



NEW YORK  
CITY BAR

**COMMITTEE ON  
FINANCIAL REPORTING**

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Mr. Martin F. Baumann  
Chief Auditor  
Public Company Accounting Oversight Board  
1666 K Street, NW  
Washington, D.C. 20006

Re: PCAOB Release No. 2011-003; Rulemaking Docket Matter No. 034;  
Possible Revisions to PCAOB Standards Related to Reports on Audited  
Financial Statements and Related Amendments to PCAOB Standards

Dear Mr. Baumann:

This letter is submitted on behalf of the Financial Reporting Committee and the Securities Regulation Committee of The Association of the Bar of the City of New York in response to Release No. 2011-003, dated June 21, 2011 (the "Release"), of the Public Company Accounting Oversight Board (the "Board" or "PCAOB"). The Release solicits public comment on the potential direction of a proposed standard-setting project on the content and form of reports on audited financial statements.

Our Committees are composed of lawyers with diverse perspectives on financial reporting and securities issues, including members of law firms, counsel to corporations, investment banks and investors and academics. We regularly comment on regulatory initiatives in the area of financial reporting (although our comment letters do not necessarily reflect the individual views of all members of the Committee).

We recognize the concerns about the audit report that have led the Board to issue the Release, and we believe that some modifications in audit reports may be desirable. However, we believe there are several reasons why the Board should proceed cautiously.

- It is the responsibility of the issuer, and not its auditors, to provide disclosure to investors. Any requirement that auditors make substantive public disclosures about the issuer will likely adversely affect the auditing process, and the related financial reporting process, by inhibiting candid, confidential discussion and exchange among the auditor, the issuer and the audit committee. The financial reporting process and related corporate governance procedures have improved, partly as a result of the Sarbanes-Oxley Act of 2002 and other reforms, and this “chilling” effect could undermine some of that progress to the detriment of reporting and auditing quality.
- Some of the perceived shortcomings to which the Release draws attention are not attributable primarily to the audit reporting format. They arise from features of SEC disclosure rules, generally accepted accounting principles, corporate governance, internal controls or the reporting practices of issuers. If there are weaknesses in those areas, they should be addressed by institutions other than the Board.
- Some of the ideas in the Release would require auditors to cover matters they do not now cover. The Board is properly concerned with how auditors report, but the matters on which they report are determined by legislation and regulations. The Board should not pursue the suggestions in the Release that would in effect extend or expand the subjects for which auditor reporting is required.
- The specific procedures performed during the course of a particular audit, and the information gathered as a result, are not designed for public disclosure and do not readily lend themselves to it. They are complex and technical, and serve to support a delicate professional judgment. We are concerned that any potential benefit to investors from disclosure about the audit process is outweighed by the potential adverse effects on the auditing process.
- It will be very easy for new disclosure requirements to devolve into boilerplate – the repetition of formulaic disclosure, with little variation from one issuer to the next, and with little benefit for investors.
- If the Board pursues the suggestions raised in the Release, it should carefully consider potential implications including, in addition to those mentioned above, additional cost for issuers, implications for already tight reporting deadlines, potential delays in initial public offerings and increased liability risks for issuers and auditors.

### *Auditor’s Discussion and Analysis*

We do not believe the Board should pursue the idea of an Auditor’s Discussion and Analysis (“AD&A”). As sketched in the Release, the AD&A would have two parts:

“Information about the Company’s Financial Statements” and “Information about the Audit.” In our opinion, auditors should not provide disclosure on either topic.

- The disclosure concerning the issuer’s financial statements would change the auditor’s role from reviewing the issuer’s financial reporting to providing substantive disclosures to investors about the issuer. As discussed above, we believe this is inappropriate. Effective financial reporting requires a complex and open discussion among the auditor, the issuer and the audit committee, which will change in character if the auditor is required to make a public report. In all likelihood, auditor and issuer will provide closely similar disclosures, because both will see serious risks if their disclosures diverge. The issuer will likely seek to limit its disclosures to statements the auditor is comfortable making, too, which will ultimately provide investors with weaker and less useful disclosure.
- We believe the disclosure concerning the audit will be of limited use to investors. As noted above, auditing involves complex professional judgments. It would be very difficult either to summarize them or to describe them fully, and neither approach would be likely to provide sufficiently useful information for investors to warrant the potential adverse effect on the financial reporting process.

#### ***Required and Expanded Use of Emphasis Paragraphs***

The required and expanded use of emphasis paragraphs could improve the auditor’s report, and it merits further consideration, although the Release does not provide enough specifics to comment in detail. As the proposal develops, the Board should consider two concerns. First, the Board should not mandate emphasis paragraphs without providing clear standards for auditors to follow. Without standards, auditors cannot perform their review in an objective manner. Second, the Board should address the risk that mandatory emphasis paragraphs will lend themselves to the development of additional boilerplate. Such rote language could make the auditor’s report more confusing and less useful for financial statement users.

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

We do not believe the Board should pursue the idea of requiring auditor assurance covering information outside the financial statements. It should in any case fall to the SEC, not to the Board, to determine when auditor assurance is required, but we would strongly oppose such a requirement.

- With respect to material outside of periodic reports (such as earnings releases), the idea of regulating its content presents much larger issues, and we question whether there is a need for such an initiative.

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- With respect to material in periodic reports, particularly MD&A, we believe imposing auditor assurance would be counterproductive. Crafting meaningful MD&A requires issuers to evaluate extensive information from outside the financial statements and the financial reporting process, to develop a nuanced analysis and to provide analytical, sometimes prospective information. The auditor does not have the same information, obligations or capabilities. Requiring auditor assurance would drive issuers to make this disclosure auditable, and potentially narrower and less useful to users – for example, by limiting forward-looking information, discussion of trends and uncertainties or disclosure about corporate strategy. There is, moreover, no time within the current periodic reporting framework for an additional process of auditor assurance.

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

The idea of clarifying the standard report is a welcome suggestion. The present practice is not particularly effective to communicate the nature of the auditor's role, the significance of independence, the risks of the process or other matters, and it is possible this contributes to the existence of an "expectations gap." We believe the Board could implement meaningful changes that would clarify the report and improve investor understanding of the audit, the auditors and the report.

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We appreciate the opportunity to provide our comments on the Release, and we believe the public would be well served if the PCAOB gave additional consideration to some elements of the proposals, as described in this letter.

We would be pleased to respond to any inquiries regarding this letter or our views on the Release more generally. Please contact Nicolas Grabar at (212) 225-2414 or Robert Buckholz at (212) 558-3876.

Very truly yours,

The Financial Reporting Committee and the Securities  
Regulation Committee of the Association of the Bar of the  
City of New York

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