



The Association for  
Accountants and  
Financial Professionals  
in Business

September 22, 2011

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

Re: PCAOB Rulemaking Docket #34

Dear Sir:

The Financial Reporting and Small Business Financial and Regulatory Affairs Committees of the Institute of Management Accountants (the Committees) are pleased to provide their views on the Concept Release on "Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements" ("the Release"). Overall, the Committees do not believe that major modifications to the auditor's reporting model, as contemplated in the Release, will improve investors' understanding of the results of the audit in a manner that is actionable and material to their investment decisions. More importantly, we are concerned that the time and effort devoted to fulfilling the proposed new requirements may distract attention from the core deliverables of the audit and divert valuable resources of audit firms and audit committees. We ask the Board to be vigilant in preserving the readiness and capability of these important functions and that any improvements be focused on the core mission of ensuring the highest quality audit possible.

The FRC includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics and analysts.<sup>1</sup> The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. The SBFRC advocates on behalf of small business entities (both public and private) to ensure that financial standards, laws, rules and regulations do not proportionately burden or disadvantage such entities. The advocacy efforts of the SBFRC include reviewing and responding to consultative documents issued by standard-setters, legislators, regulators, and other organizations.

### **Overview**

The Committees believe that the overall framework for the auditor reporting model should be consistent with the following principles:

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

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<sup>1</sup> Additional information about the IMA Financial Reporting Committee can be found at [www.imafrc.org](http://www.imafrc.org)  
Suite 1  
Montvale, NJ 07645  
[www.imanet.org](http://www.imanet.org)

We believe that the potential expansion of auditor reporting into some of the areas identified in the Release violates certain of these principles. We further believe that if these ideas are pursued they should not be folded in as part of the audit.

The Concept Release states that its objective is to increase the transparency and relevance of the auditor's reporting model while not compromising audit quality. It is our hope that the Board will be persuaded that audit quality may, in fact, be adversely affected by the diversion of auditor and audit committee focus and attention if certain of the more far-reaching and fundamental changes are carried forward to a final rule. We strongly encourage the Board to refine its objective in a manner that is more consistent with the true purpose of the auditor's opinion: providing investors with comfort that they can rely on the financial information provided in financial reports prepared by management in making investment decisions. In our view, the auditor's opinion regarding the resolution of the annual audit is a matter that requires an unambiguous and unqualified response. This objective is achieved with today's version of the auditor's opinion. If there is additional information that helps investors to better understand the scope of the audit and the meaning and limitations of the opinion, we would support these efforts. Beyond that, we have concerns that expanding the auditor's report to provide other information (e.g., the quality of management's choices of accounting policies) or redefining the purpose of the audit opinion may be potentially harmful to the core audit processes.

It is understandable that in the wake of the recent financial crisis, investors would desire improvements in financial reporting that would provide greater transparency, in a timely manner, into the depth and breadth of the impact of the crisis on the companies and the likely effect on their future results. However, the best source of this information is management not the auditor. If more transparency is desired, we believe that enhanced reporting by management in MD&A is the most appropriate and effective avenue to achieve this objective, as financial statements report on the effect of historical events and conditions at a point in time. Absent a situation that gives rise to the need for a going concern opinion, we do not believe the auditor's report should address these matters. If the Board decides further reporting is necessary, we believe it is important not to diminish the value of the core audit opinion by diffusing its focus and providing potentially non-comparable and subjective views on a wide variety of matters.

The Committees believe that it also is important to maintain a perspective on the relative ability of auditors and audit committees to provide the most relevant information in meeting investor needs for this kind of information. Corporate management has the requisite resources and regular, direct involvement in the core quarterly and annual processes to provide the insights that investors desire about their financial results and the difficult judgments and uncertain estimates contained therein. While the role of the auditors and audit committees is substantive and vital, they have less regular, direct involvement in these processes. Accordingly, they can only provide a level of assurance that is commensurate with the amount of time and resources they expend on these activities as compared to management.

We are concerned that the potential changes to the auditor's reporting model put forward in the Release do not fully contemplate these realities and endeavor to provide enhanced reporting through a less appropriate, and therefore less effective, channel.

We recommend that the Board consider more modest changes to the form and content of the auditor's report that would be limited to clarifying, at a summary level, the role of the auditor in planning and performing the audit in order to provide reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud.

Separately, the SEC may wish to consider whether certain of the transparency concerns of financial statement users raised in the Release should be addressed through enhancements to Management's Discussion & Analysis or other non-financial statement sections of SEC filings.

Our specific concerns related to the proposals in the Release follow.

### **Proposals in the Concept Release**

The Release identifies four principal alternatives for improving the Auditor's Report: (1) institute a new component, Auditor's Discussion and Analysis (AD&A); (2) require use of emphasis paragraphs and expand the circumstances in which they would be used; (3) require auditor assurance in other areas of financial reporting; and (4) clarify certain aspects of the auditor's report. Our views on these alternatives follow.

#### *Auditor's Discussion and Analysis*

The Release describes AD&A as an adaptable report that the auditor can tailor to a company's specific risks, facts, and circumstances. We expect that a custom report of this type would consume a significant amount of time and effort by the audit engagement team and, given the proposed information content, significant review time for the Audit Committee and management. For a reasonably large company, we could envision that a fulsome discussion of the type contemplated in the Release might fill many pages if it were to thoroughly and appropriately provide context and meaning to the matters discussed.

Moreover, given that the proposed form of the AD&A is likely to include commentary on critical accounting policies, significant estimates, professional judgments and other matters that are the responsibility of management, we would envision extensive consultation would be required with the reporting entity's finance and legal personnel at what is likely to be the very peak of the closing cycle. It also is unclear what framework the audit firms and engagement teams would use to reach conclusions about which alternative accounting treatments/disclosures are preferable to those selected by management and the reasons why this is so, given that preferability often is highly dependent on the issuer's specific facts and circumstances. Even if the PCAOB were to develop supplemental guidance to assist auditors in reaching conclusions on these matters, they are inherently highly judgmental and unlikely to be comparable across companies and industries. Accordingly, we question whether they would accomplish the objectives that the Board has set for them.

In addition to concerns about diverting important resources from the audit process, the Committees believe that a new AD&A requirement will be a costly and time-consuming exercise added to an already heavily burdened closing process. We envision the cost of diverted resources and time from senior management, audit committees and audit partners to be very significant and, in our view, would exceed any potential benefit for investors. However, if the Board decides to move forward with its proposal, we strongly encourage further direct outreach to companies. We believe it would be valuable and instructive for the Board to field test this proposal with a range of different size companies to better understand the nature of what would be reported and the impact that this requirement would have on audit and closing processes. To assure a thorough, frank and specific discussion of the ramifications of this concept, we believe the research should be augmented through site visits at large and small companies, in addition to the roundtable discussions the Board has already scheduled.

#### *Emphasis Paragraphs*

While the Committees understand that emphasis paragraphs are provided today in certain relatively limited circumstances, we do not support making these a requirement and expanding the contemplated circumstances in which they would be included in audit reports.

The Release indicates that emphasis paragraphs would assist investors in identifying the most significant accounting matters and their location within the financial statements. We believe that this is the purpose of MD&A and that further revisions to the requirements in this area should be addressed through modifications to the SEC's rules.

The Release also contemplates that the matters covered in emphasis paragraphs could include detailed explanations of the procedures performed with respect to relevant areas of the audit. Without a thorough understanding of the audit process, we believe these explanations may confuse, rather than enlighten, the readers of the financial statements. If additional and more detailed explanations of audit procedures are warranted, this would seem more appropriate as a part of the communication between the auditor and the audit committee.

#### *Auditor Assurance on Other Information Outside the Financial Statements*

As discussed previously, the size and scope of auditor involvement in the financial reporting process is a fraction of the resources employed by the reporting entity, which makes it challenging for the auditor to provide additional assurance related to other information outside of the financial statements beyond what is currently required under AU 550, *Other Information in Documents Containing Audited Financial Statements*. In addition, areas such as MD&A involve relatively more analysis and forward looking disclosure, which are not within the normal scope of the audit. In our view, any changes in this area require services that are beyond the scope of the current audit and, accordingly, would require a more significant amount of audit resources than are allocated today which would significantly increase the cost of the audit. When mandatory auditor attestation for MD&A has been proposed in the past, we have heard investors say that such involvement might actually make this section of the report less useful as the auditor might limit or object to the amount of forward looking, judgmental information included by management.<sup>2</sup>

While the Committees do not support extending the auditor's opinion to cover other areas of filed reports (e.g., MD&A, other 10-K information) or earnings releases, we would agree that there may be some benefit to providing investors and other readers of the financial statements a clearer articulation of the extent of the auditor's responsibility for the other information in filed financial reports. This information is currently provided to the audit committee and could be added to the auditor's external report in a manner that would not be disruptive or otherwise detrimental to the audit and closing processes.

We continue to believe that the involvement of auditors should be limited to reading the non-financial statement information and considering whether it is materially consistent with the audited financial statements. We do not believe that requiring auditor assurance related to MD&A or other information outside the financial statements would be cost-beneficial. However, we would not object if the PCAOB required that a brief description be added to the Auditor's report to assist investors in understanding the nature and extent of auditor involvement in reviewing other areas of the reporting entity's filed information.

#### *Clarification of the Standard Auditor's Report*

We do not object to the proposed clarifications to the standard auditor's report, if these changes enhance the understanding of investors of the important aspects and limitations of the audit. For example, we understand that it could be helpful to further clarify the auditor's responsibilities with regard to detecting

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<sup>2</sup> The Committees observe that auditing standards have, for some time, permitted auditor reporting on MD&A and set requirements for doing so and providing guidance on what the report would say. We note that, to the best of our knowledge, there has been little to no market demand for the service.

September 22, 2011

Page 5

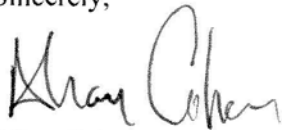
fraud. We would suggest that the Board conduct further investor outreach to better understand what aspects of the auditing process are not well understood and, based on the results, focus on ways in which those matters could be clarified.

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We believe that it is paramount that if the Board decides to move forward to a rule proposal, it conduct field visits with audit committees of large and small public companies to better understand how the proposed changes would affect their ability to meet their responsibilities to investors and other stakeholders. We strongly believe that any proposed changes that interfere with or otherwise adversely affect the work of auditors and audit committees should not be carried forward to a final rule.

We appreciate the opportunity to provide our views on the Concept Release. We would be pleased to answer any questions the Staff of the PCAOB may have on this response.

Sincerely,



Allan Cohen  
Financial Reporting Committee  
Institute of Management Accountants



Irvin Andre Alexander, III  
Small Business Financial & Regulatory Affairs Committee  
Institute of Management Accountants

