

J. Gordon Seymour
Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

30 September 2011

PCAOB Rulemaking Docket Matter No. 34
Concept release on possible revisions to PCAOB standards related to reports on audited financial statements

Dear Mr. Seymour:

Ernst & Young LLP (Ernst & Young) is pleased to comment on the Public Company Accounting Oversight Board's (PCAOB or Board) concept release on possible revisions to the auditor's reporting model (the Concept Release). We believe that some change is clearly necessary and fully support responsible change in this area. This letter provides our views on the Concept Release and outlines a possible approach to revising the auditor's reporting model that would provide useful information to investors and other financial statement users. In the Appendix to this letter, we respond to the questions posed in the Concept Release.

1. A General observation – a measured approach to changes to the auditor's reporting model would be more productive at this stage

Some financial statement users have expressed dissatisfaction with the current reporting by auditors and have suggested a variety of changes to the model, some of which would represent fundamental changes to the auditor's role. Some financial statement users also have expressed dissatisfaction with corporate financial reporting, saying annual reports are becoming too complex and, in some cases, appear to be more focused on compliance than on effectively communicating key information and performance trends.

While we recognize that there are clear calls for improvements to auditor reporting, we believe the auditor's report is just one element in the suite of information provided to users of the financial statements. We believe it is important to consider changes to the auditor reporting model in the context of other initiatives aimed at enhancing overall corporate financial reporting. Attempts to address concerns with corporate financial reporting solely through changes in the auditor's reporting model will not be successful and could result in significant change to or expansion of the auditor's role, which we do not believe is appropriate or cost-effective.

We note that both the Financial Accounting Standards Board (FASB) and the Securities and Exchange Commission (SEC) have ongoing projects, or have expressed an intention to undertake projects, to address perceived weaknesses in financial reporting. Therefore, we suggest the Board

take a measured approach to changing the auditor's reporting model at this time. We recommend that the PCAOB and its staff collaborate with the SEC and the FASB to consider how changes in reporting by both issuers and auditors can better address the needs of users of the financial statements over the longer term.

However, we don't believe a collaborative longer-term effort on this front should prevent some needed improvements to the auditor's reporting model in the near-term. In the following sections, we propose an approach, which uses certain of the ideas outlined in the Concept Release, that could be developed and applied in a practical, cost-effective manner and would represent a constructive change to the information auditors currently provide to investors and other financial statement users.

In addition, we encourage the Board to consider the efforts of other standard setters, such as the International Auditing and Assurance Standards Board (IAASB) and the AICPA's Auditing Standards Board (ASB), which are also exploring changes to the auditor reporting model. We believe that users would be better served if the nature of information communicated by the auditor is generally consistent, regardless of the jurisdiction. Although we recognize that certain differences in auditor reporting standards will continue to exist, unnecessary differences in IAASB, ASB and PCAOB requirements will cause confusion and could lead to inappropriate inferences about a company's financial statements, audit quality and the nature of assurance provided.

2. The overarching principles described by the CAQ must be addressed when considering any changes to the auditor's reporting model

On 9 June 2011, the Center for Audit Quality (CAQ) submitted a letter¹ outlining five overarching principles that should guide the development of any changes to the auditor's reporting model. These principles are:

1. Auditors should not be the original source of disclosure about the entity; management's responsibility should be preserved in this regard. A substantive shift in responsibility from the auditor attesting to information prepared by management to the auditor providing original information about the company being audited could result in unintended consequences that are not in the best interest of investors and other financial statement users.
2. Any changes to the reporting model need to enhance, or at least maintain, audit quality.
3. Any changes to the reporting model should narrow, or at least not expand, the expectations gap.
4. Any changes to the reporting model should add value and not create investor misunderstanding. Specifically, any revisions should not require investors to sort through "dueling information" provided by management, the audit committee and independent auditors.

¹ For the full text of the Center for Audit Quality's letter to the PCAOB dated 9 June 2011, go to http://pcaobus.org/Rules/Rulemaking/Docket034/001_CAQ.pdf

5. Auditor reporting should focus on the objective rather than the subjective. Financial reporting matters assessed by an auditor can be highly subjective; however, it is important that auditor commentary, communicated in a widely distributed report, provide objective information about such matters. Requests for an auditor's subjective views or impressions on financial reporting matters cannot be effectively communicated and understood without the existence of an appropriate two-way discussion protocol. Without such dialogue, the communication of subjective views and impressions could lead to a misunderstanding and harmful consequences.

We firmly agree with these principles and believe the Board should evaluate any proposed changes to the auditor reporting model against each of them. Our approach adheres to these principles.

3. We continue to support the current pass/fail opinion

Users have consistently noted that a concise conclusion as to whether the financial statements, taken as a whole, are presented fairly in accordance with the applicable financial reporting framework is meaningful information. Therefore, we support maintaining the pass/fail framework in the current auditor's report.

4. Changes to the current pass/fail opinion are needed to help investors and other financial statement users – summary of a proposed approach to revising the auditor reporting model

Based on the principles noted above and views expressed by a number of participants in the Board's outreach, we believe the following approach, which incorporates certain of the ideas reflected in the Concept Release, would be a meaningful and practical change to the existing auditor reporting model:

- ▶ Adding certain clarifying language to the auditor's report
- ▶ Requiring the expanded use of emphasis paragraphs in the auditor's report

We believe this approach, while not addressing all of the calls for change, would be responsive to many of the suggestions and provide a meaningful enhancement to the information provided to investors and other financial statement users. Additional thoughts on this approach follow:

Adding certain clarifying language to the auditor's report

Many investors and other users of financial statements have suggested that adding certain clarifying language to the standard auditor's report could enhance users' understanding of an audit. We agree and strongly support adding new text or clarifying the existing language in the following areas of the standard auditor's report:

- ▶ *Reasonable assurance* – The report should clarify that reasonable assurance represents a high level of assurance, but reasonable assurance is not absolute assurance and an audit conducted in accordance with PCAOB standards may not always detect a material misstatement.

- ▶ *Auditor's responsibility for fraud* – The report should clarify, as set forth in PCAOB Interim Standard AU 316, that the auditor's responsibility is to plan and perform the audit to provide reasonable assurance about whether the financial statements are free of material misstatement, *whether caused by error or fraud*.
- ▶ *Auditor's responsibility for financial statement disclosures* – The report should explicitly state that the footnotes are an integral part of the financial statements, are subject to audit procedures and are covered by the auditor's report.
- ▶ *Management's responsibility for the preparation of the financial statements* – The report should provide an expanded discussion covering management's responsibilities for the financial statements and other information provided to users of the financial statements.
- ▶ *Auditor's responsibility for information outside of the financial statements* – The report should describe the auditor's responsibility to read certain other information in documents containing the audited financial statements for inconsistencies with the audited financial statements and to identify whether there are material misstatements of fact pursuant to PCAOB Interim Standard AU 550. We also believe it would be appropriate for an auditor to state in the audit report his or her conclusion on the results of these procedures (i.e., whether any inconsistencies or material misstatements of fact exist in the information containing audited financial statements).
- ▶ *Auditor independence* – The report should explicitly state that the auditor is independent under all relevant standards of the SEC and PCAOB.

We also believe the PCAOB should consider adding the following clarifications:

- ▶ *Material misstatements and assessment of materiality* – The report should identify what is meant by "material misstatement" and provide more qualitative information about the auditor's consideration of materiality when planning the audit and evaluating the financial statements. We do not believe that it would be appropriate to include specific quantitative measures of materiality in the auditor's report.
- ▶ *Audit committee responsibilities* – The auditor's report should provide an expanded discussion of the audit committee's responsibilities.
- ▶ *Addressing the audit report* – The report should be addressed to the shareholders of the company as well as the Board of Directors.
- ▶ *Professional judgment* – The report should highlight the need to use professional judgment in assessing audit risk, selecting audit procedures and considering the issuer's internal control over financial reporting.

- ▶ *Additional information about public company audits* – The report should include a reference and link to more information about public company auditing (e.g., the CAQ's *In-Depth Guide to Public Company Auditing: the Financial Statement Audit*²), similar to the approach used in the United Kingdom.
- ▶ *Scope limitations and non-compliance with US Generally Accepted Accounting Principles (GAAP)* – The report should outline the auditor's responsibility in the event a conclusion is reached that the financial statements are not presented in accordance with GAAP or the audit scope is limited.
- ▶ *Firm network structure and responsibilities* – The report should describe the accounting firm network structure, the responsibility of the member firm signing the audit report and, where applicable, the participation of other member firms in the audits.

We believe these clarifications would provide users with meaningful perspective on the auditor's responsibilities. We also believe the clarifications represent a cost-effective step that could be performed under the current PCAOB standard-setting process and be adopted by auditors in a timely manner.

Requiring the expanded use of emphasis paragraphs in the audit report

Outreach conducted by the PCAOB indicated that many users want additional information from the auditor about significant matters affecting the financial statements. Users noted that, because the number and variety of disclosures continue to grow, it is often difficult to identify the matters that have the most significant effects on a company's financial results and that auditors could help users better focus their analyses. In addition, users have requested additional insights into the auditor's communications with the audit committee on significant matters affecting the financial statements.

We believe the required and expanded use of emphasis paragraphs could help address certain of these requests. As outlined in the Concept Release, the approach could be used to highlight matters that, in the auditor's judgment, are the most significant matters in the financial statements and to point users to where those matters appear in the financial statements and related disclosures. This approach would draw attention to important items that may warrant a detailed review by financial statement users. We also believe identifying these matters in the auditor's report may increase preparer focus on these areas, thereby improving the quality of disclosures provided to investors.

The objective of this approach would be for the auditor to answer the following basic question: "What, in your view, are the most important matters affecting the financial statements this year?" Developing the criteria for the auditor to use to consistently determine the types of matters to include in the report will be challenging, but we believe it can be accomplished. Selecting the most

² See Center for Audit Quality's *In-Depth Guide to Public Company Auditing* (2010). Available at: http://www.thecaq.org/publications/In-Depth_GuidetoPublicCompanyAuditing.pdf

important matters will require the use of judgment. We believe the auditor should start by evaluating the material areas that involve an accounting policy or practice that has a significant effect on the issuer's financial reporting, a highly subjective accounting estimate, a material uncertainty, a significant unusual or infrequent event or transaction, or information about the structure of an entity that is significant to understanding the assertions made in the financial statements. The auditor should then evaluate whether these matters were the subject of significant discussion with the audit committee, required significant audit effort, underwent significant change or were unique to the company or the industry during the period. We believe these matters are the types of topics that users would like to see identified in the audit report.

Care would need to be taken to encourage auditors to highlight only the most important matters. Including too many areas would risk minimizing the intended emphasis. In addition, the report would need to clarify that while the audit included the performance of specific procedures designed to address the risks of material misstatement associated with these areas (1) no separate form of assurance has been given for any specific item emphasized and (2) the matters included in the report do not represent a complete list of all areas addressed in the audit. Finally, it should be clear that matters emphasized in the report are based on the auditor's professional judgment and may change from year to year based on a company's particular facts and circumstances.

Consistent with the CAQ's overarching principles noted above, we do not believe that the auditor should provide subjective views or impressions about financial statement matters in the audit report. We believe the emphasis paragraphs should be objective, fact-based descriptions of the items and should direct the reader to where such matters appear in the financial statements, including the related disclosures. Based on investor input provided at the PCAOB's recent roundtable on the Concept Release, we would also support the suggestion that the auditor identify why the matters emphasized were selected for specific emphasis in the audit report.

We do not believe the emphasis paragraphs should include a summary of "key audit procedures" performed in these areas. For important areas, it would be difficult to summarize the hundreds of audit hours spent into a few crisp sentences. We also do not believe that an expansive description of the audit procedures carried out in a particular area would be helpful to users. In addition, since specific procedures performed in a particular area are developed in the context of the overall audit, it may be difficult to effectively convey how such procedures relate to the auditor's evaluation of the financial statements taken as a whole.

Finally, we believe the required emphasis paragraph approach could be implemented timely.

5. The value of standardized language

As noted in the Concept Release and in the Board's outreach, users of financial statements have said that standardized (or boilerplate) language lacks substance. These users have said any modifications to the auditor's report that allow for additional standardized language would not be as useful as modifications requiring the communication of subjective views or impressions.

We believe there is significant value in using standardized language. For example, investors and other users have said they appreciate the clarity and simplicity of the current pass/fail opinion, which provides a succinct, objective conclusion about whether the financial statements are presented fairly in accordance with GAAP. We believe that modifications to the report should be clear, concise and objective. In addition, the use of consistent and objective language facilitates user comparisons across companies and minimizes the risk of user misunderstanding.

6. Our views on other alternatives outlined in the concept release

Reporting on other information outside the audited financial statements—this may be a viable approach, but the cost-benefit analysis is important

Users have noted that they use sources of financial information beyond a company's financial statements, such as management's discussion and analysis (MD&A), earnings releases and investor presentations to evaluate a company and that auditor reporting on this information could improve the quality, completeness and reliability of the information. This reporting would provide users with a higher level of confidence in the information. As noted above, professional standards require auditors to read information in documents containing the audited financial statements for any inconsistencies with the audited financial statements or any material misstatements of fact. We believe the audit report clarifications above would help users better understand the auditor's involvement with information in documents that contain the audited financial statements and the auditor's conclusion related to the procedures performed in this area.

We note that auditors often perform certain procedures on information such as earnings releases before public distribution to assess whether the information is consistent with the audit in process. We recognize that some investors may not be aware that these procedures are performed. Having auditors issue the equivalent of agreed-upon procedures reports for general use, describing the procedures performed on this information, could potentially provide investors with added visibility in this area.

Auditor reporting on information outside the financial statements would increase the scope of the auditor's responsibilities, would require the development of new auditing standards and would potentially require additional regulatory efforts. For example, if auditor attestation were deemed appropriate for earnings releases, preparer guidance would also need to be developed. We believe certain of these alternatives would require careful study.

As with all alternatives, the costs will need to be weighed against the benefits. As contemplated in the Concept Release, auditor attestation on a company's entire MD&A disclosure is an alternative. Such an attestation would be a significant undertaking and we do not believe financial statement users have requested this level of auditor involvement.

Given users' requests for more explicit auditor involvement in the most critical, subjective matters affecting a company's financial statements, we believe that separate auditor attestation on an issuer's critical accounting policies/estimates disclosure in MD&A may be a more modest step in this broad area. It would direct auditor effort to those areas that appear to be of the highest interest to investors, and could be a more cost-effective alternative. We also believe additional

auditor involvement would likely lead to preparer focus and improved disclosures. While we believe requiring the expanded use of emphasis paragraphs may be a preferable alternative, consistent with the CAQ's June letter to the Board, we believe that auditor involvement with a company's critical accounting policies/estimates disclosure in MD&A is also a viable approach that merits further consideration by the Board.

Auditor's Discussion and Analysis—we do not support this concept

We do not support an Auditor's Discussion and Analysis (AD&A) approach as an alternative to address user requests for auditor's views on the company's financial statements and on the audit.

We strongly believe an AD&A would have adverse consequences for a variety of reasons, including the following:

Auditor commentary on a company's financial statements

A requirement for the auditor to provide subjective comments on a company's financial statements would be inconsistent with several of the overarching principles. For example, we do not believe auditor views on issues as subjective as the "quality" of the company's accounting policies and practices, difficult or contentious matters or "close calls" can be effectively communicated in a widely distributed report where no two-way dialogue will exist. In addition, inconsistencies in the areas emphasized in an AD&A between companies in the same industry may be difficult for users to reconcile and potentially result in inappropriate judgments related to the company or the audit. Moreover, the subjective nature of such matters could result in the presentation of information by the auditor that is not consistent with the information presented by management (as overseen by the audit committee). Providing information that may "compete" with information reported by management would likely be difficult for users to reconcile, particularly without the existence of a two-way discussion protocol.

Moreover, we do not believe the auditor should be the original source of information about the entity. The longstanding role of the auditor is to attest to information prepared and presented by management in accordance with an established framework. If the Board were to require an auditor to provide subjective impressions, it might inappropriately expand the role of the auditor into financial reporting, rather than opining on the company's financial statements. While the Concept Release notes that an AD&A may encourage management to improve a company's financial statements to prevent disclosure of conflicting information, such pressure could give the auditor undue influence on the presentation of matters in the financial statements. If management defers to the views of the auditor, this could effectively place the auditor in the role of the preparer, which would be contrary to the auditor's responsibility to provide an independent, objective evaluation of the financial statements.

Such an outcome could also adversely affect the auditor's relationship with management and the audit committee, which could have a negative effect on the audit. For example, it may discourage the company and its audit committee from engaging in robust discussions with the auditor of matters related to the financial statements for fear of that discussion being reported

by the auditor. As the Board recognized in its proposed standard on the auditor's communications with the audit committee, open communication with both management and the audit committee is integral to the execution of a quality audit.

We are also concerned that an AD&A requirement could place significant additional pressure on the audit process and the company's ability to meet its regulatory filing deadlines. Due to the nature of issues that might be included in an AD&A, it would need to be developed during the completion phase of the audit. The effort to develop the AD&A could potentially divert attention away from the audit at a crucial time. In addition, audit firms would need to develop robust quality control processes to review the subjective views and impressions contained in an AD&A before the report is released. These processes would take time, which could place further strain on the challenging reporting timetable facing issuers and auditors.

Auditor commentary on the audit

The Concept Release considers whether an AD&A could present information about the audit, such as audit risk assessments, audit procedures performed and the results of those procedures, and auditor independence. Some users have suggested that additional information about the audit would enhance their understanding of what an audit represents and perhaps better equip them to evaluate the quality of the audit. We believe that subjective areas such as audit risk assessments and the related audit responses would be difficult to communicate in a widely distributed report.

Some users have also suggested that providing additional information about the audit would help them evaluate audit issues and efforts across companies in a particular industry. An audit is tailored to an assessment of the risks of material misstatement at the specific company under audit, takes into account the company's internal control structure, and is influenced by the audit team's perspectives and experience. As such, there may be disparity in information presented in an AD&A about the risks identified and audit procedures employed between audits of similar companies, even for two companies in the same industry. Investors would need to reconcile why different procedures were performed, even if the risks of material misstatement highlighted were similar. These differences may cause investors to inappropriately question the quality of the audits.

As previously discussed, we believe it would be very difficult for an auditor to concisely describe the procedures performed to inform its conclusion on an individual area or matter in the context of its evaluation of the financial statements taken as a whole. While this type of information is typically discussed with the audit committee, the opportunity for a two-way dialogue is critical to this communication. This dialogue would not exist with a widely distributed public report. In addition, while an auditor designs and performs procedures to identify material misstatements of significant accounts and assertions, the auditor's report provides an opinion on the financial statements taken as a whole. We fear that having auditors provide significant details on audit risks and related procedures in specific areas could result in users misinterpreting this communication as an opinion, or separate form of assurance, on the particular audit area being discussed.

While we understand that investors want more information about the audit and the company's financial statements, we do not believe an AD&A is an effective means of providing such information. As noted in the Concept Release, it would likely be the most expansive form of reporting and would likely be the most costly alternative. We doubt the benefits would exceed the cost and believe other alternatives could provide meaningful improvements to auditor reporting in a more cost effective manner.

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We would be pleased to discuss our comments with members of the Public Company Accounting Oversight Board or its staff.

Sincerely,

Ernst & Young LLP

Responses to questions raised in the Concept Release**1. Many have suggested that the auditor's report, and in some cases, the auditor's role, should be expanded so that it is more relevant and useful to investors and other users of the financial statements.**

- a. Should the Board undertake a standard-setting initiative to consider improvements to the auditor's reporting model? Why or why not?

We fully support the Board undertaking a standard-setting initiative to consider responsible change to the auditor's reporting model to continue to provide investors and other users of a company's financial statements with relevant reports. As more fully described in our response, we believe certain changes to the auditor's report can provide benefits to users of the financial statements by providing additional clarification about the audit and audit process, as well as additional input on significant matters affecting a company's financial statements.

- b. In what ways, if any, could the standard auditor's report or other auditor reporting be improved to provide more relevant and useful information to investors and other users of financial statements?

Overall, we support enhancing auditor reporting by including information that is objective and adds value. We believe that the five principles expressed in the letter from the Center for Audit Quality (CAQ) to the PCAOB should guide the development of any alternatives. Specifically, as more fully detailed in our response to Question 21, we support modifying the standard financial statement audit report to better articulate the role of the auditor, highlight the professional judgment auditors exercise in making audit-risk assessments and selecting audit procedures and, where applicable, describe the accounting firm network structure and the participation of other member firms in audits. This type of information also could be included in reports on audits of internal control over financial reporting.

We also support using an expanded emphasis paragraph approach in which an auditor would identify specific topics or events, unusual transactions or other matters viewed to be most significant to the financial statements. Such an approach would provide additional transparency related to important areas of the financial statements and the audit that may help users analyze a company. Consistent with the June 2011 CAQ letter, we also believe that auditor reporting on management's critical accounting estimates disclosure in MD&A is a viable approach that deserves further consideration by the Board.

- c. Should the Board consider expanding the auditor's role to provide assurance on matters in addition to the financial statements? If so, in what other areas of financial reporting should auditors provide assurance? If not, why not?

Many parties play a role in reporting to investors – management, the audit committee and auditors, as well as regulators and standard setters who establish the framework for each party's reporting responsibilities. In addition to suggestions for improvements to auditor reporting, some financial statement users have expressed dissatisfaction with the corporate financial reporting model. We believe that any changes to auditor reporting should be made in the context of other initiatives aimed at enhancing overall corporate financial reporting. Attempts to address investor dissatisfaction with corporate financial reporting solely through changes in the auditor's reporting model would significantly expand the auditor's role, which we do not think is

appropriate or cost-effective. Therefore, we suggest the Board take a measured approach to changing the auditor's reporting model at this time. We also believe the Board should work with the SEC and the FASB to consider how changes in reporting by both issuers and auditors can better address the needs of users of the financial statements over the longer term.

However, we believe that meaningful enhancements to the auditor reporting model can and should be achieved in the near term without expanding the role of the auditor. Such changes could provide users with additional perspective on the role of the auditor, highlight the professional judgment auditors exercise in making audit-risk assessments and selecting audit procedures, describe, where applicable, the accounting firm network structure and the participation of other member firms in audits and indicate the most significant matters affecting a company's financial statements.

Auditor attestation over other matters outside of the financial statements, such as a company's MD&A, would expand the role of the auditor and therefore we believe that careful consideration needs to be given to the costs and benefits, including consideration of the additional regulatory/standard-setting activity needed to implement such expansion. Given user requests for additional auditor involvement with significant matters affecting a company's financial statements, separate attestation over a company's critical accounting policy/estimate disclosure within MD&A may be a cost-effective alternative that should be considered by the Board.

- 2. The standard auditor's report on the financial statements contains an opinion about whether the financial statements present fairly, in all material respects, the financial condition, results of operations, and cash flows in conformity with the applicable financial reporting framework. This type of approach to the opinion is sometimes referred to as a "pass/fail model."**

- a. Should the auditor's report retain the pass/fail model? If so, why?

We support maintaining the current pass/fail model. This model provides a concise conclusion as to whether the financial statements, taken as a whole, are presented fairly in accordance with the applicable financial reporting framework. Users have consistently noted that they find this overall conclusion useful.

- b. If not, why not, and what changes are needed?

Not applicable

- c. If the pass/fail model were retained, are there changes to the report or supplemental reporting that would be beneficial? If so, describe such changes or supplemental reporting.

As more fully described in our responses to Questions 21 and 22, we believe it would be beneficial to clarify a number of areas in the standard auditor's report, such as the role of the auditor, the auditor's responsibility for footnote disclosures, management and audit committee responsibilities for financial reporting, the concepts of reasonable assurance and material misstatement, the auditor's responsibility for fraud, and the professional judgment auditors exercise in making audit-risk assessments and selecting audit procedures, among others.

- 3. Some preparers and audit committee members have indicated that additional information about the company's financial statements should be provided by them, not the auditor. Who is most appropriate (e.g., management, the audit committee, or the auditor) to provide additional information regarding the company's financial statements to financial statement users? Provide an explanation as to why.**

Management has overall responsibility for the preparation of the financial statements. Consistent with the overarching principles previously noted, we strongly believe that auditors should not be the original source of disclosure about the entity; management is in the best position to provide information about the company and their responsibility should be preserved in this regard. The longstanding role of the auditor is to attest to information prepared and presented by management in accordance with an established framework. As more fully discussed in our responses to Questions 5 and 12, we believe that auditors providing additional information about the company's financial statements would fundamentally change the role of the auditor and could have adverse effects on audit quality, the auditor's relationship with management and the audit committee and the clarity of information provided to investors.

We also note that the Board's outreach indicated that additional reporting by a company's audit committee related to significant matters addressed with the company and the auditor may provide users with meaningful information. Users indicated that auditor attestation of such enhanced audit committee reports may be useful in providing additional comfort that such reports accurately represent the interaction and conclusions of the matters discussed. Consistent with our previous comments, we are supportive of the PCAOB working with the SEC and other relevant organizations to evaluate whether modifications to audit committee reports, including potential auditor association with such reports, would be a cost-effective enhancement to the information provided to users.

- 4. Some changes to the standard auditor's report could result in the need for amendments to the report on internal control over financial reporting, as required by Auditing Standard No. 5. If amendments were made to the auditor's report on internal control over financial reporting, what should they be, and why are they necessary?**

To the extent auditors are required to report additional information about a company's financial statements and such information is inconsistent in some respects with information provided by management, we believe investors may make inferences about a company's internal control over financial reporting (ICFR) that may not be appropriate. For example, to the extent AD&A emphasizes different areas across companies in the same industry, users may make inappropriate inferences about a company's controls compared to another. In addition, to the extent an auditor provides information that is somewhat different from information provided by management, an investor may inappropriately infer that those inconsistencies represent internal control deficiencies, rather than resulting from reasonable differences in judgment between the auditor and management that do not result from a deficiency in the company's ICFR. Given these potential outcomes, the Board will need to evaluate any proposed changes to the auditor reporting model to determine if clarifications are also needed to the auditor's report on ICFR.

Questions related to the auditor's discussion and analysis

5. Should the Board consider an AD&A as an alternative for providing additional information in the auditor's report?

- a. If you support an AD&A as an alternative, provide an explanation as to why.

As more fully explained in our response to Question 5(d), we do not support an AD&A as a responsible change to the auditor reporting model.

- b. Do you think an AD&A should comment on the audit, the company's financial statements or both? Provide an explanation as to why. Should the AD&A comment about any other information?

As more fully explained in our response to Question 5(d), we do not support an AD&A as a responsible change to the auditor reporting model.

- c. Which types of information in an AD&A would be most relevant and useful in making investment decisions? How would such information be used?

As more fully explained in our response to Question 5(d), we do not support an AD&A as a responsible change to the auditor reporting model.

- d. If you do not support an AD&A as an alternative, explain why.

We do not support an AD&A as an alternative and strongly believe an AD&A would have adverse consequences to users of the financial statements and audit quality. While we acknowledge that investors want more information about a company's financial statements and the audit process, we do not believe an AD&A is an effective means of providing that information for a variety of reasons, including the following:

Auditor commentary on a company's financial statements

A requirement for the auditor to provide subjective comments on a company's financial statements would be inconsistent with several of the overarching principles. For example, we do not believe auditor views on issues as subjective as the "quality" of the company's accounting policies and practices, difficult or contentious matters or "close calls" can be effectively communicated in a widely distributed report where no two-way dialogue will exist. In addition, inconsistencies in the areas emphasized in an AD&A between companies in the same industry may be difficult for users to reconcile and potentially result in inappropriate judgments related to the company or the audit. Moreover, the subjective nature of such matters could result in the presentation of information by the auditor that is not consistent with the information presented by management (as overseen by the audit committee). Providing information that may "compete" with information reported by management would likely be difficult for users to reconcile, particularly without the existence of a two-way discussion protocol.

Moreover, we do not believe the auditor should be the original source of information about the entity. The longstanding role of the auditor is to attest to information prepared and presented by management in accordance with an established framework. If the Board were to require an auditor to provide subjective impressions, it might inappropriately expand the role of the

auditor into financial reporting, rather than opining on the company's financial statements. While the Concept Release notes that an AD&A may encourage management to improve a company's financial statements to prevent disclosure of conflicting information, such pressure could give the auditor undue influence on the presentation of matters in the financial statements. If management defers to the views of the auditor, this could effectively place the auditor into the role of the preparer, which would be contrary to the auditor's responsibility to provide an independent, objective evaluation of the financial statements.

Such an outcome could also adversely affect the auditor's relationship with management and the audit committee, which could have a negative effect on the audit. For example, it may discourage the company and its audit committee from engaging in robust discussions with the auditor of matters related to the financial statements for fear of that discussion being reported by the auditor. As the Board recognized in its proposed standard on the auditor's communications with the audit committee, open communication with both management and the audit committee is integral to the execution of a quality audit.

We are also concerned that an AD&A requirement could place significant additional pressure on the audit process and the company's ability to meet its regulatory filing deadlines. Due to the nature of issues that might be included in an AD&A, it would need to be developed during the completion phase of the audit. The effort to develop the AD&A could potentially divert attention away from the audit at a crucial time. In addition, audit firms would need to develop robust quality control processes to review the subjective views and impressions contained in an AD&A before the report is released. These processes would take time, which could place further strain on the challenging reporting timetable facing issuers and auditors.

Auditor commentary on the audit

The Concept Release considers whether an AD&A could present information about the audit, such as audit risk assessments, audit procedures performed and the results of those procedures, and auditor independence. Some users have suggested that additional information about the audit would enhance their understanding of what an audit represents and perhaps better equip them to evaluate the quality of the audit. We believe that subjective areas such as audit risk assessments and the related audit responses would be difficult to communicate in a widely distributed report.

Some users have also suggested that providing additional information about the audit would help them evaluate audit issues and efforts across companies in a particular industry. An audit is tailored to an assessment of the risks of material misstatement at the specific company under audit, takes into account the company's internal control structure, and is influenced by the audit team's perspectives and experience. As such, there may be disparity in information presented in an AD&A about the risks identified and audit procedures employed between audits of similar companies, even for two companies in the same industry. Investors would need to reconcile why different procedures were performed, even if the risks of material misstatement highlighted were similar. These differences may cause investors to inappropriately question the quality of the audits.

We believe it would be very difficult for an auditor to concisely describe the procedures performed to inform its conclusion on an individual area or matter in the context of its evaluation of the financial statements taken as a whole. While this type of information is typically discussed with the audit committee, the opportunity for a two-way dialogue is critical

to this communication. This dialogue would not exist with a widely distributed public report. In addition, while an auditor designs and performs procedures to identify material misstatements of significant accounts and assertions, the auditor's report provides an opinion on the financial statements taken as a whole. We fear that having auditors provide significant details on audit risks and related procedures in specific areas could result in users misinterpreting this communication as an opinion, or separate form of assurance, on the particular audit area being discussed.

While we understand that investors want more information about the audit and the company's financial statements, we do not believe an AD&A is an effective means of providing such information. As noted in the Concept Release, it would likely be the most expansive form of reporting and would likely be the most costly alternative. We doubt the benefits would exceed the cost and believe other alternatives could provide meaningful improvements to auditor reporting in a more cost effective manner.

- e. Are there alternatives other than an AD&A where the auditor could comment on the audit, the company's financial statements, or both? What are they?

We believe that any modifications to the auditor's report should focus on the objective rather than the subjective and should maintain the auditor's role of attesting to assertions made by management. An auditor's views or impressions on financial reporting matters cannot be effectively communicated and understood without a two-way dialogue. Without such a dialogue, the communication of subjective views could lead to investor misunderstanding and harmful consequences.

However, we believe that adding certain clarifying language in the auditor's report and requiring the expanded use of emphasis paragraphs in the auditor's report would represent a constructive change to the auditor's reporting model. For more details of our rationale for both of these alternatives, see our responses to Questions 13, 21 and 22.

6. What types of information should an AD&A include about the audit? What is the appropriate content and level of detail regarding these matters presented in an AD&A (i.e., audit risk, audit procedures and results, and auditor independence)?

See our response to Question 5(d).

7. What types of information should an AD&A include about the auditor's views on the company's financial statements based on the audit? What is the appropriate content and level of detail regarding these matters presented in an AD&A (i.e., management's judgments and estimates, accounting policies and practices, and difficult or contentious issues, including "close calls")?

See our response to Question 5(d).

8. Should a standard format be required for an AD&A? Why or why not?

We do not support an AD&A as a responsible change to the auditor reporting model. We do not believe that requiring the auditor to provide his or her subjective views on information about the company's financial statements or the audit is appropriate. In addition, we do not believe the disadvantages of the AD&A approach can be mitigated through the use of a standardized report.

9. Some investors suggested that, in addition to audit risk, an AD&A should include a discussion of other risks, such as business risks, strategic risks, or operational risks. Discussion of risks other than audit risk would require an expansion of the auditor's current responsibilities. What are the potential benefits and shortcomings of including such risks in an AD&A?

We do not support an AD&A as a responsible change to the auditor reporting model. We do not believe that requiring the auditor to provide his or her subjective views on information about the company's financial statements or the audit is appropriate.

10. How can boilerplate language be avoided in an AD&A while providing consistency among such reports?

We do not support an AD&A as a responsible change to the auditor reporting model. We do not believe that requiring the auditor to provide his or her subjective views on information about the company's financial statements or the audit is appropriate. In addition, we do not believe the disadvantages of the AD&A approach can be mitigated through the use of a standardized report.

11. What are the potential benefits and shortcomings of implementing an AD&A?

See our response to Question 5(d).

12. What are your views regarding the potential for an AD&A to present inconsistent or competing information between the auditor and management? What effect will this have on management's financial statement presentation?

As discussed in our response to Question 5(d), we believe the potential to present information that may not be consistent (and could compete) with information provided by management would prove to be a strong incentive for management to conform its disclosures to the auditor's. We believe such a situation would represent a fundamental shift in the auditor's role from attesting to information provided by management to that of a preparer.

Such an outcome could also adversely affect the auditor's relationship with management and the audit committee, which could have a negative effect on the audit. For example, it may discourage the company and its audit committee from engaging in robust discussions with the auditor of matters related to the financial statements for fear of that discussion being reported by the auditor. Open communication with both management and the audit committee is integral to the execution of a quality audit.

Questions related to required and expanded use of emphasis paragraphs

13. Would the types of matters described in the illustrative emphasis paragraphs be relevant and useful in making investment decisions? If so, how would they be used?

Outreach conducted by the PCAOB indicated that many financial statement users want additional information from the auditor about significant matters affecting the financial statements. Users noted that, because the number and variety of disclosures continue to grow, it is often difficult to identify the matters that have the most significant effects on a company's financial results. Some users have suggested that further input from the auditor could help better focus their analyses. In addition, users have requested additional insights into the auditor's communications with the audit committee on significant matters affecting the financial statements. We believe the emphasis

paragraph approach, based on suitable, well-defined criteria that are understood by the users of the financial statements, would be responsive to user requests and would help users analyze a company's financial statements.

14. Should the Board consider a requirement to include areas of emphasis in each audit report, together with related key audit procedures?

- a. If you support required and expanded emphasis paragraphs as an alternative, provide an explanation as to why.

See our response to Question 13. We believe the required and expanded use of emphasis paragraphs could help address certain user requests by highlighting matters that, in the auditor's judgment, are the most significant matters in the financial statements and by pointing users to where those matters appear in the financial statements and related disclosures. This approach would draw attention to important items that may warrant a detailed review by financial statement users. We also believe identifying these matters in the auditor's report may increase preparer focus on these areas, thereby improving the quality of disclosures provided to investors.

However, we do not believe the auditor should comment on key audit procedures performed in these areas. As expressed in the CAQ letter, the Auditor's Reporting Model Working Group challenged itself to develop examples of how such an approach could be implemented in practice and determined that emphasis paragraphs should not include audit procedures for the following reasons:

- ▶ *Audit procedures, particularly those performed for the most significant areas in a company's financial statements, rarely consist of a few, easily described procedures. We believe that it is unreasonable to expect the auditor to summarize the audit approach in a few sentences in the audit report.*
- ▶ *The audit procedures for a particular area are developed in the context of the audit of the financial statements taken as a whole. It may be difficult to appropriately convey to users how the audit strategy for a particular area relates to the audit as a whole. Without such context, users may not find a summary of the audit procedures useful.*
- ▶ *Users may perceive the additional discussion as representing a separate form of assurance on the individual areas included in the report.*
- ▶ *Users may also make inappropriate inferences to audit quality. For example, an auditor rarely has a single approach to addressing audit risk in an area, and the methods employed by the auditor depend on the company's internal controls and the auditor's assessed level of risk for the particular area relative to the financial statements taken as a whole. Without such context, users may inappropriately make assessments of audit quality based solely on differences in the audit procedures performed described.*
- ▶ *More thorough descriptions of audit processes could contribute to disclosure overload and detract from the purpose of providing useful information to investors.*

- b. If you do not support required and expanded emphasis paragraphs as an alternative, provide an explanation as to why.

We support required and expanded use of emphasis paragraphs. See response to Question 13.

15. What specific information should required and expanded emphasis paragraphs include regarding the audit or the company's financial statements? What other matters should be required to be included in emphasis paragraphs?

Consistent with the overarching principles discussed previously, we believe emphasis paragraphs should be objective and factual and direct the user to the related disclosures within the financial statements. We believe the emphasis paragraphs should include the following:

- ▶ *A brief factual and objective description of the item that should not include information that is not otherwise reflected in the company's disclosures.*
- ▶ *The identification of where the item has been accounted for and disclosed in the financial statements.*
- ▶ *The reason why the auditor identified the matters for emphasis.*
- ▶ *Clarification that no separate form of assurance has been given for any specific item emphasized and that the items identified do not represent a complete list of all significant areas addressed in the audit. The following is an example of language that could convey this clarification: "We highlight the above matters because they represent, in our judgment, important financial statement matters. While we have brought these specific matters to your attention, we note that such items do not represent a complete list of the matters that should be considered when evaluating the company's financial statements. Our audits included performing procedures designed to address the risks of material misstatements associated with the above matters. However, such procedures were designed in the context of our audits of the financial statements taken as a whole, and not to provide assurance on individual accounts or disclosures."*

As discussed in our response to Question 14(a), we do not believe that emphasis paragraphs should include discussions of the audit procedures performed.

16. What is the appropriate content and level of detail regarding the matters presented in required emphasis paragraphs?

As discussed in our response to Question 15, users have requested additional information on the most significant matters affecting a company's financial statements. We believe criteria should be developed to help the auditor determine the matters that, in the auditor's judgment, are viewed to be the most significant/important to a user's understanding of the financial statements. Such criteria should not require emphasis of all matters that may be material to the financial statements, that were the subject of significant audit effort or that involved the use of judgment in determining the accounting conclusions for such areas.

We believe the following criteria may provide a foundation for the auditor's selection of matters to emphasize:

- ▶ An item initially considered for inclusion in an emphasis paragraph should be material to the financial statements in the current period and have one or more of the following characteristics:
 - ▶ The item involves an accounting policy or practice having a significant effect on the company's financial reporting. This may involve a policy or practice in a controversial or emerging area for which there may be a lack of authoritative guidance or consensus.
 - ▶ The item involves a highly subjective accounting estimate – an area requiring significant judgment and with substantial measurement challenges, including an estimate or assumption that could be susceptible to significant change in future periods
 - ▶ The item involves a material uncertainty (for example, an uncertainty about the ability of the entity to continue as a going concern or the existence of significant litigation)
 - ▶ The item is a significant unusual or infrequent event or transaction affecting the financial statements and related disclosures in the current period (for example, a significant subsequent event or a significant acquisition completed during the period)
 - ▶ The item involves information about the structure of the entity that is significant to understanding assertions made in the financial statements (for example, the existence of significant related party transactions or a parent/sub relationship)
 - ▶ The item is a matter not otherwise covered in one of the categories above, but is viewed by the auditor as a significant matter in the financial statements that may be worthy of emphasis in the audit report
- ▶ For items meeting one or more characteristics above, an auditor should also consider the following indicators to determine whether a particular item should be included in an emphasis paragraph:
 - ▶ The item was the subject of significant discussion with the audit committee.
 - ▶ The item underwent a significant change in the current period.
 - ▶ The item was the subject of significant audit effort or audit challenges/difficulties.
 - ▶ The item is unique to the company or its industry and has a significant bearing on a company's financial statements.

Care would need to be taken to encourage auditors to highlight only the most important matters. Including too many areas would risk minimizing the intended emphasis. We believe the Board should consider providing general guidelines about the number of items to be emphasized in the auditor's report. We note that similar guidance exists in accounting standards, most notably in ASC 280, Segment Reporting.

17. How can boilerplate language be avoided in required emphasis paragraphs while providing consistency among such audit reports?

We believe that the main objective, and primary benefit, of this approach would be the identification of the items that are most significant to a user's understanding of the financial statements. This identification may help users better focus their analyses of a company. We believe objective, factual emphasis paragraphs that direct the reader of the financial statements to the related disclosure within the financial statements would help accomplish this objective. We believe these types of emphasis paragraphs would also be consistent with an overarching principle that the auditor not be the original source of information about the company.

We believe there is significant value in using standardized language in the auditor's report. For example, investors and other users have said they appreciate the clarity and simplicity of the current pass/fail opinion, which provides a succinct, objective conclusion about whether the financial statements are presented fairly in accordance with GAAP. We believe that modifications to the report that are clear, concise and objective provide for a more effective communication by the auditor. In addition, the use of consistent, objective language would minimize the risk of user misunderstanding and would allow for easier comparison of companies by users.

18. What are the potential benefits and shortcomings of implementing required and expanded emphasis paragraphs?

As noted in our response to Question 13, we believe that a required and expanded use of emphasis paragraphs would respond to user requests for additional input on the most significant matters affecting the financial statements. We also believe identifying these matters in the auditor's report may increase preparer focus and improve the quality of disclosures provided to investors. Such an approach could also be implemented in a timely manner.

Shortcomings to such an approach would be the potential for users to interpret the areas emphasized as subject to separate auditor assurance or as some form of "guarantee" as to the accuracy of the specific areas. Such inferences would be inappropriate given the auditor's responsibility to conclude on the fair presentation of the financial statements taken as a whole. Users could also interpret the areas included in the emphasis paragraphs as the only items that warrant further understanding/analysis when evaluating a company's financial statements. We believe that both of these shortcomings can be overcome by well defined and understood criteria, as well as appropriate explanatory language in the auditor's report.

Questions related to auditor assurance on other information outside the financial statements

19. Should the Board consider auditor assurance on other information outside the financial statements as an alternative for enhancing the auditor's reporting model?

- a. If you support auditor assurance on other information outside the financial statements as an alternative, provide an explanation as to why.

Users have noted that they use sources of financial information beyond a company's financial statements, such as MD&A, earnings releases and investor presentations to evaluate a company and that auditor reporting on this information could improve the quality, completeness and reliability of the information. This reporting would provide users with a higher level of confidence in the information. Professional standards require auditors to read

information in documents containing the audited financial statements for any inconsistencies with the audited financial statements or any material misstatements of fact. We believe the audit report clarifications noted above would help users better understand the auditor's involvement with information in documents that contain the audited financial statements and the auditor's conclusion related to the procedures performed in this area.

We note that auditors often perform certain procedures on information such as earnings releases before public distribution to assess whether the information is consistent with the audit in process. We recognize that some investors may not be aware that these procedures are performed. Having auditors issue the equivalent of agreed-upon procedures report for general use, describing the procedures performed on this information, could potentially provide investors with added visibility in this area.

Auditor reporting on information outside the financial statements would increase the scope of the auditor's responsibilities, would require the development of new auditing standards and would potentially require additional regulatory efforts. For example, if auditor attestation were deemed appropriate for earnings releases, guidance would also need to be developed. We believe certain of these alternatives would require careful study.

As with all alternatives, the costs would need to be weighed against the benefits. As contemplated in the Concept Release, auditor attestation of a company's entire MD&A disclosure is an alternative. Such an attestation would be a significant undertaking and we do not believe financial statement users have requested this level of auditor involvement.

Given users' requests for more explicit auditor involvement in the most critical, subjective matters affecting a company's financial statements, we believe that separate auditor attestation on an issuer's critical accounting policies/estimates disclosure in MD&A may be a more modest step in this broad area. It would direct auditor effort to those areas that appear to be of the highest interest to investors, and could be a more cost-effective alternative. We also believe additional auditor involvement would likely lead to preparer focus and improved disclosures. While we believe requiring the expanded use of emphasis paragraphs may be a preferable alternative, consistent with the CAQ's June letter to the Board, we believe that auditor involvement with a company's critical accounting policies/estimates disclosure in MD&A is also a viable approach that merits further consideration by the Board.

As previously noted, we believe that any changes to auditor reporting should be made in the context of potential improvements to the total package of information provided to users of the financial statements. Expanded reporting by the audit committee, on which the auditors could report, may be an enhancement to the overall corporate reporting model.

- b. On what information should the auditor provide assurance (e.g., MD&A, earnings releases, non-GAAP information, or other matters)? Provide an explanation as to why.

See our response to Question 19(a).

- c. What level of assurance would be most appropriate for the auditor to provide on information outside the financial statements?

AT Section 701 includes guidance for both review and examination engagements on a company's MD&A. We believe the Board should consider the costs and benefits of these alternatives. In general, we believe an examination approach would be more responsive to user requests in this area.

- d. If the auditor were to provide assurance on a portion or portions of the MD&A, what portion or portions would be most appropriate and why?

See our response to Question 19(a).

- e. Would auditor reporting on a portion or portions of the MD&A affect the nature of MD&A disclosures? If so, how?

As mentioned above, we believe that auditor involvement could enhance the quality, completeness and the reliability of MD&A disclosures.

- f. Are the requirements in the Board's attestation standard, AT sec. 701, sufficient to provide the appropriate level of auditor assurance on other information outside the financial statements? If not, what other requirements should be considered?

We believe that the guidance in AT section 701 would be sufficient if a review or examination engagement related to a company's critical accounting estimates/policies is determined appropriate.

- g. If you do not support auditor assurance on other information outside the financial statements, provide an explanation as to why.

See our response to Question 19(a).

20. What are the potential benefits and shortcomings of implementing auditor assurance on other information outside the financial statements?

With respect to potential benefits, we believe that auditor reporting on a company's critical accounting policies/estimates could improve the company's disclosures in areas users have noted are important to their evaluation of a company. However, this alternative would require coordination with the SEC, which would need to undertake a rule-making process to require issuers to obtain auditor attestation on the information.

With respect to auditor involvement with other information outside of MD&A, such as earnings releases, investor presentations and non-GAAP measures, we question whether it is feasible to develop frameworks in the short term for these communications (that would provide issuers with the required flexibility).

Questions related to clarification of the standard auditor's report

21. The concept release presents suggestions on how to clarify the auditor's report in the following areas:

- ▶ Reasonable assurance
- ▶ Auditor's responsibility for fraud
- ▶ Auditor's responsibility for financial statement disclosures
- ▶ Management's responsibility for the preparation of the financial statements
- ▶ Auditor's responsibility for information outside the financial statements
- ▶ Auditor independence

a. Do you believe some or all of these clarifications are appropriate? If so, explain which of these clarifications is appropriate? How should the auditor's report be clarified?

By clarifying and defining certain terms and phrases, auditors can provide useful information to investors about the audit process and the auditor's responsibilities in an audit. We strongly support clarifying each of these terms in the standard auditor's report as follows:

- ▶ *Reasonable assurance – The report should clarify that reasonable assurance represents a high level of assurance, but reasonable assurance is not absolute assurance and an audit conducted in accordance with PCAOB standards may not always detect a material misstatement.*
- ▶ *Auditor's responsibility for fraud – The report should clarify, as set forth in PCAOB Interim Standard AU 316, that the auditor's responsibility is to plan and perform the audit to provide reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud.*
- ▶ *Auditor's responsibility for financial statement disclosures – The report should explicitly state that the footnotes are an integral part of the financial statements, are equally subject to audit procedures and are covered by the auditor's report.*
- ▶ *Management's responsibility for the preparation of the financial statements – The report should provide an expanded discussion of management's responsibilities for the financial statements and other information provided to users of the financial statements.*
- ▶ *Auditor's responsibility for information outside of the financial statements – The report should describe the auditor's responsibility to read certain other information in documents containing the audited financial statements for inconsistencies with the audited financial statements and to identify whether there are material misstatements of fact pursuant to PCAOB Interim Standard AU 550. We also believe it would be appropriate for an auditor to state, in the audit report, his or her conclusion on the results of these procedures performed (i.e., whether any inconsistencies or material misstatements of fact exist in the information containing audited financial statements).*

- ▶ *Auditor independence – The report should explicitly state that the auditor is independent under all relevant standards of the SEC and PCAOB.*
- b. Would these potential clarifications serve to enhance the auditor's report and help readers understand the auditor's report and the auditor's responsibilities? Provide an explanation as to why or why not.

We believe the Board's outreach confirmed that users of the financial statements would like additional information about the auditor's responsibilities and the audit process. We believe clarifications of the items noted above would provide users with meaningful information about the type of assurance provided in an audit, the inherent limitations of an audit and the responsibilities of management and the auditor's as they relate to the financial statements.

- c. What other clarifications or improvements to the auditor's reporting model can be made to better communicate the nature of an audit and the auditor's responsibilities?

We also believe the PCAOB should consider adding the following clarifications:

- ▶ *Material misstatements and assessment of materiality – The report should identify what is meant by "material misstatement" and provide more qualitative information about the auditor's consideration of materiality when planning the audit and evaluating the financial statements. We do not believe that it would be appropriate to include specific quantitative measures of materiality in the auditor's report.*
- ▶ *Audit committee responsibilities – The auditor's report should provide an expanded discussion of the audit committee's responsibilities.*
- ▶ *Addressing the audit report – The report should be addressed to the shareholders of the company as well as to the Board of Directors.*
- ▶ *Professional judgment – The report should highlight the need to use professional judgment in assessing audit risk, selecting audit procedures and considering the issuer's internal control over financial reporting.*
- ▶ *Additional information about public company audits – The report should include a reference and link to where more information about public company auditing (e.g., the CAQ's In-Depth Guide to Public Company Auditing: the Financial Statement Audit³), similar to the approach used in the United Kingdom.*
- ▶ *Scope limitations and non-compliance with US Generally Accepted Accounting Principles (GAAP) – The report should outline the auditor's responsibility in the event a conclusion is reached that the financial statements are not presented in accordance with GAAP or the audit scope is limited.*

³ See Center for Audit Quality's In-Depth Guide to Public Company Auditing (2010). Available at: http://www.thecaq.org/publications/In-Depth_GuidetoPublicCompanyAuditing.pdf

- ▶ *Firm network structure and responsibilities – The report should describe the accounting firm network structure, the responsibility of the member firm signing the audit report and, where applicable, the participation of other member firms in the audits.*

- d. What are the implications to the scope of the audit, or the auditor's responsibilities, resulting from the foregoing clarifications?

Because the clarifications noted above would largely explain to users information already resident in PCAOB standards, we do not believe these alternatives would have any significant implications on the scope of the audit or the auditor's responsibilities. We also believe auditors would be able to implement this alternative in a timely manner.

22. What are the potential benefits and shortcomings of providing clarifications of the language in the standard auditor's report?

We believe that the clarifications discussed above would respond to users' requests for additional information about the audit and audit process. In addition, we believe that this alternative could be implemented timely.

We do not believe the clarifications discussed above have any significant shortcomings, although we recognize that modifications to the auditor's reporting model that consist solely of the above clarifications would likely not satisfy users.

Questions related to all alternatives

23. This concept release presents several alternatives intended to improve auditor communication to the users of financial statements through the auditor's reporting model. Which alternative is most appropriate and why?

For the reasons stated above, we believe that an approach that includes clarifications of the auditor's current responsibilities and the audit process, as well as the required and expanded use of emphasis paragraphs would provide some insights into the audit and the audit process and would be cost-effective enhancements that could be implemented in a timely fashion.

We also believe that additional auditor involvement with an issuer's critical accounting estimates/policies disclosure in MD&A deserves further consideration by the Board based on users' views on the importance of such disclosures to their understanding and analysis of a company's financial statements.

24. Would a combination of the alternatives, or certain elements of the alternatives, be more effective in improving auditor communication than any one of the alternatives alone? What are those combinations of alternatives or elements?

See our response to Question 23.

25. What alternatives not mentioned in this concept release should the Board consider?

As discussed in our letter, we believe that changes to auditor reporting should be made in the context of other initiatives aimed at enhancing overall corporate financial reporting. We believe the Board should work with the SEC, FASB and others to consider how changes in reporting by both

issuers and auditors can better address the needs of users of the financial statements over the longer term. We believe this effort should also address whether enhanced audit committee reporting, which was noted by users in connection with the Board's outreach, might also respond to user requests for additional information on significant areas affecting the financial statements.

We also encourage the Board to consider the efforts of other standard setters, such as the IAASB and the ASB, which are also exploring changes to the auditor's reporting model. We believe that users would be better served if the nature of information communicated by the auditor is generally consistent, regardless of the jurisdiction. Although we recognize that certain differences in auditor reporting standards will continue to exist, unnecessary differences in IAASB, ASB and PCAOB requirements will cause confusion and could lead to inappropriate inferences about a company's financial statements, audit quality and the nature of assurance provided.

26. Each of the alternatives presented might require the development of an auditor reporting framework and criteria. What recommendations should the Board consider in developing such auditor reporting framework and related criteria for each of the alternatives?

See our responses to Questions 14, 15, 16 and 21 related to considerations for criteria and reporting for alternatives related to clarifications to the auditor's report and the required and expanded use of emphasis paragraphs.

With respect to an AD&A, as more fully discussed in our responses to Questions 5, 6 and 12, we do not believe a reasonable and practical framework can be developed to drive consistency both within and across firms (given such disclosure would result from a free-writing exercise in which the auditor would share his or her views on a variety of topics related to the company's financial statements and the audit).

27. Would financial statement users perceive any of these alternatives as providing a qualified or piecemeal opinion? If so, what steps could the Board take to mitigate the risk of this perception?

As discussed in our response to Questions 5(d) and 18, there is a risk that a user would interpret the auditor's discussion in an AD&A and the emphasis of certain matters in the audit report as constituting an opinion on the particular area being discussed. While we believe that such risk can be mitigated in an emphasis paragraph approach, we believe it would be significantly more challenging to mitigate the risk of this perception in an AD&A given the more expansive discussion and the wide disparity of disclosures.

28. Do any of the alternatives better convey to the users of the financial statements the auditor's role in the performance of an audit? Why or why not? Are there other recommendations that could better convey this role?

We believe that clarifying terms in the standard auditor's report is the alternative that would best inform users of the financial statements about the audit process and the role of the auditor in financial reporting. As described in our response to Questions 21(a) – (c), this alternative would provide users with additional input on the professional standards governing the conduct and performance of the audit, as well as the role of management, the audit committee and the auditor as it relates to information provided to users of the financial statements.

29. What effect would the various alternatives have on audit quality? What is the basis for your view?

We believe clarifying terms in the standard auditor's report, expanding and requiring the use of emphasis paragraphs and auditor involvement with information outside of the financial statements would not have a meaningful effect on audit quality, but would have a meaningful effect on a user's understanding of significant matters affecting a company's financial statements, the role of the audit and the audit process.

As further detailed in our response to Question 5(d), we believe an AD&A could adversely affect audit quality.

30. Should changes to the auditor's reporting model considered by the Board apply equally to all audit reports filed with the SEC, including those filed in connection with the financial statements of public companies, investment companies, investment advisers, brokers and deals, and others? What would be the effects of applying the alternatives discussed in the concept release to the audit reports for such entities? If audit reports related to certain entities should be excluded from one or more of the alternatives, please explain the basis for such a conclusion.

With respect to whether changes to the auditor reporting model apply to all reports filed with the SEC, we believe further analysis of the how financial statements, including the audit report, are used by both users and regulators is necessary to answer this question.

In addition, with respect to domestic and foreign private and listed companies, we note that other standard setting bodies, such as the AICPA's ASB and the IAASB, are undertaking initiatives to clarify the standard auditor's report issued in connection with the standards set by those bodies. As those changes take effect, there would be a variety of forms of auditor reporting. We believe users would find significantly different reports confusing. This could potentially result in inappropriate inferences as to audit quality and the level of assurance provided in an audit of companies in different jurisdictions around the world. As previously discussed, we encourage the Board to work with the AICPA's ASB, IAASB, the SEC and other securities regulators to consider the effects of varying auditor reporting on users of the financial statements. They should consider the fact that users of financial statements may have different needs depending on the nature and type of company (e.g., regulated vs. non-regulated).

Questions related to changing the auditor's report

31. This concept release describes certain considerations related to changing the auditor's report, such as effects on audit effort, effects on the auditor's relationships, effects on audit committee governance, liability considerations and confidentiality.

- a. Are any of these considerations more important than others? If so, which ones and why?

We believe all of these matters should be carefully considered when evaluating potential changes to the auditor reporting model.

With respect to audit effort, as discussed previously, we believe an approach that includes adding clarifying language to the auditor's report and requiring the expanded use of emphasis paragraphs is a viable approach that would respond to many of the suggestion made by users of the financial statements, could be implemented in the near term and would be cost-effective. We also believe that auditor attestation on an issuer's critical accounting policy/estimate

disclosure in MD&A merits further study and could be cost-effective. We do not believe any benefits of an AD&A approach or auditor attestation on an issuer's complete MD&A disclosure outweigh the costs.

As described in our response to Question 5(d), we believe that an AD&A alternative is the most expansive alternative that would likely have the most significant effect on the audit committee's governance role and the auditor's relationships with management and the audit committee. In addition, we believe that an AD&A approach where the auditor expresses his or her views about the company's financial reporting matters could raise confidentiality concerns at a company if the auditor provides information that has not been disclosed by the company. This concern could discourage management and the audit committee from engaging in robust discussions of matters related to the financial statements for fear of additional disclosure by the auditor.

With respect to liability considerations, we believe that all alternatives should be analyzed to evaluate their potential effect on auditor liability. For example, areas identified in either an AD&A or emphasis paragraph approach could be misinterpreted as an opinion or separate form of assurance on the particular area being discussed. In addition, under both approaches, users may inappropriately question whether the auditor should have emphasized particular areas or the adequacy of the audit procedures with the benefit of hindsight. We believe this risk would be particularly acute in an AD&A approach, under which an auditor may be required to provide subjective views or impressions on the company's financial statements. Finally, auditor attestation on other information, such as earnings releases, would expand the auditor's role and therefore, the auditor's exposure to litigation.

- b. *If changes to the auditor's reporting model increased cost, do you believe the benefits of such changes justify the potential cost? Why or why not?*

We believe the alternatives to clarify terms in the standard auditor's report and expand and require the use of emphasis paragraphs would provide users of financial statements with enhanced understanding of significant matters affecting a company's financial statements as well as the role of the audit and the audit process. We also believe that such changes would respond to user requests for such information and could be implemented cost effectively.

For the reasons stated in our response to Question 5(d), we believe the potential costs of the AD&A approach would outweigh any benefits associated with this alternative.

- c. *Are there any other considerations related to changing the auditor's report that this concept release has not addressed? If so, what are these considerations?*

As discussed in our letter, we believe that changes to auditor reporting should be made in the context of other initiatives aimed at enhancing overall corporate financial reporting. We believe the Board should work with the SEC, FASB and others to consider how changes in reporting by both issuers and auditors can better address the needs of users of the financial statements over the longer term. We believe this effort should also address whether enhanced audit committee reporting, which was noted by users in connection with the Board's outreach, might also respond to user requests for additional information on significant areas affecting the financial statements.

- d. What requirements and other measures should the PCAOB or others put into place to address the potential effects of these considerations?

Not applicable.

- 32. The concept release discusses the potential effects that providing additional information in the auditor's report could have on relationships among the auditor, management and the audit committee. If the auditor were to include in the auditor's report information regarding the company's financial statements, what potential effects could that have on the interaction among the auditor, management, and the audit committee?**

See our response to Question 5(d).