



**Marsha A. Schulte**  
Vice President, Finance and  
Controller

**Rockwell  
Collins**

400 Collins Road NE  
Cedar Rapids, IA 52498

September 30, 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. 34, Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements**

Members of the Board:

Thank you for the opportunity to provide comments to the Board with respect to your recent Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements (the concept release). As the Controller of a public company who works with our auditors on a regular basis, I read the concept release with great interest.

Rockwell Collins (the Company) is a pioneer in the development and deployment of innovative communication and aviation electronic solutions for both commercial and government applications. Our expertise in flight deck avionics, cabin electronics, mission communications, information management, and simulation and training is delivered by 20,000 employees and a global service and support network that crosses 27 countries.

Our Company recognizes the important role that audits play in providing assurance to users of financial statements and we have a long-standing and productive relationship with our external audit firm, Deloitte. Further, the Company is committed to providing relevant, accurate and timely disclosures to investors in the most cost effective and transparent manner possible.

The Company has concerns regarding the ideas presented in the concept release, which are discussed below.

**The proposed Auditor's Discussion and Analysis (AD&A) will confuse the auditor client relationship, increase costs and delay the financial reporting process**

Role Confusion

A primary strength of today's "pass or fail" audit reporting model is that it avoids role confusion; management is responsible for the preparation of financial statements and

auditors are responsible for attesting to their conformity with Generally Accepted Accounting Principles (GAAP). The AD&A as contemplated in the concept release may unduly place shared accountability for some elements of the financial statements on the auditor.

The relationship between management and auditor is often characterized by healthy and robust debate. Financial reporting, by its very nature, often requires management to evaluate a wide variety of complex (and sometimes contradictory) accounting rules in order to determine the most appropriate accounting model for a given transaction. At times, a variety of accounting models may be plausible for a given set of facts and circumstances. In situations such as this, the "best" accounting model often becomes evident after an exhaustive and iterative research process that at times, appropriately includes collaboration with the audit team. Working closely with the auditors on a "real time" basis, it is entirely appropriate for management to research and evaluate the various accounting models prior to selecting the accounting treatment that is most appropriate and reflective of the substance of the transaction. In order for this type of analysis to be effective, management teams and audit teams must be able to discuss issues in a frank and open manner. This ongoing dialogue on important issues ensures that management and the auditors build an effective understanding of the complex and often confusing accounting and reporting requirements. In addition, this dialogue between management and the auditor ultimately results in higher quality financial statements that fairly present the financial condition of the issuer.

The proposed AD&A will inevitably complicate the relationship between management and the auditor, turning an often collaborative and healthy relationship where open dialogue is the norm into a potentially combative relationship more frequently. The AD&A is also likely to create a culture of confusion and indecisiveness as management may feel the need to "run every decision past the auditor." The auditor, in turn, may feel the need to "run every decision" past the engagement quality review partner or various other individuals within the audit firm. In this environment, the auditors run the risk of becoming a stand-in for management as management may be pressured to minimize even the slightest difference in opinion with the auditor; to that end, management may be motivated to defer to the judgment of the auditor in a variety of routine areas. The auditor, fearing potential litigation or the constant threat of being "second guessed" by regulators, may be unreasonably biased towards overly conservative estimates.

There are several important problems with this outcome. First, it assumes that the judgment of the auditor is better than that of management. Lost in the discussion of management's purportedly biased estimates is the fact that auditors may be biased toward the most conservative of possible estimates in order to manage their potential liability and

mitigate the possibility of being “second guessed” by regulators. Financial statements that are overly conservative run the risk of not being representative of results and being a disservice to shareowners. In addition to the bias problem, the industry knowledge and experience of management far outweighs that of the auditor in most circumstances. Further, it is important to recognize that any information possessed by the auditor is by definition a mere subset of the “complete picture” of information possessed by management. Finally, in situations where management is motivated to simply defer to the judgment or estimate of the auditor, it creates the awkward situation of the auditor becoming the source of financial statement information. Put simply, the Board’s concept of an AD&A undermines the fact that financial statements are management’s responsibility.

#### Delays in Financial Statement Issuance and Increased Audit Fees

The concept release and feedback from investor representatives at the September 15, 2011 PCAOB Roundtable on Auditor’s Reporting Model (the roundtable) imply that the AD&A, if issued as proposed, should be a highly customized report reflecting the specific risks facing the issuer and judgments of the auditor in light of those risks. If implemented, reporting of this nature will dramatically increase the cost of the audit and decrease the timeliness of the financial statements.

The consistency of today’s audit report across public accounting firms is not an accident; consistency in format is an outcome of the regulatory and legal environment in which financial statements are prepared and issued to the public. A custom report specific to each issuer runs in stark contrast to this environment.

Ignoring the legal and regulatory issues, a report of this nature suitable for public issuance is certain to take hundreds of hours to prepare, depending on the size and complexity of the issuer. This time will inevitably result in significant delays to the issuance of the financial statements when compared to current timelines. Further delays in the issuance of audited financial statements runs in direct conflict with the goal of timely financial information as described in Statement of Financial Accounting Concepts No. 8, *Conceptual Framework for Financial Reporting*. Further, the audit partner’s attention to this reporting task will inevitably detract from the traditional audit tasks performed by the partner, potentially resulting in decreased audit quality.

The draft AD&A prepared by the engagement partner will inevitably be reviewed and edited by the engagement quality review partner, national office and the firm’s legal department resulting in additional delays. Further, the resources in question are the most expensive resources of the firm which will lead to a dramatic increase in engagement cost. Finally, management teams at the issuer will want to review the AD&A and this too will result in

additional review cycles that slow down financial reporting and drain critical management resources. Drafts of Management's Discussion and Analysis (MD&A) will likely impact the AD&A and vice versa, causing additional delays and use of resources.

The audit firms will obviously seek to recoup the increased costs in the form of higher audit fees. A highly customized AD&A may also expose the firm to substantially increased liability to investors. The fee increases likely to be sought by the audit firms will compensate them not only for increased engagement costs, but for increased liability as well.

In summary, we believe that the increased audit fees and drain on management resources will not dramatically improve the information that is currently available to investors. The current state reporting model already requires issuers to evaluate and disclose their "Critical Accounting Policies" within the MD&A section of the financial statements, with similar disclosures typically found within the financial statement footnotes. Many of the issues raised by the PCAOB in its concept release could theoretically be addressed in a far simpler manner by revising some of the currently required disclosure areas as needed. If the Board feels that the current GAAP reporting model fails to accomplish key goals, then GAAP should be amended. If the Board feels additional information needs to be reported that is not currently contemplated in the financial statements by GAAP or SEC Regulations S-K / S-X, then we suggest the Board should develop proposals on how to improve those standards. In any case, financial statements are the responsibility of management, not auditors. Proposals to use the auditor's report or a forum like "AD&A" to fix any perceived shortcomings in the current state reporting model are misguided.

## **Required and Expanded Use of Emphasis Paragraphs in Auditor Reports**

### Lack of Consistency and Comparability

Another strength of today's pass or fail audit reporting model is that it is consistent and easily comparable by investors; the introduction of mandatory emphasis paragraphs will drastically reduce comparability of audit reports across issuers. The concerns expressed here apply to the AD&A section as well.

Investors are likely to interpret the presence of each emphasis paragraph as a cause for concern. This concern could result in lower share prices if investors are unable to quickly reconcile their concern by fully understanding the issue. Given the complexity of some issues likely to be discussed in emphasis paragraphs, some investors may be unwilling or unable to spend the time necessary to fully reconcile the issue.

Given this outcome, the judgment of audit firm partners responsible for drafting the required emphasis paragraphs could have the unintended consequence of causing a direct impact on the share price of issuers. Given the same facts, circumstances and risk profile,

some partners will exercise their judgment to include fewer emphasis paragraphs in the audit report, whereas other partners will likely include more emphasis paragraphs. This variability among auditors will be confusing to investors and will create unpredictable and inconsistent outcomes in situations with similar facts, circumstances and risks.

Audit firms are very likely to recognize this concern and will work to bring consistency across the emphasis paragraphs utilized across issuers. This effort may mitigate the concern discussed here to some degree, but will likely result in boilerplate reports. The Board will endeavor to draft specific rules governing when emphasis paragraphs must be presented; the need for detailed PCAOB guidance in this area was discussed at great length during the roundtable. Even if the PCAOB is able to provide exhaustive guidance to auditors regarding where emphasis paragraphs are required, subjectivity and significant judgment on the part of audit partners will inevitably be required in selecting the issues for inclusion in the audit report. Ultimately, there will be second guessing related to “what needs to be emphasized” which most certainly will result in confusion and inconsistency, and inappropriately imply that investors need not review the financial statements and accompanying footnotes in their entirety.

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

#### Forward Looking Data

In today’s audit reporting model, auditors are primarily responsible for testing and providing assurance on historical financial statements. While forward looking estimates are inescapably part of developing certain account balances, such as pension liabilities and impairment reviews, these situations are relatively rare and are generally limited to financial forecasts.

Audit assurance on MD&A and earnings releases as contemplated in the concept release would drastically increase the number and breadth of forward looking estimates under review by auditors. The nature of forward looking information contained in MD&A and earnings releases is based on a wide range of both financial and non-financial forecasts. This information is typically industry specific and outside the scope of the auditor’s current work. The auditor’s specialized training and experience, while critical to their role, is not as well suited to providing assurance on industry specific, non-financial forecasts. Given this training and experience gap, the cost of an audit opinion on forward looking data seems to outweigh the relatively little incremental value to investors.

#### Contemplated Enhancements are Already Substantially Performed

To the extent that historical information is included in MD&A, auditors are already required to review that data to ensure that it is not inconsistent with the historical data presented in

the financial statements and notes. In our Company's experience, this process extends to earnings releases as well. So, with the exception of the forward looking data discussed above, auditors are, to some extent, completing much of the work contemplated by the exposure draft.

A substantial overlap already exists between the information required for presentation in the notes to the financial statements and in MD&A. To the extent that unique MD&A disclosures exist on which investors would like audit assurance, the SEC should explore whether to direct the FASB to incorporate those disclosure requirements into GAAP thereby ensuring the desired audit coverage.

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

The clarifications of the standard auditor's report identified in the concept release are relatively modest in nature, will not result in enhancements to current audit procedures and will not drastically improve the understanding of most financial statement users. The vast majority of investors willing to review issuer financial statements have a relatively strong understanding of the language identified for enhancement in the concept release.

As suggested by other responders, the additional information to be conveyed by the contemplated enhancements is freely available today from other authoritative public sources. We suggest that it would be far more cost effective for the PCAOB to develop a resource page for investors conveying the additional information contemplated in the concept release. The audit report of every issuer could be enhanced with a common sentence directing the reader to the resource page on the PCAOB web site.

This resource page could include links to more detailed information for interested readers and could quickly and cost effectively be enhanced to meet the new information requirements without the time and expense associated with the rulemaking process.

### **An Alternative**

We support the alternative approach suggested by others in comment letters and during the roundtable, which is to enhance management disclosures to address the reasonable requests for additional information from the investor community. We also support calls to simplify disclosure requirements where possible to avoid overly complex information that is not meaningful to financial statement users.

The FASB and SEC are empowered to respond aggressively to investor calls for improved information through additional rulemaking. Further, the SEC comment letter process can specifically address situations where issuers are not adhering to current disclosure requirements. The inspection program of the PCAOB also plays an important role in

Office of the Secretary, PCAOB

September 30, 2011

RE: PCAOB Rulemaking Docket Matter No. 34

Page 7 of 7

ensuring compliance with regulatory requirements by issuers and auditors alike. To the extent that concerns exist regarding ineffective disclosure, the SEC and PCAOB should respond through established review mechanisms to improve the information available to investors. This pointed approach will be far more cost effective than what is proposed in the concept release.

Again, thank you for the opportunity to provide comments on these matters.

Sincerely,

/s/ Marsha A. Schulte

Marsha A. Schulte

Vice President, Finance and Controller

Rockwell Collins, Inc.