

September 26, 2011

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

Re: PCAOB Rulemaking Docket Matter No. 034, *Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements*

Dear Office of the Secretary:

We appreciate the opportunity to respond to the Public Company Accounting Oversight Board's ("PCAOB" or "Board") *Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements* ("Concept Release").

We commend the PCAOB and its staff ("Staff") for its outreach to explore whether changes to the auditor's reporting model would increase transparency and relevance to financial statement users, and we fully support the Staff's goal of enhancing communication with financial statement users. It is evident based on the responses from investors to the Staff's outreach that there is a desire for increased communication from the auditor to the financial statement user. We recognize the need for change to improve the relevance of the current auditor's reporting model, and we support changes that are guided by the following overarching principles set forth by the Center for Audit Quality ("CAQ") in their recent letter to the PCAOB:

1. Auditors should not be the original source of disclosure about the entity; management's responsibility should be preserved in this regard.
2. Any changes to the auditor's reporting model need to enhance, or at least maintain, audit quality.
3. Any changes to the auditor's reporting model should narrow, or at least not expand, the expectation gap.
4. Any changes to the auditor's reporting model should add value and not create investor confusion. Specifically, any revisions should not require investors to sort through "dueling information" provided by management, the audit committee, and the independent auditors.

5. Auditor reporting should focus on the objective rather than the subjective. Financial reporting matters assessed by the auditor can be highly subjective; however, it is important that auditor communications provide objective information about these highly subjective matters.

We are submitting for the Board's consideration our views on the four alternatives described in the Concept Release.

#### **Auditor's Discussion and Analysis (AD&A)**

The Concept Release contemplates an AD&A as a supplemental narrative to the standard auditor's report to provide investors and other financial statement users with a view of the audit and the financial statements "through the auditor's eyes." We do not support the inclusion of an AD&A with the auditor's report, as we believe it would be counter to the goal of enhancing communication with financial statement users.

The analysis contemplated in an AD&A regarding the auditor's views about significant matters includes discussion of audit risks identified, audit procedures and results, and views on management's judgments and estimates, accounting policies and practices, and difficult or contentious issues. This analysis without the proper context and absent the robust dialogue necessary to understand the information would likely result in misunderstanding and misinterpretation of the auditor's communication. Specifically, we are concerned that inclusion of an AD&A as a supplement to the auditor's report could result in the following:

1. As contemplated in the Concept Release, information in an AD&A is very similar to that discussed with the audit committee. The auditor communication with the audit committee is designed to include a robust dialogue on key matters and allows the auditor to provide sufficient context for the information being communicated. We believe that presenting information about auditor risk assessments, choice of audit procedures and views on estimates and management judgments without the accompanying dialogue with investors would create confusion among investors and other financial statement users.
2. Auditor disclosure about significant audit risks identified and audit responses to those risks to investors who lack the proper education and training about those matters would create investor confusion as opposed to increased transparency. We are concerned that it would not be possible to provide enough information to adequately educate financial statement users about the risk evaluations and procedures that encompass the audit process. Such confusion may result in the improper use of the information provided in an AD&A for decision making by investors.

3. In an AD&A, an auditor would provide subjective views about risks and estimates embodied in the company's financial statements. We believe the source of information about the company should be provided by management, not the auditor. Management has far more insight and greater knowledge of the company, making them better equipped to provide the most meaningful information to investors. Discussion about the company by the auditor could result in conflicting information with that presented by management and, ultimately, lead to investor confusion.
4. Developing a disclosure framework for AD&A that can be consistently followed would be very difficult given the subjectivity involved in the analysis. Without such a framework, information disclosed in an AD&A would lack comparability between companies and potentially result in misinterpretation by users and create confusion. Variations would exist in how auditors determine what matters reach the level of significance to be included in an AD&A and the extent to which such matters are discussed. AD&A wording would be carefully crafted by auditors to limit exposure to litigation. The result would likely be a diluted message that is not easily understood by financial statement users and, thus, not achieving its intended purpose. We believe it would be inappropriate and potentially harmful for investors to use AD&A as a tool for analyzing risks and for investment decisions to be influenced by the writing skills of auditors and by the volume of information and level of detail auditors choose to disclose.
5. Drafting an AD&A would be time consuming due to necessary quality control reviews and could result in difficulty meeting filing deadlines and would certainly result in increased costs for issuers.

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

The Concept Release outlines an alternative to require expanded emphasis paragraphs in all audit reports to highlight the most significant matters in the financial statements along with key audit procedures performed pertaining to the identified matters. While we do not support the inclusion of a required emphasis paragraph as outlined in the Concept Release, we do believe a slightly modified alternative would be beneficial to financial statement users.

We support including an emphasis paragraph in the auditor's report to call attention to significant accounting estimates used in the preparation of the financial statements that are subject to material change in the near term and require difficult subjective judgments by management and auditors. Highlighting significant estimates used in the preparation of the financial statements would allow investors to easily identify the related financial statement disclosures made by management as well as the discussion of critical accounting estimates included in Management's Discussion and Analysis (MD&A). We believe emphasizing significant estimates in the

auditor's report would likely result in improved disclosures about accounting estimates thereby increasing transparency. In order to be effective in enhancing communication with investors, we believe it is critical that the scope of emphasis paragraphs be sufficiently narrow to limit inconsistencies based on the subjectivity of auditors. We believe the most effective means of ensuring consistent application in practice is to establish parameters for emphasis paragraphs that mirror the disclosure requirements for significant estimates in the current disclosure framework under U.S. GAAP.

At your request, we would be happy to provide an example auditor's report illustrating our proposed changes.

### **Clarification of Language in Standard Auditor's Report**

We support including the following clarifying language to the auditor's report as suggested in the Concept Release along with other clarifications that we believe would enhance the auditor's report and help users to better understand the nature of an audit and auditor and management responsibilities.

1. *Reasonable Assurance* - Add clarifying language to explain that reasonable assurance is a high level of assurance, but not absolute assurance.
2. *Auditor's Responsibility for Fraud* - Highlight that the auditor is responsible to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud.
3. *Auditor's Responsibility for Financial Statement Disclosures* - Add clarifying language regarding the auditor's responsibility for financial statement disclosures.
4. *Management's Responsibility for the Preparation of the Financial Statements* - State that management prepares the financial statements and has responsibility for the fair presentation of the financial statements.
5. *Auditor's Responsibility for Information Outside the Financial Statements* - Describe the auditor's responsibility with respect to such information.
6. *Auditor Independence* - Include statement regarding the auditor's responsibility to be independent and compliance with the independence requirements.
7. *Audit Committee Responsibilities* - Describe the responsibilities of the audit committee.

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In addition, we believe further enhancing investor understanding of what an audit represents and the auditor's responsibilities would best be accomplished by including reference in the auditor's report to a supplemental document that describes the audit process similar to the CAQ's *In-Depth Guide to Public Company Auditing*.

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

We support expanding the auditor's role to provide assurance on matters in addition to the financial statements that provide value to investors if the matter is within the skill set of auditors and could be applied within a framework that balances benefits and costs. One area that may provide a cost/benefit balance is an examination of issuer disclosures about significant accounting estimates within MD&A.

We believe reporting on issuer disclosures about critical accounting estimates could improve the quality of the information disclosed, thereby enhancing communication with investors. We believe enhanced communication also could be achieved by increased enforcement of the current disclosure requirements prescribed by SEC regulations related to critical accounting estimates and critical accounting policies without further imposing additional costs to issuers by requiring auditor assurance on this information.

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We appreciate the opportunity to express our views for the Board's consideration. If you have any questions or would like to discuss these matters further, please contact Steve Rafferty or Doug Bennett at 417.831.7283, or by email at [srafferty@bkd.com](mailto:srafferty@bkd.com) or [dbennett@bkd.com](mailto:dbennett@bkd.com), respectively.

Sincerely,

*BKD, LLP*

**BKD, LLP**