



September 30, 2011

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

Dear Board Members:

The Audit and Assurance Services Committee of the Illinois CPA Society (“Committee”) is pleased to comment on the Concept Release on Possible Revisions to PCAOB Standards Related To Reports On Audited Financial Statements (Docket Matter No. 34) dated June 21, 2011. The organization and operating procedures of the Committee are reflected in the attached Appendix A to this letter. These comments and recommendations represent the position of the Illinois CPA Society rather than any members of the Committee or of the organizations with which such members are associated.

### ***Executive Summary***

Our Committee is in favor of adding clarity to the auditor’s report so that the responsibilities of the auditor, management and the audit committee are better understood by financial statement users. As described further in the following responses, our Committee is opposed to any mandatory expansion of the auditor’s role into areas that we believe are the responsibility of management. Accordingly, we oppose a requirement to include an AD&A and have certain reservations regarding the required use of expanded emphasis of matter paragraphs and auditor reporting on information outside of the financial statements.

1. *Many have suggested that the auditor's report, and in some cases, the auditor's role, should be expanded so that it is more relevant and useful to investors and other users of financial statements.*
  - a. *Should the Board undertake a standard-setting initiative to consider improvements to the auditor's reporting model? Why or why not?*

Yes. If investors or other users feel the current reporting model is becoming less relevant, then the Board should seek to increase the auditor’s relevancy and communication to them. However, extreme caution should be exercised so that the objective of the initiative and resulting standards solely improves relevancy and communication of the auditor and the results of the audit. We believe many of the potential changes described in the concept release have the ultimate impact of shifting the responsibility of due diligence about an entity for investment purposes from the investor to the auditor; or shifting the responsibility for full financial statement disclosure and analysis about significant matters from management to the auditor. Transferring these responsibilities must be avoided as it could lead to an adverse effect on the



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credibility of financial reporting and ultimately impair the auditor's objectivity and independence as well as its ability to perform a cost-effective audit in a timely manner. Further, many of the potential changes in the concept release seem to change the definition of an audit. If changing the definition of an audit is the desire of the Board, the Board should consider exposing a specific model describing such changes rather than having such overarching changes to auditor responsibility be an unintended consequence of this proposal.

- 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?*

As further described in our responses to Questions 21 and 22, we believe that the language in the auditor's report could be clarified. Also as further described herein, we believe that management should be responsible to provide much of the additional information that investors and others claim they need by means of additional note disclosures in an entity's financial statements or expanded MD&A requirements. Auditor reporting should continue to primarily focus on communicating whether the auditor considers the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

- 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?*

In general, the Committee is not opposed to mandatory auditor reporting on information outside of the financial statements as long as there is appropriate, objective guidance on how the auditor is to accomplish such reporting. We believe, in particular, that one reporting option should include a report that simply indicates the auditor's current AU 550 responsibility in regards to information outside of the financial statements.

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?*

While we do not necessarily agree that the characterization of the current model of reporting as simply "pass/fail" is appropriate, we do believe that the auditor's report should retain the current model. Changing the model would result in ambiguous auditor opinions that could easily be misinterpreted by the



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users of the financial statements. The current model provides consistency and comparability in opinions.

We do note that the current model of reporting provides for numerous variations in reporting, such as scope limitations, departures from generally accepted accounting principles and adverse opinions. We believe the variety of responses provided for in the literature is sufficient to cover the needs of users.

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

Not applicable based on prior response.

*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 set forth in our answers to Questions 21 and 22 herein, the clarification of language in the standard auditor's report could be appropriate. However, although we agree with the Board's suggestion for clarification to include an enhanced discussion about the "auditor's responsibility for fraud," we also believe that the discussion of "management's responsibility" should also include a statement that management is ultimately responsible for the prevention and detection of fraud.

*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.*

As stated throughout our response to the Concept Release, management and the audit committee members are the most appropriate parties to provide additional information to financial statement users regarding the entity's financial statements. They are intimately involved with the business on a day-to-day basis and have knowledge of all information affecting it, including business risks, strategic risks, and operational risks.

*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?*



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Based upon our answers to the questions throughout this document, the current guidance included in Auditing Standards No. 5 is appropriate when an auditor is engaged to perform an audit of management's assessment of the effectiveness of internal control over financial reporting that is integrated with an audit of the financial statements. We do not support the reporting alternative that includes an AD&A and therefore, we believe that no changes to Auditing Standards No. 5 are necessary.

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

Our Committee does not believe that the Board should consider an AD&A as a means of providing additional information to the auditor's report.

If additional information is needed specifically for investment decisions, it should be prepared and presented by management to the extent that current or revised disclosure rules require or as management deems appropriate. Relevant investment information is readily and easily available from a variety of different sources, such as company web sites, company press releases, company investor calls, industry publications and web sites, and the like that would be appreciably more useful to investors than information provided in regards to historical financial statements by the auditors. These other communication vehicles could provide management a means to enhance relevant information to investors.

One of the basic underlying principles of auditing is that the auditor performs audit services for the benefit of ALL of the people, not necessarily or specifically for one group, e.g. the investment community. Furthermore, the auditor stands between management and the investment community and must be viewed as independent of each. The auditor should not be viewed as an advocate of either party. In addition, auditing standards should not force the auditor into a position of addressing investment risk. While the auditor's role certainly includes a focus on investor protection, that role is, as it should be, limited to assessing management's historical financial statements' compliance with the appropriate financial reporting framework. Auditors do not have the necessary training or experience with investment principles to best determine what information is most appropriate to an investment decision.

The investment community, in its desire for enhanced auditor reporting, such as the reporting considered in an AD&A, appears to be attempting to shift its own investment due diligence responsibilities to the auditor.

In addition, we believe that the incremental cost of providing the type of information proposed for an AD&A could be substantial in terms of efforts by the auditor, efforts by management in 'negotiating' with the auditor the extent of the AD&A disclosures, timeliness of reporting and ultimate financial burden to the company.

5. *Should the Board consider an AD&A as an alternative for providing additional information in the auditor's report?*
  - a. *If you support an AD&A as an alternative, provide an explanation as to why?*



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The Committee does not support 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?*

As described above, our Committee does not support an AD&A alternative. The responsibility of providing additional information about a company's financial statements should reside with the company itself. As described in other parts of this response letter, to provide audit-related comments in sufficient detail to be well understood by readers who are not educated and experienced with the audit process is impractical.

- 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?*

Information about how management views its financial statements and the risks it faces in operating its business are inherent in the estimates it makes to prepare those financial statements would be relevant and useful in making investment decisions. However, as described above, we do not believe it is the auditor's role to provide such information.

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

We do not support an AD&A as an alternative for providing additional information in the auditor's report. The Concept Release suggests that the intention of having an AD&A is to facilitate an understanding of the auditor's opinion on the financial statements taken as a whole. We believe that the current auditor's report is quite clear as to whether the auditor considers management's financial statements are presented fairly in all material respects in conformity with the applicable financial reporting framework. Further explanation of that opinion would necessitate significant additional guidance in the auditing standards to provide the auditor with instructions as to what particular aspects to consider in this explanation and how to describe such matters. Absent such guidance, the auditor would be asked to incur significant litigation risk by determining, on its own, what matters should be considered and described. Ultimately, this atmosphere will create additional market turmoil and distrust, the very environment the PCAOB wants to avoid with the current Concept Release. Management, and not the auditor, is responsible for the financial statements. As described, the AD&A appears to place responsibility for interpreting the financial statements with the auditor or, at a minimum, place the auditor as an investment analyst.

Auditing is an art, not a science. Auditors form their opinion on the financial statements based on judgments that require an evaluation of many relevant factors at one time. These factors include information widely available to the public, such as the



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general economic environment and industry climate, as well as factors specific to the company, such as corporate culture, management's operating style and competency, the specific findings from auditor procedures and auditor inquiries.

The judgments auditors form are so involved that to explain only specific portions of the audit in the AD&A will lead to more investor confusion, incorrect expectations and misleading conclusions. Audit risk and procedures performed as a response to those risks require years of training and experience to properly understand and assess. Most users of the financial statements do not have experience performing audits to determine whether the audit judgments are appropriate or comparable between entities - even between entities in the same industry or of the same size. A proper audit response will be different for two entities in the same industry because of the totality of each entity's specific processes, internal controls, culture, strategy, and people. For example, auditors may correctly designate different risks for two different companies in the same industry, located in the same city, operating under similar economic and other conditions because one of the two companies has highly qualified professionals using well designed and operating internal controls while the other may not. These differences do not necessarily translate into one company's audited financial statements being any more or less reliable than the other's. If both sets of financial statements received unmodified auditor's reports, then the investor has reasonable comfort that – regardless of the specific risks to each company – the audited financial statements are fairly stated in all material respects in accordance with the appropriate financial reporting framework.

An AD&A cannot realistically present the myriad of nuances involved in making auditor judgments, particularly without providing the audited company with too much insight into the audit process, including fraud procedures and rotation of audit procedures. The Concept Release states the AD&A is “not intended to provide separate assurance” on the financial statements. However, the typical investor could easily believe that the auditor is, in fact, providing incremental assurance or doubts as to the financial statements by its comments in an AD&A. Investors struggle with understanding the meaning of an audit opinion as is. Adding this additional requirement will likely increase the expectation gap. This confusion might also be compounded by making this AD&A requirement only applicable to U.S. public companies. Users of financial statements of non-U.S. and/or private companies will be less certain that the auditor's role is as robust in those circumstances and thereby reduce investor confidence.

Additionally, the AD&A requirement may add tension between management and the auditor. The AD&A adds an element of management bargaining with the auditor to limit its disclosures in the AD&A – almost all of which will serve to heighten investor concern about the company. Such bargaining might include management changing what it otherwise believes to be appropriate accounting or disclosure to appease the auditor in an effort to avoid adversarial auditor disclosures in the AD&A.



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Ultimately, AD&A disclosures regarding estimates in the company's financial statements will allude to the likelihood of future events and trends. The auditor should not be in a position – even if just in appearance – to comment or provide any assurance on such forward-looking matters, unless specifically engaged to report on projections in a restricted report.

- 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?*

Alternatives already exist for the auditor to provide its more detailed assessment of management's financial statements, including consideration of internal controls, acceptability and appropriateness of selected accounting policies, critical accounting policies and the like. PCAOB standards require such communications between the auditor and the company's audit committee. As management is typically present when such communications are made, either the audit committee or management can leverage those communications into whatever public disclosures they deem necessary or are required by current or revised SEC or financial reporting framework standards. We note that the two-way dialogue explicit in the auditor/audit committee communication is critical to its complete understanding by all parties. Trying to put such communications into an AD&A is not feasible. As such, we suspect that it would be similarly difficult for management to make public disclosures regarding some of the auditor/audit committee communications. However, if the investors demand additional information in this regard, we believe that enhanced accounting and footnote or other disclosure requirements to which the company would be bound might serve that objective.

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)?*

Overall, we do not support the addition of an AD&A. However, if the AD&A is incorporated into professional standards, it should focus on items that the auditor noted of relevance, not those items deemed to be relevant from management's point of view. Items in this category include independence issues and any disagreements with management and their resolution. An AD&A should not include items considered audit team judgments requiring an auditor's breadth and depth of knowledge and experience to understand. Such matters include audit team decisions, audit risks, and audit procedures. Furthermore, auditor disclosure of some of these matters could jeopardize the effectiveness of future audits by informing management of the auditor's plan.

7. *What types of information should an AD&A include about an 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 procedures, and difficult or contentious issues, including "close calls")?*



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Overall, we do not support the addition of an AD&A. As described above, we believe that the auditor's overall view on the company's financial statements is already clearly articulated in the current standard auditor's report. Publicly providing more detailed views could be interpreted as adding piecemeal qualifications of the auditor's overall opinion on the financial statements taken as a whole. Such auditor disclosures could also be perceived to impact its independence. An AD&A should not include the auditor's views or opinions of the financial statements because it may leave an impression that the auditor "approves" all items not specifically mentioned in the AD&A. "Close calls" should not be disclosed as it would not be practical to adequately explain the full spectrum of information used in the judgment. As such, investors will interpret items out of context and potentially make inappropriate investment and other decisions, particularly if they compare auditor comments between companies and even between periods.

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

Regardless of whether or not a standard AD&A format is released, audit firms will gravitate to a common presentation within their own firm and amongst each other – perhaps even as a means to be able to issue the financial statements timely. Firms will want to work together to find a similar method for communicating the AD&A in an effort to minimize perceived litigation risks associated with such disclosures. Investors will more readily understand a common format and consistent wording if the AD&A is standardized. Additionally, there is less risk of an auditor being scrutinized only because its AD&A is formatted or worded differently.

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 benefit of increased information for investors is enhanced decision making ability. However, an AD&A, in this capacity, will expand the responsibilities and role of an auditor while reducing those of management. Allowing management less culpability will only increase the likelihood of corporate corruption and investor insecurity. The auditor is not in the best position to provide this information; management and the audit committee should communicate such matters. Management best understands the entity and its operating environment. To a certain extent, some of this information should remain confidential within the company. Companies are at a distinct disadvantage if they have to disclose business and operational risks to competitors that are not public registrants. Ultimately, such AD&A disclosures may dissuade U.S. security market participation.

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

We hypothesize that firms will adopt boilerplate language as described above.

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





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As indicated throughout our response, we see minimal, if any, benefit and significant shortcomings in this proposal. An additional shortcoming is the likely continued overreliance by the user community on the literal wording in the financial statements as opposed to users utilizing their own knowledge and experience in reading and analyzing management's financial statements and commentary, including the MD&A. Additionally, the AD&A will increase the cost of an audit and the time it takes to provide investors with the audited financial statements.

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?*

The AD&A could provide competing views of the financial statements. The differences in disclosures will reduce investor's confidence in management and create an adversarial relationship and atmosphere between the auditor and management. This tension is already apparent even in the auditor's communications with the audit committee whereby management often tries to dissuade auditors from raising potentially concerning matters with the audit committee. Additionally, AD&A disclosures could confuse investors and decrease the credibility of audit opinions in general.

### ***Required and Expanded Use of Emphasis Paragraphs***

In general, the consensus of the Committee is that the required and expanded use of emphasis paragraphs, while providing another means to highlight and reference certain matters that are deemed significant to the financial statements, will not necessarily provide a user of the financial statements with appreciably more information than is already provided in current financial reporting. Having the auditor make such highlights and references in its report does indicate what another informed constituent believes is significant to the financial statements, but the matters that are likely to be highlighted will already be described in the U.S. GAAP compliant financial statements and related disclosures, Management's Discussion and Analysis (including Critical Accounting Policies) and elsewhere in current reporting. In many if not most cases, the matters that an auditor would highlight in its report will not be different than the matters management describes in fulfilling its responsibility in preparing such reports.

A strong consensus of the Committee was that any required or expanded use of emphasis paragraphs should not include a discussion of audit procedures performed by the auditor in regards to the matters described therein. It is impractical to expect the whole body of audit procedures that serve to mitigate audit risk in any single particular area to be adequately described in such paragraphs and incomplete descriptions (which will result particularly if the requirement is to describe only *key* procedures) will only serve to cast doubt in a reader's mind as to the adequacy of such procedures. For this and several other reasons, the Committee is opposed to any requirements to describe audit procedures.



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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?*

Yes. However, the description of such matters in the auditor's report would necessarily not be sufficiently comprehensive to provide adequate information to help make such decisions. As the auditor's report would also reference further descriptions of the identified matters, the report merely acts as a cross reference guide to information that should otherwise already be more detailed in the footnotes and elsewhere in the filing. It can certainly be envisioned that the auditor's description of such matters in its report may contain incremental information about the matter that is not part of the required disclosure under US GAAP; however, such limited incremental information is not likely to completely address the matter in any case.

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

The Committee is not convinced that providing highlights of matters deemed to be significant to the financial statements will appreciably serve the purpose of better informing readers of the financial statements. If such a requirement is mandated, it must be flexible enough to allow adequate auditor judgment as to what matters to include in these paragraphs, including not describing any such matters if none are deemed significant to warrant more heightened identification.

If such a requirement is not mandated, there is a risk that audit committees, when selecting their independent auditing firm, begin to consider whether an auditor does or does not routinely include such paragraphs in its reports.

As described above, the Committee is opposed to describing any audit procedures in the emphasis paragraphs or any other communication.

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?*

In addition to the matters included in the illustrative emphasis paragraphs (excluding key auditing procedures) and as already provided as examples in current PCAOB standards, other matters that an auditor might consider identifying include significant non-routine transactions, selection of alternative new accounting policies or practices that might have significant alternative impacts, changes in prior period estimates that resulted in a significant impact on earnings and that the audit process does not mitigate all risk that future events and developments will not result in material adjustments in the financial statements.



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The level of detail in which to describe such matters should be limited to objective facts and only a brief description sufficient to provide a basic understanding of the applicable matter and a specific reference to the footnote where more comprehensive detail can be found. Auditor judgment will be required as to whether specific account balances, if applicable, are required to convey that basic understanding. A requirement for the auditor to specifically describe the particular risks that a specific matter might raise in the financial statements would necessitate lengthy descriptions and potentially dilute the confidence in the auditor's overall opinion regarding the financial statements taken as a whole.

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

See above response 15.

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

With the potential conflicts that might arise between auditors and management about the descriptions of matters in this paragraph and the litigation risk that auditors will try to avoid, it is difficult to contemplate that a certain amount of the language will not become boilerplate. It is possible that the resulting boilerplate language will adequately provide the required information and thereby not be a detriment. Unique matters that effect different companies' and different industries' financial statements should naturally prompt unique descriptions in some areas. The more prescriptive the Staff's requirements are (and some prescription will be required to drive some appreciable level of consistency as to what descriptions are required), the greater the tendency to become boilerplate.

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

Potential Benefits:

- Highlighting matters the auditor considers significant to the company's financial statements will provide readers with direction on where to focus their attention
- Footnote disclosures may improve if auditors insist or encourage additional description of the matters in the footnotes to avoid lengthy descriptions in the auditor's report
- Simply describing the significant matters should not significantly increase efforts or cost of auditing the financial statements
- Potential decreased liability to companies and auditors as significant matters are more prominently highlighted and less likely to be overlooked by users of the financial statements.



#### Potential Shortcomings:

- Increase conflicts between auditors and management in regards to what matters to disclose and how they are described in the auditor's report
- Potential dilution of the confidence of the auditor's opinion on the financial statements as a whole due to the highlighting of risk areas
- Determining what and how to disclose matters in the auditor's report and discussing those decisions with management and audit committees may appreciably increase auditor efforts and audit costs and delay financial statement issuance.
- Duplication of descriptions in the footnotes and/or other parts of the periodic reports will decrease the effectiveness of the proposed model
- Potential increased liability to companies and auditors if matters not included in recent reports eventually have significant adverse impact on investors

#### ***Auditor Assurance on Other Information Outside the Financial Statements***

In general, the Committee is not opposed to mandatory auditor reporting on information outside of the financial statements as long as there is appropriate, objective guidance on how the auditor is to accomplish such reporting. We believe, in particular, that one reporting option should include a report that simply indicates the auditor's current AU 550 responsibility in regards to information outside of the financial statements.

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

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

Auditor assurance on other information outside of the financial statements would provide users some additional comfort regarding the completeness and appropriateness of the information presented as compared to the SEC or other requirements for disclosure of such information. However, this auditor reporting must stop short of providing the auditor's detailed views on the company's financial statements and of describing audit procedures. The auditor reporting must be limited to no more than an examination or review of the other information, generally as contemplated by AT Sec. 701 for auditor reporting on MD&A.

*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?*



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Auditor reporting should be limited to financial statement-related information. However, great care must be taken not to associate auditor reporting on information that includes forward looking statements or expectations. Even limited auditor assurance on such areas of information can be inappropriately perceived as the auditor providing its views on such forward looking statements or expectations. In any case, applicable auditing standards would need to be developed to provide guidance to auditors as to how to accomplish the required reporting (other than for MD&A). We also recommend that auditor reporting on other information outside of the financial statements be available, but not required in most circumstances.

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

The level of assurance contemplated in AT Sec. 701 appears appropriate, or, as suggested in the introduction to this section of our response, assurance equivalent to the current AU 550 requirements can be provided.

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

As the current MD&A requirements contemplate significant forward looking statements and expectations, it does not seem appropriate to mandate auditor reporting on all of MD&A. However, the Critical Accounting Policies and Contractual Obligations section of MD&A is generally important to investors and could be subject to auditor reporting. Additionally, reporting on strictly historical comparisons of operating results and liquidity could be possible.

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

The Committee does not believe auditor reporting will significantly affect the nature of MD&A disclosures. Management is already aware of the auditor's responsibility to read the MD&A and consider whether such information or the manner of presentation is materially inconsistent with the financial statements or represents a material misstatement of fact. However, we do believe that specific reporting on MD&A could prompt management to better comply with the spirit of MD&A disclosure requirements thereby improving the final product.

- 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 do believe that the current requirements are sufficient. As described above, reporting only on auditor responsibilities as contemplated under AU 550 would also be appropriate.



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

Management is responsible for information presented in MD&A, earnings releases, and other communications about their company and that responsibility should not be shifted in any way to the auditor. Management should be responsible to its investors first and foremost. However, as long as auditor reporting on such information is limited as described above and does not serve to shift responsibility, the Committee is not opposed to certain mandatory auditor reporting on such information.

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

Potential benefits

- Investors gain incremental comfort in the other information because of the auditor's reporting thereon
- Users would be more conscious of the auditor's requirement to review MD&A for consistency with the audited financial statements
- Filers may become more conscientious in preparing their filings

Potential shortcomings

- Increased audit effort and increased fees
- Increase time to release the filing because of the additional procedures
- Decrease in market participation due to the prior shortcomings
- Possibility that investors assume more auditor assurance than is actually given on such information
- Increased responsibility and increased legal liability for auditors

***Clarification of the Standard Auditor's Report***

In general, the consensus of the Committee was that clarification of the standard auditor's report is appropriate. Information that might enhance a financial statement user's understanding of the audit process and auditor's, management's and the audit committee's roles in regards to the audited financial statements would be beneficial. We concur with the specific items that the staff suggests might be clarified, subject to two caveats. First, the clarifications will need to be succinct so as not to lengthen the standard auditor's report to an extent that it distracts the reader from the auditor's opinion on the financial statements. Second, the clarifications will need to be worded such that they do not read as if the auditor is attempting to relinquish or diminish its responsibilities to accurately report on the financial statements.

Another alternative, or perhaps a supplemental alternative, is for the auditor's report to provide a cross reference to a more complete description of what a public company auditor's role and



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responsibilities are and what level of assurance a compliant audit might provide. The referenced materials can be either a standard exhibit in all filings or available to the general public on a free basis from a named web-site.

*21. a. Do you believe some or all of {the clarifications described in the concept release} are appropriate? Is so, explain which of these clarifications is appropriate? How should auditor's reports be clarified?*

We agree that each of the noted matters should be clarified in the standard auditor's report. We make reference to the Center for Audit Quality's June 9, 2011 letter addressed to Mr. Martin Bauman of the PCAOB. The clarifications of these matters provided in the example standard auditor's report in that letter are adequate – both succinct and appropriately tailored to not appear to diminish the auditor's responsibilities. That example report also provides clarity as to a) the audit committee's responsibility for financial statements, b) the audit firm network structure and related matters, c) what is meant by 'material misstatement' and the auditor's general approach to determining 'materiality', d) the auditor's professional judgment in making audit risk assessments and in selecting audit procedures, e) the auditor's responsibility if the financial statements are not in accordance with the appropriate financial reporting framework or when audit scope has been limited and f) the addressees of the report. We have no objections to clarifying these matters or the manner in which the example report does so.

*21. 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?*

These clarifications would serve the indicated purpose. As noted above, an even more comprehensive description of these matters as cross referenced from the auditor's report would be even more valuable (absent undue length which might reduce its impact). The more financial statement users understand about the public company auditor and its responsibilities in regards to the audited financial statements, the more informed they will be as to the level of assurance the auditor provides in its report as to the fair presentation of the financial statements. While this incremental understanding does not necessarily translate into a better understanding of what risks might reside in those financial statements, it nonetheless allows the user to better appreciate how the auditor may have addressed such risk as part of its audit.

*21. 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?*

See responses above. In addition, although we agree with the Board's suggestion for clarification to include an enhanced discussion about the "auditor's responsibility for fraud," we also believe that the discussion of "management's responsibility" should also include a statement that



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management is ultimately responsible for the prevention and detection of fraud.

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

We do not believe the clarifications described or referred to above would significantly impact the scope of the audit or the responsibilities of the auditor.

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

Potential Benefits:

- Enhanced understanding by audited financial statement users of the differing roles and responsibilities between management, audit committees and auditors in the presentation of those statements
- Enhanced understanding by audited financial statement users of the audit process and the level and areas of assurance provided in an auditor's report

Potential Shortcomings:

- Either the additional length of the auditor's report necessary to more fully clarify its terms and other matters or the need to obtain and read a separate document
- In an attempt to cover all areas of importance, the clarifications are truncated to reduce length, thereby reducing – rather than increasing – clarity
- Reduced focus on the auditor's opinion regarding the financial statements

### ***All Alternatives***

23. *The 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?*

Our Committee believes the most appropriate alternatives are clarification of certain language in the auditor's report and potentially the expanded use of the emphasis paragraphs in the auditor's report. We believe that the current "pass/fail" model of reporting continues to be the best method to communicate the auditor's conclusion. Therefore, clarification of the terms used in the report and the concepts and limitations of the auditor's opinion would be helpful to the users of the financial statements. We also believe that expanded use of the emphasis paragraph could improve the auditor's report by directing users of the statements to footnotes where management describes issues that are essential for the reader to be aware of when evaluating the financial information. We believe that expanded





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footnote and other management-provided disclosures that provide more completely the information that investors are requesting is the best way to inform the reader of risks related to the financial statements.

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 prior response. We believe that a combination of clarification and an expanded use of the emphasis paragraph would be the best combination of improving auditor communication.

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

The historical approach to communicating the auditor's findings through a "pass/fail" auditor's report continues to be an acceptable overall approach.

Should one of the alternatives described in the Concept Release or a combination of them and/or other alternatives become PCAOB standards, the Board might consider whether any of them should be limited to only specific issuers – for example, just for large accelerated filers or just for issuers in certain industries.

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?*

Auditors are not and should not be financial advisors; therefore, reporting frameworks should be based on a concept that the auditor tested management's financial information. The conclusions of the auditor should be easy for a reader to clearly understand and be based on independently verifiable evidence. This basic concept precludes an auditor from giving its perspective on the reasonableness of information provided in MD&A that cannot be independently verified.

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?*

Our Committee believes that users could perceive that the auditors are providing a qualified or piecemeal opinion such as:

- The AD&A discussion of audit issues changes the users' perception of the value of the auditor's opinion.



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- A report that includes multiple emphasis paragraphs could also devalue the auditor's opinion.
- The auditor reporting on other information could be perceived, when combined with the auditor's report, as a piecemeal opinion.
- The clarification of terms in the auditor report reach the level that it appears the auditor is attempting to diminish its responsibility and/or lengthens the report to the point it becomes unreadable.

The Board should remain cognizant of the fundamental principles on which an auditor's opinion is based. Any changes to the auditor's reporting model should continue to emphasize auditor independence from management and be based on information obtained through auditor procedures.

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? What is the basis for your view?*

Further clarification in the auditor's report of the auditor's role in the performance of an audit could, if properly written, convey a better understanding of the auditor's role to the users of financial statements.

The other alternatives could lead the user to the conclusion that the auditor's opinion has too many caveats and therefore cannot be relied upon.

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

AD&A and auditor's reporting on other information could reduce audit quality since management and the audit committee would be more guarded about sensitive information because of the risk that the auditor's interpretations of the facts would be reported to the public. Such measures could lead to a) less open discussions between the auditor, management and the audit committee about significant audit issues and b) more boilerplate disclosures in an attempt to avoid issues and limit litigation risk.

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 advisors, brokers and dealers, and others? What would be the effects of applying the alternatives discussed in the concept release to the audit reports of other 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.*

Our Committee has not formed an opinion on this question.



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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?*

All of these considerations are important. Attempting to identify the “most” important should not be seen as relegating the other considerations to an “unimportant” category. Perhaps the most important consideration is the credibility of the auditor’s opinion. The “pass/fail” approach to providing an opinion on financial statements has been in place for decades for a good reason, it works effectively. Although different auditors interpret the “pass/fail” line at somewhat different points, and decisions such as a company’s ability to continue as a going concern, remain subjective, there is a well-established framework within which a user of financial statements can have a significant level of confidence in the auditor’s opinion.

The Board’s efforts to enhance the auditor’s reporting model seem to focus primarily on the needs of users in the investment community. These users have a higher level of “competence” in evaluating information available to them from a myriad of sources in making investment decisions. The audited financial statements are a key, but not the only, component in making their decisions. As auditors expand the scope of information over which they opine, the question of competency to do so will be an element in how investors evaluate such information. As historical information more appropriately subject to the audit process becomes combined with forward-looking information which is less subject to that process, sophisticated users will begin to question the auditor’s overall opinion on all information. This dilution of credibility would likely have the impact of cheapening the value of the auditor’s opinion and ultimately, market confidence.

The existing relationship between the auditor and management will also likely change significantly under certain of the options presented in this proposal. Currently, the auditor depends on ongoing, open, honest communications with management. Certain matters that impact the decisions that frame an auditor’s opinion are shared by management because it understands much of that information – which may include confidential information as well as competitive information – will remain out of the public domain. Under the current model, there is proper and appropriate exposure to the audit committee and those charged with governance; and the “pass/fail” framework serves to protect the confidentiality where warranted. For example, assume that in the course of the audit, the auditor becomes aware of certain weaknesses in internal controls, and management is not required to obtain an auditor’s report on controls. The auditor, under current auditing standards, is



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obligated to inform those charged with governance of his or her concerns about the impact those weaknesses might have on the presentation of financial statements and/or the conservation of the entity's assets. This creates a positive atmosphere wherein the auditors can express their concerns, and management can evaluate the seriousness of the auditor's concerns and take appropriate actions. This is a "win-win" situation for the auditor and management. However, in a scenario where such control weakness(es) are made public, there would be a win-lose or a lose-lose scenario. The open communication that both auditor and management need to identify and evaluate the control weakness(es) suffers in management's attempt to keep the issues private. The users of the financial statements are left to wonder how the control deficiency impacts their investment decision. More information is not always better information. And what happens when management has a response to the auditor's findings? What weight does the auditor give to that response in his report, and how does the user evaluate it? This becomes problematic and likely not useful information to the user.

Finally, cost and timing of the audit can only suffer from requiring additional efforts from the auditor, and exposing the auditor to increased liability.

- 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?*

The justification depends on the nature of the changes. A relatively simple change requiring the use of emphasis paragraphs in the auditor's report which functions like an "index" to information provided elsewhere in the financial statements and the accompanying disclosures, would not significantly increase costs and might be worth the additional information. Given the concerns we identified in our response to Question 31 a., above, we have significant doubts as to the cost justification for any of the other proposals. If credibility is harmed, as we suspect it would be, then any additional cost would not be justified.

- 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?*

Enhanced usefulness of financial statements is most likely to involve more meaningful disclosures within the financial statements and MD&A. Some of the current information required in these disclosures borders on the incomprehensible to many readers. The sheer volume of information can distract from the most important issues on which a user should be focused. One suggestion for enhancing disclosures would be to have a separate footnote that identifies all significant risks associated with use of the financial statements. This could include the sensitivity of certain key estimates, the impact on going concern should certain key assumptions not prove as positive as projected, etc. On the other hand, certain disclosures should be evaluated



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to determine if they could either be eliminated or reduced to convey only the most meaningful and relevant information to users.

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

The additional effort required to add the “financial statement risk” disclosure would likely be offset by reduction in other less meaningful disclosures. Any addition to the auditor cost becomes problematic due to competitive pressures in acquiring large audit clients. This price competition will not, in the long run, prove to be motivation on the auditor’s part to improve the audit process.

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?*

We do not agree with the concept of the auditor providing additional information on the company’s financial statements in auditor reporting. We do agree, as the release describes in detail, that there may be many practical challenges and unintended consequences that would result from additional auditor reporting. The working dynamics of the triangle of the auditor, management, and the audit committee is typically fragile at best, with each member of the triangle having its own direct responsibilities which at times may not be consistent with that of the other members. As a result, this additional information should not become a corroborative effort nor should it ever become an integrated type of reporting method. The nature, timing, cost, content and extent of the additional information would most certainly weigh heavily on the interaction of the auditor, management, and the audit committee. As we have previously indicated, any additional information regarding the company’s financial statements that is to be required should not be included in the auditor’s report but rather should be included in expanded note disclosure and /or expanded MD&A required topics of discussion, both of which are management’s responsibilities.

The Illinois CPA Society appreciates the opportunity to express its opinion on this matter. We would be pleased to discuss our comments in greater detail if requested.

Sincerely,

Kevin V. Wydra, CPA  
Chair, Audit and Assurance Services Committee

James J. Gerace, CPA  
Vice Chair, Audit and Assurance Services Committee



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## APPENDIX A

### AUDIT AND ASSURANCE SERVICES COMMITTEE ORGANIZATION AND OPERATING PROCEDURES 2011 – 2012

The Audit and Assurance Services Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members. The Committee seeks representation from members within industry, education and public practice. These members have Committee service ranging from newly appointed to more than 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of audit and attestation standards. The Committee's comments reflect solely the views of the Committee, and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to study and discuss fully exposure documents proposing additions to or revisions of audit and attestation standards. The Subcommittee develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

#### **Public Accounting Firms:**

##### **Large:** (national & regional)

James J. Gerace, CPA  
William P. Graf, CPA  
Howard L. Gold, CPA  
Jeremy L. Hadley, CPA  
Jon R. Hoffmeister, CPA  
James R. Javorcic, CPA  
Michael J. Pierce, CPA  
Elizabeth J. Sloan, CPA  
Kevin V. Wydra, CPA

BDO USA, LLP  
Deloitte & Touche LLP  
LarsonAllen LLP  
McGladrey & Pullen LLP  
Clifton Gunderson LLP  
Mayer Hoffman McCann P.C.  
McGladrey & Pullen LLP  
Grant Thornton LLP  
Crowe Horwath LLP

##### **Medium:** (more than 40 professionals)

Jennifer E. Deloy, CPA  
Sharon J. Gregor, CPA  
Timothy M. Hughes, CPA  
Andrea L. Krueger, CPA  
Matthew G. Mitzen, CPA  
Stephen R. Panfil, CPA  
Richard D. Spiegel, CPA

Frost, Rittenberg & Rothblatt, P.C.  
Selden Fox, Ltd.  
Wolf & Company LLP  
Corbett, Duncan & Hubly, P.C.  
Blackman Kallick LLP  
Bansley & Kiener LLP  
Steinberg Advisors, Ltd.

##### **Small:** (less than 40 professionals)

Scott P. Bailey, CPA  
Julian G. Coleman, Jr., CPA  
Patrick J. Dolan, CPA  
Robert D. Fulton, CPA  
Loren B. Kramer, CPA  
Ludella Lewis  
Carmen F. Mugnolo, CPA  
Jodi Seelye, CPA

Bronner Group LLC  
Horwich Coleman Levin LLC  
CJBS LLC  
Mulcahy, Pauritsch, Salvador & Co Ltd  
Kramer Consulting Services, Inc.  
Ludella Lewis & Company  
Philip + Rae Associates, CPA's  
Jodi Seelye, CPA

##### **Staff Representative:**

Ryan S. Murnick, CPA

Illinois CPA Society