

Let me first thank Chairman Doty and the other members of the PCAOB for giving me the opportunity to speak with you today about the Board's proposed standard regarding Auditors' Reporting on their involvement in Other Information.

In being here with you today, I speak from three different perspectives—first as a former audit partner with Deloitte & Touche where I practiced for over 25 years, second as the current CFO for Legg Mason which is an S&P 500 public company, and last but not least as a fiduciary for almost \$700 billion of 3<sup>rd</sup> party assets under management by Legg Mason and our investing affiliates. I should also point out that my remarks today represent my own views, and do not necessarily reflect those of Legg Mason or my colleagues at the firm.

So with that bit of housekeeping out of the way, let me provide you with my high level thoughts on the proposed reporting standard that would require an auditor to evaluate "Other Information" included in documents which also contain audited financial statements.

At a very high level, I think it is important to point out that this Proposal provides the audit profession an opportunity to improve the understanding by investors, and other users of public company filings, as to what information--outside of the audited financial statements--the auditor has been involved with. I believe that this is a worthy objective, and one that could be of some value to users of financial statements--but we should also be careful to understand the derivative real world implications such a change would have in all likelihood—and accordingly weigh the total potential costs against the benefits of making a change in this area of auditor reporting. We also need to be clear-eyed in understanding the value of the benefits to investors, which could easily be overstated.

Specifically on the cost front, we need to be thoughtful about the added costs to issuers--which are ultimately borne by our investors. We need to also consider the likely reality of a lot of boilerplate language being developed that would obviate the clarity the

PCAOB and investors seek in this area. Given the unfortunate, but very true fact that we live in one of the most litigious societies on the planet, boilerplate **will be** part of the bargain here and we should acknowledge that outcome upfront, and be careful to encourage as little of it as possible in the final form of this Proposal.

When we think about the “Other Information” Proposal, we’re talking about information that auditors are already required to read and consider in auditing public company financials. So I believe it is a positive to have auditors clarify what it is they are currently involved with, as users of financial information very often rely on numbers that are outside of the audited financials.

Let me give you an example of this from my own industry--for asset managers like Legg Mason, a key performance indicator is assets under management, which we refer to as AUM—and you may recall I used this number in describing Legg Mason at the outset of my remarks. AUM gets significant MD&A attention by asset managers, but the related numbers are not, per se, audited, and they are clearly not covered in an auditor’s report. However, the auditors are doing more work relating to AUM besides just reading the numbers, given its direct impact on our revenues, even if they are not formally responsible for verifying to 3<sup>rd</sup> parties the AUM reported by firms such as ours. Consequently, investors in Legg Mason would likely find value and comfort in knowing our auditors have done work on our AUM disclosures.

So, the Proposal provides an opportunity for auditors to educate the public on what their processes around Other Information actually entails. The public in general believes that auditors are already involved in some way with verifying information outside of the audited financials. As a consequence, investors may have an over- or under-stated view of what auditors actually do---for instance, they may believe that auditors are involved with any and all numbers in a company’s annual report or 10-K, including numbers not derived from the company’s books and records, which of course is not true.

Thus, a new standard that asks auditors to clarify their role as to Other Information can help the public better understand where the auditor is providing a valuable check on managements' disclosures, and also clarify what the limits are of their work outside of the audited financials.

The Proposal also provides the audit community with better leverage as they audit Company financials and review information outside of those audited financials. Currently there is no recourse for audit firms if they disagree with any management assertions outside of the financials, other than a nuclear option of pulling their audit opinion and resigning from the client. So I believe the Proposal, properly structured, could provide for a more useful dialogue between auditors and management.

There also could be other benefits to having auditors formally and regularly report on information outside of the financials. When firms are engaged in stock and debt offerings, underwriters require that the Company's auditors review and report on information outside the financials, and issue so-called "comfort letters". If the Other Information is already reviewed and reported on, this could expedite and lower the expense of public offerings.

I also see other aspects of the new Proposal which I believe require further review and consideration. First and foremost, is the development of a common understanding of what the word "evaluate" means in terms of how much work the audit firm should do, and how much information they should provide in their report. Personally, I find this term to be vague, and if left in the Proposal I feel it will cause a significant amount of additional work by the auditor and resulting expense for issuers and investors, which I do not believe would add commensurate value. So, the PCAOB should endeavor to make it clear whether the Proposal is a call for the auditor to do more work or simply report on the work they have already done---I for one would be a strong advocate of the latter, in order to obviate the need for any additional costs to be incurred by issuers.

Further, it is not clear what “Other Information” is in scope. For example, Other Information in Annual Reports often includes a firm’s headcount, which is a Company disclosure the auditor generally is not involved in. Also, to the extent information outside of the audited financials is deemed to be part of the auditor’s scope, it becomes very important to clearly identify that information which is not within an auditor’s expertise, and thus is not within their scope.

In addition, there needs to be clarity around how an auditor evaluates qualitative statements or assesses materiality of non-financial data. A typical example would include descriptors that firms frequently use to reference their standing in their industry-- things like “we are one of the largest” or “we are one of the fastest growing”. Clearly an auditor is not in an ideal position to verify, and thus cannot report on, these types of statements.

Finally, there is the cost of the reporting extension itself. Auditors will be doing more, even if it’s just adding language and documentation based on existing requirements. Auditors will want to pass these costs on to their clients. There will also be more work for their clients in dealing with the higher level of questions and documentation the auditors will need for their files. It is critically important to weigh whether the potential benefits from the final form of this Proposal truly exceed the costs before we make a change, as it would be rare to see new regulations rolled back as not cost effective after they have been launched.

I do not see any of these concerns as being fatal to some form of this Proposal moving forward, but I do believe the PCAOB needs to exercise proper due diligence in adopting the Proposal on Other Information, as I know it has with other initiatives in the past. This would include a thorough outreach to the multiplicity of constituencies involved, which this session is a great example of, **and** giving audit firms and their clients adequate time to work through any ultimate changes.

So to wrap up, let me thank you for your kind attention today, and I look forward to further discussion and debate in developing the final form of what auditors include in their reports on Other Information.