



The Association of
Accountants and
Financial Professionals
in Business

November 12, 2013

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, DC 20006-2803

PCAOB Rulemaking Docket Matter No. 034

Dear Board Members:

The Financial Reporting Committee (FRC) and Small Business Financial and Regulatory Affairs Committee (SBFRC) of the Institute of Management Accountants (IMA) are writing to provide their views on the proposed auditing standards dealing with the auditor's report, PCAOB Release No. 2013-005 dated August 13, 2013 (Exposure Draft). We certainly understand the desire of the Board to "make the auditor's report more informative, thus increasing its relevance and usefulness to investors and other financial statement users." However, while we are pleased that certain major modifications to the auditor's report suggested in the earlier concepts release are not proposed in this Exposure Draft, we believe that key aspects of the current draft will not achieve the objective quoted above. Further, we are concerned that significant audit time will be added to most engagements without commensurate benefit and the timing of some of this work will be problematic with respect to Security Exchange Commission (SEC) filing deadlines.

The IMA is a global association representing more than 65,000 accountants and finance team professionals. Our members work inside organizations of various sizes, industries and types, including manufacturing and services, public and private enterprises, not-for-profit organizations, academic institutions, government entities and multinational corporations. The FRC is the financial reporting technical committee of the IMA. The committee includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics and analysts. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. The SBFRC addresses issues that impact small and medium-sized organizations. On behalf of IMA's members, the SBFRC engages and suggests solutions to standard-setters and regulatory agencies such as the Financial Accounting Foundation, SEC, International Accounting Standards Board, Small Business Administration, American Bankers Association, Internal Revenue Service and others. Information on both committees can be found at www.imanet.org under the Advocacy section.

Overview

As noted in our September 22, 2011 letter commenting on the Concepts Release on this same subject, we believe that the overall framework for the auditor reporting model should be consistent with the following principles.



1. The objective of an audit should remain as we know it today. It should provide an opinion on the financial statements, not management's discussion and analysis (MD&A) or other areas of financial reporting.
2. Auditors should not be disclosing information for which they are not the original source. Rather they should opine on information provided by management.
3. The auditor's report should provide transparency for investors as to what the audit provides in terms of assurance (what it is), as well as, what it does not address (what it is not).
4. Auditor involvement and attestation should be limited to areas for which they have the appropriate expertise.

Consistent with this framework, we fully support the existing "pass/fail" model that has stood the test of time and is endorsed by the Board in the current proposal. Notwithstanding efforts of the PCAOB or others to improve the usefulness of the auditor's report, we believe most users will continue to look only to see if a company has received an unqualified ("clean") opinion. Our strong support for the pass/fail model is one reason we are concerned about critical audit matters (CAMs), as discussed below, as lengthy lists of CAMs may tend to obscure the actual pass/fail conclusion.

Also consistent with our framework, we strongly support the Board's decision not to include a proposal for an auditor's discussion and analysis (AD&A) in the exposure draft. In particular, an AD&A would have required auditors to report information that in many cases was not already being reported by the company itself. Financial statements and other information in SEC filings are representations of management. While investors may always desire improvements in financial reporting and other disclosures in filings, the proper source of this information is management and not the auditor. We also believed that a requirement for an AD&A would have diverted resources from the audit process and have similar concerns about the proposal for CAMs as discussed below.

Our earlier letter also suggested that a requirement for emphasis paragraphs to be added to auditor's reports in most cases was not warranted. Thus, we support the position in the Exposure Draft to continue current practice to allow such paragraphs in unusual circumstances but not burden all reports with numerous emphasis paragraphs. Some companies have experimented with "road maps" to their annual reports or similar ways to highlight matters that they believe will help readers better understand those reports. We encourage those efforts by companies but again believe it should be management's responsibility to take the lead on such disclosure matters rather than assigning such reporting to the auditor.

Critical Audit Matters

Without question the most significant proposed change to the auditor's report is the inclusion of critical audit matters. The Board defines CAMs as the audit matters that:

- involved the most difficult, subjective, or complex auditor judgments;
- posed the most difficulty to the auditor in obtaining sufficient appropriate evidence; and



- posed the most difficulty to the auditor in forming an opinion on the financial statements.

The source of such matters is identified as being:

- included in engagement completion documents;
- reviewed by the engagement quality reviewer; and
- communicated to the audit committee.

Proposed documentation requirements are such that any matters in the above source list are likely to be judged as CAMs under the proposal as the auditor would be required to otherwise justify in the working papers why such treatment was not appropriate. And that judgment, of course, would be subject to second guessing by PCAOB inspectors. Thus, we assume that the practical application of this guidance would be for most auditors to err on the side of including more rather than fewer CAMs in their reports. This, of course, would lead to several CAMs being included in an auditor's report in typical circumstances and resulting multi-page reports.

While we are concerned about whether multi-page auditor reports would be truly useful to the readers of those reports, our real concern about the proposed addition of CAMs to the auditor's report is not just with the issue of size. Rather, we return to the fundamental issue of the roles of the auditor and management. While the notion of CAMs purports to provide users with information about the audit, for all practical purposes the definition is simply an indirect way of identifying important matters in the company's financial reporting (where significant estimates were made, etc.). The Exposure Draft requires a description of the CAM and why it is one but is silent on whether the auditor should include a description of audit procedures applied (although the examples provided do include such procedures). This indicates that the information being provided is intended more as a way of helping the reader understand the financial reporting rather than understand the auditing performed.

As noted earlier, we understand the desire to "make the auditor's report more informative," which is the PCAOB's objective in this project. But we strongly believe that the report should be limited to describing the auditing procedures performed and related matters and not be extended to serve as guidance for readers of the financial statements and other information in annual reports, etc. to better understand that information. The latter responsibility clearly lies with management. Frankly, we believe the sections of MD&A covering critical accounting policies and use of estimates are quite informative at present for most companies. However, to the extent this and other financial reporting needs improvement, we stand ready to work with the FASB, SEC, and other parties as appropriate.

We also are concerned that the time and effort devoted to fulfilling these particular requirements could distract attention from what we consider the core deliverables of the audit and divert valuable resources of audit firms, management, and audit committees. At present, companies present their financial statements and other information for final review and signoff by the audit engagement partner, concurring partner, and often, national office SEC reviewing partner – all of this under very tight SEC filing deadlines. With a CAM requirement, the process would become



more like a “simultaneous equation” as the company would have its information and the auditors would have their own version and each party would then have to enter into negotiations on which version of the description of certain significant estimates, etc. is in the CAM vs. the MD&A, footnotes, etc. This would require discussions among financial management, audit committees, internal and external legal advisors, local and possibly regional and national office audit personnel, and so on. It’s hard to understand how this can possibly be a productive use of senior audit executive time at the critical audit closing juncture.

We are pleased that the Board has encouraged companies and auditors to field test how the CAM provision would be applied in practice and submit the results to the PCAOB. As noted, this exercise will be most effective if the auditor/company information is reviewed with users of the information (investors, creditors, etc.) and the investors’ views are also shared with the Board. We believe that field testing is likely to demonstrate operational difficulties with the proposal and other negatives rather than positive reinforcement for the CAM notion. If nothing else, however, it will be useful to have some real examples of five to ten page reports that mainly repeat what is already in MD&A, footnotes, etc. and then to ask investors what they find useful about such reports.

In summary, we do not support the inclusion of CAMs in auditor’s reports and urge that this part of the proposal be dropped.

Reporting on Other Information

In our earlier letter we indicated, “While the Committees do not support extending the auditor’s opinion to cover other areas of filed reports (e.g., MD&A, other 10-K information) or earnings releases, we would agree that there may be some benefit to providing investors and other readers of the financial statements a clearer articulation of the auditor’s responsibility for the other information in filed financial reports. This information is currently provided to the audit committee and could be added to the auditor’s external report in a manner that would not be disruptive or otherwise detrimental to the audit and closing processes.” Thus, we end that section of our letter with the following, “... we would not object if the PCAOB required that a brief description be added to the auditor’s report to assist investors in understanding the nature and extent of auditor involvement in reviewing other areas of the reporting entity’s filed information.”

However, in the Exposure Draft, the Board has proposed a different standard of auditor involvement with other information. Rather than read the other information and “consider” whether it is materially consistent with the audited financial statements, the auditor would now be required to read and “evaluate” the consistency of the information. Further, paragraph 4 of the Exposure Draft states in part, “The auditor should read the other information and, based on relevant audit evidence obtained and conclusions reached during the audit, evaluate the ...”

The change from “consider” to “evaluate,” and the phrase “based on relevant audit evidence obtained and conclusions reached during the audit” has resulted in some accounting firms indicating that they believe substantial additional auditing procedures would be necessary to



satisfy the Board's intent. It apparently is unclear whether the quoted phrase was intended by the PCAOB to mean only what had already been performed or whether at least some additional procedures are needed to meet an "evaluate" standard. And if some additional procedures are needed, what are they? We assume this concern is based in part with the firms' experience with the PCAOB inspection program in second guessing the application of many audit judgments. And we are particularly interested in making sure that we learn from our past experience with auditing of internal controls, wherein the accounting firms went well beyond what seemed reasonable in the initial application of Auditing Standard No. 2, which ultimately resulted in the need to issue a revised auditing standard a few years later.

Rather than bringing forward the current auditing guidance in Section AU550 with an added reporting responsibility (to which we had not objected in our earlier letter), the Board seems to have carefully chosen words in its proposal to significantly expand the auditor's responsibility and risk. For example, the Board could have required that the auditor disclaim an opinion – e.g., "Because we were not able to apply sufficient auditing procedures, the scope of our work was not sufficient to enable us to express an opinion, and we do not express an opinion." Or the relevant paragraph could be titled differently, such as "The Auditor's Disclaimer Regarding Other Information." In other words, there are several means available to make clear that no audit of the other information was performed and to not create report language that may well be misunderstood by even a sophisticated investor. It's no wonder that accounting firms' first reaction to the proposal is to suggest that they would have to perform substantially more auditing procedures.

As a final point on this issue, we urge the Board to study (field test) how accounting firms would apply the proposed guidance on the auditor's responsibility for other information. It is important to determine, before the fact, whether such procedures would be unduly costly. It is our belief that substantially expanding auditing procedures in exchange for some form of negative assurance on the other information would not meet any sort of reasonable cost-benefit evaluation. A robust field test of how the proposed guidance would be applied should help demonstrate that to the Board.

Auditor Tenure

We understand that there is some (limited?) investor interest in auditor tenure. However, given the lack of evidence of association with audit quality, we do not support inclusion in the auditor's report. Rather, we believe this is more appropriately considered a corporate governance matter and considered for disclosure in proxy statements as part of audit committee reports or in connection with shareholders' ratification of auditor reappointment.

Other Matters

The remaining matters in the Exposure Draft are modest wording changes that we support or at least do not object to as follows:

- addressing the report to shareholders and the board;



- adding wording to clarify that a material misstatement means whether due to unintentional error or intentional fraud;
- adding footnotes to the language of “financial statements” covered by the auditor’s report; and
- adding wording to the report indicating that the auditor is independent (as defined by the SEC).

Conclusion

We appreciate the opportunity to express our views on the exposure draft. We would be pleased to further explain these views or provide additional information at your request.

Sincerely,

A handwritten signature in blue ink, appearing to read "N. Schroeder".

Nancy J. Schroeder, CPA
Chair, Financial Reporting Committee
Institute of Management Accountants
nancy@beaconfinancialconsulting.com

A handwritten signature in blue ink, appearing to read "J. Exline".

John K. Exline, CMA, CPA
Chair, Small Business Finance and Regulatory Committee
Institute of Management Accountants
Jexline01@cox.net