Council of Institutional Investors
The Voice of Corporate Governance

Via Email

September 19, 2011

Office of the Secretary
PCAOB
1666 K Street, NW
Washington, DC 20006-2803

Re: Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards (PCAOB Rulemaking Docket Matter No. 34)[1]

Dear Office of the Secretary:

I am writing on behalf of the Council of Institutional Investors ("Council"), a nonprofit association of public, corporate, and union pension funds with combined assets of over three trillion dollars. Member funds are major shareowners with a duty to protect the retirement assets of millions of American workers.[2]

The Council appreciates the opportunity to respond to the Public Company Accounting Oversight Board's ("PCAOB" or "Board") *Concept Release on Possible Revisions to the PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards* ("Release"). Our detailed responses to the questions contained in the Release are included as an Attachment to this letter.

The Council wants to thank the PCAOB for its outreach to investors and other stakeholders in connection with the development of the Release. We congratulate the Board on its leadership and courage in exploring issues that have long been debated and remain controversial with some stakeholders. As you may be aware, the Council's membership approved policies contain a statement that expresses the widely held view that "investors are the key customer of audited financial reports and, therefore, the primary role of audited financial reports should be to satisfy in a timely manner investors' information needs."[3]

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[1] Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards, PCAOB Release No. 2011-003, 34 PCAOB Rulemaking Docket Matter 1 (June 21, 2011), http://pcaobus.org/Rules/Rulemaking/Docket034/Concept_Release.pdf [hereinafter Release].

[2] For more information about the Council of Institutional Investors ("Council") and its members, please visit the Council's website at http://www.cii.org/.

[3] Council of Institutional Investors, Statement on Independence of Accounting and Auditing Standard Setters 2 (adopted Oct. 7, 2008), http://www.cii.org/UserFiles/file/Statement%20on%20Independence%20of%20Accounting%20and%20Auditing%20Standard%20Setters.pdf.

Moreover, as indicated in the Release, the "auditor's report is the primary means by which the auditor communicates to investors and other users of financial statements information regarding his or her audits of financial statements."[4] Thus, from the perspective of Council members, the Release raises two core issues: (1) whether the current auditor's reporting model satisfies investors' information needs; and (2) if not, how the model might be improved so that it is more responsive to those needs.

1. The current auditor's reporting model does not satisfy investors' information needs

The evidence indicates that there is a strong consensus among investors' that the auditor's report no longer satisfies their information needs. In just the past four years that view has been reflected in, among other sources: the recommendations and conclusions of the Department of the Treasury's Advisory Committee on the Auditing Profession ("Advisory Committee");[5] the surveys of members of the CFA Institute, the global not-for-profit association of more than 100,000 investment professionals;[6] a survey of investors by the PCAOB's Investor Advisory Group ("IAG Survey");[7] and in the PCAOB staff's own extensive research in connection with the development of the Release.[8]

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[4] Release, *supra* note 1, at 2.

[5] U.S. Department of the Treasury, Final Report of the Advisory Committee on the Auditing Profession to the U.S. Department of the Treasury VII:13 (Oct. 6, 2008), http://www.treasury.gov/about/organizational-structure/offices/Documents/final-report.pdf ("**Recommendation 5: Urge the PCAOB to undertake a standard-setting initiative to consider improvements to the auditor's standard reporting model**.") [hereinafter Treasury Report].

[6] CFA Institute, Usefulness of the Independent Auditor's Report, Survey to the CFA Institute Financial Reporting Survey Pool 6 (Mar. 2011), http://www.cfainstitute.org/Survey/usefulness_of_independent_auditors_report_survey_results_march_2011.pdf ("58% think that the independent auditor's report needs to provide more specific information about how the auditors reach their opinion . . . .") [hereinafter 2011 CFA Survey]; CFA Institute, Independent Auditor's Report Survey Results 4 (Mar. 2010), http://www.cfainstitute.org/Survey/independent_auditors_report_survey_results.pdf ("94 percent of respondents would like to see additional information in the auditor's report"); CFA Institute, CFA Institute Member Poll on the Independent Auditor's Report 1 (Mar. 2008), http://www.cfainstitute.org/Survey/independent_auditors_report_poll_results_march_2008.pdf (80% responding that the "independent external auditors report [should] provide specific information about how the auditors reach their unqualified opinion").

[7] Joseph Carcello *et al*., Improving the Auditor's Report (Mar. 16, 2011), http://pcaobus.org/News/Events/Documents/03162011_IAGMeeting/Role_Of_The_Auditor.pdf ("23% of respondents believe the current auditor report provides valuable information") [hereinafter IAG Survey].

[8] Release, *supra* note 1, at 7 ("The staff observed that there was consensus among investors that the auditor has significant insight into the company and that the auditor's report should provide additional information based on that insight to make it more relevant and useful.").

2. *The current auditor's reporting model should be improved by supplementing the auditor's report with an auditor's discussion and analysis ("AD&A") that includes, at a minimum, the auditor's assessment of management's critical accounting judgments and estimates*

An AD&A is an ideal approach to improving the current auditor's report so that it provides information more responsive to investors' needs. An AD&A that supplements, rather than expands or replaces the current auditor's report, would retain the value of the existing report while responding to the needs of investors for more relevant and useful information from the auditor. We note that the recent IAG Survey revealed that a majority of investors responding "believe there should be a separate Auditor's Discussion and Analysis section in the 10-K."[9]

An AD&A should include, at a minimum, the independent auditor's assessment of management's critical accounting judgments and estimates. Such disclosure was supported by 86% of the respondents to the 2011 CFA Institute survey[10] and 79% of the respondents to the IAG Survey.[11] Other disclosures highly valued by many investors that should also be considered for inclusion in the AD&A, include: (1) areas of high financial statement and audit risk; (2) unusual transactions, restatements and other significant changes to the financial statements; and (3) the quality—not just acceptability—of the issuer's accounting policies and practices.[12]

The potential benefits of an AD&A approach as we have proposed are many. In addition to preserving the value of the current auditor's report, the AD&A would provide investors with critical information from an independent expert relevant to analyzing and pricing risks and making investment and voting decisions. An AD&A would also heighten the perceived value of the work of audit firms, increase quality competition among the firms, particularly with respect to auditor skepticism, and provide the firms more leverage to affect change and enhance management disclosure in the financial statements. The result would be increased transparency to investors and an overall boost to investor confidence in audited financial reports.

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[9] IAG Survey, *supra* note 7.
[10] 2011 CFA Survey, *supra* note 6, at 6 ("[i]nformation about the independent auditor's assessment of management's critical accounting judgments and estimates (86% felt this was important to include)").
[11] IAG Survey, *supra* note 7 ("79% of respondents believe the auditor should discuss significant estimates and judgments made by management, the auditor's assessment of their accuracy, and how the auditor arrived at that assessment").
[12] *Id.*

The costs of an AD&A approach should not be particularly burdensome for public companies or their auditors. The type of information we propose to be included in an AD&A is already collected by auditors for a summary memorandum included in their work papers describing the major risks of the audit, or is required to be provided by the auditor to the audit committee. In any event, we believe the evidence indicates that investors, who ultimately pay the auditor's bill, have concluded that the benefits of the additional information they seek would outweigh the incremental costs.

Finally, we would like to take this opportunity to reiterate to the Board our strong support, consistent with the recommendation of the Advisory Committee and the existing requirements of the European Union's Eight Directive,[13] for requiring the engagement partner's signature on the auditor's report.[14] We continue to endorse the findings of the Advisory Committee that "the engagement partner's signature on the auditor's report would increase transparency and accountability."[15]

We are disappointed that more than two years have passed since the Board issued a concept release on requiring the engagement partner to sign the audit report and a proposed rule has not yet been issued. We would respectfully request that the Board either promptly release a timeline for issuing a proposed rule, or provide investors and the public with an explanation as to why this important improvement is no longer under active consideration.

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[13] Treasury Report, *supra* note 5, at VII:19-20.

[14] Letter from Jonathan D. Urick, Analyst, Council of Institutional Investors to J. Gordon Seymour, Secretary and General Counsel, Public Company Accounting Oversight Board 3 (Sept. 4, 2009), http://www.cii.org/UserFiles/file/resource%20center/correspondence/2009/CII%20Comments%20on%20PCAOB%20Rulemaking%20Docket%20Matter%20No%20%2029%20(3)%20doc%20(final).pdf ("In light of the enhanced transparency and accountability resulting from the signature of the engagement partner on the auditor report, the Council strongly supports the PCAOB's Concept Release.").

[15] Treasury Report, *supra* note 5, at VII:20.

The Council appreciates the opportunity to comment on the Release. We thank you for considering our views and we stand ready to assist you in your efforts to improve the auditor's report so that it is more responsive to the information needs of its key customer—investors.

Sincerely,

Jeff Mahoney

Jeff Mahoney
General Counsel

Attachment

Concept Release on Possible Revisions to PCAOB Standards Related To Reports on Audited Financial Statements and Related Amendments to PCAOB Standards

Council of Institutional Investors

Responses to Questions

September 19, 2011

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 financial statements.

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

    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?

    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?[1]

The Public Company Accounting Oversight Board ("PCAOB" or "Board") should undertake a standard-setting initiative to consider improvements to the auditor's reporting model because the standard auditor's report no longer satisfies the information needs of its key customer—investors.

As an initial matter, we note that the membership approved policies of the Council of Institutional Investors ("Council") recognize that "investors are the key customer of audited financial reports, and, therefore, the primary role of audited financial reports should be to satisfy in a timely manner investors' information needs."[2] Moreover, the "auditor's report is the primary means by which the auditor communicates to investors regarding

[1] Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards, PCAOB Release No. 2011-003, 34 PCAOB Rulemaking Docket Matter 1 (June 21, 2011), http://pcaobus.org/Rules/Rulemaking/Docket034/Concept_Release.pdf [hereinafter Release].

[2] Council of Institutional Investors, Statement on Independence of Accounting and Auditing Standard Setters 2 (Adopted Oct. 7, 2008), http://www.cii.org/UserFiles/file/Statement%20on%20Independence%20of%20Accounting%20and%20Auditing%20Standard%20Setters.pdf.

its audit of the financial statements."[3] In our view, the evidence indicates that the standard auditor's report, which has had few alterations since the 1930's, no longer satisfies the information needs of its key customer.

The failure of the standard auditor's report to satisfy the information needs of investors was reflected in the PCAOB's outreach in connection with the development of the *Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards* ("Release").[4] More specifically, the PCAOB staff "observed that *there was consensus among investors* that the auditor has significant insight into the company and that the auditor's report should provide additional information based on that insight to make it more relevant and useful."[5]

The PCAOB staff observations that the primary customers of the standard auditor's report believe the report should be improved to make it more relevant and useful should not have been a surprise to anyone who is interested in, or follows, investor views on issues relating to accounting and auditing. As early as 1978, the Commission on Auditor's Responsibilities, one of the most significant studies of the auditing profession in U.S. history, concluded:

> **Evidence abounds that communication between the auditor and the users of his work—*especially through the auditor's standard report*—is unsatisfactory.[6]**

Since 1978, the evidence that investors demand more information from the auditor's report has only grown. As indicated in the Release, a March 2008 poll of the members of CFA Institute, the global not-for-profit organization of over 100,000 investment professionals, found that more than 80% of members responding agreed that the "independent external auditors report

[3] U.S. Department of the Treasury, Final Report of the Advisory Committee on the Auditing Profession to the U.S. Department of the Treasury VII:13 (Oct. 6, 2008), http://www.treasury.gov/about/organizational-structure/offices/Documents/final-report.pdf [hereinafter Treasury Report].
[4] Release, *supra* note 1, at 7.
[5] *Id.* at 7 (emphasis added).
[6] The Commission on Auditor's Responsibilities: Report, Conclusions, and Recommendations 71 (1978) (emphasis added) (on file with Council of Institutional Investors). The Commission on Auditor's Responsibilities was chaired by Manuel F. Cohen, partner in the law firm of Wilmer, Cutler & Pickering and a former chairman of the Securities and Exchange Commission. *Id*. at xiv. Other members included: Lee J. Seidler, professor of accounting of New York University and a consulting financial analyst; Walter S. Holmes, Jr., chairman of the board and chief executive officer of C.I.T Financial Corporation; William C. Norby, senior vice president of Duff & Phelps, Inc., an independent investment research firm, and former president of the Financial Analysts Federation; LeRoy Layton, a retired managing partner of the public accounting firm of Main Lafrentz & Co., former president of the American Institute of Certified Public Accountants, and former chairman of the Accounting Principles Board; Kenneth W. Stringer, senior technical partner of the public accounting firm of Haskins & Sells; and John J. van Benten, managing partner of the public accounting firm of Geo. S. Olive & Co. *Id.*

[should] provide specific information about how the auditors reach their unqualified opinion indicating that a company has fairly presented its financial statements in accordance with the required financial reporting standards."[7]

In October 2008, an advisory committee to the U.S. Department of the Treasury ("Advisory Committee") completed a comprehensive study on the auditing profession ("Treasury Report").[8] That study, "reflecting nearly one year's efforts of a philosophically diverse, talented, and committed group of investor, business, academic, and institutional leaders,"[9] including a chairman and CEO of one of the big four auditing firms,[10] explicitly recommended that the PCAOB "undertake a standard-setting initiative to consider improvements to the auditor's standard reporting model."[11]

In August 2009, a research paper authored by Professors Gray, Turner, Coram, and Mock was issued entitled "User Perceptions and Misperceptions of the Unqualified Auditor's Report"("Gray Paper").[12] The Gray Paper findings included, based on a series of focus groups, that

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[7] CFA Institute, CFA Institute Member Poll on the Independent Auditor's Report 1 (Mar. 2008), http://www.cfainstitute.org/Survey/independent_auditors_report_poll_results_march_2008.pdf.

[8] Treasury Report, *supra* note 3, at I:1.

[9] *Id*. at II.2.

[10] *Id*. at III:1. The advisory committee members included: Arthur Levitt, Jr., Co-Chair, Senior Advisor, The Carlyle Group; Donald T. Nicolaisen, Co-Chair, Board Member, Morgan Stanley Corporation, MGIC Investment Corporation, Verizon Communications Inc., and Zurick Financial Services; Alan L. Beller, Counselor to the Co-Chairs, Partner, Cleary Gottleib Steen & Hamilton LLP; Amy Woods Brinkley, Global Risk Executive, Bank of America Corporation; Mary K. Bush, Board Member, Briggs and Stratton Corporation, Discover Financial Services, ManTech Corporation, and United Airlines Inc.; H. Rodgin Cohen, Chairman, Sullivan & Cromwell LLP; Timothy P. Flynn, Chairman and Chief Executive Officer, KPMG LLP; Robert R. Glauber, Board Member, Moody's Corporation, XL Capital Ltd., and Quadra Realty Trust; Ken Goldman, Chief Financial Officer, Fortinet Inc.; Gaylen R. Hansen, Board Member, National Association of State Boards of Accountancy, and Principal, Director of Accounting and Auditing Quality Assuance, Ehrhardt Keefe Steiner & Hottman PC; Barry C. Melancon, President and Chief Executive Officer, American Institute of Certified Public Accountants; Anne M. Mulcahy, Chairman and Chief Executive Officer, Xerox Corporation; Richard H. Murray, Managing Director and Chief Claims Strategist, Swiss Re; Gary John Previts, President, American Accounting Association, and E. Mandell de Windt Professor, Weatherhead School of Management, Case Western Reserve University; Damon A. Silvers, Associate General Counsel, The American Federation of Labor and Congress of Industrial Organizations; Richard A. Simonson, Executive Vice President and Chief Financial Officer, Nokia Corporation; Sarah E. Smith, Controller and Chief Financial Officer, Goldman Sachs Inc.; William D. Travis, Director and Former Managing Partner, McGladrey & Pullen LLP; Lynn E. Turner, Former Chief Accountant, Securities and Exchange Commission, and Senior Advisor, Kroll Zolfo Cooper LLC; Paul A. Volcker, Vice-Chair, Former Chairman, Board of Governors, Federal Reserve System; and Ann Yerger, Executive Director, Council of Institutional Investors. *Id* at III:1-2.

[11] *Id.* at VII:13.

[12] Glen L. Gray, *et al*., User Perceptions and Misperceptions of the Unqualified Auditor's Report 11, 31 (Aug. 30, 2009), http://aaahq.org/meetings/AUD2010/UserPerceptionsAndMisperceptionsUnqualifiedAuditorsReport.pdf [hereinafter Gray Paper].

because of its limited informational content "[u]sers generally do not read the auditor's report and auditors do not expect that they do."[13]

In March 2010, the CFA Institute conducted a second survey of its members "to gather feedback on topics associated with the independent auditor's report."[14] That survey found that "94 percent of respondents would like to see additional information in the auditor's report."[15] One of the respondents provided the following elaborative comments consistent with the survey results:

> ***Because the auditor's report has become rather "boiler-plate" it is not very useful to investors. That being said, the "auditor's report" should be extremely valuable. The auditors possess much information which could be useful to investors.[16]***

In April 2010, the Financial Services Faculty of the Institute of Chartered Accountants in England and Wales ("FSF") released the results of their interviews with investors and other stakeholders in connection with their research on the financial crisis and "ways in which bank auditors can more effectively support confidence."[17] The FSF's paper, entitled "Audit of Banks: Lessons from the Crisis," included the following observation summarizing the investor views on the audit reports of banks:

> **The audit report itself, however, was not viewed as providing useful information to users. It was variously described as a statement of compliance with accounting standards and lacking in information content, since unqualified audit reports use standardized wording. This can make it difficult for investors to assess the quality of individual auditor performance and differentiate between audit firms.[18]**

In January 2011, the Financial Reporting Council issued a paper entitled "Effective Company Stewardship, Enhancing Corporate Reporting and

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[13] *Id.* at 31.
[14] CFA Institute, Independent Auditor's Report Survey Results 4 (Mar. 2010), http://www.cfainstitute.org/Survey/independent_auditors_report_survey_results.pdf [hereinafter 2010 CFA Survey].
[15] *Id.* at 3.
[16] *Id.* at 5.
[17] ICAEW Financial Services Faculty, Audit of Banks: Lessons from the Crisis § 1 (Apr. 2010), http://www.icaew.com/~/media/Files/technical/Financial-services/audit-of-banks-stakeholder-feedback [hereinafter FSF Paper].
[18] *Id.*

Audit"("FRC Paper")[19] The FRC Paper describes the potential benefits to enhancing auditor skepticism if auditors provide "greater transparency . . . [of their assessments to] the Audit Committee and *investors*."[20]

In March 2011, the Investor Advisory Group ("IAG") of the PCAOB released their survey of investors' views on improving the auditor's report ("IAG Survey").[21] The IAG Survey included responses from multiple representatives from six institutional investors whose combined assets under management exceeded six trillion dollars.[22]

The IAG survey revealed that "45% of respondents believe the current audit report does *not* provide valuable information that is integral to understanding financial statements."[23] Perhaps more telling, only "23% of respondents believe the current audit report provides valuable information."[24] Some comments from those respondents include the following:

> **"Over the years, the report has evolved into something that really communicates as little new information as possible." –Head of Fixed Income Portfolio Management, Money Management Firm**
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> **"The audit report is largely boilerplate, and only provides meaningful information in extreme circumstances, usually around going concern issues." – Chief Investment Officer, Mutual Fund.[25]**

Finally, also in March of this year, the CFA Institute issued a third survey of its members relating to the auditor's report ("2011 CFA Survey").[26] Entitled "Usefulness of the Independent Auditor's Report," the 2011 CFA Survey found that "58% think that the independent auditor's report needs to

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[19] Financial Reporting Council, Effective Company Stewardship, Enhancing Corporate Reporting and Audit 1 (Jan. 7, 2011), http://www.frc.org.uk/images/uploaded/documents/Effective%20Company%20Stewardship%20Final2.pdf [hereinafter FRC Paper].
[20] *Id.* at 14 (emphasis added).
[21] Joseph Carcello *et al*., Improving the Auditor's Report (Mar. 16, 2011), http://pcaobus.org/News/Events/Documents/03162011_IAGMeeting/Role_Of_The_Auditor.pdf [hereinafter IAG Survey].
[22] *Id*. (Multiple responses were received from representatives of BlackRock, Vanguard, Capital Group, TIAA-CREF, Legg Mason, and Breeden Capital).
[23] *Id.*
[24] *Id.*
[25] *Id*.
[26] CFA Institute, Usefulness of the Independent Auditor's Report 1 (Mar. 2011), http://www.cfainstitute.org/Survey/usefulness_of_independent_auditors_report_survey_results_march_2011.pdf. [hereinafter 2011 CFA Survey]

provide more specific information . . . ."[27] Some comments from those respondents include:

> ***Current opinion is boilerplate.***
> ***. . . .***
> ***Not a lot of confidence in current auditor's report.***
> ***Report now contains no information.***
> ***Right now it is boilerplate wording.***
> ***. . . .***
> ***Some highly legalised text that is the same for pretty much every company (as it is today) is not very useful.***
> ***. . . .***
> ***The current boilerplate language is simply not sufficient.***
> ***. . . .***
> ***The final presentation of the statements is very boilerplate and explains nothing that was encountered during the audit.***
> ***. . . .***
> ***The language is too boilerplate. The company is still the customer of the auditor.***[28]

In our view, and generally consistent with the results of the PCAOB staff outreach, the evidence indicates investors believe the standard auditor's report should be improved to provide more relevant and useful information by supplementing the existing "pass/fail model and standardized language of the auditor's report."[29] More specifically, the standard auditor's report should be supplemented with, at a minimum,[30] "the independent auditor's assessment of management's critical accounting judgments and estimates."[31]

We note that our view is supported by 86% of respondents to the 2011 CFA Survey[32] and 79% of respondents to the IAG Survey.[33] One of the respondents to the 2011 CFA Survey explained:

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[27] *Id.*
[28] *Id*. at 2-3.
[29] Release, *supra* note 1, at 9 ("Accordingly, many of these investors supported a reporting format in which a standard auditor's report is retained, with certain language in the report clarified, but supplemented with discussion by the auditor about the audit and the company's financial statements.").
[30] Other disclosures highly valued by many investors that should also be considered for inclusion in the AD&A, include: (1) areas of high financial statement and audit risk; (2) unusual transactions, restatements and other significant changes to the financial statements; and (3) the quality—not just acceptability—of the issuer's accounting policies and practices. IAG Survey, *supra* note 21.
[31] 2011 CFA Survey, *supra* note 26, at 6 ("Information about the independent auditor's assessment of management's critical accounting judgments and estimates (86% felt this was important . . . .))."
[32] *Id*.

> ***Careful accounting analysts know that there is some discretion about which principle to apply and how to apply it. We can reach our own assessment of whether these principles are conservative or aggressive, but it would be nice if there was some way to indicate how much discretion the auditor believed had been taken, and in theory, in which direction.***[34]

Similarly, a respondent to the IAG Survey, identified as a Chief Investment Officer of a Mutual Fund, commented:

> **"There are many judgments that ultimately determine the data on the financial statements. It's critical to understand how estimates were made and how much margin of error there might be in the estimates."**

Our view is also generally supported by the FRC Paper's observations that the auditor should enhance the transparency of their assessments of "material assumptions and estimates,"[35] and the Advisory Committee findings that "some institutional investors believe an expanded auditor's report would enhance investor confidence in financial reporting and recommended exploring a more 'narrative' report in areas, such as 'estimates, judgments . . . .'"[36]

Finally, we do not object to the Board considering the expansion of the auditor's role to provide assurance on matters in addition to the financial statements. We, however, currently have no basis for concluding that such an expansion would necessarily be responsive to the information needs of the key customer of the auditor's report.[37]

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

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[33] IAG Survey, *supra* note 21 ("79% of respondents believe the auditor should discuss significant estimates and judgments made by management, the auditor's assessment of their accuracy, and how the auditor arrived at that assessment (14% disagree with requiring this disclosure)").
[34] 2011 CFA Survey, *supra* note 26, at 7.
[35] FRC Paper, *supra* 19, at 14.
[36] Treasury Report, *supra* note 3, at VII:17.
[37] One prominent accountant/analyst/investor has indicated that an expansion of the auditor's role to provide assurance on matters in addition to the financial statements, while not necessarily responsive to the information needs of investors, may be responsive to some audit firms' desire to increase audit fees. Jack T. Ciesielski, A PCAOB Proposal: Not Your Father's Audit Opinion, 20(9) Analyst Acc. Observer 4 (July 16, 2011) (on file with Council) ("Auditing firms would likely favor this approach: by increasing the reach of the auditor's responsibilities, audit prices should increase.") [hereinafter Ciesielski].

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?

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

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.[38]

As indicated in response to question 1, and consistent with the results of the PCAOB staff outreach to investors[39] and other available evidence,[40] the auditor's report should retain the pass/fail model, but be supplemented, at a minimum, with the independent auditor's assessment of management's critical accounting judgments and estimates. The pass/fail model, while clearly insufficient to meet investors' information needs, provides investors some value by allowing them to "skim [the] report quickly [and easily identify] . . . departures from the standard unqualified report."[41] As further explained by one respondent to the IAG Survey:

> **"Either a qualified opinion or not. Not a lot of incremental information once a company gets an unqualified opinion."[42]**

Similarly, a respondent to the 2010 CFA Survey commented:

> ***Clean vs. not clean. Otherwise, not important, since it is boilerplate*.[43]**

Finally, the Gray Paper included the following similar results form its series of focus groups on the auditor's report:

> **When asked how they use the auditor's report, the most common response by users indicate they look at the third paragraph to see if there is an**

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[38] Release, *supra* note 1, at 10-11.
[39] *Id*. at 9 ("Many investors indicated that the pass/fail model and standardized language of the auditor's report provides consistency, comparability, and clarity of auditor reporting.").
[40] *See, e.g.*, 2010 CFA Survey, *supra* note 14, at 3 (indicating that 72 percent of respondents believe that the existing "auditor's report is important to their analysis and use of financial reports in the investment decision making process").
[41] IAG Survey, *supra* note 21 ("73% of respondents skim report quickly for departures from the standard unqualified report while 18% believe it is of no use to them at all").
[42] *Id.*
[43] 2010 CFA Survey, *supra* note 14, at 5.

> **unqualified opinion and then they look to see which audit firm signed the report. If the report is unqualified and signed by a Big 4 firm, they do not consider the report again and move on to analyze the financial statements.**[44]

Thus, in our view, supplementing the current auditor's report, rather than expanding or replacing it, preserves the value of the pass/fail model while at the same time responding to the needs of investors for more relevant and useful information from the auditor.

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.[45]

As indicated in response to question 1, and consistent with the results of the PCAOB staff outreach to investors,[46] and other available evidence,[47] investors are demanding that the auditor provide additional information about the company's financial statements for several reasons. First, the auditor would be in a unique position to provide investors with information relevant to analyzing and pricing risks and making informed investment decisions because (a) the auditor's extensive knowledge of the company and industry obtained through the audit process and the auditor's experiences with other companies in similar industries;[48] (b) the auditor is an independent third party that could provide an unbiased view of the company's financial statements;[49] and (c) the auditor could use the disclosure requirement to "leverage to effect change and enhance management disclosure in the financial statements, thus increasing transparency to investors."[50]

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[44] Gray Paper, *supra* note 12, at 11.
[45] Release, *supra* note 1, at 11.
[46] *Id*. at 7-8.
[47] *See, e.g.,* Treasury Report, *supra* note 3, at VII:13-19.
[48] Release, *supra* note 1, at 7 ("During the staff's outreach, many investors indicated that the auditors are in a unique position to provide relevant and useful information, because of the auditors' extensive knowledge of the company and industry obtained through the audit process and the auditors' experiences with other companies in similar industries.").
[49] *Id*. ("Some investors indicated that one of the primary reasons that they are looking to the auditor for more information, rather than management or the audit committee, is that the auditor is an independent third party.").
[50] *Id.* at 13.

Second, additional information from the auditor could increase quality competition among audit firms,[51] particularly in the area of professional skepticism,[52] and, thereby, enhance the value of the audit to investors and the confidence in audited financial reports.[53] Third, investor/shareowners would have more information to assist them in their responsibilities for overseeing company directors and management.[54] For example, information provided by the auditor providing insight into any disconnect between the company's and the auditor's assumptions would provide investor/shareowners a better sense of management, and perhaps management's willingness to engage in aggressive accounting.[55] Finally, investor/shareowners would have more information to assist them in making an informed vote on the board's choice of the external independent auditor.[56]

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?[57]

No response.

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.

    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?

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[51] *See, e.g.*, 2011 CFA Survey, *supra* note 26, at 9 ("This [more transparency from the auditor] would increase quality competition between auditors.").

[52] *See, e.g.*, FRC Report, *supra* note 19, at 14 ("Such scepticism would be enhanced by greater transparency, with the assessments made by auditors being open to effective challenge by the Audit Committee and investors.").

[53] *See, e.g.*, Treasury Report, *supra* note 3, at VII:17 ("One witness noted that some institutional investors believe an expanded auditor's report would enhance investor confidence in financial reporting and recommended exploring a more 'narrative' report in areas, such as 'estimates, judgments, sufficiency of evidence and uncertainties.'").

[54] *See, e.g.*, IAG Survey, *supra* note 21 ("'[a]ny insight into the disconnect between the company's and the auditor's assumptions gives a better sense of management, and management's willingness to engage in aggressive accounting'").

[55] *Id.*

[56] *Cf.* FSF Paper, *supra* note 17, at § 1 (noting that the standard auditor's report makes "it difficult for investors to assess the quality of individual auditor performance and differentiate between audit firms").

[57] Release, *supra* note 1, at 11.

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?

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

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?[58]

The Board should consider an AD&A as an alternative for providing additional information in the auditor's report. As indicated in response to question 2, an AD&A as a supplement to the standard auditor's report is the best of the alternatives presented in the Release because it provides a vehicle to satisfy the information needs of investors for more relevant and useful information from the auditor without diminishing the value of the pass/fail model derived from investors' ability to quickly discern whether the report departs from the standard unqualified report.

We note that our view finds support in the results of the IAG Survey which found that "52% [of institutional investors responding] believe there should be a separate Auditor's Discussion and Analysis section in the 10-K . . . ."[59] We agree with the view expressed by a respondent to the IAG Survey who stated:

> **This [an AD&A] would be a preferable approach to enhancing auditor information available versus changing the audit report rating system.[60]**

As indicated in response to question 1, an AD&A should include, at a minimum, the independent auditor's assessment of management's critical accounting judgments and estimates. The evidence demonstrates that such a disclosure is strongly supported by investors.

As indicated in response to question 3, an AD&A disclosure about the independent auditor's assessment of management's critical accounting judgments and estimates would be relevant and useful in making investment decisions and would also be used for several other important purposes, including as an additional piece of relevant information to assist investor/shareowners in making an informed vote on the board's choice of the external independent auditor. Finally, of the four alternatives presented in the Release, the only alternative (other than an AD&A) that could potentially be responsive to investors' information needs is a "[r]equired

[58] *Id.* at 18.
[59] IAG Survey, *supra* note 21.
[60] *Id.*

and expanded use of emphasis paragraphs" to the extent that the emphasis paragraphs could accommodate, at a minimum, the auditor's assessment of management's critical accounting judgments and estimates.[61] In our view, the location of the information is less important than the existence, source and content of the information.

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)?[62]

As indicated in response to question 1, the AD&A should include, at a minimum, the independent auditor's assessment of management's critical accounting judgments and estimates. The appropriate content and level of detail regarding this, and potentially other, financial statement related matters presented in the AD&A should generally be consistent with the information currently required to be communicated to the audit committee, or the information required to be included in the summary memorandum prepared by the engagement partner for the audit work papers describing the major risks of the audit.[63]

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")?[64]

See response to question 6.

8. Should a standard format be required for an AD&A? Why or why not?[65]

While we do not oppose a standard format for an AD&A, we would be concerned with any overly prescriptive format requirements that might cause the AD&A disclosures to become boilerplate and, thereby, limit the potential benefits to investors resulting from the information we have proposed to be included in the AD&A. As described in response to question 3, two of the potential benefits of the information would be to: (1) increase the quality competition among audit firms and, thereby, enhance the value of the audit to investors and the confidence in audited financial

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[61] Release, *supra* note 1, at 12.
[62] *Id*. at 18.
[63] *See*, *e.g.*, Ciesielski, *supra* note 37, at 3 ("The ADA might be a forum where auditors could give investors the same information they provide to a firm's audit committee.").
[64] Release, *supra* note 1, at 18-19.
[65] *Id.* at 19.

reports; and (2) assist the investor/shareowners in making an informed vote on the board's choice of the external independent auditor. These and other potential benefits could be diminished if the AD&A is subject to a rigid standard format.

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?[66]

As indicated in response to question 1, we believe the standard auditor's report should be supplemented with, at a minimum, the independent auditor's assessment of management's critical accounting judgments and estimates. We are not, at this time, advocating that the auditor's current responsibilities be expanded beyond their current level of expertise and training.

10. How can boilerplate language be avoided in an AD&A while providing consistency among such reports?[67]

In our view, boilerplate language might best be avoided in an AD&A through vigorous enforcement of requirements that are not overly prescriptive. Our view is generally consistent with that of prominent accountant/analyst/investor Jack Ciesielski who opined that "[v]igorous enforcement by the PCAOB, through the inspection process, might discourage auditors from making the AD&A a boilerplate document."[68]

We are not overly concerned with "consistency among such [AD&A] reports."[69] As indicated in response to question 3, if the information contained in AD&A reports is always consistent, the potential benefits to investors would be diminished.

11. What are the potential benefits and shortcomings of implementing an AD&A?[70]

See responses to questions 3 and 5 for our views on the potential benefits to investors of implementing an AD&A. In addition, as indicated in response to question 10, one of the likely shortcomings of implementing an AD&A is the need for vigorous enforcement of the requirements to avoid an AD&A that produces only boilerplate information.

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[66] *Id.*
[67] *Id.*
[68] Ciesielski, *supra* note 37, at 3.
[69] Release, *supra* note 1, at 19.
[70] *Id.*

We acknowledge that an AD&A would add to the cost of an audit.[71] We, however, note that the cost should be somewhat limited under our proposed AD&A because the information to be disclosed is already required to be collected by the auditor. Moreover, as indicated in response to question 1, we believe the evidence suggests that investors, who ultimately pay the auditor's bill, are willing to incur the added cost of receiving more relevant and useful information from the auditor.

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?[72]

As indicated in response to question 3, if an AD&A presents inconsistent or competing information between the auditor and management that information would be of significant benefit to investors by assisting them: in making an informed investment decision; by increasing quality competition among audit firms; in their responsibilities as investor/shareowners for overseeing company directors and management; and in making an informed vote as investor/shareowners on the board's choice of external independent auditor. If, in contrast, management's financial statement presentation is changed or enhanced to avoid potentially inconsistent or competing information between the auditor and management, investors would still benefit as a result of the "enhanced management disclosure in the financial statements, thus increasing transparency . . . ."[73]

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?[74]

As indicated in response to question 1, we believe the standard auditor's report should be supplemented with, at a minimum, the independent auditor's assessment of management's critical accounting judgments and estimates. In addition, in response to question 5, we explain why including the independent auditor's assessment in an AD&A would be superior to including the information in the emphasis paragraphs. If, however, the PCAOB ultimately rejects the AD&A alternative, we would not object to having the independent auditor's assessment or assessments be described in the emphasis paragraphs. In our view, the location of the

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[71] *See, e.g.*, Ciesielski, *supra* note 37, at 4 ("*Of the four alternatives presented in the concept release, it's the most expansive form of communication to investors – and one that would certainly add to the cost of an audit.").*
[72] Release, *supra* note 1, at 19.
[73] *Id*. at 13; *see, e.g*., Ciesielski, *supra* note 37, at 3 (noting that one benefit of an AD&A is that management "might be more likely to knuckle under to auditors when contentious issues develop").
[74] Release *supra* note 1, at 22.

information is less important than the existence, source and content of the information.

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.

    b. If you do not support required and expanded emphasis paragraphs as an alternative, provide an explanation as to why.[75]

See response to questions 5 and 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?[76]

See response to questions 5 and 13.

16. What is the appropriate content and level of detail regarding the matters presented in required emphasis paragraphs?[77]

See response to questions 6 and 13.

17. How can boilerplate language be avoided in required emphasis paragraphs while providing consistency among such audit reports?[78]

See response to questions 10 and 13.

18. What are the potential benefits and shortcomings of implementing required and expanded emphasis paragraphs?[79]

See response to questions 11 and 13.

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

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[75] *Id.*
[76] *Id.*
[77] *Id.*
[78] *Id.*
[79] *Id.*

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

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.

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

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?

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

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?

g. If you do not support auditor assurance on other information outside the financial statements, provide an explanation as to why.[80]

We do not support the Board considering auditor assurance on other information outside the financial statements *as an alternative* for enhancing the auditor's reporting model because it would not be responsive to investors' information needs. As indicated in response to question 1, we believe the standard auditor's report should be supplemented with, at a minimum, the independent auditor's assessment of management's critical accounting judgments and estimates.

We also note that if the Board were to pursue a project that considers auditor assurance on other information outside the financial statements as an alternative for enhancing the auditor's report, that project would not be responsive to the explicit recommendation of the Advisory Committee "[u]rging the PCAOB to undertake a standard-setting initiative to consider improvements to the auditor's standard reporting model."[81] We believe it is relevant that the Advisory Committee spent a significant amount of time and effort on issues surrounding potential improvements to the auditor's reporting model, and yet the findings of the Advisory Committee give no

[80] *Id.* at 26.
[81] Treasury Report, *supra* note 3, at VII:13.

indication that any member of the Advisory Committee, or any of the many prominent investors, preparers, members of audit committees, and auditors that provided input to the Advisory Committee, advocated auditor assurance on other information outside the financial statements as an alternative to improving the auditor's reporting model.[82]

20. What are the potential benefits and shortcomings of implementing auditor assurance on other information outside the financial statements?[83]

No response.

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?

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.

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?

d. What are the implications to the scope of the audit, or the auditor's responsibilities, resulting from the foregoing clarifications?[84]

We believe the clarifications described in the Release are generally not appropriate with the exception of the clarification in the area of the "[a]uditor's responsibility for fraud."[85] Our support for that clarification is

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[82] *Id.* at VII:13-19.
[83] Release, *supra* note 1, at 27.
[84] *Id*. at 29-30.
[85] *Id*.

based on the recommendation of the Advisory Committee that urged "the PCAOB and the SEC clarify in the auditor's report the auditor's role in detecting fraud under current auditing standards and further that the PCAOB periodically review and update these standards."[86] As the basis for this recommendation, the Advisory Committee found "that expressly communicating to investors, other financial statement users, and the public the role of auditors in finding and reporting fraud would help narrow the 'expectation gap.'"[87] We agree.

The remaining five clarifications in the Release appear designed more to benefit auditors, rather than investors, by clarifying the limits of the auditor's responsibilities.[88] In addition, as indicated in response to question 1, the clarifications are not responsive to investors' information needs regarding the auditor's reporting model. Finally, as indicated in response to question 2, the clarifications, at least in combination, would likely diminish the value of the existing auditor's report by making it more difficult for investors to quickly discern whether the report departs from the standard unqualified report.

22. What are the potential benefits and shortcomings of providing clarifications of the language in the standard auditor's report?[89]

See response to question 21 for a discussion of the potential benefits of providing a clarification of the language in the standard auditor's report on the auditor's responsibility for fraud. We are presently unaware of any shortcomings of providing this clarification.

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?[90]

As indicated in response to question 5, we believe an AD&A is the most appropriate of the several alternatives presented in the Release for improving auditor communication to the users of financial statements.

24. Would a combination of the alternatives, or certain elements of the alternatives, be more effective in improving auditor communication than

[86] Treasury Report, *supra* note 3, at VII:13.
[87] *Id*. at VII:18.
[88] *Cf.* Ciesielski, *supra* note 37, at 5 (commenting that the clarification for reasonable assurance "doesn't really add much value to the information supplied to investors - but it does the auditor more good in that it establishes more limits on what they're seeking in an audit and puts investors on notice").
[89] Release, *supra* note 1, at 30.
[90] *Id*.

any one of the alternatives alone? What are those combinations of alternatives or elements?[91]

As indicated in response to questions 5 and 21, we believe an AD&A alternative with, at a minimum, a required disclosure of the independent auditor's assessment of management's critical accounting judgments and estimates, together with clarification of the auditor's report in the area of the auditor's responsibility for fraud, would be the most appropriate combination of alternatives or elements contained in the Release for improving auditor communication to investors.

25. What alternatives not mentioned in this concept release should the Board consider?[92]

We would like to take this opportunity to reiterate to the Board that the Council strongly believes, consistent with the recommendation of the Advisory Committee and the existing requirements of the European Union's Eight Directive,[93] that improvements to the auditor's reporting model should include requiring the engagement partner's signature on the auditor's report.[94] We endorse the findings of the Advisory Committee that "the engagement partner's signature on the auditor's report would increase transparency and accountability."[95]

We are disappointed that more than two years have passed since the Board issued a concept release on requiring the engagement partner to sign the audit report and a proposed rule has not yet been issued.[96] We would respectfully request that the Board either promptly release a timeline for issuing a proposed rule, or provide investors and the public with an explanation as to why this important improvement is no longer under active consideration.

26. Each of the alternatives presented might require the development of an auditor reporting framework and criteria. What recommendations should

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[91] *Id.*
[92] *Id.*
[93] Treasury Report, *supra* note 3, at VII:19 ("**Recommendation 6: Urge the PCAOB to undertake a standard-setting initiative to consider mandating the engagement partner's signature on the auditor's report**.").
[94] Letter from Jonathan D. Urick, Analyst, Council of Institutional Investors to J. Gordon Seymour, Secretary and General Counsel, Public Company Accounting Oversight Board 3 (Sept. 4, 2009), http://www.cii.org/UserFiles/file/resource%20center/correspondence/2009/CII%20Comments%20on%20PCAOB%20Rulemaking%20Docket%20Matter%20No%20%2029%20(3)%20doc%20(final).pdf ("In light of the enhanced transparency and accountability resulting from the signature of the engagement partner on the auditor report, the Council strongly supports the PCAOB's Concept Release.").
[95] Treasury Report, *supra* note 3, at VII:20.
[96] PCAOB, Docket 029: Concept Release on Requiring the Engagement Partner to Sign the Audit Report (July 28, 2009), http://pcaobus.org/Rules/Rulemaking/Pages/Docket029.aspx.

the Board consider in developing such auditor reporting framework and related criteria for each of the alternatives?[97]

As indicated in response to question 8, in developing an auditor reporting framework and related criteria the Board should take care to not be overly prescriptive so as to reduce the risk of boilerplate disclosures that would limit the benefits of our proposed alternative.

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?[98]

We are currently unaware of any basis for a financial statement user to perceive the AD&A alternative we have proposed as providing a qualified or piecemeal opinion. In our view, the AD&A alternative would include information that clearly supplements, rather than qualifies, the opinion in the standard auditor's report. If the Board disagrees with our view and concludes that an AD&A would result in some users perceiving the AD&A as providing a qualified or piecemeal opinion, the Board could potentially mitigate the risk by simply requiring an explanatory paragraph in the AD&A clearly describing the purpose of AD&A 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?[99]

As indicated in response to question 21, the alternative clarifying the auditor's responsibility for fraud would better convey to users of the financial statements the auditor's role in the performance of an audit. That alternative, however, would not be fully responsive to investor information needs regarding improvements to the auditor's reporting model.

29. What effect would the various alternatives have on audit quality? What is the basis for your view?[100]

As indicated in response to question 3, we believe the evidence indicates that the AD&A alternative with, at a minimum, a required disclosure of the independent auditor's assessment of management's critical accounting judgments and estimates, could increase quality competition among audit firms, particularly in the area of professional skepticism.

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[97] Release, *supra* note 1, at 30.
[98] *Id.* at 31.
[99] *Id.*
[100] *Id.*

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 dealers, 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 an exclusion.[101]

We are currently unaware of any basis for excluding an AD&A alternative, as we have proposed, from the audit reports of any entity subject to the Board's rulemaking authority that files financial statements that include management's critical accounting judgments and estimates.

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?

    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?

    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?

    d. What requirements and other measures could the PCAOB or others put into place to address the potential effects of these considerations?[102]

As indicated in response to question 1, in our view, none of the considerations described in the Release relevant to changing the auditor's report are individually or collectively more important than the goal of improving the auditor's reporting model to satisfy the information needs of its key customer—investors. Moreover, as indicated in response to questions 1, 3, 5, and 11, we believe the evidence suggests that investors, who ultimately pay the auditor's bill, are willing to incur the added cost of receiving more relevant and useful information from the auditor.

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[101] *Id.*
[102] *Id.* at 33-34.

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?[103]

As indicated in response to question 3, one of the many potential benefits of having the auditor's report be supplemented, at a minimum, with the independent auditor's assessment of management's critical accounting judgments and estimates, is that the requirement would provide the auditor with leverage to effect change and enhance management disclosure in the financial statements, thus increasing transparency to investors. We, therefore, are not particularly troubled by the concern expressed by some that providing additional information in the auditor's report could "create more tension" or "result in additional stress" in the relationships among the auditor, management, and the audit committee.[104] In our view, the greater concern is that the current level of tension and stress among the three parties may in fact be too low.

[103] *Id*. at 34.
[104] *Id.* at 32.