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April 23, 2010

Office of the Secretary

PCAOB

1666 K Street, N.W.

Washington, DC 20006-2803

Re: Rulemaking Docket Matter No. 030

Gentlemen:

I am pleased to submit these comments on the PCAOB's Release No. 2010-0001, "Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards." To put my comments in perspective, I currently serve as chairman of the audit committee of three New York Stock Exchange listed companies and previously served in the same capacity for two other NYSE companies. Further, in recent years I have been involved in numerous audit committee educational seminars as a speaker or participant. Therefore, I believe my comments are reasonably representative of many currently serving audit committee members. However, these are my personal views and should not be attributed to the three corporate boards on which I serve or any other organization.

General Comments

Excellent communications between independent auditors and a corporation'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. I also endorse the objectives noted in the release of (1) enhancing the relevance and effectiveness of the communications between the auditor and the audit committee and (2) emphasizing the importance of effective, two-way communications

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between the auditor and the audit committee to better achieve the objectives of the audit.

I do not know the extent to which the PCAOB consulted with audit committee members in reaching the decisions in the proposed standard. However, my own reservations about certain key matters lead me to believe that much more consultation is essential before issuing a final standard. The impression I have of the current draft is that it seems to represent what auditors think audit committee members should want to receive from them rather than representing what those audit committee members really want.

There are already a fairly large number of required communications from auditors to audit committees and this proposal would add many new ones. A significant danger is that auditors would perhaps focus too much on meeting these extensive requirements to the detriment of truly effective communications with audit committees. For example, audit committee members probably are more interested in knowing auditors' assessment of the quality of financial management and the "tone at the top" of a corporation than most of the matters covered by the required communications. I'm not necessarily suggesting that these should be the subject of additional requirements but I do think that the PCAOB really needs to learn more about what audit committee members want to hear from auditors before finalizing a new standard. It may well be that "guidance" does not need to be in the form of more required communications or other auditing standards but rather in best practices ideas that could be published jointly by the PCAOB and the National Association of Corporate Directors, for example.

Directors probably aren't strongly motivated to write comment letters on matters like this so other ways of obtaining their views should be sought. I will encourage other directors to write but I also urge the PCAOB to reach out through focus groups or other approaches to obtain direct input from those most affected by this proposal.

In the remainder of this letter I will address the specific questions raised in the proposal, some of which I have significant reservations about in addition to the general matters mentioned above.

Responses to Questions

Questions 1 and 2 – I agree with the objectives of the auditor in the proposed standard. I think it is important to point out that the four objectives stated deal with communicating aspects of the audit process. However, some of the matters in the proposal arguably go beyond the basic audit process and relate instead to management's role in communicating certain information about accounting estimates or other financial details to the audit committee. As noted below, I take issue with certain of those, particularly the ones that expand on interim auditing standard section 380.08. The stated objectives of the auditor do not seem to encompass such supplemental management reporting to the audit committee, nor should they.

Questions 3 and 4 – I agree with the requirement for an annual engagement letter. Audit committees must decide whether to reappoint the auditor or select a new auditor each year and it is a good practice to have a written agreement of the terms of the current understanding, including the auditor's compensation. One issue is that these letters are often quite lengthy and contain a certain amount of "boilerplate." Thus, I always ask the auditor to highlight what is new or different from the prior year's letter. While I and other members of the audit committee will read the entire letter to be sure we have a good understanding of what has been drafted by the auditor, we want to be sure to focus on any subtle changes the auditor may wish to make for the current year. Thus, the PCAOB might consider adding to a final standard encouragement to highlight changes in the engagement letter from year to year.

Question 5 – The proposed requirement to inquire about risks of material misstatement, including inquiries related to fraud risks, is certainly appropriate. In particular, auditors should inquire about receipt of complaints through "hot lines" or similar procedures. However, in the normal situation it should be extremely rare that a matter would arise for the first time during discussions between the auditor and the audit committee – if important, it should have been discussed by management with the auditor well before this point. In my experience, these discussions about fraud between auditors and the audit committee tend to be relatively perfunctory rather than "robust and substantive" (as suggested in the proposal), simply because normal procedures should have surfaced any important issues at a much earlier date.

Questions 6 and 7 – I absolutely support a new requirement for the auditor to communicate to the audit committee an overview of the audit strategy, including a discussion of the significant risks identified by the auditor, and the timing of the audit. This has been done for several years for each of the companies for which I serve as audit committee chairman. The matters that should be covered according to the proposal are all appropriate. However, here are some specific matters that are not covered in the proposal but should be:

1. The final standard should make clear that this communication must be issued as early as possible in the year under audit. I don't think precise timing can be specified but in general the audit committee should receive and approve this information by at least the end of the second quarter of the year in question.

2. The final standard should specify that the auditor must communicate any "risk rating" he or she has assigned to the company. Also, when that risk rating indicates a higher than normal risk, the auditor should describe the nature of the "extra" procedures that will be performed due to the higher risk.

3. In this document (or perhaps in the audit engagement letter) there should be a listing of upcoming required rotation of key engagement personnel. While audit committees nearly always focus on engagement partner rotation, there may not be as much focus on rotation of other key individuals and the risk that represents at least to future audits.

Questions 8-11 – Paragraphs 12 (Accounting Policies, Practices, and Estimates) and 13 (Auditor's Evaluation of the Quality of the Company's Financial Reporting) are key components of the proposed standard. The Overview of the release provides a reasonably good description of the most important changes from the current interim auditing standard. However, I found the actual detailed changes somewhat difficult to follow because of the different paragraph layout and numerous wording changes. Some of the new wording is undoubtedly due solely to style differences between the PCAOB and the ASB but other new wording may be intended to represent substantive new guidance – it's somewhat hard to tell. In any event, I've analyzed the proposal as best I can and provide my comments below.

First, I strongly object to the new requirements listed on page 12 of the Release:

1. How critical estimates are monitored.

2. Significant assumptions in critical estimates that have a high degree of subjectivity.

3. Discussion of significant changes to estimates, along with reasons therefor, effects on financial statements, and support for changes.

4. How estimates within ranges would affect financial statements.

Essentially, I believe the PCAOB should retain section 380.08 of the existing literature and not require paragraph 12b of the proposal. While I'm sure the proposed changes are well intentioned, they simply go too far beyond any notion of an auditor's obligations to the audit committee or reporting company. Some audit committees may well feel these are useful pieces of information to have, in which case they can ask corporate management to provide them. However, mandating this in the form of a required auditor communication would mean that all companies would be obligated to establish systems to capture this information and corporate management would have to regularly provide these very subjective judgments to the audit committee. Worse yet, in the cases where the company would deem it impractical to do so, the auditor would somehow have to come up with his or her own judgments and communicate them to the audit committee. I'm not sure that this is operational in many cases, such as the wide variety of possible outcomes within a range for loan losses of a large financial institution. And the cost of auditors somehow trying to do this would clearly exceed the benefits in my opinion.

With respect to the reporting on critical accounting policies and accounting estimates, I support continuing the current approach whereby the auditor generally defers to the reporting company's reporting as indicated in the Note to paragraph 12 of the proposed standard. As an important drafting matter, I would put this Note at the beginning of paragraph 12 rather than the end in order to emphasize that in most cases financial management will report these matters to the audit committee and the auditor's responsibility is to verify that this has happened and report only on an exception basis.

I do not agree with the proposed new requirement to require auditors to communicate "The anticipated application by management of accounting or regulatory pronouncements that have been issued but are not yet effective and may have a significant effect on financial reporting (12aii)." This information is required to be reported by management in annual or quarterly SEC filings and I believe auditors generally would be expected to point out significant errors or omissions without a specific new auditing requirement to this effect. This is an example of perhaps "too many required communications" that could possibly stifle effective communications between auditors and audit committees on things that really matter.

I agree with the new requirement for the auditor to communicate to the audit committee significant accounting matters on which the auditor has consulted outside the engagement team (proposed paragraph 13f). That is something I've asked for on my audit committees for several years. I often ask to see copies of the consultation memos as well, depending on the nature of the issue

Proposed paragraph 13d that requires reporting of potential bias in management's accounting estimates seems unworkable to me. Does the PCAOB have evidence of this ever actually occurring in practice? This seems extremely subjective and I believe it would result in useful information for audit committees in few, if any, situations. On balance, I recommend this paragraph be deleted.

Question 12 – I see no compelling need to expand this requirement to report consultations on accounting or auditing matters beyond discussions with other auditors.

Question 13 – I have no comment on the going concern communication requirement. It seems clear enough.

Questions 14 and 15 – I support the requirement to report the uncorrected misstatements to the audit committee. I think it is useful for the audit committee to also receive a report on adjustments made as a result of the year end audit process although sometimes it's difficult to determine whether those adjustments were initiated by the company or by the auditor.

There are two matters on this issue that the Board may wish to clarify. First, management, of course, has the responsibility for presenting financial statements fairly stated in conformity with generally accepted accounting principles. Thus, management has to accept responsibility for assessing the materiality of any entries that could have been but are not made at period end. However, with respect to the communication requirement in this proposal, it is crystal clear that this is the auditor's responsibility. Nevertheless, in practice I have seen auditors insist that letters of representation be worded so that the company takes responsibility for immateriality of uncorrected misstatements. Thus, in the auditor's communications he refers to the company's position rather than taking a direct position. This may be a matter of compliance that could be addressed through the inspections process rather than standard setting but I do support the position that the auditor ought to explicitly acknowledge agreement with the materiality judgment.

The other matter has to do with disclosures. In paragraph 17, reference is made to "…uncorrected misstatements related to accounts and disclosures …." However, footnote 21 referenced to that paragraph cites SEC guidance and refers only to "…material correcting adjustments…." I am concerned that auditors may not have a common understanding of how to evaluate the materiality of disclosures for purposes of whether and how to communicate them to audit committees on "schedules of passed adjustments." In my experience, I have been notified by an auditor of "passed disclosures" in only a few cases even though I'm reasonably sure that there were other possible disclosures that could have been made but were clearly immaterial.

There is certainly no need for the auditor to communicate a long list of disclosures that were not made because the matter was not present in the company's circumstances. Further, audit committees generally would not be interested in receiving a list of several possible disclosures for matters that were present in the circumstances but were clearly inconsequential. However, there may be other matters for which the materiality judgment for omitting a disclosure is a closer call and I'm not sure if auditors have a common understanding of when these need to be reported to audit committees. I believe the PCAOB needs to clarify the language in the proposal to distinguish between the necessary guidance for immaterial accounting misstatements and immaterial omitted disclosures.

Question 16 – I strongly urge the PCAOB to require all communications pursuant to a final standard to be in writing. My reasons are twofold.

First, time at audit committee meetings is limited and valuable. Generally, audit committee chairs expect members to read materials, including letters and other materials received from auditors, in advance of the meeting. This saves valuable meeting time and allows us to focus on the most important matters and engage in discussion among members rather than having auditors or others present at the meetings simply read their presentations. Allowing auditors to present important required communications orally would almost certainly be an inefficient use of meeting time.

Second, these required communications are important and thus they must be complete and unambiguous. It may make it easier for the auditor to report orally and then just write a memo for the file to satisfy a PCAOB documentation requirement, but that doesn't ensure an understanding by the audit committee members. And members may wish to refresh their memories on a particular matter later. While they may do so by referring to minutes, those minutes are likely to be brief in referring to required communications and having the actual documents in the corporate files is far superior, in my view.

In my experience, substantially all required auditor communications have been in writing. About the only exception is that auditors sometimes feel uncomfortable responding in writing to the requirement to discuss "judgments about the quality, not just the acceptability, of the entity's accounting principles as applied in its financial reporting (380.11)." It is admittedly difficult to assess an entity's overall selection of accounting policies and estimates as "conservative or aggressive" or by some other qualitative measure. However, rather than letting auditors off the hook by allowing an oral and possibly misunderstood response to this requirement, I would prefer to see the PCAOB spend more time refining the requirement so that a satisfactory written response is possible.

Question 17 – The timing specified in the proposal seems adequate other than my comment above on the engagement letter (see Questions 3 and 4). And all of these matters should be communicated annually.

Question 18 – I don't think it is necessary to have a required audit procedure to evaluate the adequacy of the two way communications between the auditor and the audit committee. While having good communications is very important, such an audit requirement is likely to become a "make work" project of limited or no substance in most cases – simply resulting in a boilerplate memorandum in the working papers. If the two way communications are poor, it probably is because of an ineffective audit committee in most cases, in which case the auditor may well conclude that there is a material weakness in internal control. I see no real incremental benefit from this proposed step.

Question 19 – The requirement in paragraph 4 for discussion of significant issues discussed with management prior to the auditor's appointment or retention seems to be a waste of time and should be deleted. Does the PCAOB have any evidence of this ever being answered in the affirmative in practice?

Questions 20-22 – I have no comments on any of these questions.

Please let me know if you have any questions about my comments or if I can provide any further assistance to the PCAOB on this project.

Sincerely,

Dennis R. Beresford

Dennis R. Beresford

Ernst & Young Executive Professor of Accounting