



Federal Housing Finance Agency

1700 G Street, N.W., Washington, D.C. 20552-0003

Telephone: (202) 414-3800

Facsimile: (202) 414-3823

www.fhfa.gov

September 30, 2011

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

Dear Office of the Secretary:

The Federal Housing Finance Agency (FHFA) welcomes the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or Board) Concept Release on *Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standard*, PCAOB Rulemaking Docket Matter No. 34 (the Concept Release).

As the regulator of the Federal Home Loan Bank System and the regulator and conservator of Fannie Mae and Freddie Mac, we consider audited financial reports by our regulated entities an important input to our safety and soundness supervision process. Therefore, we are interested in high-quality accounting and auditing standards that promote the reporting of unbiased, transparent and relevant information about the performance and condition of these entities. We support the Board's efforts to improve audit quality and provide users of the financial statements with relevant and useful information about audit results.

As stated in the Concept Release, "the auditor's report is the primary means by which the auditor communicates to investors and other users of financial statements information regarding his or her audits of financial statements." However, the current format and content of the standard auditor's report, besides communicating the auditor's overall conclusion in "boilerplate" wording, provides users of financial statements with too little relevant and useful information. We believe some of the alternatives discussed in the Concept Release could significantly increase the transparency and communicative value of the auditor's report. We recommend the following alternatives for the Board's consideration:

- Require an Auditor's Discussion and Analysis (AD&A) as a supplement to the standard auditor's report;
- Amend the format and content of the current standard auditor's report to improve understandability and clarify certain audit-related concepts and
- Require auditor's assurance on other information outside of the financial statements, such as the Management's Discussion and Analysis (MD&A), earnings releases and other non-GAAP information.

I. Require an AD&A as a supplement to the standard auditor's report:

The current standard auditor's report that employs the "pass/fail" model is a straightforward and practical way to inform users of financial statements about the audit opinion and therefore should be retained albeit with some minor modifications that we discuss in Item II below.

The external auditor, as an independent expert who spends a significant amount of time and effort to understand a company and audit its books and records, is uniquely positioned to provide valuable insights and observations about the company and the quality of its financial reporting. As noted in the Concept Release, including the AD&A as a supplement to the auditor's report could improve the understanding of the basis for the auditor's opinion and "could give the auditor greater leverage to effect change and enhance management disclosure in the financial statements, thus increasing transparency to investors."

The Concept Release noted that some preparers, auditors and audit committee members expressed concerns that requiring an AD&A could impair the transparency and openness of discussions among the auditors, management, and the audit committee and could create more tension in the overall relationship between these parties. However, since the AD&A would be supported by evidence obtained during the audit, it would continue to be in the company's best interests to be transparent with its auditor so that the auditor's insights and observations presented in the AD&A faithfully reflect the company's basis for its financial reporting policies and practices. A company's decision to temper discussions with its auditor would not only risk causing the auditor to misunderstand the perspectives behind the company's financial reporting practices but also could lead to higher audit costs if the auditor concludes that the inherent and control risks around the audit are higher due to management's lack of candor.

To provide relevant information, improve understandability and facilitate the timely filings of company's financial reports, we propose that the Board require that:

1. The AD&A be written in plain English;
2. The AD&A's audit and financial reporting issues be limited to the following important subject matters:
 - Significant audit risks identified by the auditor;
 - Management's critical accounting policies including accounting treatments for significant unusual transactions;
 - Management's significant judgments and estimates and
 - Difficult and contentious issues, including "close calls" and "material matters" as described in the Concept Release.
3. The AD&A format be standardized similar to that of the MD&A and consist of two sections:
 - a. Executive Summary: We suggest limiting this section to approximately two pages and including a bullet-point list of only the most significant audit and financial reporting issues to be described in details in the Discussion and

Analysis section. Each bullet would also provide a reference to the page number in the Discussion and Analysis section where in-depth description of the issue is presented.

- b. Discussion and Analysis: For each of the audit and financial reporting issues discussed and analyzed in this section, the auditor should provide information similar to that included in the illustrated example of the Concept Release. For instance, the auditor should discuss:
- The nature of the issue;
 - The reasons the auditor considers the issue to be most significant;
 - The permissible alternative accounting policies or possible range of accounting estimates;
 - The auditor's assessment of the company's critical accounting policies or estimates including where each of the critical policies or estimates falls within a range of possible views or results, respectively.

II. Amend the format and content of the current standard auditor's report to improve understandability and clarify certain language

We recommend the following incremental modifications to the standard auditor's report to enhance its transparency and clarity:

- a. In the first (introductory) paragraph, require the auditor to explicitly identify the information audited. This means identifying, in addition to the financial statements, the notes to the financial statements, the related schedules and other supplemental information that have been audited.
- b. At the end of the second (opinion) paragraph, refer readers to the AD&A for more in-depth discussions and analyses on significant issues identified during the audit.
- c. In the final (scope) paragraph, include additional language to clarify concepts such as "reasonable assurance," "the auditor's responsibility for fraud," "fair presentation in conformity with GAAP" and "the level of materiality applied by the auditor in performing the audit."
- d. At the end of the auditor's report, require both the firm and the engagement partner to sign the report.

III. Require auditor's assurance on other information outside of the financial statements, such as the MD&A, earnings releases and other non-GAAP information

Management's Discussion and Analysis, earnings releases and other non-GAAP information are currently not required to be audited. However, information included in these documents is increasingly used by management to communicate the company's views on its financial results to users of financial statements. Also according to the Concept Release, "investors use and rely on MD&A and other financial information (e.g., non-GAAP information and earnings releases) for their investing decisions, in addition to historical audited financial statements."

Therefore, we agree with the Concept Release that having the auditor provide assurance on these disclosures “could improve the quality, completeness and reliability of such information, providing investors and other users of financial statements with a high level of confidence in information about the company.”

However, we also concur with the recommendation expressed by some participants at the PCAOB’s roundtable on the Concept Release in September 2011 that the Board consider creating a separate long-term project to develop reporting and auditing standards for this alternative. Arguments for a separate long-term project for this alternative include:

- This alternative expands the current scope of the auditor’s responsibilities and therefore would require the Board to develop auditing standards to determine (1) what disclosures documents outside of the financial statements (MD&A, non-GAAP information or earnings releases) and which portions of these documents should be audited (2) what level of assurance would be appropriate for the auditor to provide;
- The reporting framework to prepare earnings releases and other non-GAAP information would need to be developed by the Securities and Exchange Commission (SEC) to provide relevant and consistent information; and
- A requirement for an auditor’s assurance would likely increase costs to prepare, and to audit, disclosures on a timely basis in compliance with all applicable financial reporting and auditing standards, respectively. Costs and efforts would be compounded since companies currently provide these disclosures on a quarterly, not yearly, basis.

Accordingly, even though we believe in the important benefits of having the auditor providing assurance on information outside of the financial statements, given the potentially lengthy rulemaking process and the substantial compliance costs, we urge the Board to focus first on improving the auditor’s report by requiring the AD&A as a supplement to the modified standard auditor’s report per our suggestions in Items I and II.

Thank you for the opportunity to provide our views. We hope the Board and staff find our comments and suggestions helpful. If the Board and staff have any questions or comments regarding this letter, please feel free to contact me at 202-343-1832.

Sincerely,



Nicholas J. Satriano
Chief Accountant
Federal Housing Finance Agency