Dec. 11, 2013

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

Re: Proposed Auditing Standards on the Auditor's Report and the Auditor's Responsibilities Regarding Other Information and Related Amendments (PCAOB Rulemaking Docket Matter No. 34).

Dear Office of the Secretary:

On behalf of the board of directors of the National Association of Corporate Directors (NACD), we are pleased to submit our comments on the above-named Exposure Draft of the Public Company Accounting Oversight Board (PCAOB or Board). Founded in 1977, NACD is the only national membership organization created for and by directors. Given the close interaction between the auditor and the audit committee of a corporate board, and because many of our more than 13,500 members are audit committee members and chairs, NACD believes it is appropriate to provide our views on these issues. We commented earlier (Sept. 27, 2011) on the PCAOB's Concepts Release on the same subject.

Primary Role of Management to Assert and Auditors to Attest

As noted in our earlier letter, NACD believes any changes to the auditor's reporting model or expansion to the role of the auditor should preserve the established relationship between management and the auditors, namely, the role of management to *present* and *assert* information, and the role of the auditor to *attest* to that information. We believe that any change that would require or allow the auditor to disclose original information about the company would undermine management's responsibility for the financial statements (including the required certifications under the Sarbanes-Oxley Act. Further, such a change would significantly interfere with the well-established audit committee role in overseeing financial reporting, and could introduce the inappropriate situation of the auditor assuming principal responsibility for certain accounting and disclosures of the registrant. While NACD strongly supports effective independent auditing of financial statements, we would oppose any new standard that blurs the roles of asserting, attesting, and overseeing. These roles and their proper owners must be kept in mind when considering possible changes in reporting on such audits.

In our earlier letter, we expressed significant concerns about the possibility of requiring an auditor's discussion and analysis as part of the standard auditor's report. Thus, we are pleased that the Board has determined that this possibility is not being proposed for adoption.

We are also pleased to note that the Board has decided not to require "emphasis paragraphs." As we noted in our earlier letter, without a framework for defining what requires emphasis, this requirement could have resulted in overly broad disclosures intended to reduce litigation risk, rather than generating any disclosures of interest to investors.

Critical Audit Matters

The most significant change to the auditor's report proposed in the Exposure Draft would be the inclusion of critical audit matters (CAM). As described in the Exposure Draft, these could include matters already communicated to audit committees under the existing PCAOB auditing standard (No. 16, Communications with the Audit Committee, effective December 2012). In addition, CAMs could include matters that were already in the engagement review memo and/or discussed with the audit firm's executive office. Thus, in other than extremely simple businesses, multiple CAMs will be added to the standard auditor's report, lengthening it and literally burying the important "pass/fail" language that most readers key into.

Setting aside the issue of whether users will find much longer reports to be truly helpful, we return to our fundamental issue of management's vs. the auditor's role. While we have not performed a formal study, during our discussions in the development of this letter, we found that most of those who have served on audit committees believed that a very high percentage of the matters discussed with them by auditors and included in those required communications are already well disclosed in annual 10-Ks' management discussion and analysis (MD&A) and/or footnotes. Thus, requiring them to be included in the auditor's report is redundant, requiring a second or third level of highlighting for important matters in management's financial statements. Furthermore, it is not in the PCAOB's proper domain. Rather than have the PCAOB introduce such an arguably unnecessary additional financial reporting requirement, we believe it would be far more appropriate for the U.S. Securities and Exchange Commission (SEC) or the Financial Accounting Standards Board to consider whether such emphasized reporting is useful in the first place. Or, perhaps audit committee reports could be enhanced to serve such a purpose. In any event, we do not support having the auditor use its report to initiate what is essentially a management reporting function.

Furthermore, the Exposure Draft delves into the matters of significant deficiencies in internal control, certain going concern considerations, and even certain legal contingencies; all these too would have to be disclosed in the auditor's report as CAMs when present. This would be the case according to the new audit requirement even when there are other accounting rules that say the opposite and do not require management to make such disclosure.

We are also concerned about the impact of an expanded auditor's report on the preparation of year-end financial statements under tight SEC deadlines when management and auditors would be developing separate descriptions of similar matters. When financial management, legal counsel, audit committees, audit engagement partners, reviewing partners, and perhaps national office partners are all asked to provide their thoughts on identical company disclosures and auditor CAM descriptions of the same matters, a fair amount of contradiction could emerge, given the fact that these participants all have different roles and types of expertise. Having to reconcile these competing positions near the critical filing date for the annual report seems to be an unnecessary complication. It could also trigger meritless litigation focusing on discrepancies, even though these arose out of good-faith efforts to comply with this challenging new standard.

Auditor's Responsibilities Regarding Other Information

In our earlier letter we indicated that NACD is not opposed to having the auditor provide some level of assurance around management's assertions contained in the MD&A if—and only if—such information is *auditable* and within the *expertise* of the auditor. Nevertheless, we also noted that we believed cost and timeliness were important considerations as well, and that the benefit provided would need to outweigh the cost of the auditor performing such procedures.

According to the current Exposure Draft, the PCAOB has proposed a heightened standard of auditor responsibility for "other information." Previously, the auditor was charged with the responsibility to read the other information and "consider" whether it was consistent with the audited financial statements in material respects. The Exposure Draft changes the "consider" part of this procedure to require the auditor to "evaluate" the information, and specifies the procedures that should be followed in order to meet such a requirement. While those procedures appear on the surface to be very similar to what many auditors are doing under current practice, at least some of the major accounting firms believe that this change will trigger substantially more work in the future.

We hope that this will not become a déjà vu of the PCAOB's first attempt to mandate the auditing of internal controls. Auditing Standard No. 2 was applied in a way that required auditors to apply far too many procedures and incur far too much time than was necessary. While the Board ultimately addressed this through the issuance of Auditing Standard No. 5, many companies and audit committees continue to have a negative attitude toward their audit firm and the PCAOB because of that unfortunate experience. At a minimum, the Board should do careful testing of this aspect of the Exposure Draft to ensure that there is a clear understanding of how a final standard would actually be applied in practice.

Auditor Tenure

"A statement containing the year the auditor began serving consecutively as the company's auditor," would be another, major addition to the auditor's report. This matter was not in the original Concepts Release so we did not comment on it in our earlier letter. In the Exposure Draft and accompanying comments by Board members, the PCAOB explains that academic and other research is mixed as to whether audit quality is enhanced by shorter or longer auditor tenure. There apparently are also mixed views among users as to whether they would find such information to be meaningful in making investment decisions.

While disclosing this information would seem to be essentially costless, we question whether including it in the auditor's report is appropriate. We are concerned that without some additional context, simply including a year of commencing an audit relationship could be misconstrued by readers. For example, some financial press accounts could focus on a very long relationship (and imply too "cozy" a situation) without also reporting the many other factors to ensure auditor independence and objectivity such as:

- Continual change among key members of financial management of the company during the audit firm's tenure.
- Mandatory rotation of the audit firm's lead partner and other key partners, as well as other changes in the members of the audit team.

- Careful oversight of the relationship by the audit committee.
- Critical evaluation of audit quality by the audit committee (see the audit firm evaluation tool created by NACD as part of a broader initiative led by the Center for Audit Quality).

We are aware of certain companies that have provided auditor tenure information in proxy statements either in the audit committee report or in information provided in connection with a shareholder ratification vote on the selection of the independent auditors for the coming year. We recognize that these disclosures are presently voluntary and not required. If there is, however, truly sufficient investor interest in the auditor tenure information, we suggest the SEC should consider requiring it to be provided as part of proxy statement disclosures. We do not support including it in the auditor's report.

Other Proposed Changes to the Auditor's Report

In addition to those major changes, the Exposure Draft suggests a number of things that we consider to be "cosmetic" changes to the standard report including:

- A statement describing the audit (paragraph 6m).
- Clarifying that the statements are free of material misstatements *whether caused by error or fraud*.
- Addressing the report to both shareholders and the board.
- Referring to footnotes, as well as the financial statements.
- Stating in the report that the auditor is independent.

We have no objections to these changes.

Summary

As noted above, we have significant reservations about the three major changes proposed in the Exposure Draft: CAMs, Auditor's Responsibilities Regarding Other Information, and Auditor Tenure. As noted in our earlier letter, NACD urges the PCAOB to thoroughly consider how the changes proposed in this Exposure Draft could impact how the audit committee and management—equally important parties in the financial reporting process—carry out their responsibility to investors. We note, with full agreement, that the Board has urged companies and auditors to test the application of the CAM proposal using recent experience. We believe that such testing will demonstrate that the vast majority of CAMs in practice will repeat similar disclosures by management as noted in our comments above. We also urge testing of the "other information" provisions of the Exposure Draft as we believe it will demonstrate that such a proposal is not cost beneficial.

As also mentioned in our earlier letter, we urge the Board to make special efforts to reach out to the investment community to ascertain clearly how the proposed changes to the auditor's report would be used in their investment decisions.

NACD appreciates the opportunity to comment on this Exposure Draft, and would be pleased to respond to any questions regarding the views expressed in this letter.

Sincerely,

Ken Daly
President and CEO, NACD

Reatha Clark King
Chair, NACD