

# Thomas P. O'Connor, Certified Public Accountant

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Public Company Accounting Oversight Board  
Office of the Secretary  
1666 K Street, N.W.  
Washington, D.C. 20006-2803

Reference: PCAOB Rulemaking Docket Matter No. 34

Members of the Board and Staff,

I appreciate the opportunity to submit my comments with respect to the proposed concept release (proposal) regarding the auditor's reporting model. I had been active in public accounting from 1980 through 2008, last at Ernst & Young LLP (audit and assurance) and am currently an actively licensed CPA providing public and privately held businesses consulting (value-added) services in the areas of external financial reporting, technical accounting research, policies and procedures, internal accounting controls and liaise technical issues on behalf of clients with their external auditors. The opinions and views expressed herein are my own and are not associated with any company or other organization that I have been associated with. My comments are as follows.

*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?*

Yes, the Board should consider and strive for improvements. I appreciate the Board's initiative in this matter. However, in my opinion the current proposal addresses changes in reporting without actual qualitative changes and or improved procedures. Additionally the proposal does not appear to result in significant practical cost/effective improvements to investors and users.

Significant issues to date have not been due to the understandability of the information within the auditor's opinion. Issues have been that the opinion was in error due to lack of error detection and/or fraud resulting in material misstatements and/or omissions as well as lack of an appropriate assessment of management's accounting policies, significant estimates and overall financial presentation.

## Thomas P. O'Connor, Certified Public Accountant

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The current standard report articulates the auditor's opinion and describes an audit in a concise and accurate manner. That it is the planning and procedures performed, examining on a test-basis that the financial statements and disclosures are free of material error and/or omissions and includes an assessment of management's accounting policies, significant estimates and overall presentation.

The over-whelming communication in reading the opinion letter is to determine if the report has an unqualified opinion. Information overload within the opinion letter may result in less reliance in the opinion in that, the suggested "fine-print" may unintentionally implicitly disclaim audit scope and responsibility. I would further suggest that any needed expanded information either be included in the notes to the financial statements and/or as supplemental schedules as applicable. I would urge the Board to consider the *Federal Plain Writing Act of 2010* for any additional wording or schedules emphasizing the omission of unnecessary details as well as the elimination of redundant information.

Additions to improve the reporting model may unintentionally confuse and/or mislead the user that auditing procedures may have been expanded and/or improved. Until there is a change in the common understanding of what an audit is, or an actual change in the auditor role, there does not appear to be a need to consider significant changes to the current report model at this time.

In an ever-changing environment we should consider if the auditor's role is appropriate and what practical improvements could be implemented. However improving the reporting model in advance of actual qualitative changes in the auditor's role or procedures, in my opinion is putting the cart before the horse.

- 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?*

Other auditor reporting information (as a separate supplement to the opinion letter) that may be of use is for the auditor/and the PCAOB to provide a summary profile of the auditing firm's basic information in the report. Such information could include, how long the firm has been in business, location of corporate headquarters and number of offices and employees, including those within the U.S. The annual number of audit reports issued for publicly traded clients. Past disciplinary actions, peer review report findings and/or other reports including past litigation.

To note, the three-person auditing firm that certified the reports of Bernard Madoff Investment Securities, LLC, may have provided a red-flag to investors. Additionally, the current popularity of foreign offshore reverse mergers and other fraudulent reports may be more easily detectable.

# Thomas P. O'Connor, Certified Public Accountant

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- 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, the Board should not consider expanding the auditor's role to provide assurance (other than negative assurance which is currently implied) on matters in addition to the financial statements. Assurance in these other areas does not result in additional useful information or any further clarification. It only adds to the cost of the audit through additional audit effort and exposure. Auditor focus should remain on the fair and full presentation of the financial statements and the effectiveness of internal accounting controls. Those responsible for the other information and matters include, not limited to lawyers, underwriters, compliance officers and investor relations personnel. The auditor does not have near the interaction activity or a relationship with these groups as they do with financial personnel. The framework of the audit would require significant change with a practical learning curve provided. In my opinion, the cost would significantly exceed the benefit to have assurance on matters apart from the financial statements.

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 pass/fail model should be retained. Providing for additional allowable alternatives could potentially provide the users misleading and/or confusing information as to the overall opinion and result in decisions based on piecemeal selected financial information versus the overall financial presentation as intended. The opinion should remain as a black and white communication, not be in shades of gray.

- 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.*

See 1b.

## Thomas P. O'Connor, Certified Public Accountant

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*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.*

Management and audit committees are the most appropriate parties to provide any potential additional information about the company's financial statements. These parties have the most insight and are most familiar with the issues and reports and have the best capacity to articulate and communicate that additional information. Management originates the information and periodically communicates key assumptions and decisions with the audit committee. It is the audit committee's responsibility to oversee the integrity of the company's financial statements and financial reporting process. An auditor's understanding of these issues is indirect and often comes from management memorandums, inquiries and discussion with said parties. Additionally it is the responsibility of the preparers and audit committee members who should decide what information should and needs to be provided. If an auditor has significant issues or reservations with other information or omitted information, they have choices including not issuing an unqualified opinion. Auditors should not disclose additional information as it could result in a (real or perceived) breach of confidentiality that could result in a deterioration of communications with preparers and audit committee members. The roles should not overlap, management reports, auditors attest.

*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?*

See 1a.

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

No, see Item 3.

*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?*

N/A

# Thomas P. O'Connor, Certified Public Accountant

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- 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?*

N/A

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

I don't believe the AD&A would be practical and/or cost effective. It potentially allows for an overload (increased complexity) of information. If said information is consistent with the report, it is of no practical benefit. Inconsistencies with the report could cause confusion resulting in a misunderstanding by the users of the financial statements as well as the audit opinion. Additionally the AD&A may become an effort in legalese that would directly conflict with the objective of providing more useful information to investors and users.

- 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?*

Any potential comments should be limited to the audit. Such comments could include clarifying issues that are unusual in nature to common practice as well as technical matters whereby there was a disagreement either between the auditors and the company or between audit team members that was ultimately decided by a consultation by a party outside the engagement team/company management.

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)?*

N/A, see Item 5.

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")?*

N/A, see Item 5.

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

While I don't agree with the inclusion of an AD&A, a standard format should not be required. Companies and audits are unique. If it is truly the intent to provide specific information as to the audit and information therein, it would be difficult to achieve through a standard format.

## Thomas P. O'Connor, Certified Public Accountant

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*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?*

An AD&A addressing risks (other than audit) would not be practical and/or cost effective. These risk assessments are judgmental in nature. They are usually feted out by the assistance of both internal and external counsel. These risks are addressed in the MD&A. If said information is consistent with the MD&A, it is of no practical benefit. Inconsistencies with the MD&A could cause confusion resulting in a misunderstanding by the users of the financial statements as well as the audit opinion. If these risks were to be addressed by a third-party, external general counsel, insurance risk professionals or applicable regulators would be more appropriate parties.

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

If the reports are consistent in format, they will appear to be boilerplate regardless.

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

An AD&A may provide potential benefit to clarify audit risks and assessments of those risks. Shortcomings include increased resources, time and cost. Potential duplication of information with the MD&A. Explicit and implicit conflicts with MD&A which may not result in an improved report to end-users. Increased legalese in the report similar to portions of the MD&A.

*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?*

It should not be the role of the auditor to provide competing and/or inconsistent information. Including said information results in less confidence in the report and the opinion letter. Management needs to be held solely responsible for the information within the report. Auditors should be responsible for the opinion. Advance oversight of management exists by the audit committee and the auditor attests. There would be no advance oversight or attestation over the auditor in terms of an AD&A. If as a result of inclusion of an AD&A, adverse litigation was to become an issue. The AD&A may unintentionally evolve into a disclaimer of the audit and opinion.

*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?*

Any matters not disclosed that would be relevant and useful in making investment decisions needs to be addressed by the FASB, IASB and SEC. These organizations are

# Thomas P. O'Connor, Certified Public Accountant

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responsible to establish the standards. It should not be left to auditor's judgment to opine on undisclosed matters for which no standard exists.

As to the illustrated examples, including related party transactions and subsequent events, these are already in scope of the standards. For example, SEC staff observed that:

Rules 10b-5 and 12b-20 under the Securities Exchange Act of 1934 and General Instruction C(3) to Form 10-K specify that financial statements must not be misleading as of the date they are filed with the Commission. For example, assume that a registrant widely distributes its financial statements but, before filing them with the Commission, the registrant or its auditor becomes aware of an event or transaction that existed at the date of the financial statements that causes those financial statements to be materially misleading. If a registrant does not amend those financial statements so that they are free of material misstatement or omissions when they are filed with the Commission, the registrant will be knowingly filing a false and misleading document. In addition, registrants are reminded of their responsibility to, at a minimum, disclose subsequent events<sup>1</sup>, while independent auditors are reminded of their responsibility to assess subsequent events<sup>2</sup> and evaluate the impact of the events or transactions on their audit report.<sup>3</sup>

Emphasis paragraphs appear to be a “work-around” or “back-door” approach. I believe we would be better served by the standard setters addressing any reporting gaps as to proper and presentation and disclosure in lieu of expanded emphasis paragraphs.

*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 emphasis conflicts with “fairly stated as a whole”. The intention of U.S. GAAP/IFRS as well as SX-reporting is to provide/disclose all applicable information to assess the overall financial results. These judgment decisions

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<sup>1</sup> AU Section 560, Subsequent Events, paragraphs 5 and 8 and Section 855-10-50.

<sup>2</sup> AU 560 and AU Section 561, Subsequent Discovery of Facts Existing at Date of the Auditor's Report.

<sup>3</sup> AU Section 530, Dating of the Independent Auditor's Report, and AU 560, paragraph 9.

# Thomas P. O'Connor, Certified Public Accountant

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would be unclear to the user as to just how much weight should be applied. Additionally areas not emphasized may be incorrectly undervalued by users.

Auditors should not be required to disclose key audit procedures to the public and/or clients. It provides no increased understanding of the report and could lead to circumvention of the effectiveness of future audits.

*15. What specific information should be 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?*

In my opinion, none should be required.

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

In my opinion, none should be presented.

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

If the reports are consistent in format, they will appear to be boilerplate regardless.

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

No benefit with an increased audit effort and complexity.

*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 increased audit effort does not appear to result in improved information or understanding of the report. There are no existing standards or an authoritative standard-setter for this other information. It increases auditor exposure and would require additional auditing standards to be implemented as well as additional disclosures and reporting rules from the SEC.

*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.*

# Thomas P. O'Connor, Certified Public Accountant

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None

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

Negative assurance, that nothing came to their attention that would materially conflict with said information.

*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?*

A piecemeal approach may cause more confusion. It should be for all of the MD&A or none.

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

No opinion.

*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, in my opinion the auditor should not be required to attest or provide assurance as to other information outside the financial statements.

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

See Item 19.

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

See Item 19.

*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?*

All, with the exception of Auditor's responsibility for information outside the financial statements may be of some benefit.

*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.*

Clarification of definitions and responsibilities could result in a greater understanding to the end-users. The shortcoming may be increased complexity.

*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?*

See Item 1b.

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

May imply expanded procedures were performed when they were not. May incorrectly segment user's understanding of responsible parties.

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

See Item 21b

*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?*

See response to Item 1b

*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?*

See responses to Item 1b and Item 21.

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

## Thomas P. O'Connor, Certified Public Accountant

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Expanding the information for registered firms on the PCAOB's web site that would include the additional information suggested in Item 1b. Require firms to update and confirm the information as accurate annually. Provide a link to the information in the report.

*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 disagree with the alternatives that would require an additional auditor framework. Any additional framework should directly relate to qualitative procedural improvements.

*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?*

Yes, retain the “pass/fail” model and exclude emphasis paragraphs.

*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?*

See responses to Item 21.

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

I would expect no significant change in audit quality as the proposal is reporting driven and does not include qualitative process improvements.

*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.*

Any changes should be consistently applied to all public registrants.

*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.*

# Thomas P. O'Connor, Certified Public Accountant

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*a. Are any of these considerations more important than others? If so, which ones and why?*

In my opinion the AD&A and assurance on other information outside the financial statements are most important. These areas have a significant impact for auditors, preparers as well as users and investors. However for the reasons stated throughout, these areas should not be implemented. In my opinion the clarification of language in the standard auditor's report is least important.

*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?*

No, cost/benefit has been addressed throughout my comments.

*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?*

While comment is open to the public, I expect comments will be coming from mostly auditors and issuers. The objective is to expand and clarify information that might be useful to investors and other financial statement users and narrow the expectation gap. Therefore it is imperative that the PCAOB seek those comments and create a two-sided dialogue.

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

I would recommend that a PCAOB committee (with applicable external representation) review the comments and hold meetings available to the public to address said issues.

*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?*

Auditors should not disclose additional information as it could result in a (real or perceived) breach of confidentiality that could result in a deterioration of communications with preparers and audit committee members.

## ***Overall***

Overall the proposal does not appear to result in achieving the objective of providing more useful and a better understanding of the information contained in the financial report and auditor's opinion.

- Does not appear to result in a cost/benefit;
- Unnecessarily expands the auditor role and exposure;
- Inappropriately expands the auditors role to areas better served by other professionals;
- Increases the complexity of the financial report and opinion letter;
- Results in duplicity and/or competing and conflicting information;
- Potentially compromises confidential information;
- Provides for (unclear) alternatives to current “pass/fail” model;
- May create confusion among end-users;
- Decisions may be made on piecemeal information and not the overall report;
- Disclosure of audit program, significant procedures and materiality thresholds could compromise audit integrity;
- Difficult or Contentious Issues, Including "Close Calls" could result in discounting the value and decreased confidence of the opinion as well as the audit profession.

The proposal does not specifically appear to be directly user/investor driven. The Commission on Auditors' Responsibilities (Cohen Commission) that was mandated by the American Institute of Certified Public Accountants (AICPA), to "develop conclusions and recommendations regarding the appropriate responsibilities of independent auditors." The Cohen Commission was directed to "consider whether a gap may exist between what the public expects or needs and what auditors can and should reasonably expect to accomplish."

We need to sharpen our focus what those expectations and needs are and in my opinion would include:

1. The auditor is independent and qualified to perform the audit and provide the opinion;
2. There is adequate oversight of the auditor;
3. Reduced complexity and the use of *Plain English* to better understand the report and opinion;
4. Elimination of voluminous information that clouds the position and results;

## Thomas P. O'Connor, Certified Public Accountant

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5. That if errors and omissions exist that would impact the end-users opinion and conclusion of the financial position and operating results that the audit would detect, report and address.

I don't believe an auditor AD&A, assurance on other information and competing information meet these objectives or narrows the expectation gap. In my opinion, this should be a qualitative process project, not a reporting model project that results in increased costs with the potential of no significant improvement on reliance or confidence on either the financial report or the auditor's opinion.

We would be better served addressing the substance of an audit versus the form of an audit and assuming that providing additional by-product information from the audit will be useful.

I appreciate the progress and improvements made by the PCAOB to date as well as the opportunity to submit my comments to the Board with respect to the proposed concept release.

Respectfully Submitted,

/s/Thomas P. O'Connor