

DODGE & COX

Investment Managers

September 30, 2011

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

RE: PCAOB Rulemaking Docket Matter No. 34

By way of background, I have worked at Dodge & Cox, an investment firm managing approximately \$175 billion in public equity and fixed income assets, since 1997. Dodge & Cox has been in business since 1930 using a long-term, value oriented, style of investing. Prior to business school, I practiced as a CPA at Arthur Andersen. I have reviewed financial statements as a former auditor and used them as an investor. I agree that the current auditor's report is deficient as a communication vehicle, and that it needs significant changes to remediate those deficiencies.

I believe that the root causes of the overall deficiency result from 1) a litigious environment causing auditors to limit disclosure, 2) the fact that auditors are paid by the company's management and 3) the different priorities of auditors and investors. With respect to the third cause, auditors spend the majority of their time auditing the client's balance sheet while performing much less work on the other statements and footnotes. Investors, on the other hand, are more concerned about the quality of earnings, cash flow and footnote disclosures. The audit report should be expanded to offer more insights to investors than just the simplistic "pass or fail" model we have today.

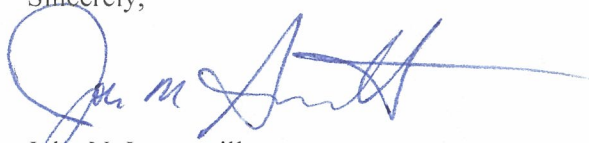
I recommend that the PCAOB consider requiring a supplemental auditor's discussion and analysis (AD&A) section in addition to the basic opinion which could include the following:

- The auditor's assessment of the estimates, principles and judgments made by management in preparing the financial statements and how they arrived at their assessment. Statistics regarding the testing that supported the opinion would be useful.
- Add disclosures detailing areas of high financial statement audit risk or significant measurement uncertainty as well as procedures performed to render the opinion. A description of materiality thresholds for financial statements taken as a whole should be disclosed, e.g., 5% of reported net income materiality standard for adjustments.
- An assessment of the *quality*, not just the acceptability, of the audit client's accounting practices and policies could be required. For example, the AD&A section of the audit opinion could include information which summarizes the following analysis demonstrating the quality of reported results:

- a. An assessment of the effectiveness of internal controls used by the client.
 - b. A description of the impact that material changes to accruals (e.g., *reserve reversals*), non-recurring or non-operating items and capitalized expenses had on reported results.
 - c. Auditor commentary on trends *between* financial statements, e.g., a comparison of net earnings to reported cash flow.
 - d. Discussion of unusual accounting related changes such as restatements that might cloud comparability and any other material changes in the financial statements or footnotes.
 - e. A comparison over a multi-year period of write-offs to cumulative reported earnings, if applicable.
 - f. *Qualitative* risk factors such as management's use of non-GAAP reporting of results, serial use of restructuring charges, expense write-offs, material M&A transactions etc. should be addressed along with quantitative factors.
- I also believe that there is a need for improved disclosure regarding the independence of the auditor. For example, the auditor should disclose if it is providing consulting services to the audit client in addition to the audit. They should have to disclose whether former auditors that worked on the audit engagement are now in senior finance roles at the client company. The nature and extent of involvement by other auditors should also be noted.
 - Finally, we agree that the audit report should more clearly describe the auditor's responsibility for detecting material fraud.

We appreciate the opportunity to provide feedback to your committee and look forward to positive future changes that might result from your efforts. Please do not hesitate to contact me if you have any questions. I can be reached at 415-273-7672.

Sincerely,



John N. Iannuccillo
Vice President
Research Analyst
Dodge & Cox