

via e-mail to: comments@pcaobus.org

December 20, 2011

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

Re: PCAOB Concept Release (No. 2011-003) on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements (PCAOB Rulemaking Docket Matter No. 034)

Ladies and Gentlemen:

The Society of Corporate Secretaries and Governance Professionals (the “Society”) appreciates the opportunity to provide comments on the Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements, PCAOB Release No. 2011-003, issued on June 21, 2011 (the “Concept Release”) by the Public Company Accounting Oversight Board (the “PCAOB”).

Founded in 1946, the Society is a professional membership association of more than 3,100 attorneys, accountants, and other governance professionals who serve approximately 2,000 companies of most every size and industry. Society members are responsible for supporting the work of corporate boards of directors and their committees and the executive managements of their companies regarding corporate governance and disclosure. Our members generally are responsible for their companies’ compliance with the securities laws and regulations, corporate law, and stock exchange listing requirements.

The Society appreciates the PCAOB’s efforts to improve the relevancy and quality of public company audit reports to investors. However, the Society believes that even though the proposals in the Concept Release will fundamentally change the auditor’s role, they will not meet the PCAOB’s stated goals. Furthermore, the Society believes that the Concept Release does not set forth evidence supporting an appropriate cost/benefit rationale for the proposed changes. Our detailed comments follow.

The PCAOB Concept Release Would Fundamentally Change the Role of the Auditor

While the Concept Release states that the alternatives for changing the auditor’s reporting model are “focused...on...improving the content of the auditor’s report rather than on changing the fundamental role of the auditor,” we believe the proposals in the Concept Release, if adopted,

would, in fact, fundamentally change the role of the auditor from an independent analyst to an original source of information for investors. The net effect of many of the suggestions in the Concept Release, including the development of new auditing standards, would make the auditor a guarantor of the accuracy and completeness of the financial statements and, indeed, of the company's historical results of operations and financial condition.

The Concept Release also states that "the alternatives presented would retain the pass/fail opinion of the standard auditor's report." However, the Society believes that the pass/fail approach would be vitiated by the alternatives set out in the release. Instead, depending upon the nature and extent of the auditor's comments in the AD&A (as defined below), and in any required "assurance" on disclosures outside the financial statements, the audit would yield the equivalent of "high pass," "medium pass," "low pass," and similar "grades" – which would add complexity and uncertainty for investors that does not exist with the current pass/fail system.

The Concept Release Provides Neither Empirical Evidence nor a Cost/Benefit Analysis for the Proposed Changes

Further, the Concept Release does not provide any empirical evidence supporting the need for the proposed changes or a cost/benefit analysis of the alternatives proposed. For example, the Concept Release states that the information proposed to be provided "might be useful to investors and other financial statement users and could lead to more efficient markets and improved allocations of capital" and that "[t]he objective of this concept release is to discuss several alternatives for changing the auditor's reporting model that could increase its transparency and relevance..." (emphasis added) (see paragraphs 1 and 3 under "Purpose" on page 2). Because the PCAOB does not have the authority to unilaterally change the standard audit report without rulemaking from the Securities and Exchange Commission (the "SEC"), and in the absence of such empirical evidence, we believe any rules adopted under the Concept Release would be invalid under the recent United States Court of Appeals decision in *Business Roundtable v. Securities and Exchange Commission*. Moreover, if a proper cost/benefit analysis were undertaken, we believe the costs would far outweigh any possible benefits derived from the proposals.

Consequently, and for the reasons discussed below, the Society's does not support the proposed specific alternatives in the Concept Release.

The Proposed Auditor's Discussion and Analysis Would be Confusing and Costly

The Concept Release proposes an Auditor's Discussion and Analysis ("AD&A") section in the audit report that would give the auditor:

"[t]he ability to discuss in a narrative format his or her views regarding significant matters. The AD&A could include information about the audit, such as audit risk identified in the audit, audit procedures and results, and auditor independence. It also could include a discussion of the auditor's views regarding the company's financial statements, such as management's judgments and estimates, accounting

policies and practices, and difficult or contentious issues, including "close calls." Additionally, an AD&A could provide the auditor with discretion to comment on those material matters that might be in technical compliance with the applicable financial reporting framework, but in the auditor's view, the disclosure of such matters could be enhanced to provide the investor with an improved understanding of the matters and their impact on the financial statements. An AD&A could also highlight those areas where the auditor believes management, in its preparation and presentation of the financial statements, could have applied different accounting or disclosures. (Release, p. 13.)”

The Society strongly disagrees with requiring an AD&A because it would (i) be counterproductive to the goal of providing greater transparency to investors; (ii) greatly increase the cost of the audit to issuers with no corresponding benefit to investors; and (iii) substitute the auditor’s judgment for management’s judgment, which could ultimately undermine the auditor’s independence and management’s responsibility for the financial statements and related disclosures.

Providing more detailed disclosure by the auditor of the matters considered and underlying considerations with regard to an issuer’s financial statements would not meet the PCAOB’s stated objectives of “increasing transparency and relevance to financial statement users, while not compromising audit quality”. Providing additional disclosure to already lengthy and granular disclosures would likely increase confusion and would substantially increase the length of disclosure documents without a corresponding benefit. In addition to reading the audited financial statements and notes and the Management Discussion & Analysis, which provides investors a detailed, comprehensive view of the business through management’s eyes, investors would be expected to read and distill additional, and possibly competing, disclosure from the auditor, without the additional context provided to management and audit committees via regular dialogue between the two. Given the substantial increase in the size of disclosure documents over the past several years (Compensation Discussion & Analysis, Dodd-Frank Wall Street Reform and Consumer Protection Act disclosures, etc.), the Society believes additional disclosure would further exacerbate the overload of information to investors. At some point, the additional information will lead to either investors “tuning out” disclosures or material information becoming buried in overly lengthy disclosures. In addition, the nature and process of review and approval of the AD&A would greatly increase the difficulty of meeting tight time frames for filings under the securities laws, particularly filings of large, accelerated filers whose financial statements are generally complex.

As our collective experience with the attestation requirement of the Sarbanes-Oxley Act of 2002 demonstrates, a substantial increase in the auditor’s workload is costly to issuers. While the attestation requirement over internal controls may provide investors with greater comfort on the validity and reliability of an issuer’s financial statements, an AD&A would greatly increase the cost of the audit to issuers with no corresponding benefit. Discussion of audit risk, audit procedures and results, and auditor independence are likely, over time, to become boilerplate discussions that will be difficult for investors to fully appreciate without having a financial

accounting and auditing background. Even if the AD&A does not become boilerplate, the lack of consistency and comparability among different issuers' AD&As would cause confusion and uncertainty. To add a discussion on difficult and contentious issues, particularly including "close calls" on the application of complex accounting standards, sets up the unproductive situation where there are two potentially competing views on accounting matters. Competing views can only lead to equally unsatisfactory conclusions by the investor – that either the auditor is wrong or the issuer, including possibly its audit committee, is wrong– which will ultimately lead to a loss of confidence in the reliability of the financial statements. The lack of any benefit combined with the expected cost of an auditor providing an AD&A would be particularly acute for small- and mid-cap public companies.

In addition, we strongly disagree that the PCAOB should require an AD&A, as it would substitute the auditor's judgment for management's judgment. Management is responsible for the preparation of the financial statements and related disclosures and is in the best position to understand its business and discuss its financial results. If an auditor were required to provide its own analysis of critical audit risks and "close calls", then the auditor would, in effect, be taking ownership of and become responsible for the financial statements and related disclosures. Having a stake, in this case its professional reputation, in the accounting treatment of an issuer would seem to ultimately undermine the independence of the auditor.

Finally, we believe that auditors will likely be concerned – possibly, justifiably – that the inclusion of an AD&A will increase their exposure to liability. This may cause auditors to draft AD&As in the most legally defensive boilerplate possible, which would result at best in ineffective communication and meaningless disclosure.

Required and Expansive Use of Emphasis Paragraphs Would Not Result in Meaningful Information

The Society disagrees with the proposal to require and expand use of emphasis paragraphs. The Society believes that requiring emphasis paragraphs would (i) provide no additional benefit to investors as the emphasis paragraphs will, over time, become boilerplate discussions and (ii) appear to "qualify" an otherwise clean audit opinion.

The Society expects the proposed AD&A to become boilerplate over time, resulting in emphasis paragraphs that become standardized. Issuers, depending on their industry, would receive the standard "revenue recognition", "goodwill", etc. emphasis paragraphs from its auditor that would merely make the audit opinion longer rather than provide any benefit to investors. Further, because of the need for the auditor to protect against future litigation, the auditor could be inclined to "emphasize" as many possible areas of accounting risk it can. Finally, due to the lack of consistency and comparability among issuers, readers of these emphasis paragraphs will have no context in which to view these paragraphs, which will render the emphasis paragraphs meaningless.

One of the strengths of having a "pass/fail" reporting model, a model that the PCAOB states that it is interested in maintaining, is its simplicity and understandability. Either an issuer receives a

“clean” opinion or it does not. Investors can rely on financial statements with “clean” opinions and should not rely on financial statements without them. By adding emphasis paragraphs, the simple, understandable approach is eviscerated. Auditor opinions will appear to be riddled with exceptions, and it would be unclear at what point multiple emphasis paragraphs would devolve, or be perceived as devolving, into an adverse or disclaimer of opinion.

Auditor Assurance on Other Information Outside of the Financial Statements Would Not Be Beneficial

The Society also does not support the proposed assurance on items outside of the financial statements because we believe that a model by which auditors would provide assurance on items such as MD&A, earnings releases and non-GAAP measures, has significant downsides. While auditors are familiar with the figures and disclosure upon which the MD&A, earnings releases, and non-GAAP measures are based, the cost of requiring an auditor opinion on MD&A or these other disclosures would provide relatively little benefit compared to the cost. Auditors already routinely review and comment on these matters (and issuers routinely take such comments into account), and their responsibilities include consideration of whether such information is materially inconsistent with the financial statements. Thus, we believe that the scope and nature of these other disclosures is unlikely to materially change as a result of requiring a more formal assurance on the part of auditors, but would rather serve only to increase the cost. We note that the illustration of a possible attestation in the Concept Release appears to suggest that such an attestation would have to contain a legal opinion that the MD&A meets the SEC rules and regulations, as well as assurance or “comfort” regarding the amounts and numbers contained therein. We believe these requirements are well beyond the scope of auditors’ duties and, among other things, would appear to require an auditor to develop expertise in areas not currently associated with auditing responsibility.

In addition, requiring such assurances is inconsistent with the existing pass/fail approach to auditor financial statement opinions because it would introduce additional numerous and complex requirements, which could be difficult to interpret without further context but which would not necessarily be comparable across issuers. Introducing additional procedures surrounding auditor sign-off on earnings releases, MD&As and the like into an already time-pressed process could delay the filing process. Among other things, the Society believes that the expected benefits of requiring these assurances should be more specifically identified and quantified prior to requiring any such assurances.

Clarification of Language Would Improve the Standard Auditor’s Report

The Society supports the continued improvement of auditor reports and believes that enhancements to such reports that further their transparency and usefulness without introducing unnecessary disclosure, complexity, and cost are valuable for investors. To the extent that additional language in the standard auditor’s report clarifies the respective responsibilities of the auditor and management that are not defined or addressed in other disclosures, the Society believes such additional clarifications could be useful. However, any such clarifications should be strictly limited to critical issues and set forth succinctly in plain English.

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For all of these reasons, the Society does not support the alternative disclosures discussed in the Concept Release.

We thank the PCAOB for its efforts to improve audit reports and enhance investor insight into issuer financial statements, and we would be happy to provide you with further information to the extent you would find it useful.

Respectfully submitted,

The Society of Corporate Secretaries and Governance Professionals

A handwritten signature in black ink, appearing to be 'R. Lamm', with a large loop at the start and a horizontal line at the end.

Robert B. Lamm,
Chair, Securities Law Committee

cc: James R. Doty
Lewis H. Ferguson
Daniel L. Goelzer
Jay D. Hanson
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