- 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?**

As we had noted previously, we believe it to be inappropriate for the auditor to originate in the auditor's report information on the company's financial statements: such information should be provided by management.