December 11, 2013

From:
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To:
Office of the Secretary, PCAOB,
1666 K
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Subject: Docket 034 : Proposed Auditing Standards on the Auditor's Report and the Auditor's Responsibilities Regarding Other Information and Related Amendments

Dear Mr. Chairman and Members of the Board:

Thank you for the opportunity to comment. Your retention of the "pass/fail" model is appropriate in my opinion. Attempting to install some sort of qualitative grading would only result in endless unwinnable arguments and little additional information, likely more confusion, for investors, energy better spent in other existing forums debating proper reporting.

The current proposal represents much work and energy for you and others. The proposal is a big step for which I commend you. You have no real choice. Your review results and the 2008 financial crisis are strong evidence problems exist in audits, probably more than can be cured by only this current proposal.

The results of PCAOB reviews of audits have been very helpful, but troubling. The database of your results is building. It is tending to show much effort is necessary to push private auditors to higher performance standards. You have now looked at thousands of audits with far too many conclusions saying "the work does not support the audit conclusions."

Regarding the 2008 financial crisis, mentioned above, I still shake my head in amazement that this situation was undetected and misreported under long existing requirements. It happened on the heels of many clean audit reports on financial statements and internal controls, issued up to immediately before the insolvencies, bailouts and forced mergers. The audit firms are likely not guilty of intentional complicity; other parties were responsible for creating the problems. However, the problems were auditor discoverable accounting and reporting problems long before they became one of history's largest financial crises. Auditors are supposed to discover problems like these.

You are constrained to some extent by coordination with your international counterparts; but you now have some temporary comfort from economic measures to restore confidence which hopefully dampens the pressure that historically has caused aggressive accounting and financial fraud. I hope it works and gives you the time you need.

In the end, probably after the next crisis, other major changes may be required. I have said before, seven things need to be fixed to provide the base of good audits. Among them are firm organization, capitalization and independence. I think I am right! Much smarter people have other ideas. The United States Treasury Advisory Committee offered a long report of suggestions, post Enron but pre 2008 financial crisis.

But, the next crisis will come. I do not think changes are yet made that make the audit firms effective warning systems for investor protection which they should be. Audit firm capital and management attention is more often, too often, spent building other service lines.

Let me then comment on components of your proposals with which I, respectfully, do not entirely agree: 1) the communication of critical audit matters; 2) a statement of the year the auditor began serving consecutively as the company's auditor; and 3) the city and state from which the auditor's report has been issued.

I know you are far down the road considering the proposals but you should recognize that misunderstandings may result.

All agree the new requirements will increase audit costs. If that is what it takes to get to the job done, it is unfortunate but necessary. The cost as usual is due to the few business managers and auditors who cause the problems, not the vast majority who consistently do a good job. Penalties for this misbehavior are far too light for the guilty, making the rest of the cost fall on the innocent.

Communication of Critical Audit Matters

This idea sounds better than reality, in my opinion.

The definition of "critical audit matters" is difficult so you must expect some evolutionary development, during which it may be premature to start listing things in the audit report. You attempt some definition using the words ***difficult***, ***subjective*** and ***complex***--- a big box to me, but not to some. You identify them as those that may have been discussed in certain audit documentation.

You have proposed a very good, robust documentation requirement for auditor consideration of Critical Audit Matters. If such documentation is not now taking place, your proposal for internal documentation is good and should be required.

Concurrently, I must also conclude that investors should accept some responsibility for their own knowledge and investigation of business risks relative to their own risk appetite, including that their auditors do not find everything. Investors will rightfully believe any list of critical matters is complete: "Nothing more is critical." They are wrong; but, it is a great argument in court.

The result of listing the critical audit matters will be, I think, an expansion of the infamous "expectation gap." This year I heard a high level management partner of a U. S. big 4 firm tell an audience that, "unlike Enron" the 2008 financial crisis was not an accounting problem. On the contrary, I think the accounting and controls in mortgage generation and for credit default swaps were awful, and had been for years. Assets were overstated; liabilities understated. There is a huge expectation gap as to what is a "critical audit matter" between the partner and me.

“Critical audit matters” go deeper than accounting matters. Other matters are often more difficult. For example, there are “tone at the top” issues and personal issues of key executives. These get much attention from auditors and audit committees and they should. But, I have to stop short of saying these matters should therefore be discussed in the audit report by anyone who has no legal right to subpoenas, sworn statements or protection from liability for public speculation.

A Statement Containing the Year the Auditor Began Serving Consecutively

Maybe auditor tenure would be appropriate information in the proxy statement, but not in the audit opinion. Keep the report confined to the central theme: the financial statements. Are they right or wrong?

Many big companies use the only audit firm they can use due to restrictive conflicts in a small group of suppliers, a fact more important for investors to know than “how long.”

If there is a concern with the auditor’s history, it should be with things that may compromise auditor objectivity. For example, if the auditor had previously served as a consultant to the company and is now subsequently the auditor, what was the nature of the prior relationship and how have they and the audit committee resolved the objectivity question? Further, for international companies or companies with significant, remote subsidiaries or divisions, to what extent is the auditor relying on the work on its own affiliated firms or other firms? But, even on these questions, if deemed important, the discussion should be in the proxy statement or annual report, not in the audit report.

I prefer not to clutter the important theme of financial statement trueness with other “clatter.”

The City and State from which the Auditor's Report has been Issued

Auditors’ reports disclose this now without your proposal. I would eliminate the disclosure. City and State of issuance is probably the least significant item in the auditors’ reports. Often, it is a little untrue, not a good way to append an audit opinion.

The effect of identifying a city or state for each audit report ranges from harmless to misleading. The range does not extend to “that’s good.”

There are many examples of audits performed by industry teams where the partner is from one city, the manager from another, staff from various locations, few of which are in the city or state of the audited company or the location of the issuing office. This dispersion of professional personnel, all transporting in for their work, can be an audit risk. It is the job of the audit committee and the audit firm to balance the risk with comfort of added expertise. If the PCAOB reviewers later disagree with the geographic staffing, they should say so.

In fact, there are other more important issues not disclosed that should be discussed somewhere, but not in an auditor’s report. What may be important to some investors is the disclosure of jurisdiction under which the audit contract must be interpreted. More often than not, that is not the state being identified in the audit report. It may also be important to know of any restrictions the audit contract places on where and how the company may pursue disputes and claims.

For smaller registered firms, I believe it is important for investors to consider remoteness of the auditor to the audited company. For large registered firms, I think it is important to consider which affiliated entity is taking responsibility for the work, regardless of who is doing the work and where. But, put this information in the proxy statement.

Otherwise, knowing the state of the issuing office, adds little to nothing. It would be better to eliminate the disclosure.

Thank you for your dedication.

Sincerely,

Gilbert F. Viets