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

PCAOB Rulemaking Docket Matter No. 34

Dear PCAOB Members and Staff:

I appreciate the opportunity to comment on the 2011 Jun 21 PCAOB Release No. 2011-003 (PCAOB Rulemaking Docket Matter No. 34), *Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards*. Please note that the views expressed in this comment letter are my own and not those of any past employers or other parties.

My opinions are informed by a career of more than twenty years in accounting. My first six years in accounting were spent in the audit (assurance) practices of two Big X accounting firms. The remainder of my accounting career included financial reporting and/or corporate controller positions at three small to mid-sized international companies which were headquartered in the United States and whose common stock traded publicly in the United States; therefore, these companies were domestic SEC registrants subject to SEC filing and financial reporting requirements. I am now retired from accounting, so my present relationship to the financial reporting process is primarily as an investor (a financial statement “user”).

Before presenting my answers to the various questions proposed by the Board about possible changes to the financial reporting model, I think it is important to briefly state my perspective on two underlying matters.

First, since the auditors’ report is on external financial statements, I think it is important to note my perspective on the purpose of external financial statements. I think that the purpose of external financial statements is to provide information to investors and potential investors in a business enterprise (a “company”) about the company’s financial position at a point in time and about changes in that financial position from the last time it was reported. For the matters at hand—possible changes to

the auditor's reporting model, I do not think it is necessary in this letter to further discuss the definition of a "business enterprise" or "company". I think that the Board and I generally have the same conception of these terms, while sharing an awareness of the difficulties in many marginal situations of determining what is or is not a business enterprise and what its extent is (see, for example, the discussion at FASB Accounting Standards Codification (ASC) 805-10-55 regarding the definition of a "business").¹ I define "investors" as persons or entities that contribute resources of financial value to a company in the form of debt or equity. For the matters at hand, I do not think it is necessary in this letter to further consider the categorization of contributions of resources between debt, equity, or something in between.

Second, I think it is important to state my perspective on the purpose of the auditors' report on external financial statements. These are as follows:

1. To document that the financial statements were audited.
2. To document who performed the audit and whether or not they were independent of the company.
3. To specify which financial statements were audited and whether any limitations were placed on the scope of those audits.
4. To specify the standard against which the financial statements were evaluated by the audit. For public companies registered in the United States, this is almost always U.S. generally accepted accounting principles (GAAP).
5. To specify the standard under which the audit procedures were conducted. For public companies registered in the United States, this is the standards of the Public Company Accounting Oversight Board (PCAOB).
6. To present the auditor's opinion about the compliance of the financial statements with GAAP based on the audit.

My responses to your questions in the concept release are based on these two perspectives.

Questions and Responses:

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?

¹ My comments in this letter also do not pertain to financial statements and the associated auditors' reports for not-for-profit and governmental entities because I do not have recent extensive experience with the accounting for or auditing of these types of entities. However, I understand that auditor's reports for these types of entities are not within the scope of the concept release and are generally outside the Board's purview.

Yes, the Board should undertake a standard-setting initiative to consider improvements to the auditor's reporting model. It has been over 20 years since the auditor's reporting model has been comprehensively revised, and continuous improvement of the model is a worthwhile activity.

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?

I think the auditor's report could be revised to better inform readers of what a financial statement audit entails and what the auditor's opinion on those financial statements means (and, to some extent, does not mean). My thoughts on these matters are further elaborated in my responses to the additional questions below.

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?

No, I do not think that the Board should consider expanding the auditor's role to provide assurance on matters in addition to the financial statements. I think that this matter is a consideration for the U.S. Securities and Exchange Commission (SEC), not the Board. Jurisdictional issues aside, I am opposed to requirements to expand the role of the auditor to provide assurance on matters in addition to the financial statements. My thoughts on this topic are further described in my responses to the additional questions below.

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

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

Yes, the auditor's report should retain the pass/fail model. Financial statements used for external financial reporting under U.S. securities laws and regulations must be prepared, in all material respects, in accordance with GAAP. Either they are so prepared or they are not. Trying to make sense of the myriad of possible points in the middle is an auditing, regulatory, and reporting quagmire best avoided.

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

N/A.

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.

For those financial statements that are not prepared, in all material respects, in accordance with GAAP, it would be useful for users of the financial statements for the auditor's report to, as briefly as possible, note the areas of material departure from GAAP.

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.

It is appropriate for management to provide additional information regarding the company's financial statements to financial statement users. Management is responsible for communicating all relevant information regarding the matters addressed in the financial statements to users in accordance with legal and regulatory requirements and in accordance with sound business practice. The audit committee may provide information about its role with respect to the financial statements and relevant comments arising from its performance of that role.

The role of auditor is to audit the financial statements for conformity with GAAP and to express an opinion about the conformity of those financial statements with GAAP. Other communications regarding the financial statements are beyond the scope of the auditor's association with the financial statements, and may also involve matters that are beyond the auditor's areas of expertise.

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?

I have no comment on this question at this time.

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

No, the Board should not 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.

N/A.

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?

No, I do not think that there should be an AD&A commenting on either the audit or the company's financial statements.

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?

I do not think an AD&A is an appropriate forum for the communication of information for making investment decisions.

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

The matters suggested in the concept release for discussion in the AD&A are not appropriate to this type of report from a financial statement auditor:

- *Audit risk* – The auditor is responsible for reducing audit risk to a sufficiently low level to provide reasonable assurance that the auditor's opinion on the financial statements is correct. This fact should be described in the auditor's report. For many, if not all, audit engagements, it is not possible for the auditor to meaningfully address audit risk in a report of reasonable length, and attempts to do so could be misleading to the reader. For example, the idea of discussing audit risk in the AD&A seems to suggest a discussion of inherent risk and internal control risk. However, these risks are not relevant to the financial statement user's reliance on financial statements on which the auditor has rendered an unqualified opinion, because when designing audit procedures, the auditor will consider the level of inherent and internal control risks in order to perform an audit that provides reasonable support for his or her opinion. In any case, the Sarbanes Oxley Act and related regulations already prescribe requirements for management and auditor reporting of material matters with respect to internal control risk.
- *Audit procedures and results* – The auditor's report should provide a high-level (one paragraph) summary of the basic steps and types of procedures performed in a financial statement audit. The second paragraph of the current standard auditor's report attempts to do this, but perhaps this discussion could be slightly deepened to give a clearer sense of the general types of procedures used in a financial statement audit. However, the purpose of this explanation is to

provide some context for the statement that an audit provides *reasonable*, but not *absolute* assurance, that the financial statements are free of material misstatement. Actually, the most important point in the discussion of audit procedures in the auditor's report is documenting the auditing standards applied, rather than any digression into the details of audit procedures; the financial statement user can then consult these standards to obtain a deeper understanding of the audit process. The existing standard auditor's report already gives the results of the audit—the auditor's opinion. The suggestion to provide more information about the audit procedures seems to shift some responsibility for ensuring the auditor has done adequate work to support his or her opinion from the auditor to the financial statement user. This is inappropriate. In summary, the suggestion noted on page 13 of the concept release that an AD&A could "provide the auditor with the ability to communicate to investors and other users of financial statements the auditor's significant judgments in forming the audit opinion" is misguided.

- *Auditor independence* – The auditor's report should state that the auditor is independent and refer to the standard by which "independence" is determined. There is no need for further elaboration in an AD&A; independence standards are readily available for review by any interested party.
- *Auditor's views regarding the company's financial statements, such as management's judgments and estimates, accounting policies and practices, and difficult or contentious issues (including "close calls")* – Accounting policies and practices and the use of judgments and estimates are financial reporting issues that should be addressed in the relevant places in the financial statements. If there exists a general opinion in financial statement user community that present disclosure of such matters is inadequate in general or in certain particular circumstances, this issue should be taken up with the accounting standard setters. The auditor's responsibility is to determine whether the financial statements adequately address and disclose these matters in accordance with GAAP, not to present what the auditor considers to be a "better" disclosure than what is prescribed by duly adopted accounting standards. In any case, I note that the SEC requires discussion in MD&A of "critical accounting policies", which include policies that involve significant judgments and estimates. I discuss "difficult and contentious issues and 'close calls'" in detail with my response to question 7 below.
- *Enhanced disclosure of material matters that are in technical compliance with the applicable financial reporting framework* – Page 13 of the concept release suggests that AD&A could include comment by the auditor "on those material matters that might be in technical compliance with the applicable financial reporting framework, but in the auditors' view, the disclosure of such matters could be enhanced to provide the investor with an improved understanding of the matters and their impact on the financial statements." The accounting standard setters are responsible for providing accounting standards that provide for adequate disclosure of all material financial matters to financial statement users, and management is responsible for complying with these standards, in all material respects, in its financial reporting. The auditor is responsible for assessing management's compliance with these standards, not for providing additional disclosures that he or she thinks would be "improvements" to the duly adopted accounting standards. If compliance—"technical" or otherwise—with the applicable

financial reporting framework and associated accounting standards does not provide investors with adequate understanding of the related matters and their impact on the financial statements, these concerns should be addressed to the accounting standard setters.

- *Areas in which management could have applied different accounting or disclosures* – This is a financial reporting matter, not an audit matter. If the accounting standard setters believe that the understanding of the financial statements by the financial statement users could be significantly enhanced by discussion of accounting or disclosure alternatives, they should require this discussion in specific, duly adopted accounting standards. It is not the responsibility or business of the auditor to amend accounting or disclosures made under the duly adopted accounting standards based on the auditor’s own opinion about what accounting or disclosures should be.

Page 13 of the concept release notes a suggestion that “an AD&A could give the auditor greater leverage to effect change and enhance management disclosure in the financial statements, thus increasing transparency to investors.” This suggestion is senseless. Accounting standard setters are responsible for establishing the accounting and disclosure framework and standards, management is responsible for preparing accounting and disclosure in accordance with those standards, and the auditor is responsible for auditing and, based on the auditing, opining on management’s application of the accounting framework and accounting and disclosure standards. If the auditor “effects change” and “enhances” disclosure, the auditor would be taking on a management responsibility. It is unclear from the concept release how this responsibility would be shared, or how liability if mistakes were made would be allocated. Furthermore, if the auditor took on responsibility for changing and enhancing disclosure, the auditor would no longer be independent with respect to that disclosure and would, therefore, not be qualified to audit it.

Page 13 of the concept release also notes a suggestion that an “AD&A could provide further context to an investor’s understanding of a company’s financial statements and management’s related discussion and analysis ...” It is not clear what “further context” means. Accounting standard setters (including the SEC for management’s discussion and analysis) are responsible for prescribing disclosure standards that are adequate to allow financial statement users to understand the financial statements (and management’s related discussion and analysis), and management is responsible for faithfully following these standards. If financial disclosures are unclear, the accounting standard setters must improve the standards, or if the standards are already adequate, management must better adhere to them. It is not the role of auditors to unilaterally decide that additional disclosure of financial matters beyond what is required by the duly adopted standards should be made. On the other hand, if management fails to materially comply with those standards, the auditor should disclose that in his or her report and cannot conclude that the financial statements were prepared, in all material respects, in accordance with GAAP. However, even in that case, it is not the responsibility of the auditor—and likely beyond the capability of the auditor—to provide sufficient additional disclosures in any auditor’s report to remedy management’s failure to follow GAAP in its financial statement disclosures.

On page 14, the concept release says, “An AD&A also could provide the auditor with an adaptable report that he or she can tailor to a company’s specific risks, facts, and circumstances.” On the same page the concept release says, “An AD&A would likely be among the most expansive form of reporting of the alternatives presented ...” The release could have substituted *expensive* for *expansive*. Presenting an AD&A will add substantially to the cost of an audit. Beyond mere preparation time, the auditor will also need to charge for time enhancing audit procedures to adequately support statements made in the AD&A and for time sending this work and the draft report through multiple layers of review. Management will also need to spend time reviewing the draft report with the auditor and attempting to reconcile any differences of opinion. Also, I think it should be obvious even to non-lawyers that the AD&A will provide a lightning rod for litigation. Besides the direct costs associated with this inevitable litigation, all the preissuance processes I have just mentioned will likely have to be performed with even more care than they would on the face suggest due to the litigation risk involved.

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?

An auditor can comment on the audit and its result in the auditor’s report. An auditor has no business making other comments about the financial statements.

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)?

An auditor should not provide an AD&A. If there are matters that an auditor considers critical to understanding the audit process and/or the auditor’s opinion on whether or not the financial statements were prepared in accordance with GAAP—including matters related to audit risk, audit procedures and results, and auditor independence—the auditor can provide the necessary communication, as briefly as is reasonable, in the auditor’s report.

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")?

The only information about the auditor’s views on the company’s financial statements based on an audit that the auditor should communicate in any report that will be delivered to users with the financial statements is the auditor’s opinion about whether or not those financial statements are prepared, in all material respects, in accordance with GAAP and, if the auditor concludes that the financial statements are not prepared in accordance with GAAP, an explanation of the significant GAAP departures noted.

The financial statements themselves should include all information needed by users to understand them, including relevant information about accounting policies and practices, areas involving significant management judgment and estimates, and matters to which application of accounting standards is particularly difficult.

The discussion of “difficult and contentious” issues on pages 17 and C-14-15 of the concept release shows confusion and misunderstanding by many parties interested in financial statements about how decisions are made by companies about the application of accounting standards to real world balances and transactions. This confusion and misunderstanding involves matters of technical knowledge and expertise that cannot be adequately resolved in any report by an auditor of reasonable length, and to attempt to do so would cause further confusion among financial statement users.

An accounting issue can be difficult for one or both of two reasons. First, the nature of the transaction or balance that is the subject of the issue could be such that it is difficult to report the transaction or balance in the financial statements in accordance with the conceptual framework used to develop those statements. This difficulty could arise from the complex nature of the transaction or balance or just some aspect of the transaction or balance that does not clearly accord with the financial reporting framework. This source of difficulty is a matter that should be clearly noted in the financial reporting standards that guide the application of the financial reporting framework to various types of transactions and balances. Of course, no financial reporting standard, or the framework that underlies it, can contemplate all the complexities of real world financial transactions and balances, but this inability is still an aspect of the financial reporting framework development and standard-setting process. Therefore, the existence and nature of these types of accounting difficulties should be addressed in the authoritative literature associated with complex transactions and measurements. This source of accounting difficulty is not an aspect of the auditing processes, although it does affect the application of the audit processes since they will be applied to balances and transactions involving these accounting difficulties.

The second reason an accounting issue can be difficult is that the accounting standard guiding application of the financial reporting framework to the particular transaction or balance is written in such a manner that the standard itself leaves itself open to multiple reasonable interpretations of what guidance it is giving. Again, this is an aspect of the accounting standard-setting process and should be addressed as part of the continuous improvement of the clarity of the guidance developed from that process. And again, this source of accounting difficulty is not an aspect of the auditing processes, although it does affect the application of the audit processes since they will be applied to balances and transactions involving these accounting difficulties.

The financial statements should assist the users in identifying material difficult accounting issues. This is done by specifically calling attention to the subject balances or transactions, summarizing the difficulties in applying the accounting framework to the balance or transaction or in interpreting the meaning of the accounting guidance, and referring to the relevant accounting guidance for further information on the

technical issues involved. The financial statements should also clearly and succinctly explain how management resolved the difficulties. Note, again, that this is a financial reporting matter, and the auditor's opinion applies to this information that should be stipulated in the relevant accounting standards and provided by management. If the auditor concludes that management's disclosures related to difficult accounting and financial reporting issues are not in accordance with GAAP and believes that the matter is material to the financial statements taken as a whole, the auditor should not render an unqualified opinion on the financial statements and only then should provide a discussion in the audit report about the difficult issue—in order to justify the impact on the audit opinion.

The discussion of “contentious issues” on page C-15 clearly reflects a deep misunderstanding about how difficult accounting issues are resolved, both internally by management, and during the audit process. Points of contention are constantly arising at all stages of the resolution of difficult accounting issues. Generally, accountants close to the transaction, often assisted by the company's internal technical accounting experts, will make the first attempt to frame the accounting issue and its resolution. Operational management frequently will challenge these early attempts at resolution, usually on grounds that the accountants did not completely and adequately understand the substance of the underlying transactions. Higher levels of financial management also often contest initial attempts at resolving an accounting difficulty. This may also be on the grounds of an incomplete or inadequate understanding of the substance of the underlying transaction, but also often based on a differing understandings of the meaning of the relevant accounting standards, the underlying accounting framework, and the application of both of these to the substance of the underlying balance or transaction. Once a solid working resolution is made internally, the matter is discussed with the auditor. Initially, the accounting may be reviewed by a staff auditor, and then an engagement manager and engagement partner. The more difficult issues are given a first pass at each of these levels within the auditor's organization, with auditors' opinions beginning to be formed along the way. Each level of auditor will ask questions of management and offer indications of their own opinions. Management will provide more information about the balances and transactions and its decisions on the application of accounting standards and frameworks to the various audit levels. Continuous back and forth discussion and debate is common. For particularly difficult accounting applications and material balances, the audit engagement team will often seek support from firm-wide experts who may have their own views and opinions. In my experience, disagreements (or at least concerns) are quite common, especially in the initial vetting of transactions. Often, these are fairly easily resolved, but some issues do require more work, including substantial involvement by audit firm experts. In a long career in accounting and auditing, I have never been associated with any issued financial statements in which management or the auditors did not reach a resolution of any material matter which they did not agree was the best application of accounting principles and standards to the subject balance or transactions. I can see no clear level in this long process at which a meaningful line can be drawn for an issue to be considered “contentious” in a way providing useful disclosure to financial statement users.

No resolution of any difficult accounting issue can ever be made with absolute certainty, but to fill auditor's reports with discussion of all significant matters of debate in the preparation and audit of financial statements would be to provide users of financial statements with information that they would

have no basis for understanding, evaluating, or using. And my discussion in the preceding paragraph should amply demonstrate the difficulty of defining what really characterizes a “contentious” accounting issue. There may be more judgment involved in deciding what is a “contentious” issue requiring disclosure in the auditor’s report than is involved in making some of the underlying accounting decisions. And in the end, the auditor who issues an unqualified opinion on the financial statements must be as comfortable as any reasonable accounting expert can be on the resolution of all material difficult accounting issues in the preparation of the financial statements.

The concept of a “close call” needs to be discussed, and I will do so now.

Practitioners of accounting and financial statement auditing frequently speak among themselves about close calls, but they do so when communicating informally. If we are to discuss formal reporting about something that is a “close call”, we need to clearly define what this means.

A “close call” is a decision made about an accounting matter where it seems that other reasonable decisions could have been made. Thus, it is a decision made as a resolution of a difficult accounting issue. I have already discussed the nature of “difficult accounting issues” in several paragraphs above.

Contrast my definition of “close call” to the attempts documented on page C-15 of the concept release, which evince a limited understanding of the actual level of difficulty and judgment involved in applying accounting concepts and standards to many financial balances and transactions. For many companies, it is a common occurrence every quarter to have several accounting decisions “that required significant deliberation by the auditor and management before being deemed to be acceptable within the applicable financial accounting framework.” This effort often involves substantial communication about the facts surrounding the financial balance or transaction and further discussion of those facts to achieve an understanding of the substance of the balance or transaction. The effort also often involves identification of and agreement upon the relevant accounting principles and practices based on the substance of the balance or transaction and how those principles and practices are to be interpreted and applied. Again, in my experience, as difficult as these issues may have sometimes appeared at the outset of the accounting and auditing process, all parties involved always ultimately became comfortable with the final financial statement presentation.

Based on my views of the nature of so-called “close calls”, I do not think they are relevant for discussion in reporting from the financial statement auditor to financial statement users. Either the auditor is satisfied that the financial statements reflect, in all material respects, a reasonable resolution of all the accounting difficulties involved in their preparation or the auditor is not. Those who are interested in how transactions and balances, including those that are complex, are accounted for and presented in the financial statements under GAAP should refer to that GAAP and the ample commentary thereon.

In concluding my discussion of “close calls”, I want to make something very clear. If management selects its accounting approach from an apparent array of permissible choices under relevant accounting standards for any purpose other than an attempt to provide financial statement users with the most

meaningful presentation of the subject transaction or balance in accordance with the conceptual framework underlying GAAP—reasonable cost-benefit considerations aside—this is not a “close call”. An accounting approach selected for any purpose other than the clearest possible presentation to financial statement users is by definition deceptive and, therefore, fraudulent. Some people may have the idea that “close calls” include selection of permissible, but not the best, accounting approaches from alternatives. Aside from reasonable cost-benefit considerations, selection of a permissible approach that management does not truly believe is the best accounting is fraudulent. The auditor should object to this accounting and cannot merely accept it as a “close call”. Therefore, situations in which these types of financial statement presentations and disclosures are made should not exist and, therefore, are not relevant to discussion of possible auditor disclosures of “close calls”.

Page 17 of the concept release includes “[a] financial statement issue that had a potential material impact to the financial statements and was corrected prior to the end of the period” under the category of “difficult or contentious issues, including ‘close calls’”. I am not sure whether this is to be viewed as a “difficult issue”, a “contentious issue”, or a “close call”, but these matters are irrelevant for disclosure, unless they indicate a material weakness in internal controls over financial reporting requiring disclosure in management and the auditor’s reports on those controls. What is relevant for disclosure to users of the financial statements is whether the financial statements as ultimately presented were prepared, in all material respects, in accordance with GAAP. It is *inevitable* that errors, occasionally material, will be made during the process of preparing financial statements. There is an inherent risk of error in all accounting processes; the level of this risk depends on the nature of the transactions, including the types of processes that can be applied to identify and record them. The point here is that errors are a routine part of accounting processing, and even material errors occur from time to time in a well-designed accounting system. Usually, but not always, any errors resulting from this inherent risk will be detected and corrected by the company’s system of internal controls over financial reporting. However, even the best designed system of internal control over financial reporting will have some small internal control risk—that is risk that a material error will occur and not be detected by the internal controls. Auditors assess inherent and internal control risk of accounting errors and tailor their audit procedures so that the likelihood of a material error occurring, not being detected and corrected by internal controls, and not being detected and corrected during the audit is minimal. Financial statements are intended to present important financial information to financial statement users. Financial statement users have a right to have faith in the processes used to prepare and audit these statements. They do not need to be bothered with the details of this process—that is other peoples’ jobs—and most financial statement users are ill-equipped to interpret details about the operation of those processes.

Even making the suggestion for this disclosure indicates how ill-equipped financial statement users are to draw appropriate conclusions from the requested information. The suggestion gives no indication of how the auditor would determine which “errors” to include in the AD&A, including from what level of the financial statement preparation process the disclosed “errors” could be drawn. Furthermore, the suggestion shows a misunderstanding of what an auditor is doing during a financial statement audit. The auditor does not perform procedures to systematically search for corrected errors (although the auditor will, of course, come across error corrections from time to time while performing normal procedures in

areas such as internal control testing and journal entry review and may indeed detect material errors that were not detected by management's internal controls). Therefore, this suggestion would require a more significant expansion of the scope of standard audit procedures than I think the requestors realized. If the request is only to disclose potentially material errors that were detected by the auditor and subsequently corrected by management before issuing the financial statements, that should be clearly stated. However, this information is, by itself, irrelevant and potentially misleading; the implications of errors that are not detected by internal controls is already considered in management and the auditor's reporting on internal controls over financial reporting.

The general idea that matters related to internal controls over financial reporting are relevant to a financial statement user's understanding of the auditor's opinion on the financial statements evinces a fundamental misunderstanding about the relationship between internal controls and the quality of the financial statements on which the auditor has rendered an unqualified opinion. An auditor, when choosing the nature, timing, and extent of auditing procedures to perform, decides whether a company's particular internal control procedures are adequate to rely on to reduce the nature, timing, and extent of audit procedures needed. If the adequacy of internal controls are—shall we say—a “contentious” issue, the auditor will simply choose not to rely on them and perform additional audit procedures to compensate for the perceived deficiency. Typically, the auditor is able to perform sufficient compensating audit procedures to permit rendering an unqualified opinion on the financial statements, although the audit may require more time and expense to complete and may result in more auditor-proposed financial statement adjustments than if internal controls were better. However, deficiencies in internal controls over financial reporting are only relevant to the auditor's report on the audit of the financial statements if they were so extensive as to prevent the auditor from performing adequate audit procedures to render an unqualified opinion on the financial statements. Of course, auditors have additional reporting requirements related to internal controls over financial reporting under the Sarbanes-Oxley Act and related regulations. Financial statement users who are interested in gaining insight into the internal controls implemented by management can refer to that report and the related report by management, but this reporting model is not the subject of this concept release.

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

No. An AD&A itself should not be required.

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?

Any report by a financial statement auditor is the wrong forum by the wrong people for a discussion of matters such as business risks, strategic risks, and operational risks. Financial statement auditors have

no particular qualifications to comment on these matters with any suggestion of sufficient authoritativeness to inform investment decisions. Frankly, suggestions like this strike me as attempts by investors and investment advisors to offload their responsibilities to understand the businesses of actual and potential investees to some other party (the auditor).

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

I do not know how boilerplate language can be avoided while maintaining consistency among AD&A reports. However, I am unclear how the concept of “boilerplate” language is distinct from standardized best practices in written communication.

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

I see no potential benefits to implementing an AD&A. The shortcomings are that an AD&A would involve a party making comments about a company’s matters that the commentator has neither the qualifications nor responsibility to make, and which might actually be seen relieve those who do have such qualifications and responsibilities from their obligations to do so. This would likely not only cause confusion among financial statement users if information from sources of different veracities conflict, but also would increase confusion about which parties are responsible for providing what information about a company. As a matter of fact, the suggestion that an AD&A be considered indicates confusion among at least some interested parties about who is responsible for providing them various types of information about a company’s financial matters.

Some of the suggestions related to AD&A seem to almost reflect a magical thinking. They seem based on an underlying idea that the auditor’s workpapers—and minds—contain mystical insights about whether a company will or won’t work out as an investment idea. I have been an auditor and worked with many others. They are, by and large, bright, competent people. However, the nature of their work, and the expertise they need to do it, are not directed toward assessing the soundness of their client companies as investments. The auditor’s work is directed toward an evaluation of historical financial information, which, along with other information, investors and their advisors can apply to draw conclusions about the company’s future prospects. I am sure that the answers investors seek are not in the auditor’s workpapers.

I close my remarks on the proposed content of an AD&A by acknowledging the suggestions from investor groups documented on pages C-2-8 (some of which might also apply to emphasis paragraphs, the subject of questions 13-18 of the concept release). I have numerous detailed criticisms of most of these suggestions. However, I agree with the comments critical of those suggestions documented on these same pages of the concept release, and I have provided significant criticism of these suggestions in

my own responses to the Board's questions documented in this letter. Therefore, I will not include a point-by-point critique of these suggestions in this response letter.

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?

In my response to question 11, I noted the potential for an AD&A to present information that is different than that presented by management (or other sources of financial analysis). From a practical standpoint, however, I expect that management and auditors will work to carefully align their messages. The word "work" in the preceding sentence is significant, because this effort will likely cause significant additional work for management and the auditor. In the end, this effort will usually result in aligned information being released, but with a confusing message about which party should really be responsible for delivering this information (again see my response to question 11).

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?

Information about significant management judgments and estimates and areas with significant measurement uncertainty are financial reporting matters that should be presented in the financial statements themselves, not the auditor's report on those financial statements. Information about audit procedures performed on significant matters should also not be presented in the auditor's report. By expressing an opinion on the financial statements, the auditor is responsible for the adequacy of the audit procedures performed. The auditor's opinion refers to the audit standards used, which users can reference if they want a more complete understand about how financial statement auditors are supposed to approach they tasks. Also, there is ample literature about auditing techniques that is available to interested financial statement users. I see no way that an auditor's report on financial statements can adequately convey meaningful details about audit procedures performed on significant matters.

Before addressing the question of matters in the illustrative emphasis paragraphs, I offer a few comments regarding matters requiring emphasis paragraphs in the current audit reporting model (AU sec. 508):

- Substantial doubt about a company's ability to continue as a going concern is a financial reporting matter that should be clearly presented in the financial statements, not in the auditor's report.
- Material changes between periods in accounting principles or in the method of their application is a financial reporting matter that should be clearly presented in the financial statements, not in the auditor's report.

- Correction of material misstatements in previously issued financial statements is both an auditing and financial reporting matter, so discussion in the auditor’s report is appropriate. The discussion in the auditor’s report should be oriented toward auditing matters, which are how the presence of undetected errors in previously issued financial statements reflects on the quality of the audit of those financial statements and, by implication, the auditor’s ability to provide a reliable opinion on the current period financial statements. However, these corrections should also be discussed in detail in the financial statements. That discussion should focus on the financial reporting implications of the misstatements, such as how their correction changes the previously issued financial statements and the implications of such misstatements for management’s ability to presently prepare reliable financial statements.
- Specific accounting matters affecting the comparability of the financial statements is a financial reporting matter that should be clearly presented in the financial statements, not in the auditor’s report.
- The financial statements should indicate if the entity audited is a component of a larger business enterprise, but including this information in the auditor’s report as well is an important aspect of clearly indicating the scope of the audit.
- Significant related party transactions are a financial reporting matter that should be clearly presented in the financial statements. These transactions are not relevant to the auditor’s report unless the nature and extent of these transactions are such as to prevent the auditor from forming a reasonably supported opinion on the financial statements. In that case, the auditor should not express an opinion on the financial statements and should clearly document the presence of these transactions as the reason why no opinion was rendered. Therefore, only if they impact on the auditor’s ability to render an audit opinion, would related party transactions rise to an audit matter requiring discussion in the auditor’s report.
- The auditor’s report should note unusually important subsequent events in order to provide financial statement users with a clear understanding of the time period covered by the financial statements and the audit thereon.

Page 20 of the concept release notes a suggestion to “further expand the emphasis paragraph to highlight the most significant matters in the financial statements and to identify where these matters are disclosed in the financial statements.” This suggestion is completely misguided. First, if it is unclear from the financial statements which matters are “most significant” and where they are disclosed, the accounting standard setters should modify their standards to provide for clearer disclosure and/or management should improve its financial statement presentation to more clearly disclose significant matters in accordance with duly adopted accounting standards. This applies to—again quoting from page 20—“significant management judgments and estimates” and “areas with significant measurement uncertainty”. It is not the responsibility of auditors to unilaterally determine an appropriate manner to disclose significant financial information in circumvention of the disclosure requirements in duly adopted accounting standards. On the other hand, if the auditor believes that management’s method of disclosure is so unclear as to materially depart from GAAP, the auditor should modify his or her opinion on those financial statements accordingly—a far different response than trying to compensate for the inadequate financial statement disclosure with supplemental disclosures in the audit report. Second, the

auditor is not in a position to identify “the most significant matters in the financial statements”. Auditors are not investment advisors and have a different skill set and training than these professionals, and the significance of various matters in the financial statements will vary from user to user in any case. It is the responsibility of the financial statement user to read the financial statements and determine what matters are significant for him or her. It is irresponsible to suggest that this work be passed off onto the auditor, including disclosure of “other areas that the auditor determines are important for better understanding of the financial statement presentation”. If the financial statement users are having difficulty understanding certain types of disclosures in financial statements, they should take up these concerns with accounting standard setters, or management for company-specific disclosure difficulties. Third, the notion from page 20 that the auditor’s report would serve as a sort of navigation aid to significant disclosures in the financial statements (“specific references to such disclosures in the auditor’s report”) implies that it is difficult to find significant information in the financial statements. If this is the case, again it should be addressed with accounting standard setters and, for company-specific difficulties, with company management. I will close this point by offering two pieces of investment advice of my own (although they are by no means original): (1) If you cannot understand a company’s financial statements, do not invest in it except upon the advice of a trustworthy investment advisor who can, and (2) if you are the trustworthy investment advisor and cannot understand the company’s financial statements, do not recommend that anyone invest in it.

Finally, a quick rhetorical question about a remark from page 21 of the concept release: “However, the Board may need to develop additional auditing standards to direct the auditor in determining which matters are of the most importance to emphasize in an auditor’s report.” Is the Board comfortable taking it upon itself to review GAAP (and international financial reporting standards) and issuing its own standards specifying which of these accounting standards “are of the most importance”—and therefore by implication which are not?

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

No.

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

N/A.

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

Areas of difficulty in measurement or application of GAAP are financial reporting matters and should be discussed in the financial statements, not the auditor's report. The auditor is responsible for performing adequate audit procedures on these areas to support the audit opinion. Financial statement users generally do not have the expertise in auditing necessary to evaluate the adequacy of these procedures, but attempting to document or summarize these procedures in the auditor's report would suggest that they have some responsibility to do so. Furthermore, the auditor's report is not a forum that can accommodate a meaningful presentation of these procedures. As I noted in my response to question 13, interested financial statement users have ample information available to them about auditing standards and procedures.

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?

The purpose of emphasis paragraphs should be for the auditor to communicate to financial statement users unique circumstances related to the audit that the users should be aware of to properly understand the auditor's opinion on the financial statements. They are not an appropriate forum for communicating financial and business information about the company. An auditor should include emphasis paragraphs in the audit report for the following reasons:

- To explain why an audit opinion was not rendered or why an opinion was rendered that the financial statements did not conform with GAAP in all material respects.
- To describe limitations on the scope of the audit.
- To clarify the time period covered by the audit when particularly significant transactions or events related to the company occurred after the date of the financial statements but before the audit report was issued.
- To further clarify the entity whose financial statements were audited, if the entity is part of an organizational structure that is so complex that the usual wording of the auditor's report is not adequate to properly identify it to financial statement users.

In response to this question, I add that I am opposed to suggestions, documented on page C-16 of the concept release, to include in or attach to the auditor's report the auditor's communications with the audit committee. I agree with the objections documented on that page.

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

Emphasis paragraphs should be as succinct as possible while still communicating the essential information to the financial statement users.

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

I do not know how boilerplate language can be avoided while maintaining consistency among audit reports. However, I am unclear how the concept of “boilerplate” language is distinct from standardized best practices in written communication.

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

I do not believe that emphasis paragraphs should be required except in situations such as I describe in my response to question 15. In those situations, emphasis paragraphs would help financial statement users better understand the meaning and context of the auditor’s opinion. On the other hand, excessive use of emphasis paragraphs could circumvent the financial reporting purpose of the financial statements themselves, encroach on communication matters that are management’s responsibility, and involve the auditor in communicating about matters beyond his or her knowledge or expertise.

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

No, the Board should not consider auditor assurance on other information outside the financial statements as an alternative for enhancing the auditor's reporting model. Any assurance on this material would be voluntary (until and unless prescribed by the SEC). Therefore, the auditor and company can presently tailor the audit scope and procedures for any such assurance as they agree, and the auditor’s report would reflect the unique decisions made during this tailoring.

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

N/A.

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.

N/A.

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

N/A.

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?

N/A.

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

Auditor reporting on a portion or portions of the MD&A should not affect the nature of MD&A disclosures because those disclosures are management's responsibility and must be prepared in accordance with SEC regulations. Auditing standards are not an appropriate forum for establishing financial (and nonfinancial) reporting requirements.

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?

N/A.

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

I urge caution about requiring auditor assurance on other information outside the financial statements. Expanding the scope of the audit could be very costly, and I am not aware of instances in which financial statement users have been misled about a company's financial situation by materially misstated information delivered with, but outside, financial statements that were not themselves also materially misstated. This is not surprising since existing audit standards already require auditors to review information outside financial statements to make sure it is consistent with any financial statements that accompany it. This connection between information presented inside and outside the financial statements is strong in both directions. Any information presented outside the financial statements that is inconsistent with information in the statements has serious implications for the propriety of those statements and the audit of them. In my many years of experience as a financial statement auditor and

preparer, I have consistently given and received ample substantive auditor comments on the information outside the financial statements.

Although I think the current negative assurance given on the material outside the financial statements is strong, shifting to the auditor providing positive assurance would still result in substantial extra cost in checking details, delving further into operating metrics, and vetting disclosures. I also note that providing positive assurance on operating metrics might require expertise not normally possessed by a financial statement auditor.

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

See my response to question 19, which I summarize as high marginal costs and low marginal benefits.

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?

Yes, clarifications are appropriate for all the areas noted. I have comments on several of them.

Language clarifying the concept of “reasonable assurance”, like that suggested on p. 27 of the concept release, would be helpful. Financial statement users must be aware that an auditor can only design and carry out an audit to provide reasonable, but not absolute, assurance that material errors in the financial statements will be detected. The following are some reasons why absolute assurance cannot be provided. The Board should consider these while drafting any succinct language changes to the standard auditor’s report explaining reasonable assurance.

- The process of preparing financial statements involves processes, measurements, estimates, and judgments that are subject to error (“inherent risk”).
- The company’s internal control systems for detecting errors in financial statements have some risk of failing to operate adequately to detect an error in the financial statements even if the systems are properly designed (“control risk”).

- Planning an audit involves making choices about the depth in which various elements of the financial statement will be examined and the particular procedures to apply to the elements of the financial statements that will be examined. An auditor does not have unlimited financial and time resources to “examine everything”. Therefore, even a properly planned audit will have some risk that the chosen procedures will not be adequate to detect all possible errors in the financial statements. Furthermore, the choices the auditor makes in planning the audit involve judgment and are therefore subject to error. These unavoidable limitations on the audit planning process are one aspect of “audit risk”.
- Audit procedures are carried out by human beings and are therefore subject to error. This is another aspect to “audit risk”.
- Audit quality control procedures involve judgments as to their adequacy and are carried out by human beings. Therefore, they are subject to error. This is another aspect to “audit risk”.

Although it is a topic widely discussed, at least within the accounting profession, I think there is still widespread misunderstanding of the auditor’s responsibility for detecting fraud among financial statement users (and also company managements). Because the popular conception of an audit is so associated with forensics, I think it is necessary to clearly address the extent of the auditor’s responsibility for detecting fraud when performing a financial statement audit. Specifically, the auditor’s report should clearly articulate that the purpose of the financial statement audit is to express an opinion about whether financial statements are, in all material respects, prepared and presented in accordance with GAAP. Therefore, the auditor will design his or her procedures only to detect instances of fraud that materially impact the preparation and presentation of the financial statements in accordance with GAAP. Therefore, the auditor will only perform audit procedures that would detect types of fraud that could materially impact the financial statements *and* then only instances of those types of fraud that are substantial enough to actually be material to the financial statements. In other words, only certain types of fraud would be detected and even then only occurrences in amounts greater than some threshold value. (And as I mention in my response to question 21 c. below, I do not support disclosure of materiality thresholds used in the audit.)

Language regarding auditor independence merely needs to be a statement that the auditor is independent and reference to the standard of independence underlying that assertion.

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.

Yes, these potential clarifications would serve to enhance the auditor's report and help readers understand the auditor's report and the auditor's responsibilities. In particular, I think that financial statement users are often unclear about the level of assurance offered by an auditor’s opinion, the auditor’s responsibility for detecting fraud, and the auditor’s responsibility for information outside the financial statements that is delivered with the financial statements.

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

I do not offer any other clarifications or improvements to the auditor's reporting model that can be made to better communicate the nature of an audit and the auditor's responsibilities. I think the list given is ample. I reiterate my opinion that information in the auditor's report should be limited to information about the audit. I think the auditor's report should be clear and cover all relevant points, but it should also be succinct. Auditing standards are available for interested parties to read, and numerous books on auditing are available. Also, classes on auditing are available, both through colleges and universities and through professional organizations (like the AICPA). Those who are interested in understanding the details of what goes behind an auditor's opinion should consult those resources. The Board oversees inspections of auditors to make sure that appropriate standards and practices are followed, providing comfort in audit quality to financial statement users, and financial statement users also have recourse to litigation if appropriate standards and practices are not followed, leading to financial losses.

At this point, I will comment on the discussion on pages C-8-9 about disclosure of materiality levels. I agree with the remarks critical of this suggestion. It is unclear what meaningful use financial statement users could make of this information or how the auditor could provide in any reasonably succinct manner the context needed to understand any benchmark quantitative measures the auditor may have used during the course of the audit.

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

Clarifications to the standard auditor's report should not affect the scope of the audit or the auditor's responsibilities; they should result in better communication of the matters addressed to financial statement users.

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

The major potential benefit of providing clarifications of the language in the standard auditor's report is that financial statement users will be able to better understand what they are "getting" with the audit opinion. The main shortcoming is the risk that the auditor's report will become too long to be clear or will creep in scope to include matters not directly related to the audit and its results.

Pages C-10-11 of the concept release document suggestions for including various engagement statistics in the auditor's report. However, the statistics suggested are inadequate to draw a reasonable conclusion about the quality of the audit, as the critical examples documented on page C-11 suggest. If financial statement users really want to get insight into an auditing firm's audit quality, they should press for release of more information about auditing firm quality control review results. I will not comment further here on that contentious subject. Financial statement users can also review information about lawsuits involving auditing firms and can review statistics about which firms were involved with failed audits.

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?

The only alternatives discussed in this concept release that I think are appropriate are judicious improvement of the use of emphasis paragraphs and clarification of the standard auditor's report.

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

A combination of the alternatives that I noted in my response to question 23 would be effective.

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

I am not aware at this time of any alternatives not mentioned in this concept release that the Board should consider.

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

I am not able to provide detailed guidance for an auditor reporting framework and criteria at this time. However, I direct the Board to my comments in the introduction to this response letter for my ideas about the purpose of the auditor's report.

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?

I believe that it is very likely that financial statement users might perceive many of the alternatives suggested in this concept release as a piecemeal opinion. I recommend avoiding this by only implementing the changes that I have commented favorably on in this response letter.

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?

Improvements to the standard auditor's report and improved guidance for emphasis paragraphs will better convey to the users of the financial statements the auditor's role in the performance of an audit.

The other alternatives suggested by this concept release would reduce clarity. This is particularly true of some possibilities for an AD&A, which could cause the auditor to appear to be a source of financial information about the company beyond what management provides (in the financial statements and elsewhere) and also to be an arbiter of whether or not the company is a good investment. Even emphasis paragraphs should be used judiciously to avoid encroaching on the realm of the financial statement preparer and users.

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

An AD&A might marginally increase audit quality, since it would subject key aspects of the audit to the scrutiny of yet more parties and because its preparation would require the auditor to do yet one more pass through his or her work (including having another look by the quality control layer). However, the cost of this marginal improvement would be great, both in terms of time to issue the auditor's report and AD&A (and therefore the financial statements with which they are associated) and the expense of preparation. Ultimately, the monetary costs would all inure to the company being audited. Incremental audit costs would be billed to the company, and management would also incur additional costs of its own review of the draft AD&A and work with the auditor to resolve issues and reconcile inconsistencies between the AD&A and management communications (including the financial statements). Another "cost" would be increased financial statement user confusion about the nature and purpose of the financial statement audit and possible misdirection away from the financial statements as the primary source of information about the company's financial position and changes therein.

Assurance on information outside the financial statements might also provide a slight improvement in audit quality; any further understanding of the company that the auditor gains from this work would inure to the benefit of the financial statement audit, but this minor benefit would come with substantial costs from the additional audit and management work required for the added auditor assurance.

More liberal use of emphasis paragraphs would likely have little effect on audit quality. Clarification of the standard auditor's report would also likely have little effect on audit quality. Properly implemented, though, these changes would improve the quality of communication between the auditor and financial statement user about the audit work done and opinion rendered.

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.

I am not familiar enough with these topics to provide an informed opinion.

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?

I think all five considerations are important and deserve careful attention before making any changes to the auditor's reporting model. However, I draw specific attention to the last sentence of "B. Effects on the Auditor's Relationships" on page 32: "Management and the audit committee also might be compelled to change the financial statements, in order to eliminate differences between the company's disclosures and the auditor's discussion in the audit report." I caution the Board to be avoid making changes to the auditor's reporting model that might inappropriately shift decision-making about financial reporting from management to the auditor. This could institutionalize an impairment of the auditor's independence.

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?

For some types of changes, I believe that the benefits would justify the cost, and for some not. I have included discussion of cost-benefit issues in my detailed responses to the preceding questions. In general, I think the higher cost proposals offered in this concept release would not provide sufficient benefits to justify their implementation.

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?

I am not aware of any other considerations at this time.

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

N/A.

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?

I have documented my thoughts on this matter in my responses to the previous questions.

Closing Comments:

I note that the proposals in this concept release are more extensive than mere continuous improvement of the auditor's reporting model. This suggests a perception that there is a serious problem with the current model. However, the release does not attempt to identify this problem. I suggest that the Board consider answering the following clarifying questions before pursuing any significant changes to the auditor's reporting model:

1. Is there a problem with audit quality? If so, would changing the auditor's reporting model be an effective element of the correction of this problem?
2. Is there a problem with communication of audit results to financial statement users?
3. Is there a problem with the relevance and understandability of the financial statements? Are users looking for help from auditors to understand the financial statements? If so, is the auditor's reporting model the appropriate place to address these problems, or should financial accounting standard setters address these problems?

Pages 7-8 of the concept release notes that some parties have suggested to the Board that auditors could have helped assess the quality of the financial statements and provided early warning signals about potential issues like off-balance sheet contingencies and the sensitivity of loan loss estimates. The concept release does not specify a suggestion that off-balance sheet contingencies and the sensitivity of loan loss estimates in financial statements were not presented in accordance with GAAP in financial statements that received unqualified opinions in auditors' reports. Therefore, I am left to assume that the financial statements, including the related required disclosures, that the commentator's had in mind were prepared in accordance with GAAP, and if there is a problem with their understandability or

disclosure about the limitations or sensitivity to economic conditions of the amounts disclosed, this is a criticism of the GAAP itself. The variability and other limitations of the judgments and estimates required for financial reporting under GAAP is a financial reporting issue. Proper financial statement disclosure of these inherent limitations on judgments and estimates should be considered by the accounting standard setters when they promulgate accounting standards requiring their use. It is not the responsibility, or business, of an auditor to criticize or expound on the auditor's perceptions of the limitations of GAAP in the auditor's report. Determination of GAAP and how its limitations are to be presented to financial statement users is the responsibility of the accounting standard setters. They meet these responsibilities through a rigorous process (although not without its criticisms as to particulars), not through ad hoc dissemination of opinions, as those who made the suggestion for auditor commentary to the Board seem to be requesting from auditors. The fact that "reasonable estimates might vary significantly" and that "there could be a wide range of acceptable results" is a financial reporting matter associated with the particular estimates and should be appropriately disclosed with them in the financial statements. Guidance for such disclosures should be developed through the established accounting standard setting process, not based on the opinions of any particular auditors.

I hope that you find my comments helpful as you consider improvements to the auditors' reporting model.

Sincerely,

/s/ Scott E. Green

Scott E. Green, CPA, CMA

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