



National Association of State Boards of Accountancy

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September 28, 2011

Public Company Accounting Oversight Board
Office of the Secretary
1666 K Street N.W.
Washington D.C. 2006-2803

By mail and e-mail to: comments@pcaob.org

RE: Concept Release on Possible Revisions to PCAOB Standards Related to
Reports on Audited Financial Statements

To the Members of the Public Company Accounting Oversight Board:

We appreciate the opportunity to offer comments to the Public Company Accounting Oversight Board (“PCAOB”) on its Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements (the “Concept Release”). The National Association of State Boards of Accountancy’s (NASBA) mission is to enhance the effectiveness of State Boards of Accountancy.

The PCAOB has undertaken an initiative to improve the present auditor’s reporting model to make the model more responsive to the needs of users. NASBA’s Regulatory Response Committee offers the following comments from a regulatory standpoint - not a practitioner’s standpoint.

Clarification of “Reasonable Assurance”

Auditing standards require that the auditor obtain reasonable assurance about whether the financial statements reported on are free of material misstatement, whether caused by error or fraud. The standards also state that, “Absolute assurance is not obtainable because of the nature of audit evidence and the characteristics of fraud. Although not absolute assurance, reasonable assurance is a high level of assurance.”

The present auditor’s report reads, in part: “The standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements.”

We believe that the clarity would be enhanced if the phrase “a high level of assurance but not absolute assurance” be substituted in the auditor’s report for “reasonable assurance,” and that

“whether caused by error or fraud” also be added after “material misstatements” in the auditor’s report. These recommended changes would not change auditing standards or the responsibility of the auditor.

Adding the Auditor’s Responsibility for Detecting Fraud to the Auditor’s Report

The present auditor’s report makes no mention of “fraud.” Fraud is encompassed in the phrase “material misstatements.”

We recommend that the auditor’s report be changed to explicitly address fraud and the auditor’s responsibility for detecting fraud in a manner that reflects current auditing standards and does not extend such standards, or the auditor’s responsibility. We also believe that the commentary added include the language in auditing standards that “absolute assurance is not obtainable because of the nature of audit evidence and the characteristics of fraud.”

Other Information in Documents Containing Audited Financial Statements

If a document contains information (“other information”) in addition to the auditor’s report and the financial statements reported on, auditing standards require the auditor to read the other information and consider whether such information, or the manner of its presentation, is materially inconsistent with the information in the financial statements, or the manner of its presentation. However, the auditor’s responsibility with respect to the other information does not extend beyond considering that the other information is not materially inconsistent with the financial statements covered by the auditor’s report. The auditor has no obligation to perform any procedures to corroborate other information contained in a document. Management’s Discussion and Analysis (MD & A) is required information in annual reports to the Securities and Exchange Commission (“SEC”) on Form 10K and in annual reports to shareholders of publicly held companies. The MD & A is “other information” and the auditor’s responsibility for such information is discussed above.

In discharging the auditor’s responsibility to read and consider other information, typical practice includes comparing dollar amounts in the MD & A to dollar amounts in the financial statements to see if they are in agreement and to recalculate percentages, or to see if they are consistent with the financial statements. Dollar amounts appearing elsewhere in the document, if derived from the financial statements, are usually subjected to the same comparisons.

Auditing standards further provide that if the auditor becomes aware of information that the auditor believes is materially misstated and the discrepancy is not a material inconsistency as discussed above, the auditor should discuss the discrepancy with the client. If after discussion the auditor believes that the auditor is correct and the client takes no action, the auditor is required to take “appropriate action.”

We believe that added assurance on MD & As and client releases should not be a part of the final changes to the auditor’s report. We believe that the additional cost to provide such assurance would far outweigh the additional benefit received. Adding cost to an audit for little benefit is not in the public interest.

We recommend that a paragraph stating the auditor's responsibility for "other information" be included in the auditor's report. It is not likely that such responsibility is currently known by most of the readers of financial statements.

Auditor's Discussion and Analysis ("AD & A")

The Concept Release includes a section suggesting that consideration be given to adding an Auditor's Discussion and Analysis (AD & A) section to the auditor's report.

The Concept Release cites surveys by the Chartered Financial Analysts Institute in which a majority of the surveys' respondents note that audit reports need to provide more specific information about how the auditor reached his or her opinion on whether the company presented its financial statements in accordance with the required reporting standards. No indication is given as to what information is needed, or how it would be used by the surveys' participants in forming investment decisions about the reporting company. To only ask the participants if more information is needed about the audit is to ask for an easy "yes."

Such concerns may question the adequacy of the financial statements and the audit of such financial statements. Such concerns, however, would not be mitigated had the subject audit reports included more extensive disclosure-say in an AD & A-of the audit procedures used to establish a basis for the auditor's opinion.

The Concept Release cites the consensus among investors that the auditor has significant insight into the company, and the auditor's report should provide additional information based on that insight to make it more relevant. The Concept Release also notes that "some investors believe that more relevant insight into the financial statements through the eyes of the auditor might better enable them [the investors] to assess how changes in the economy might affect a company's future financial performance or condition."

The Concept Release also cites "recent concerns highlighted by the financial crisis related to preparing and auditing financial statements for complex global businesses" and comments that "reporting in advance of the crisis might have been helpful in assessing the quality of the financial statements, and providing early warning signals regarding potential issues including off-balance sheet contingencies or the sensitivity of loan losses." The Concept Release also cites views expressed by some investors that: (a) they would have a better perspective regarding the risks of material misstatements if they had a better understanding of how the audit was conducted; (b) the auditor should express the auditor's views regarding the quality of the financial statements reported on; and (c) the range of acceptability of judgments and estimates is not mentioned in the auditor's report and might not be fully reflected in the financial statements.

Further, the Concept Release notes that many investors want a discussion about the audit and the company's financial statements, and some want a discussion of risks, other than audit risk, such as business risks, strategic risks and operational risks.

The auditor's responsibility is to form an independent unbiased opinion, based on auditing standards, on whether the financial statements are fairly presented in accordance with the established reporting standards. The value of the audit rests on the independence of the auditor and the competence of the auditor. Management has the responsibility for preparing and issuing the financial statements, subject to the oversight of "those charged with governance," which group includes audit committees. Auditors are not the source of disclosures.

Some of the concerns noted in the Concept Release are concerns about the financial reporting model that could be considered by the setter of financial accounting standards. For example, how changes in the economy might affect a company's future financial performance or condition is a matter of financial reporting - not a matter for the auditor's report. Similarly, providing early warning signals regarding potential issues including off-balance sheet contingencies or the sensitivity of loan losses is a matter of financial reporting. Also, reporting in advance of the [financial] crisis might have been helpful in assessing the quality of the financial statements. Such a reporting issue is one that could be considered by the setter of financial reporting standards.

The request for discussion of risks other than audit risks is also a financial reporting issue that the setter of financial reporting standards might wish to consider. Such discussions are presently available in Form 10K, the annual report to the SEC, in items 1, 7 and 7a outside of the financial statements.

Regarding the commentary that the range of acceptability of judgments and estimates is not mentioned in the auditor's report and might not be fully reflected in the financial statements, the disclosure of the range of judgments and estimates is another financial reporting issue. If the reported estimates do not fall within the range of acceptability, then the results of the audit performed and the fairness of the financial statements could be questioned.

Requiring the auditor to have "more relevant insight," which is different from having an understanding of the client, its business and the business environment, could require development of an auditing standard that would by its very nature be vague and, therefore, unenforceable. As regulators, the enforceability of auditing standards is essential to the State Boards. Requiring the auditor to comment on the quality of earnings would compromise the independence of the auditor since such commentary is the responsibility of an analyst.

We believe that addressing issues in the auditor's report that should properly be included in financial statements would blur and undermine the very clear distinction between the responsibilities of the auditor and management. Such blurring of responsibility is not in the public interest.

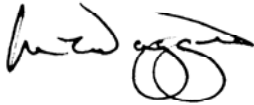
We strongly disagree with the concept of an AD & A and believe that such addition to an auditor's report would not be in the public interest.

Information about the audit, how it was conducted, significant issues considered by the auditor, the independence of the auditor and other matters are required to be communicated to the audit committee by the auditor before the auditor's report is released. If additional information is

desired for communication to the audit committee, the PCAOB has the authority to add to the current required communications, subject to approval of the SEC. We believe that this communication is the appropriate form for discussing audit performance - not an AD & A included in an auditor's report.

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael T. Daggett". The signature is fluid and cursive, with a large loop at the end.

Michael T. Daggett, CPA
NASBA Chair

A handwritten signature in black ink, appearing to read "David A. Costello". The signature is fluid and cursive, with a large loop at the end.

David A. Costello, CPA
NASBA President & CEO