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Members of the PCAOB:

This letter contains my comments on the re-proposed auditing standard relating to "Communications with Audit Committees." These comments are from my perspective of serving as the Chairman of two large public company audit committees at present and four others in the past. I submitted a letter (dated April 23, 2010) on the earlier proposal and while I am, of course, disappointed that the Board did not adopt all of my recommendations, I appreciate that they were given consideration per the discussion in Appendix 4. However, I do have a few remaining important concerns with the revised exposure draft that I hope the Board will carefully consider in its final deliberations.

I was disappointed that only three or so of the relatively small number of comment letters on the earlier exposure draft came from audit committee members, including mine. After all, three of the four objectives of this communication process as stated in the new draft deal with what the audit committee should want from the auditor. I greatly appreciate that the PCAOB did reach out to audit committee members through a subsequent roundtable meeting (with other participants) and by extending the comment deadline, but input from audit committee members was still quite limited. The relative lack of involvement by audit committee members on this project vs. the great interest from them on the audit firm rotation project may lead you to conclude that audit committee members are either supportive or ambivalent about the communication project. I think, however, for the audit firm rotation project audit committee members saw their responsibility or even integrity being more directly attacked by the PCAOB and, thus, were more motivated to write. On the other hand, I believe they just haven't fully awakened to the consequences of this project.

I do appreciate the Board's re-exposing the document for further input. However, given the relatively short comment period occurring during the year-end closing period for most corporations, it's likely that this won't be a high priority response item. I urge the Board to be sure it receives a reasonable amount of input in some form from audit committee members before making final decisions.

Overall objectives of the release

As noted in my earlier letter, excellent communications between independent auditors and a company's audit committee are a critically important contributor to high quality corporate financial reporting, even more so as a result of the Sarbanes-Oxley Act of 2002. Thus, I fully support updating the interim auditing standards that deal with this topic. However, I also noted in my earlier letter that there are already a fairly large number of required communications from auditors to audit committees and this proposal would add others. A danger is that auditors will perhaps focus too much on meeting these extensive requirements to the detriment of truly effective communications with audit committees – an increase in number or detail doesn't necessarily mean better. For example, I have observed that in some audit committee meetings it's necessary for the Chairman to closely monitor activities of the audit engagement team who, left unchecked, may spend large amounts of precious meeting time reading some of those required communications to committee members.

Given the lengthy list of required communications, I remain concerned that the revised document may result in "checklist behavior" or an exercise in compliance rather than communication. With so many references to auditing standards that may well be reviewed by the PCAOB through the inspection process, the standard simply may not reach an appropriate balance between what auditors think audit committees should receive vs. what the members of those committees actually need to receive from auditors.

Having expressed the above concerns, I acknowledge that there probably isn't much the PCAOB can do to address them in a final standard. It's hard to make a case for deleting any of the specific requirements (except as noted below). And the overall tone of the release is generally positive. The issue is whether a new standard will actually result in improved communications or simply more compliance activity by the accounting firms and after the fact challenges by PCAOB inspection teams. If the former, than this will be a real plus for audit committees. If the latter, we will have taken a step backwards.

<u>Confusing the Roles of the Auditor and Management</u>

I am somewhat concerned that the revised proposal does not acknowledge the proper roles of the auditor and management in certain key respects. In such a lengthy document (considering all of the appendices, etc.), it is easy to lose focus on the big picture and I probably didn't do a very good job of analyzing the earlier release in thinking about the roles of management and the auditor. However, I've now done this in the chart that appears as the attachment to this letter. This chart notes my analysis that while most of the proposed requirements in the exposure draft are auditor initiated matters, there are some that represent management reporting responsibilities. For the latter, the traditional auditor responsibility would be to "attest" or to communicate to the audit committee that management has reported appropriately rather than initiating the reporting. However, the proposal instead would require that the auditor must initiate this reporting in at least some cases.

For items grouped under paragraphs 4, 5-7, and 8-11 in the attachment, I think it is fair to describe them as being related to the <u>nature</u> of the audit and matters that are appropriately communicated by the auditor to the audit committee. And items grouped under paragraphs 13, 15, 17, 18-19, 20, 21, and 22, can fairly be related to the <u>results</u> of the audit and are also appropriately communicated by the auditor to the audit committee.

However, paragraphs 12 and 14, in particular, cover what I would characterize as matters that the PCAOB believes should be reported by the auditor to the audit committee when they aren't reported directly by management (and the auditors have to be at least somewhat involved as described further below). I have some separate comments about paragraph 14 in the following section but first a few comments about paragraph 12.

The information covered in paragraph 12 generally would be made available to audit committees by management through a company's financial statements and SEC filings as well as other presentations during committee meetings. And the paragraph is worded such that the auditor's responsibility is to communicate that information already developed by management and not to initiate the development of such information. However, by placing the reporting responsibility squarely on the shoulders of the auditor rather than on management where it belongs, the PCAOB has reversed the normal relationship. Perhaps the problem here is that AU 380 needs reconsideration but it is clearly inappropriate for auditors to have the primary responsibility for communicating management information.

The note to paragraph 12 indicates that the auditor might not have to communicate these matters "at the same level of detail as management" given certain conditions. However, page 23 of Appendix 4 makes clear that the auditor must "participate in management's discussion." Further, the auditor must identify for the audit committee those accounting policies and practices that the auditor considers critical – is this intended to be a different listing than what management presents to the audit committee?

As an audit committee chairman I rely on the CFO, CAO, Controller, etc. to provide this information and it's also important for the auditor to be present during those discussions to speak up if they feel anything is left out. However, I don't think this communication needs to be a joint presentation by the CFO and engagement partner, for example, where it would then become more like the two of them telling me what they have designed as the company's policies and practices. I think this proposal steps over the independence line and requires the auditor to act more like a member of the management team, which is unacceptable.

In summary, I strongly believe that the final standard should be reworded such that the matters in question are described solely as management's reporting responsibilities and the auditor's role as informing the audit committee only when the information is materially misreported.

<u>Significant unusual transactions</u>

The re-proposal introduces a new requirement for the auditor to communicate significant transactions that are "outside of the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature." The rational for this new requirement as stated in paragraph IX of Appendix 4 is that "Some commenters suggested (it) …" That is not very compelling, and I hope that the Board will now be open minded about comments to the contrary.

Audit committee members certainly want to be well informed about the key issues involved in a company's financial statements. Thus, on the surface, receiving information about "significant unusual transactions" would seem to help audit committee members better understand those financial statements and related materials in SEC filings. However, if a new rule would become effective there would be the inevitable questions about such matters as:

> What does significant mean? Does it have the same meaning as material? Should it apply to segments or only to consolidated amounts?
>
> How should "unusual" be determined? For example, would large real estate loan related losses in recent years be considered "unusual" for financial institutions? (Recall the debate over whether the costs related to terrorists attacking the World Trade Center in 2001 should have been considered "extraordinary.")

Your response may well be "let judgment deal with these issues." However, practice generally demands responses through FASB Emerging Issues Task Force attention, accounting firm guidance, etc. Thus, accounting firms and corporations will almost certainly demand more guidance before this could be effectively applied. And the PCAOB inspection process will be challenging accounting firms for their compliance with this new rule after the fact.

As an audit committee member I fully expect that management will inform me about the types of matters that would no doubt fall under what the PCAOB has in mind in paragraph 14. Similar to my comments in the preceding section, I would expect the auditor to inform me only if management has failed to do so. Further, paragraph 14 and the related explanations in the Appendix are worded such that the auditor apparently <u>must</u> communicate these significant unusual transactions regardless of whether management has already done so. That seems to add further insult to the normal management/audit committee reporting relationship.

I strongly urge that paragraph 14 be deleted from a final standard.

<u>Other Comments</u>

I continue to believe that communications with audit committees ought to be in writing, notwithstanding the arguments in the revised exposure draft. Writing a memo for the file to satisfy a communication requirement simply doesn't ensure an adequate understanding by audit committee members.

I agree with the commenters who said that the engagement letter also should include the responsibilities of the audit committee. While you note that "those responsibilities are governed by other rules," it doesn't make sense to have such an obvious omission from the engagement letter.

Please let me know if you have any questions about my comments.

Sincerely,

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Analysis of Requirements Between Auditor and Management Responsibility

Paragraph Number and Description	Auditor Initiated	Company Initiated
4 – Issues discussed before appointment	X	
5-7 – Engagement letter	X	
8-11 – Audit strategy	X	
12 – Accounting policies, practices, and estimates		X
13 – Evaluation of the quality of financial reporting	X	
14 – Significant unusual transactions		X
15 – Other information in documents containing audited financial statements	X	
16 – Management consultation with other accountants about significant auditing or accounting matters		X
17 – Going concern considerations	X	
18-19 – Uncorrected and corrected misstatements	X	
20 – Departures from the standard auditor's report	X	
21 – Disagreements with management	X	
22 – Difficulties encountered in performing the audit	X	