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Via e-mail: comments@pcaobus.org

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

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

Dear Members and Staff of the Public Company Accounting Oversight Board:

BDO USA, LLP welcomes this opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) Concept Release, *Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards* (the Concept Release). We note that the International Auditing and Assurance Standards Board (IAASB) has issued a consultation paper on the same subject matter, so we encourage the PCAOB to work with the IAASB to ensure convergence on auditor reporting so differences are minimized to the extent possible.

We support the Board's initiative to reassess the appropriateness of the current form and scope of the auditor's report. The increased complexity of financial reporting, recent events in the financial markets and the current economic environment have renewed interest in enhancing the transparency and relevance of auditor reporting. We strongly support objective consideration of changes that could enhance the transparency and relevance of auditor reporting to financial statement users¹ in recognition of the Board's mission to protect the interest of investors. As described below, we are confident that certain changes could be implemented in the short term, which have the potential to enhance auditor reporting in a relatively cost effective manner. Other changes that have the potential to positively impact auditor reporting may require significant training of professionals, regulatory rulemaking, and/or participation by other standard setters and, as such, could be considered as a subsequent phase of any project.

In conjunction with this initiative, we believe it is important to also consider how changes in the auditor's reporting model might impact the profession's liability risks.

Our comments to the specific questions posed in the Concept Release are presented below and have been developed consistent with the following overarching principles that we believe are essential to preserve the integrity of the auditor's report:

¹ In the context of this letter, the term "users" refers to investors and other financial statement users.



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- i) Management and the audit committee, rather than the auditor, should be the original source of information about the company;
- ii) Auditor reporting should focus on objective matters;
- iii) Changes should not detract from audit quality; and
- iv) Changes should enhance transparency in a way that does not promote information overload.

In addition, we believe that any changes to the reporting model should be responsive to the underlying objectives of reasonable user demands and be cost-beneficial and practical to implement.

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?
 - 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?
 - 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 support the Board's initiative to consider improvements to the auditor's reporting model. The recent calls by some investor groups to increase the transparency and relevance of this model emphasize the importance of the auditor's report to their decision making process. The more clearly the auditor's report can communicate the results of the audit, in accordance with the fundamental role of the auditor in performing an audit, the more valuable the auditor's report will be to users.

As set out above, consistent with the overarching principles on which our comments are based, we strongly believe that management is responsible for providing information about the company, since it is in the best position to provide such information. If the auditor were required to provide original information about the company, it could create a situation where competing or inconsistent disclosures about the company, by management and the auditor, reduce rather than promote clarity. Our suggestions for improvements to the auditor's reporting model are grounded on the principle that management is the original source of information on which the auditor provides assurance.

While we believe the standard auditor's report in its current pass/fail form provides value to users, we recognize that improvements can be made to the report to provide more relevant and useful information to them. We believe significant improvements can be made through various means such as: clarification of the standard auditor's report, inclusion of emphasis of



matters paragraphs, and auditor reporting on certain matters outside of the financial statements, which we discuss in detail in our responses to the questions set out below.

We believe suggestions to expand the auditor's role to provide assurance on certain matters in addition to the financial statements, specifically Management's Discussion and Analysis (MD&A) or portions thereof such as "Critical Accounting Estimates," merit further consideration. As noted in the Concept Release, auditor reporting on MD&A is currently available under the Interim Attestation Standards, AT Section 701 - *Management's Discussion and Analysis* (AT 701), although it is rarely used. This guidance could be refined such that a report on the examination of specific portions of the MD&A could be issued, if users considered that auditor association on such information provided sufficient value to warrant the extra cost.

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?
 - b. If so, why? 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.

We believe that the current form of reporting, referred to above as the pass/fail model, provides a clear mechanism to highlight the results of the audit and should be retained. We understand that the perceived value of this core model is shared by most constituents of the financial reporting community, although there are divergent views as to the degree to which that model should be expanded to provide supplemental reporting. Current auditing standards already allow for circumstances in which the auditor may provide emphasis of matters and explanatory language regarding certain matters and we believe this reporting can be mandated in certain circumstances and expanded into other areas, as discussed below.

We note that the Concept Release explains that some investors believe that when an auditor identifies and communicates to management a significant matter that is not necessarily material to the financial statements, and management has not fully addressed that matter in the financial statements, the auditor does not have a mechanism to communicate such information to investors. However, we believe that, by definition, immaterial matters do not impact the "fair presentation" of the financial statements to a reasonable user, so communication of such matters is not necessary and could possibly attribute greater importance to the matter than warranted.

To provide clarity about what the audit report conveys, we suggest providing definitions of the following terms:



- Present fairly
- Reasonable assurance
- Materiality
- Material misstatement

In this regard, rather than including these definitions in the report itself, it may be useful to include a cross reference to a glossary of technical terms used, in a manner similar to the approach adopted by the Auditing Practices Board in the UK that provides a dedicated area for information about the scope of the auditor's report.

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 noted earlier, we strongly believe that management is responsible for providing information about the company and that the auditor's responsibility is to provide assurance on that information, rather than providing such information to users directly. Any requirement for the auditor to provide additional information directly to users about the company has the potential to (1) blur the lines of responsibility as it relates to financial reporting, (2) result in competing or inconsistent disclosures from the auditor and management that could create confusion and/or the perception of a qualified opinion, and (3) depending on the nature and extent of information disclosed/reported on, negatively impact the effectiveness of communication between management, the audit committee, and the auditor.

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?

If changes to the audit report on the financial statements are made, consideration of how those changes might impact the report on internal control will also need to be assessed. For example, if the auditor's report on the financial statements is modified to explain the responsibility of management and the audit committee as it relates to the financial statements, the report on internal control over financial reporting should be similarly modified. Please see our response to question 2 and 21, where we have outlined other revisions to the auditor's report, which would also need to be assessed for applicability to reporting on internal control over financial reporting.



Auditor's Discussion and Analysis

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

We do not support an AD&A alternative because such an approach is inconsistent with the overarching principles described in our introductory comments.

While we appreciate the rationale behind some investors' calls for additional information about the audit, certain of the matters mentioned in the Concept Release, such as audit risk, areas of significant audit judgment, and areas of significant difficulty encountered during the audit, are highly subjective and cannot be explained succinctly in any meaningful manner. Accordingly, these matters are typically discussed in depth between the auditor and management and the audit committee in the context of a dialogue where all of the relevant considerations can be explored in proper context. The PCAOB's proposed Auditing Standard, *Communications with Audit Committees*, paragraph 1 states, "Effective two-way communications throughout the audit assist the auditor and the audit committee in understanding matters related to the audit." In contrast, any additional information provided in the audit report is unlikely to be understood by others who would not possess a comprehensive knowledge of all of the attendant facts and circumstances, including expert knowledge as to how to conduct an audit.

Moreover, even if the matters that are set out as examples in question 7 below were required to be disclosed, they would necessitate development of disclosure frameworks to enable consistent assessments to be made in an infinite variety of circumstances. In that regard, it is also likely that auditor disclosures would differ in some respects from those of management, which could result in competing and inconsistent disclosures that may create confusion and/or the impression that the difference of views represents a qualified opinion. Further, to the extent that management would feel pressure to provide disclosures that mirror those of the auditor, this would seem to dilute management's primary responsibility for financial reporting.

We also believe any additional information about the company for which users require an associated auditor attestation should be provided in the context of auditor reporting on information already provided by management. In this way, the need to include additional



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information about the audit would not drive the information that the company describes within the financial statements. Rather, the auditor would comment on information that the company provides. This approach preserves the distinction between the company and the auditor, whereby management prepares the financial statements and the auditor expresses an opinion through the auditor's report.

We would also be concerned with the unintended consequences of disclosing sensitive information about the company that may limit the robustness and candor of discussions between the auditor and management/the audit committee. Such candid discussions are essential for the auditor to understand the company and its financial information and are critical to properly assess audit risk and therefore preserve the quality of the audit.

While we believe that certain important improvements to the auditor reporting model could be achieved in a relatively cost effective manner, the AD&A approach, to be effective, would require significant additional auditor effort to prepare and additional time for quality review and approvals, all of which would add cost and time to the financial reporting process.

We have provided our suggestions for improvements to the auditor reporting model that we believe are more cost effective and avoid the adverse unintended consequences of the AD&A approach. These suggestions are included in our responses to the questions below relating to the mandated use of emphasis of matters paragraphs, auditor assurance on other information outside the financial statements, and clarification of the standard auditor's report.

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)?

See our response to question 5.

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")?

See our response to question 5.

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

As previously stated, we do not support an AD&A alternative and therefore have no comment regarding the format of such a report.

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?

As previously stated, we do not support an AD&A alternative. The areas mentioned in question 9 are even more subjective than audit-related areas and are outside the usual expertise of an auditor. Communication of the above-referenced matters is best left to company management or the audit committee, as they are in the best position to communicate these matters in the context of their company and the industry in which they operate.

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

As noted in our response to question 5 above, the requirement to report under this alternative would necessitate development of disclosure frameworks to enable consistent assessments to be made in an infinite variety of circumstances, which would not be feasible. Further, we believe the need to avoid competing or inconsistent disclosures between management and the auditor will likely result in these disclosures becoming boilerplate.

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

There are a number of challenges to implementing this alternative that we believe would substantially outweigh any perceived benefits. These challenges include:

- (1) possible delays in filing documents with regulators because of (i) additional internal review processes within audit firms necessary to provide an appropriate degree of consistency, given the highly judgmental analyses that would be susceptible to varying degrees of interpretation, and (ii) extensive additional discussions among auditors, the company, the audit committee, and the company's counsel that will likely need to take place with respect to the more judgmental types of matters;
- (2) the potential to adversely impact the robust communications that would otherwise take place between the auditor and management or the audit committee;
- (3) excessive information that could obfuscate rather than clarify meaningful information to users;
- (4) shifting the respective roles of the auditor and management in terms of the responsibility for providing original information; and
- (5) increasing the liability exposure of auditors, management, and the audit committee to the extent that certain information is highly subjective and subject to wide variations in interpretation.



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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?

Our comments relating to this matter are included in our response to question 5 above.

Required and Expanded Use of Emphasis Paragraphs

13. Would the types of matters described in the illustrative emphasis paragraphs be relevant and useful in making investment decisions? If so, how would they be used?

We agree that requiring this approach would be relevant and could be useful in making investment decisions since we believe pointing out areas of audit emphasis that are described in the financial statements would likely sharpen users' focus on these matters and could provide additional context for users to understand the more significant matters included in the financial statements.

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 believe that the required use of emphasis of matters paragraphs is an appropriate approach to provide users with additional information by drawing attention to those disclosures in the financial statements that the auditor believes are most significant to an understanding of those statements. Accordingly, we favor mandating such disclosures provided that a suitable framework and implementation guidance is developed to ensure consistency in identification of relevant matters for inclusion therein. In crafting the framework, care should be taken to ensure that users understand that such paragraphs are written in the context of the financial statements taken as a whole.

While we support the use of emphasis of matters paragraphs, we are not in favor of describing key audit procedures within the auditor's report. A description of audit procedures, without a full understanding of the audit process, would not likely be understandable to users without the full context of the complex conduct of an audit, such as information on the risks, controls, and quality of audit evidence obtained. This would present an incomplete and potentially misleading picture of the auditor's response to the assessed risks of material misstatement and detract from, rather than enhance, transparency. Further, describing audit procedures relating to specific accounts or disclosures may inappropriately convey a higher level of assurance on those items than is actually the case. The auditor's report needs to be clear that audit procedures related to any particular area are performed in the context of an audit of the financial statements taken as a whole, and do not provide assurance on individual accounts or disclosures. An



example of an auditor's report that includes an illustration of the use of emphasis paragraphs, which is consistent with our suggestions described above, is set out in the Center for Audit Quality's (CAQ) letter to the PCAOB, dated June 9, 2011, which has been posted on the Board's website as part of the CAQ's June 28, 2011 comment letter submission.

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?

We believe that required and expanded use of emphasis paragraphs should focus attention on those areas of the audit that were of such importance that, in the auditor's judgment, they are fundamental to a user's understanding of the financial statements, even though those matters were considered to be appropriately presented and disclosed. While auditor judgment will be essential to assessing which matters to emphasize, we believe additional standard setting in this area would be needed to provide a framework within which the auditor can exercise his or her judgment and to ensure a level of consistency among practitioners in the types of matters identified and the extent and content of the auditor's emphasis of those matters.

Matters that may be appropriate to emphasize, if they represent the most significant matters to a user's understanding of a specific company's financial statements, could include: highly subjective accounting estimates, particularly those estimates that reflect significant unobservable inputs that are based on management assumptions or expectations; significant unusual or infrequent transactions; significant related party transactions; material weaknesses in internal control; and material uncertainties.

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

As noted above, we believe emphasis paragraphs should draw attention to matters presented or disclosed in the financial statements and be an objective, fact-based discussion. It is also important that any additional commentary within an emphasis paragraph not undermine the auditor's opinion on the financial statements as a whole.

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

We believe the key to providing information that is meaningful and specific to the circumstances of the reporting entity is through the development of principles based standards and implementation guidance that provide a framework to guide the auditor in identifying the types of matters appropriate for an emphasis paragraph, and the nature and extent of the discussion required.

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



The potential benefits of implementing required and expanded emphasis paragraphs are that they potentially:

- Enhance the communicative value of the auditor's report;
- Provide a roadmap to focus users of the financial statements on the key areas that are included in the financial statements that have become increasingly long and complex;
- Highlight the accounts and disclosures that are based on subjective judgments; and
- Improve the quality of financial statement disclosures in the areas emphasized.

The potential shortcomings of implementing required and expanded emphasis paragraphs are that:

- Users may inappropriately assume a greater level of assurance on an account or disclosure than is appropriate;
- Users may focus solely on those areas of emphasis and not the rest of the financial statement disclosures;
- Judgment will be needed to identify the appropriate items for emphasis and such judgments may be inappropriately and/or inconsistently applied; and
- Auditor's liability may increase as a result of judgments applied in selecting disclosures for emphasis. This in turn raises the costs of providing such services.

Auditor Assurance on Other Information Outside the Financial Statements

19. Should the Board consider auditor assurance on other information outside the financial statements as an alternative for enhancing the auditor's reporting model?
- a. If you support auditor assurance on other information outside the financial statements as an alternative, provide an explanation as to why.
 - 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.
 - c. What level of assurance would be most appropriate for the auditor to provide on information outside the financial statements?
 - 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?
 - e. Would auditor reporting on a portion or portions of the MD&A affect the nature of MD&A disclosures? If so, how?
 - 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?
 - g. If you do not support auditor assurance on other information outside the financial statements, provide an explanation as to why.



We support consideration by the Board of auditor assurance on other information outside the financial statements as an alternative to, or in conjunction with, other auditor reporting enhancements. In particular, we believe that auditor assurance on MD&A, or on a portion thereof, may be appropriate. As noted in the Concept Release, the PCAOB currently has an attest standard relating to MD&A, AT 701. In such an engagement, the auditor performs procedures to express an opinion on the MD&A presentation taken as a whole by reporting whether the:

- Presentation includes, in all material respects, the required elements of the rules and regulations adopted by the SEC;
- Historical financial amounts have been accurately derived, in all material respects, from the company's financial statements; and
- Underlying information, determinations, estimates, and assumptions of the company provide a reasonable basis for the disclosures contained therein.

While we believe reporting under AT 701 could provide the basis for further standard setting to more broadly address information outside the financial statements, it is our understanding that AT 701 engagements are rarely requested by issuers.

One approach that we believe would furnish investors with useful information, while also offering a cost effective alternative, would be the development of an examination level service on a specific portion of the MD&A that investors have suggested is important to their investment decisions – the disclosure relating to critical accounting estimates. Reporting on this portion of the MD&A would likely improve the quality of such disclosures as a result of the increased attention given to these matters by management.

If this approach is implemented, the SEC would need to consider whether amendments to Regulation S-X are necessary to require the report or otherwise describe the circumstances when such a report would be required. Further, the supplemental report would need to clearly identify the applicable section of MD&A covered by the report. In addition, safe harbors may be necessary with respect to this type of reporting for both issuers and auditors, given the lack of precision generally inherent in such disclosures.

With respect to other types of information on which auditor reporting may be appropriate, we are generally in agreement that some form of auditor assurance on such matters as earnings releases and non-GAAP information should be considered. Providing assurance on such information would potentially improve the quality, completeness and reliability of such information and would likely provide users with an increased level of confidence therein.

Further, the level of assurance that an auditor will be able to provide on this other information will depend on the nature of the other information and the degree of assurance required by market participants. In this regard, consideration should be given to amending AT 201, *Agreed-Upon Procedures Engagements (AUP)*, to permit its use in general purpose reporting, if such AUP reporting would be the appropriate mechanism for reporting in a particular area.



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

We believe that requiring an auditor to provide assurance on certain information (e.g., critical accounting estimates) outside the financial statements has the potential to improve the quality of such information. We are also open to exploring the feasibility and benefits of providing assurance on other areas as described in question 19 above. However, it is important to recognize the potential for unintended consequences in that regard. For example, some have suggested that auditor reporting on matters such as earnings releases would provide users with a higher level of confidence in the information. However, we believe that it is important to recognize that this financial information is often communicated prior to the completion of the audit, and that there is a trade-off between the timeliness of the information provided to the public and the level of assurance that can be provided. The different levels of assurance may not be apparent to users and this has the potential to expand the expectation gap. Moreover, there is a risk that providing a form of assurance on earnings releases may result in unwarranted pressure on auditors to reach premature conclusions on elements of the financial statements without subjecting them to sufficient audit procedures to support those conclusions.

Clarification of the Standard Auditor's Report

21. The concept release presents suggestions on how to clarify the auditor's report in the following areas:

- Reasonable assurance
 - Auditor's responsibility for fraud
 - Auditor's responsibility for financial statement disclosures
 - Management's responsibility for the preparation of the financial statements
 - Auditor's responsibility for information outside the financial statements
 - Auditor independence
- a. Do you believe some or all of these clarifications are appropriate? If so, explain which of these clarifications is appropriate? How should the auditor's report be clarified?
 - 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.
 - 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?
 - d. What are the implications to the scope of the audit, or the auditor's responsibilities, resulting from the foregoing clarifications?



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We support clarifying the auditor's report and agree that the areas specified above would be appropriate and enhance transparency. In particular, we suggest:

1. Add titles to highlight the various sections of the auditor's report, similar to the International Auditing and Assurance Standards Board's ISA 700, *Forming an Opinion and Reporting on Financial Statements*
2. Include a section in the report that states the auditor is independent under all relevant SEC and PCAOB standards
3. Where applicable, include a section that explains the firm network structure and the responsibility of the member firm signing the audit report. Additionally, describe whether any component auditors participated in the engagement
4. Emphasize that management is responsible for establishing and maintaining adequate internal control over financial reporting to support the preparation of financial statements, including the notes, that are free from material misstatement, whether due to error or fraud
5. Include a section that describes the audit committee's responsibility for oversight of the financial reporting process
6. Include within the description of the auditor's responsibility that the auditor is responsible to obtain reasonable assurance about whether the financial statements, which include the notes, are free from material misstatement *whether due to error or fraud* and a description of the meaning of reasonable assurance
7. Include within the report itself a section that defines the technical terms used or provide a link to where such definitions are maintained
8. Emphasize the importance and integral nature of the notes to the financial statements, especially as disclosures are now more likely to include a broad range of types of information, some of which may not be derived from the accounting system and include more forward looking information
9. Add a section that describes the auditor's responsibility for other information presented outside the financial statements

We do not believe these clarifications would have any significant implications to the scope of the audit or the auditor's responsibilities.

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

In general, we believe clarifying the language in the standard auditor's report would be beneficial in that it sets the foundation for all users of the report to more fully understand the auditor's conclusion and level of assurance provided. The shortcoming of adding such clarifying language would be that the increased length of the report may lead to information overload. However, these shortcomings could be partially overcome through the use of links to a central location where such clarifications are maintained, similar to the reporting model used in the UK.



Questions Related to all Alternatives

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

We believe a combination of the alternatives may be the most appropriate approach to meeting investors' information needs and narrowing the expectations gap. The use of emphasis paragraphs to highlight and focus investors' attention on the significant areas of the financial statements would potentially benefit users by providing insights about these accounts and disclosures in the financial statements.

Another cost effective alternative to improving auditor communication, which could be implemented in conjunction with the use of emphasis paragraphs, would be to include additional clarification in the auditor's report regarding certain terms and concepts and revise the form of the report to provide more clarity about the audit process and the responsibilities of each of the parties involved in that process.

Auditor reporting on selected other information is another way to inform investors about the integrity of the information provided to investors by management. For example, providing for an examination engagement on the Critical Accounting Estimates disclosure in MD&A would potentially improve disclosures in this area and be responsive to suggestions by investor groups for auditors to emphasize the important judgments made by management in the preparation of the financial statements. Since this type of reporting would likely require some additional auditor effort, incremental to the work performed to report on the financial statements, it may be appropriate to first apply any requirements to larger issuers to evaluate the results of such reporting before considering the advisability of expanding such reporting requirements to smaller issuers.

- 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?**

As set out in our response to question 23 above, we believe the most effective approach to improving auditor communication would likely include a combination of alternatives.

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

The IAASB's Consultation Paper, *Enhancing the Value of Auditor Reporting: Exploring Options for Change*, describes an alternative that is not mentioned in the Concept Release. This alternative is referred to as the "Enhanced Corporate Governance Reporting Model." The Consultation Paper explains that the existing interaction between those charged with governance of an entity and the external auditor provides a platform to explore further enhancements in corporate governance reporting and expanded auditor reporting on such information. Under this alternative, the audit committee would issue a report to investors with information about its oversight of the financial reporting process, accompanied by some



level of assurance provided by the auditor. We would support further consideration of the development of a framework to support this type of reporting. In conjunction with the development of such a framework, and in light of the importance of the audit committee in overseeing financial reporting, we suggest further consideration be given to ways to strengthen the role of the audit committee in the financial reporting process.

- 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?**

Those areas that we support and that would require more standard setting relate to clarifying the language in the auditor's report, the expanded use of emphasis paragraphs, and separate reporting on the Critical Accounting Estimates disclosure. Additionally, action by the SEC would likely be needed to require auditor reporting and to develop guidance for management regarding the preparation of MD&A relating to these estimates.

With respect to the expanded use of emphasis paragraphs alternative, additional guidance would be required to provide the auditor with criteria with which to assess the matters requiring emphasis and to determine the nature and extent of the auditor's discussion relating to such matters.

- 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?**

As auditors, we cannot say definitively how users may perceive any of the alternatives suggested to enhance auditor reporting. However, we believe certain of the alternatives are subject to greater susceptibility to misinterpretation than others and for this reason we caution the PCAOB to ensure that any changes to auditor reporting clearly describe the auditor's responsibility to provide an opinion on the financial statements as a whole so as to avoid any perception that a qualified or piecemeal opinion has been provided.

- 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 the modifications to the auditor's report, as described in our response to questions 2 and 21, particularly changes calling for descriptions of the role of management, the audit committee, and the external auditor best clarify the role of the auditor in the financial reporting process.



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

While the concept of audit quality is often discussed, it is not easily defined and may be perceived differently depending on the unique position of the stakeholder. The IAASB's recent publication, *Audit Quality, An IAASB Perspective*, explores the meaning of audit quality and explains that "perceptions of audit quality vary amongst stakeholders depending on their level of direct involvement in audits and on the lens through which they assess audit quality." Certain academic research suggests that user perceptions of audit quality are influenced by the communicative value of the auditor's report. Accordingly, improvements to the auditor's report that provide increased transparency about the audit process could be considered a contributing input to enhancing audit quality.

We believe that certain alternatives discussed in the PCAOB Concept Release would potentially improve the communicative value of the auditor's report and advance audit quality, while others may have a detrimental effect. For example, the alternatives that (1) clarify the terms used in the auditor's report, (2) emphasize the importance of certain matters reflected in the financial statements, (3) explain the auditor's responsibility for the audit of the financial statements and other financial information presented in a document containing the audited financial statements, and (4) provide for reporting on the Critical Accounting Estimates disclosure section of the MD&A all serve to improve communication and will potentially improve the related disclosures, thereby enhancing audit quality in a relatively cost effective manner.

On the other hand, we believe other alternatives that do not meet the overarching principles described in the introductory section of our letter would tend to reduce the communicative value of the auditor's report.

Further, we believe any alternative auditor reporting that has the potential to impede the candid two-way communication between the auditor and the audit committee could negatively impact audit quality. Examples include the alternatives that call for a discussion of the auditor's views regarding the company's financial statements, such as management's judgments and estimates, accounting policies and practices, and difficult or contentious issues including "close calls."

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.

While we believe that a broad based initiative to enhance the communicative value of the auditor's report and its relevance to the investing public is appropriate, there may be different approaches from those contemplated within this Concept Release to enhance the



auditor reporting model with respect to the specific entities listed above. For this reason, we would support further consideration by the PCAOB of how best to enhance audit reports for these entities as part of a separate project.

Considerations Relating to Changing the Auditor's Report

31. This concept release describes certain considerations related to changing the auditor's report, such as effects on audit effort, effects on the auditor's relationships, 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?
 - 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?
 - 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?

All of the considerations set out above are important and interrelated, and as such, it would be difficult to assess the relative importance of one consideration over another. We believe that any changes to the auditor reporting model need to be considered in tandem with how the interrelationships impact audit quality and cost.

Many of the suggested changes would be unlikely to increase audit costs significantly; for example, modifying the form and content of the audit report would potentially provide enhanced clarity with little additional associated costs. However, other alternatives, such as auditor reporting on Critical Accounting Estimates disclosures, would likely require additional work by both management and the auditor, with a corresponding increase in costs. Cost implications of other changes would be dependent on the specific nature of the change and their relevance to the entities concerned.

As the Board considers the comments received on this Concept Release, in advance of any standard setting project, we encourage the Board to consider the most effective way to implement any changes to accommodate smaller public companies and provide a way forward that considers user needs, while recognizing the cost constraints facing many of these companies. Additionally, other than those that could be easily implemented (such as changes to the format of the standard auditor's report), we believe that it would be reasonable to consider a phased in approach where larger public companies would implement any changes before applying the changes to smaller public companies.

We encourage the Board to collaborate with the IAASB, investors and other users of the financial statements, preparers, audit committees, auditors, and academics to flesh out the implications of the various options expressed in the Concept Release and to identify any



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others that should be considered. We believe that the Roundtable held on September 15th was an excellent step in that direction.

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 stated elsewhere in our letter, we believe that inclusion in the auditor's report of qualitative insights and perceptions gleaned during the audit, which are of the kind usually communicated to management and the audit committee in the context of an extensive dialogue among all parties, would not be practical to communicate in an external communication. In addition, disclosure of this type of information would likely discourage a candid and robust dialogue that we believe is essential to the performance of a high quality audit.

In summary, we are supportive of the Board's initiatives to explore options to enhance the transparency and relevance of the auditor's report to financial statement users in response to their calls for change. As part of the Board's assessment of the various alternatives proposed within the Concept Release, in addition to any other alternatives that may be suggested as a result of outreach efforts, we strongly encourage the Board to ensure that any proposed standards meet the overarching principles set out in our introductory comments. In addition to ensuring costs are balanced against the need for additional/enhanced reporting, we also believe a project to educate users about the audit process and the meaning of the auditor's report would further the Board's goals of improving the transparency and relevance of auditor reporting and reducing the expectation gap.

We appreciate your consideration of our comments and suggestions, and would be pleased to discuss these with you at your convenience. Please direct any questions to Chris Smith, Audit and Accounting Professional Practice Leader, at 310-557-8549 (chsmith@bdo.com) or Susan Lister, National Director of Auditing, at 212-885-8375 (slister@bdo.com).

Very truly yours,

/s/ BDO USA, LLP

BDO USA, LLP