



September 30, 2011

Office of the Secretary
Public Company Accounting Oversight Board
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Re: PCAOB Rulemaking Docket Matter No. 34, *Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards*

Dear Board Members and Staff:

We appreciate 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 Standards* (Concept Release) and respectfully submit our observations and recommendations thereon.

We commend and support the Board on its standard-setting initiative to amend the auditor's reporting model to address the expressed needs of investors and other users of financial information (collectively referred to herein as "investors"). Throughout history and through recent profession research and outreach, we have noted that there are concerns as to the suitability of the current reporting model. We acknowledge and agree that revisiting the reporting model is warranted at this time due to the recent dramatic changes in the global economic environment, as well as the increasing complexity of financial and regulatory reporting, among other factors.

We generally support a combination of the potential reporting alternatives described in the Concept Release. However, we are concerned that focusing changes solely on the auditor's reporting model without considering potential issues or exploring opportunities for improvements in other aspects of the financial reporting model may result in marginal improvements in the usefulness of the auditor's report, as well as unintended consequences for investors and the financial markets. Our participation in profession outreach and firm discussions indicate that many of the areas for potentially increasing the quality of the financial reporting model go beyond the auditor's report. These areas generally include the current financial and regulatory reporting framework, the role and communication responsibilities of the audit committee, the transparency of management's disclosures within and outside of the financial statements, including Management's Discussion and Analysis (MD&A), and overall

investor education and awareness. As discussed below, we believe that broader initiatives and outreach are needed to assess and inform recommendations in each of these areas.

The Concept Release describes the current auditor's report as a pass/fail model. Although this is true with respect to the fairly standardized language used by accounting firms, we would note that for a public company, only an unqualified opinion (pass) is accepted by the U.S. Securities and Exchange Commission (SEC or Commission). Unlike the views expressed by certain investors, we believe that, in consideration of this standardized language, the SEC's position provides ample leverage for the auditor to "effect appropriate change in the company's financial statements" (page 9 of the Concept Release) based on the applicable financial reporting framework. Certain of the Board's potential reporting alternatives attempt to address this investor view by requiring auditors to disclose their views regarding the sufficiency and appropriateness, among other matters, of certain of management's financial reporting decisions and disclosures. We believe that such commentary, on what also may be deemed confidential company information, could essentially provide information that management may not agree with nor find necessary to meet their reporting requirements. Other proposed alternatives contemplate an auditor's discussion about audit risks, related audit procedures and results, and auditor independence for investors to, in effect, assess the adequacy of the audit engagement and the accuracy of the related financial statements. While we believe that it may be possible to devise a standard that prescribes such reporting, we question whether this would truly address investor needs. In our view, the lack of transparency into the specific audit process details may not be a key investor concern and would be better relegated to the audit committee and the PCAOB to assess. We note that the implications of this aspect of auditor reporting also seem to imply a lack of trust or obfuscation inherent in management's reporting process and a possible need for assurance on other types of information communicated to investors. We believe that the latter would come at a greater cost and delay the timely reporting of financial information to the marketplace.

The value of the current auditor's report is that it provides an objective and independent opinion on financial statement compliance with an applicable financial reporting framework. The auditor is not in a position to serve as an analyst, which would blur the lines between the financial statement and the business and operational risks. Nor do we believe that an investor can accurately make allowances or adjustments for auditor subjectivity in assessing and making investment decisions based on their limited understanding of audit precision and processes. We do not believe that moving in this direction will address the issues with the current financial reporting model.

Stakeholders have continued to express concerns relating to the increasing complexity of financial reporting and the foundational aspects of auditing, including auditor objectivity and skepticism. Some form of enhanced reporting could improve the reliability of information used for investment decision making, while increasing investor trust and confidence. However, we note that challenges to the transparency and accuracy of financial information could arise from many factors, including the need for more timely information, deception or fraud, complexity of the underlying framework and significant changes thereto, and familiarity to name a few. The Board and the SEC may need to explore other opportunities to address such factors.

As expressed previously, we note that there are other standard-setter and regulator initiatives to assess the various auditor reporting models used today. In that context, we believe that it is imperative for the Board to work closely with other organizations, including the International Auditing and Assurance Standards Board (IAASB), to propose a global solution, including recommendations to other parties involved in the financial reporting process. Although the Board oversees the audits of public companies, as well as certain other organizations, to protect investor interests, we believe that those interests exist worldwide. Inconsistent approaches could bring about additional confusion among investors.

The following provides our specific views on the potential reporting alternatives and the Board's considerations related to changing the auditor's reporting model.

Potential alternatives for changes to the auditor's report

Our views as to each of the potential reporting alternatives are expressed below. Overall, we support a short-term solution that includes a combination of certain elements of the alternatives proposed in the Concept Release: clarifying language in the standard auditor's report and the required use of emphasis of matter paragraphs. This specific combination should generally improve auditor communications to investors, while allowing more time for the Board to consider additional outreach along with other professional bodies. We encourage the Board to consider other alternatives, including the feasibility of an Auditor's Discussion and Analysis (AD&A), in a separate workstream that would also benefit from continued outreach and coordination with other regulators and standard-setters.

With respect to whether the changes being considered should apply equally to all audit reports filed with the SEC, we believe that the Board should proceed with caution, particularly for non-issuer affiliated entity audit reports filed as part of an issuer's filing or even employee benefit plans that file a Form 11-K. We suggest that the Board seek additional guidance on this matter upon issuing its proposed standards, as views may differ depending on the alternatives that are ultimately adopted.

Auditor's Discussion and Analysis

We acknowledge that investors demand and need certain information for their investment decision making and that those needs should be addressed not only by the Board but also the SEC and the Financial Accounting Standards Board (FASB). The nature and extent of the information that is needed and by whom it should be provided is a vital consideration. We acknowledge the views expressed in various profession outreach and discussion forums that expanding the role of the auditor and leveraging the auditor's knowledge obtained throughout the audit process and other auditor related interactions could be valuable to investors. Thus, we support further evaluation by the Board and other standard-setters of the auditor's role and reporting responsibilities, including the use of an AD&A. Our comments below highlight some challenges both in mindset and current responsibilities that would need to be assessed and considered in further evaluating the feasibility of an AD&A within the context of the current financial and regulatory reporting framework.

Several Board members have indicated that an AD&A could be very costly in addition to other auditor requirements (refer to our comments below regarding the effects on audit effort). The Board also acknowledges that new auditing standards would need to be developed in collaboration with the SEC. We agree that this deserves much more attention and discussion so that information is appropriately provided to investors. In consideration of the potential costs and litigation risks involved, however, a more viable approach may be to strengthen the financial reporting requirements allowing management to provide the necessary information and the auditor to provide assurance on such information, such as enhanced MD&A. Generally, auditor involvement would drive better behavior. This is discussed further below

First and foremost, however, it is currently not the auditor's responsibility, nor does the auditor have the appropriate authority, to disclose information related to the company or its financial statements without specific consent (refer to our specific comments on confidentiality below). We believe that management has and would have the primary and sole responsibility to disclose such information, including the matters concerning management's judgments and estimates and accounting policies and practices described on pages 16 and 17 of the Concept Release, to users of the company's financial statements. Management's disclosures are also considered and approved by the audit committee. If investors believe that management's disclosures related to these or other matters are currently inadequate or obfuscated, it would be the FASB's and the SEC's responsibility to appropriately modify the accounting and regulatory presentation and disclosure requirements to meet investor needs. Disclosures made directly by the auditor to *fill the gap* could be seen by investors as likely more important or reliable than management's required disclosures. Such a change in focus would diminish the value of management's disclosures – those made by the people in the best position to enlighten investors – and elevate inappropriately the value of the auditor's disclosures, which are based on inherently inferior information.

Also, as previously noted, an auditor does not serve as, and is not trained to be, an analyst. Because an auditor reports on historical financial information, the Board cannot reasonably expect that an AD&A would enable investors "... to assess how changes in the economy might affect a company's future financial performance or condition" (page 8 of the Concept Release). This is clearly beyond the scope of an audit and could potentially conflict with the requirements therewith. We have the same view as it relates to any required discussion regarding business, strategic, or operational risks; however, we acknowledge that further exploration for auditor attestation in such areas, pursuant to an appropriate framework for management to operate in, would be worthwhile. In addition, performing an analyst-type role would require extensive training and significant costs for audit firms. We are concerned that an AD&A might be viewed as an alternative for the investor to perform a thoughtful review of MD&A. One of the objectives of MD&A is to provide information about the quality and potential variability of the company's earnings and cash flows so that investors can ascertain the likelihood that past performance is indicative of future performance (see Commission Statement About Management's Discussion and Analysis of Financial Condition and Results of Operations, Release No. 33-8056 issued Jan. 22, 2002). We believe that auditor assurance on some aspects of MD&A would provide greater value to investors by enhancing the quality and reliability of the information presented, as further described in our comments below.

Further, as proposed, certain potential AD&A content, particularly content related to difficult or contentious issues and “close calls,” seems to undermine the convictions inherent in the auditor’s opinion on the financial statements from two different but related perspectives. The first relates to the discussion about matters that are deemed acceptable within the applicable financial reporting framework or were appropriately corrected to comply with that framework but required significant deliberation or audit effort. We believe that such discussion can convey an inappropriate message that the auditor may not be objective by actually being a part of the company’s system of internal control as it relates to the matters corrected. Additionally, matters that require significant deliberation or audit effort ordinarily would be those with significant risks that easily could be highlighted through the use of an emphasis of matter paragraph, as discussed in our subsequent comments. The second relates to the discussion about matters that are in technical compliance but “could be enhanced to provide the investor with an improved understanding,” matters where the auditor believes that management “could have applied different accounting or disclosures,” and *significant* matters that are “not necessarily material to the financial statements, and management does not adequately address the matter” (pages 9, 13, and 18 of the Concept Release). In this regard, another area that would need to be explored and assessed by the Board would be the education of and communication with the users of such information. It is possible that, if not properly understood or explained, such disclosures could raise doubts or uncertainties as to the appropriateness of the auditor’s unqualified opinion by indirectly promoting the use of an AD&A as a substitute for a modified opinion for a departure from the framework, including a lack of fair presentation by omitting or providing incomplete disclosures.

In regards to changes in accounting principles and the application of different accounting principles or disclosures, we believe that the SEC’s filing requirements related to preferability letters effectively eliminate the need for additional discussion in an AD&A. In either of the two aforementioned scenarios, we believe that the auditor’s perspectives should not differ from those of management, as implied on page 14 of the Concept Release, for to do so could result in challenges to the validity of the auditor’s opinion. We do, however, acknowledge that additional discussion or disclosure by management may be beneficial related to areas where estimates or fair value determinations are necessary. Recent FASB issuances and SEC comments to issuers have focused on expanding such disclosures to highlight key assumptions, methods, and the like. But, such expanded disclosures may be difficult for an investor to factor into their assessment. In our experience, we have noted, for example, that the application of *FASB Accounting Standards Codification*® (ASC) 820 “Fair Value Measurements and Disclosures” allows for application of differing valuation methods. While the standard suggests certain implementation criteria, preparers and valuation experts may differ in selecting the most appropriate method or when multiple methods provide a better answer. We believe more clarity around such disclosures, and auditor involvement, particularly in MD&A, may be beneficial to investors.

We believe that the Board also should consider the following additional matters in the context of evaluating the operability and appropriateness of an AD&A:

- A standard report format would be necessary, along with clear and concise criteria related to its content. It is apparent to us that there are differing views as to what is expected in an AD&A and what an AD&A may encompass. We generally believe that introducing subjective assessments can undermine the overall quality of the auditor's opinion on the financial statements. In addition, such assessments would often relate specifically to the issuer without providing the investor with the benefit of a total view of the marketplace. For example, commenting on an issuer's specific estimate with regard to a warranty reserve would be limited to the auditor's knowledge of that particular issuer's methods and assumptions; so, in that context, the auditor commentary would be limited to that assessment. It would be difficult for an investor to put such an assessment into context or compare it across like companies in the same industry.
- Discussions in an AD&A regarding independence could be misused from an investment perspective causing undue harm to the company (refer to our comments below regarding auditor independence). We believe that the audit committee is appropriately charged with the appointment and oversight of the auditor and that the assessment of the auditor's relationships and independence is best left to the audit committee. If proxy materials need to be enhanced to include discussions regarding auditor independence for purposes of making voting decisions, we believe that the SEC should be charged with considering whether amendments to their disclosure rules are necessary.
- With regard to matters related to internal control over financial reporting, we believe that the internal control disclosures, including those related to material weaknesses, that are currently required are sufficient. We do not fully understand what is intended by a discussion about *significant deliberations* in this area and whether such discussion would include the communication of significant deficiencies or other significant internal control processes that may be effective. By no means do we believe that the Board should require auditor discussions in this area beyond the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 and the related SEC rules and regulations. However, we do recognize that adopting certain reporting alternatives may require conforming amendments to an audit report on the effectiveness of internal control over financial reporting. For example, if the financial statement audit report was amended to describe the auditor's responsibility for other information, similar modifications may be needed in the internal control audit report. At this time, we do not envision any other needed amendments to that report.

For additional considerations, we refer the Board to our comments on the use of emphasis of matter paragraphs with respect to auditor discussions regarding significant risks and audit procedures. For an AD&A, we believe that the Board would need to develop suitable criteria that will strike an appropriate balance between providing relevant information to investors and describing the significant risks and related audit procedures and results. In addition, we believe that investors will be challenged to make adequate judgments about the sufficiency and appropriateness of the audit, including its precision, from one report to another, without having

a full understanding of each individual audit engagement. Lengthy audit reports that provide significant details would seem to defeat the purpose of focusing investor attention on significant matters in the financial statements and also increasing investor confidence as to the reliability of information outside the financial statements. Language that summarizes the procedures would be too general in nature to be useful.

As an aside, we do not understand the language used in the Concept Release as to whether the Board foresees the need for a discussion of immaterial matters, which we think would make an AD&A ineffective. For example, we do not believe that a matter can be both significant but not necessarily material. This type of language challenges the notion of fair presentation and the fact that matters can be qualitatively material.

Overall, we recognize that there are many challenges to an AD&A approach for the Board to consider and overcome. Accordingly, we believe that the potential use of an AD&A would benefit from further dialogue and outreach, as part of a longer term project.

Required and expanded use of emphasis paragraphs

We believe that defining situations requiring the use of emphasis of matter paragraphs in all audit reports may result in improvements to auditor reporting and investor analysis. Although we continue to believe that investors must read the financial statements as a whole, we also believe that emphasis of matter paragraphs may assist investors in analyzing those financial statements by directing them, or providing a *roadmap*, to the more significant matters. The usefulness of such paragraphs, however, will depend on the matters to be emphasized and the detail provided by management in the underlying financial statements. However, as with an AD&A, there is a potential increase in the risk of litigation against audit firms (see our comments below on liability considerations).

The Concept Release notes on page 21 that the auditor could emphasize "...those matters that are important in understanding the financial statement presentation, including significant management judgments and estimates and areas with significant measurement uncertainty." We believe that this *criteria* may be too broad and could result in drawn out audit reports that do not necessarily focus investors on significant matters, particularly as certain significant matters are quite common across various industries. We believe that the matters to be emphasized should not include all significant management judgments and estimates or all matters with complex or subjective measurements. To do so, could overshadow the importance of other matters, such as those listed above. Thus, it will be necessary for the Board to develop suitable criteria to assist auditors in determining the matters to be emphasized.

Matters that we believe may be most useful to investors are those that, based on auditor judgment, are not only significant but are unusual or non-recurring. Significant matters to be emphasized also could be similar to, but not the same as, those deemed by the auditor as significant risks. These matters could include:

- recent significant economic or other developments
- complex transactions or significant transactions with related parties

- measurements involving a wide range of measurement uncertainty, such as litigation
- transactions outside of the normal course of business or outside of industry norm.

Additionally, since we believe that the primary purpose of an emphasis of matter paragraph is to direct investors to significant matters, such paragraphs should simply identify the matter being emphasized and refer to the note to the financial statements that describes the matter. The auditor's emphasis of matter paragraph should not attempt to recreate or summarize the company's disclosure because investors should read the entire disclosure in context. In this regard, the auditor's required use of emphasis of matter paragraphs could generally improve management's disclosures.

Further, we believe that an emphasis of matter paragraph should not include a description of the audit procedures performed on the particular matter for several reasons. Audit procedures can vary significantly and are particularly dependent on the nature and depth of management's processes and supporting documentation. Consequently, investors, particularly those that are unfamiliar with audit standards and related guidance, may be unable to properly use such information in a logical or consistent manner. Inappropriate conclusions also can be reached as to the assurance expressed by the auditor (that is, a piecemeal opinion on the matter, rather than on the financial statements as a whole) and the appropriateness and sufficiency of the procedures between companies and audits. We do not believe that investors are seeking long form reports that include drawn out descriptions of audit procedures and results. Accordingly, the auditor's description may be at a higher level resulting in fairly boilerplate language that may not be deemed useful. In some respects, audit procedures also should remain confidential and unpredictable.

Auditor assurance on other information outside the financial statements

In addition to modifying the standard auditor's report for the purpose of enhancing investment making decisions, we support a separate Board initiative, jointly with the SEC, to consider auditor assurance on information outside the financial statements and whether there is investor and market demand for such assurance. We genuinely believe that auditor assurance could enhance the quality and reliability of such information, in particular MD&A, which is used and relied on by investors today. In addition, unlike the AD&A reporting alternative, auditor assurance on information outside the financial statements maintains the appropriate lines of accountability between the auditor and management.

We believe that auditor assurance on information outside the financial statements generally would start with exploring additional involvement in certain areas of the issuer's MD&A. Auditor assurance would be difficult for information containing forecasts, projections, and subjective assertions due to its measurability and subjectivity, without the development of an appropriate framework and criteria. Thus, much of the information in earnings releases may not be conducive to auditor assurance. If the auditor were to report on only a portion(s) of MD&A, we believe that the information not covered by the auditor's report would need to be clearly differentiated and that the quality and reliability of that information could vary.

AT sec. 701, *Management's Discussion and Analysis*, provides a starting point for guidance for an assurance engagement related to MD&A. However, because AT sec. 701 has not been updated since 2001 and is rarely used, modifications may be necessary based on changes in the MD&A requirements. The framework and criteria for AT sec. 701 is based on SEC presentation and disclosure requirements. If the auditor were to report on other types of information outside the financial statements, suitable criteria against which the auditor would evaluate the information may need to be developed depending on the information presented.

To develop the standards and potential regulations necessary to facilitate auditor assurance on information outside the financial statements, we believe that additional outreach will be critical. Issues to be addressed might include the following:

- the sufficiency of the information presented. Changes in regulations may be necessary to modify or expand the disclosures to meet investor needs.
- the performance of an examination or a review engagement. The nature of a review may not necessarily boost investor confidence as to the information presented or it may be misunderstood as to the level of assurance provided.
- the form of opinion. An opinion on MD&A differs from an opinion as to *fair presentation* on audited financial statements. Investors may need to be well-informed on this matter.
- the nature, timing, and extent of related Board inspections. If AT sec. 701 were to be used in the short term, inspections could inform decisions about whether changes are necessary.
- the costs involved and whether the benefits outweigh those costs. Refer to our comments below regarding the effects on audit effort, including the potential impact on the ability for auditors to complete such work within the current issuer filing deadlines.

Clarification of the standard auditor's report

Overall, we believe that adding certain clarifying language in the standard auditor's report is both appropriate and in the public interest. Considering the fact that there is a wide range of investors with various levels of knowledge, we support the general investor view that such language could enhance an investor's understanding of an audit and of the auditor's and management's responsibilities. We do not believe that any of the potential clarifications would affect either the scope of the audit or the auditor's responsibilities. Our specific views as to each of the potential clarifications follow.

- **Reasonable assurance** – Because the concept of reasonable assurance may not be fully understood by all investors, we understand the impetus to provide additional clarification around this term. However, we believe that simply adding a statement indicating that reasonable assurance is a *high level of assurance, but not absolute assurance* would not fully address the concern, particularly for less sophisticated investors. The Concept Release notes on page C-18: "Because of the nature of audit evidence and the characteristics of fraud, the auditor is able to obtain reasonable, but not absolute, assurance that material misstatements are detected. Therefore, an audit may not detect a material misstatement." We believe that combining the concept that reasonable assurance, although a high level of assurance, is not absolute assurance with the notion that a material misstatement, due to error or fraud, may

remain undetected would provide much better clarity to an investor. We understand, however, that such language may be erroneously viewed as self-serving. As such, addressing the auditor's risk assessments, as described below, may be a more appropriate change.

- ***Auditor's responsibility for fraud*** – We support clarifying the standard auditor's report to indicate that the auditor is required to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement, due to error or fraud. Management, however, has the same responsibility as it relates to preparation and fair presentation. Accordingly, we believe that the description of management's responsibility also should refer to both error and fraud. In addition, because the risks of material misstatement due to fraud differ from those due to error, a discussion in the auditor's report indicating that the audit procedures are based on the auditor's assessment of risks might be helpful. This discussion could be similar to that included in an auditor's report issued in accordance with International Standards on Auditing (ISA).
- ***Auditor's responsibility for financial statement disclosures*** – We also support referring to the related notes to the financial statements within the introductory paragraph of the standard auditor's report. Such reference will more clearly identify the financial statements subject to audit and covered by the auditor's opinion and will give more prominence to the auditor's responsibility for disclosures.
- ***Management's responsibility for the preparation of the financial statements*** – To more fully describe what is currently meant by the phrase *these financial statements are the responsibility of the company's management*, we agree with clarifying management's responsibility by stating that management is responsible for the preparation and fair presentation of the financial statements in accordance with generally accepted accounting principles (or other applicable financial reporting framework). Management, however, also is responsible for establishing and maintaining effective internal control over financial reporting. As such, we believe that management's responsibility for such internal control should be included within that description. To visibly separate management's responsibility from that of the auditors, we believe that the description of management's responsibility should be included in a separate paragraph following the introductory paragraph of the standard auditor's report.
- ***Auditor's responsibility for information outside the financial statements*** – We understand how some unsophisticated investors may misinterpret the auditor's responsibility regarding other information presented outside the financial statements. Although clarifying such responsibility within the standard auditor's report could benefit those investors, we believe that there are certain drawbacks to be considered by the Board. Today's electronic environment can pose various challenges, particularly in describing the auditor's responsibility to read the other information and to consider whether the information is materially inconsistent with the financial statements. Although such description may be appropriate in a specific document or filing, it can be misconstrued when the same financial statements and related auditor's report are included on a website or otherwise distributed with additional information that was not subjected to these procedures. Also, depending on the form and content of the description, there may be other unanticipated

consequences when the financial statements are included or incorporated by reference in a subsequent filing under the Securities Act of 1933, particularly for predecessor auditors.

Further, by indicating that the auditor has a responsibility to read the other information and to consider material inconsistencies, a user of the auditor's report may gain more comfort than what is intended by these procedures. Accordingly, what we believe needs to be clear to a user is that the auditor does not corroborate other information contained outside the financial statements and related notes and schedules and that the auditor does not express an opinion on such information. This form of description would be appropriate regardless of where the financial statements and related auditor's report are filed, included, or otherwise distributed. We view such a description as an additional communication that would be included in a separate paragraph following the opinion paragraph. That said, we encourage the Board to work with the IAASB with regard to the auditor's responsibility for other information to ensure a practical and operational approach.

- ***Auditor independence*** – We concur with the outreach participants views that the title of the standard auditor's report conveys compliance with the relevant independence rules and that additional discussion about independence could be redundant. Accordingly, we believe that an explicit statement regarding independence, in addition to the report title, does not seem warranted. If the Board were to consider requiring such a statement, it is important for the Board to consider the nature and extent of that statement and how it may be perceived by investors. Differing independence rules may apply, including their application to affiliated entities, depending on the circumstances. Because the rules are quite complex, investors may not fully understand these differences and may wrongly perceive a greater or lower level of assurance from one report to another. In which case, a general statement regarding compliance with the *applicable* rules may be more appropriate.

We believe that other potential clarifications or improvements to the standard auditor's report could include the use of headings, similar to the ISAs. Not only will such report format converge internationally promoting investor's understanding worldwide, it would also facilitate the potential additional reporting alternatives described in the Concept Release by differentiating the auditor's additional communications. As you may have noted, our views on report clarifications are based on achieving consistency between standard report language worldwide.

Considerations related to changing the auditor's report

As the Concept Release describes, there could be practical challenges as well as unintended consequences related to certain potential reporting alternatives. Our views on these matters are discussed in more detail below.

Effects on audit effort

As previously indicated, we generally believe that adding certain clarifying language in the standard auditor's report would not affect either the scope of the audit or the auditor's responsibilities. Other than the timing and costs involved in updating firm materials, this reporting alternative would have the least effect on audit effort. On the other hand, auditor

assurance on other information would greatly affect audit effort and substantially increase audit costs because this would constitute a separate engagement that is rarely being performed today due, historically, to market demand and cost. For this type of engagement, in addition to considering the benefits to investors and the costs to companies and their auditors, consideration would need to be given to the ability to meet filing deadlines, which were accelerated to provide more timely information to investors.

We believe that the AD&A and the required and expanded use of emphasis paragraphs, particularly if such paragraphs describe the audit procedures performed, also would affect audit effort and costs, even though these reporting alternatives are not intended to affect audit scope or audit procedures. Obviously, the AD&A would have a greater affect, as we agree with the issues described in the Concept Release related to the need for increased quality control procedures over non-standardized reports, as well as the potential for significant discussions and debates with management and the audit committee. We also believe that an AD&A would require extensive training and quality monitoring by audit firms.

Effects on the auditor's relationships

We think it is important for the Board to consider the potential effects that requiring an AD&A might have on auditor relationships with management and the audit committee and whether such effects could result in possible audit quality challenges. We believe that the effectiveness of the audit could be affected primarily by the nature of the information that would be expected to be disclosed and commented on in the AD&A. Because the audit committee represents the interests of investors, we believe that there needs to be a further assessment of the audit committee's role in this proposed approach. It is critical that the responsibility of the audit committee be defined with respect to overseeing the auditor in their process of developing an AD&A, in particular, and also in the other areas of expanded auditor disclosure and potential involvement.

On page 32, the Concept Release indicates that management and the audit committee "...might be compelled to change the financial statements, in order to eliminate differences between the company's disclosures and the auditor's discussion in the audit report." Consistent with our previous concerns, it appears that the Board is concerned that without requiring an AD&A, a company's disclosures may be deemed deficient. We note that the auditor must evaluate the appropriateness of the company's disclosures against the requirements of the applicable financial reporting framework. As we previously expressed, an AD&A should not be used to disclose information that management should have otherwise disclosed in the financial statements in order to preclude a modified opinion.

Effects on audit committee governance

The audit committee plays an important role by challenging the company's activities in the financial arena and overseeing the auditor. We do not necessarily believe that information provided by the auditor would undermine the governance role of the audit committee. We do, however, believe that management and the audit committee have the primary responsibilities to communicate company matters to investors. Expanding that responsibility to allow the auditor to make assertions about the company would be a significant shift, and the impact of that shift

would need to be considered and vetted against the current role of the audit committee, including the need to be cautious so as not to inappropriately suggest that governance disclosures may exist. We believe that the PCAOB could join efforts with other regulators and industry groups, including for example the SEC and National Association of Corporate Directors, to enhance the current reporting model for audit committees. Such reporting model, for example, could include the audit committee's views on significant matters, not necessarily the auditor's procedures on those matters.

Liability considerations

As recognized by the Board, changes in the role of the auditor and related reporting could have significant repercussions to auditor liability. Whether such information is furnished or filed or whether the auditor disclosures or involvement in other information could be accompanied by legal disclaimers are key questions that need answering. What might be perceived to be minor modifications might result in more time in the courtroom. With regard to an AD&A, we believe that it is highly likely that investors would place more weight on the auditor's perspectives about the company's financial statements, which could, in the glare of hindsight, result in allegations of harm by investors against the audit firm claiming inadequate, incomplete, or inaccurate auditor discussions. Furnishing, rather than filing, such information may be a factor with respect to the litigation exposure of these allegations and the auditor's liability related thereto.

Potential litigation also may result from the use of emphasis of matter paragraphs, particularly since such paragraphs are included within the auditor's report and would be deemed filed, rather than furnished. Regardless of whether suitable criteria are developed for the inclusion of such paragraphs in the standard auditor's report, we believe that there will always be some element of auditor judgment as to the significance of the particular matter. The auditor's judgment may be questioned by those who view a particular matter to be significant but not emphasized. Over time, any type of litigation increases audit costs.

Confidentiality

We are concerned that some aspects of the proposed AD&A could cause the auditor to violate professional ethical requirements relating to confidential client information by requiring the auditor to disclose information that has not been previously disclosed by the company. This could also be viewed as a breach of trust and confidence. Further, it could potentially jeopardize the auditor's independence and objectivity by performing this management function and by communicating matters that may be perceived as the auditor being a company advocate. While this discussion highlights what may be somewhat extreme implications of the disclosures, we think these are important considerations, which any proposed rulemaking would need to address.

In summary, we strongly support the Board's efforts to assess possible revisions to the auditor's reporting model to enhance the relevance and usefulness of the current financial reporting model. We also support moving with measured caution in that regard due to the potentially significant change in the role and expectations of the auditor that certain of the proposed amendments would entail. We have noted certain short-term amendments that could be implemented and encourage more study and collaborative efforts with other regulators and standard-setters on the more challenging proposals.

We would be pleased to discuss our letter with you. If you have any questions, please contact Karin A. French, National Managing Partner of Professional Standards, at (312) 602-9160.

Sincerely,

