

September 27, 2011

Office of the Secretary  
PCAOB  
1666 K Street, N.W.  
Washington, D.C. 20006-2803

Submitted via email to: [comments@pcaobus.org](mailto:comments@pcaobus.org)

**Re: PCAOB Release No. 2011-003—Concept Release on Possible Revisions to  
PCAOB Standards Related to Reports on Audited Financial Statements and  
Related Amendments to PCAOB Standards**

**Rulemaking Docket Matter No. 34**

The New York State Society of Certified Public Accountants, representing more than 28,000 CPAs in public practice, industry, government and education, welcomes the opportunity to comment on the above captioned release.

The NYSSCPA's Auditing Standards Committees deliberated the release and prepared the attached comments. If you would like additional discussion with us, please contact Jan C. Herringer, Chair of the Auditing Standards Committee at (212) 885-8133, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely,

  
Richard E. Piluso  
President

Attachment

**NEW YORK STATE SOCIETY OF  
CERTIFIED PUBLIC ACCOUNTANTS**

**COMMENTS ON**

**PCAOB RELEASE NO. 2011-003—CONCEPT RELEASE ON POSSIBLE  
REVISIONS TO PCAOB STANDARDS RELATED TO REPORTS ON AUDITED  
FINANCIAL STATEMENTS**

**AND**

**RELATED AMENDMENTS TO PCAOB STANDARDS**

**RULEMAKING DOCKET MATTER NO. 34**

**September 27, 2011**

**Principal Drafters**

**Michele Amato  
Robert W. Berliner  
Jan C. Herringer  
Julian E. Jacoby  
Renee Mikalopas-Cassidy  
William M. Stocker III**

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Ernest J. Markezin  
William R. Lalli

# **New York State Society of Certified Public Accountants**

## **Comments on**

### **PCAOB Release No. 2011-003—Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards**

We appreciate the opportunity to comment on the Public Company Accounting and Oversight Board’s (“PCAOB” or the “Board”) Concept Release, *Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards*, (the “Concept Release or the release”). While we recognize the mission of the PCAOB is to protect the interests of investors and further the public interest in the U.S., we note that the International Auditing and Assurance Standards Board (IAASB) has issued a consultation paper on the same subject and we encourage the PCAOB and IAASB to work together to ensure convergence on auditor reporting so differences are minimized to the fullest extent possible.

#### **Responses to Specific Questions**

- 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?**
  - 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?**
  - 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?**

We believe that audited financial statements are one of the primary sources of information investors use in making investment decisions. The auditor’s report provides reasonable assurance that the financial statements do not contain material misstatement(s) and are presented fairly based on the financial reporting framework on which the auditor is reporting. However, we recognize that investors and other users of the financial statements have voiced concerns about the need for “richer” information available about the financial statements that they believe would be useful to them in making their investment decisions, and, as such, we support an initiative to explore how meaningful and cost efficient improvements can be made.

We do not believe that the current pass/fail audit report is deficient. If the objectives of the report are not readily understood in the marketplace, we suggest providing clarification through other means such as through education efforts. A glossary of terms could accompany the auditor's report until such time as users become more comfortable with the terms and concepts used.

Clarification of the following terms may be helpful to users:

- Reasonable assurance
- Fair presentation
- Materiality
- Material misstatement

We do not see an overriding need to substantively revise the format of the audit report, and believe that expanding the content and reorganizing the format would not impact the effectiveness of the audit report substantively.

We are generally supportive of auditor reporting on "other information" outside the financial statements that users may consider appropriate for their purposes.

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?**
  - b. **If not, why not, and what changes are needed?**
  - 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.**

As stated above, we believe the pass/fail model of reporting should be retained.

Additionally, we have provided an illustration of an auditor's report (**Exhibit** attached) that provides for four main headings and includes report modifications, including some simplifications. We have added headings to make the audit report easier to understand, and to allow for those users only interested in the opinion paragraph a direct pathway. We believe that emphasis paragraphs can be used when deemed necessary; but not to be used for every report.

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.**

Information about the entity should be provided by management and/or the audit committee, as appropriate, because it is in the best position to provide such information.

- 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?**

If changes to the audit report on the financial statements are made, consideration of how those changes might impact the report on internal control will need to be assessed. For example, if the auditor's report on the financial statements is modified to explain the responsibility of management and the audit committee as it relates to the financial statements, the report on internal control over financial reporting should be similarly modified.

#### **Auditor's Discussion and Analysis**

- 5. Should the Board consider an AD&A as an alternative for providing additional information in the auditor's report?**
- a. If you support an AD&A as an alternative, provide an explanation as to why.**
  - 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?**
  - 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?**
  - d. If you do not support an AD&A as an alternative, explain why.**
  - 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?**

An auditor's discussion and analysis ("AD&A"), which as described in the Concept Release, would provide the auditor's view of significant matters and how they were addressed in the audit engagement, is basically an affirmation of communications made to the audit committee and/or those charged with governance. There is a compelling difference when this information is provided to the audit committee as opposed to when it is issued to shareholders/investors. In the former situation there is a two way dialogue throughout the course of the audit; whereas in the latter situation it is a one way communication at a point in time.

Further, if there is competing or "dueling" information such that the communication results in a perceived difference about what is said and what is disclosed in the financial statements, a credibility issue for the entity and auditor could arise. The level of detail disclosed about the audit procedures employed might result in an inference

of providing assurance at the account balance or assertion level for the issues discussed when the level of assurance is provided only on financial statements taken as a whole.

For these reasons, this initiative would be the most difficult to implement, the most problematic and the least beneficial. Although there is subjectivity in many pronouncements, if there is management bias or in the auditor's judgment an erroneous conclusion or evaluation were made, we believe this is best dealt with as a proposed adjustment and/or a communication to the audit committee. Further, a matter that is germane is that a discussion of the quality of financial reporting may dwell on the accounting standards at issue, and that such a discussion may be construed or implied as critical to those standards.

**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)?**

See our response to question 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")?**

We believe it is inappropriate for the auditor to provide their views on the company's financial statements. Any auditor reporting or other means of communication to investors or other users should be based on objective criteria; not subjective views.

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

We do not believe the AD&A form of reporting is appropriate; therefore we have no comment regarding the format of such a report.

**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?**

We do not believe it is appropriate for the auditor to comment on matters that cannot be objectively evaluated or that are outside the auditor's expertise. Communication of the above-referenced matters is best left to company management or the audit committee as it is in the best position to communicate these matters in the context of its company and the industry in which it operates.

Further, requiring auditors to discuss these matters, separate from the company, has the potential to provide investors with information that may not correspond with the way such information is provided by the company, creating confusion, rather than enhancing financial reporting

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

We do not believe the AD&A form of reporting is appropriate; therefore we have no comment concerning the language to be used in such a report.

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

There are a number of challenges to implement this alternative, and they include:

- (1) possible delays in filing documents with regulators because of additional internal reviews;
- (2) extensive additional discussions between auditors, the company, and the entity's counsel that will likely need to take place with respect to the more judgmental types of matters;
- (3) the potential to inhibit communication between the auditor and management or the audit committee; and
- (4) shifting the roles of the auditor and management in terms of the responsibility for providing the financial statement information.

Further, the additional costs associated with this alternative, due to the significant effort on the part of the auditor and the entity to provide such information would need to be considered to determine if such an alternative were appropriate from a cost/benefit perspective. This cost/benefit analysis is especially significant as it relates to smaller public companies.

**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?**

See our response to question 5 above.

**Required and Expanded Use of Emphasis Paragraphs**

**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?**

The illustrative emphasis paragraph included on page 21 of the Concept Release explains that matters that are important in understanding the financial statement presentation, including significant management judgments and estimates and areas with significant measurement uncertainty, should be emphasized. We do not believe that the current audit report is deficient; nor that including mandatory emphasis paragraphs is appropriate.

A required emphasis paragraph would, in many cases, diminish the effect of the auditor's opinion. The current Standards appropriately provide for a qualification or disclaimer of opinion when the adequacy of disclosures and the suitability and implementation of Accounting Principles are inappropriate. Under current Standards, an auditor uses an emphasis paragraph to emphasize certain disclosure and/or very significant transactions and/or comparability if the financial information is not easily comparable. The scope and opinion paragraphs do not change. A qualified opinion would apply when there is a lack of sufficient appropriate evidence or a restriction on the scope in certain circumstances or there are material departures from Generally Accepted Accounting Principles. We assume that the use of a qualified opinion would not change with this initiative.

Historically, auditors use emphasis paragraphs to highlight such matters as:

- The entity is part of a larger business enterprise
- There are significant related party transactions
- A significant subsequent event has occurred
- An accounting matter other than a change in Accounting Principle occurred
- A matter affecting financial statement comparability has occurred

Under mandatory use of an emphasis paragraph, a significant expansion of the types of matters previously considered will be included and the intended effect of such an inclusion will dilute the financial reporting objectives.

**14. Should the Board consider a requirement to include areas of emphasis in each audit report, together with related key audit procedures?**

- a. **If you support required and expanded emphasis paragraphs as an alternative, provide an explanation as to why.**
- b. **If you do not support required and expanded emphasis paragraphs as an alternative, provide an explanation as to why.**

We believe it is inappropriate to require the use of emphasis paragraphs in each audit report. Please see our response to question 13.

**15. What specific information should 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?**

We do not believe the use of emphasis paragraphs should be required.

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

We do not believe the use of emphasis paragraphs should be required; therefore we have no comment regarding the level of detail of matters to be presented in such paragraphs.

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

As noted above in response to question 13, under the mandatory use of an emphasis paragraph, a significant expansion of the types of matters emphasized will dilute the financial reporting objectives and not increase transparency for users of the financial statements.

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

Please see our response to question 13 above.

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

**19. Should the Board consider auditor assurance on other information outside the financial statements as an alternative for enhancing the auditor's reporting model?**

- a. **If you support auditor assurance on other information outside the financial statements as an alternative, provide an explanation as to why.**
- 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.**
- c. **What level of assurance would be most appropriate for the auditor to provide on information outside the financial statements?**
- 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?**
- e. **Would auditor reporting on a portion or portions of the MD&A affect the nature of MD&A disclosures? If so, how?**
- 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?**
- g. **If you do not support auditor assurance on other information outside the financial statements, provide an explanation as to why.**

We are generally supportive of auditor reporting on “other information” outside the financial statements. The standard for examining MD&A, AT 701, *Management’s Discussion and Analysis*, has been in place since 2001. Practitioners can examine such information and express reasonable assurance if:

- The presentation includes, in all material respects, the required elements of the rules and regulations adopted by the SEC,
- The historical information has been derived accurately, in all material respects, from the entity’s financial statements, and
- The underlying information, estimates, and assumptions of the entity provide a reasonable basis for the disclosures contained therein.

While reporting under AT 701 could provide the basis for further standard setting to broadly address more information outside the financial statements, it is our understanding that AT 701 engagements are rarely requested by issuers for a variety of reasons which include cost/benefit analysis considerations.

One approach that would furnish investors with useful information, while also offering a cost-effective alternative, is the development of an examination level service on a specific portion of the MD&A that investors have suggested is important to their investment decisions: the disclosure relating to critical accounting estimates. Reporting on this portion of the MD&A is likely to improve the quality of such disclosures as a result of the increased attention given to these matters.

Should this approach be implemented, amendments to Regulation S-X might be needed to require the report or describe the circumstances in which such a report would be required. Further, the supplemental report would need to identify clearly the applicable section of MD&A covered by the report.

It is interesting to note that auditors of certain governmental entities communicate within the auditor’s report on MD&A that is required supplemental information in U.S. GAAP for governmental entities under a Government Accounting Standards Board opinion (GASB No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*).

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

We believe that requiring an auditor to provide assurance on certain information (*e.g.*, critical accounting estimates) outside the financial statements has the potential to improve the quality of such information. We also think it feasible to explore the benefits of providing assurance on other areas.

For example, some have suggested that auditor reporting on matters such as annual earnings releases would provide users with a higher level of confidence in the information. However, we believe that it is important to recognize that this financial

information is often issued prior to the completion of the audit, and that there is a trade-off between the timeliness of the information and the assurance level that can be provided.

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

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

We believe the clarifications listed above would be appropriate. We have provided an illustration of an auditor's report that provides four main headings and includes report modifications including some simplifications (see attached **Exhibit**).

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

In general, clarifying the language in the standard auditor's report would be beneficial in that it sets the foundation for all users of the report to understand more fully the auditor's conclusion and level of assurance provided. The shortcoming of adding such clarifying language would be that the increased length of the report may add to "information clutter." This shortcoming could be overcome easily through the use of links to a central location where such clarifications are maintained. This approach is similar to the reporting model used in the U.K.

### **Questions Related to all Alternatives**

- 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?**

We believe the most appropriate approach to improve auditor communication to users would be to revise the auditor's report and the description of the auditor's responsibility for the additional information outside the financial statements.

Auditor reporting on selected other information is another way to inform investors about the integrity of the information provided to investors by management. For example, providing an examination engagement on the Critical Accounting Estimates disclosure in MD&A would promote improved disclosures in this area and respond to suggestions by investor groups for auditor's to emphasize the important judgments made by management in the preparation of the financial statements.

In addition to these matters, the PCAOB should undertake a project to educate investors and other users of the financial statements about the meaning of the auditor's opinion on the financial statements and the terms used within the report.

- 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 our response to question 23.

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

See our response to question 23.

- 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?**

While standard setting initiatives by the Board will likely be needed for all of the alternatives as it relates to the alternatives we support, the alternative requiring more significant standard setting relates to the separate reporting on the Critical Accounting Estimates disclosure.

- 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?**

We believe certain of the alternatives are subject to greater susceptibility to misinterpretation than others, and, for this reason, we caution the PCAOB to ensure that any changes to auditor reporting clearly describe the auditor's responsibility to provide an opinion on the financial statements as a whole to avoid any perception that a qualified or piecemeal opinion has been provided.

**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?**

The modifications calling for descriptions of the role of management, the audit committee and the external auditor would clarify the role of the auditor in the financial reporting process sufficiently.

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

We believe that certain alternatives discussed in the PCAOB Concept Release would improve the communicative value of the auditor's report and advance audit quality while others may have a detrimental effect. For example, the alternatives that (1) clarify the terms used in the auditor's report, (2) explain the auditor's responsibility for the audit of the financial statements and other financial information presented in a document containing the audited financial statements, and (3) provide for reporting on the Critical Accounting Estimates disclosure section of the MD&A all serve to improve communication and the related disclosures enhancing audit quality in a cost effective manner.

**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.**

There are unique characteristics that necessitate different approaches to enhance the reporting model for investment companies, investment advisers, broker dealers and others such that a "one-size-fits-all" approach would be inappropriate. For this reason, we would support further consideration of how best to enhance other reports called for by the Board's standards as part of a separate project.

**Considerations Relating to Changing the Auditor's Report**

**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.**

- a. Are any of these considerations more important than others? If so, which ones and why?**
- 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?**
- 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?**
- d. What requirements and other measures could the PCAOB or others put into place to address the potential effects of these considerations?**

All of the considerations set out above are important and interrelated, and it would be difficult to assess the importance of one consideration over the other. Any changes to the auditor reporting model need to be considered in tandem with consideration given to how the interrelationships impact audit quality and cost.

Some of the suggested changes would not increase audit costs significantly. For example, modifying the form and content of the audit report would provide enhanced clarity while it would have little additional costs associated with it. However, other alternatives such as auditor reporting on Critical Accounting Estimates disclosures are likely to require additional work effort by both management and the auditor with a corresponding increase in costs.

We encourage the Board to consider the most effective way to implement any changes to accommodate the needs of smaller public companies and provide a way that considers the needs of investors while recognizing the cost constraints facing many smaller public companies.

We believe that a phased-in approach would be appropriate, that is, one that provides that the larger public companies would implement changes initially (other than those changes that could be easily implemented such as changes to the format of the standard auditor's report) in order to allow the smaller public companies and their auditors learn from the experience of their larger counterparts.

**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?**

As stated throughout our letter, management should be the source of original information about the company. We believe this position is consistent with the view of others integral to the financial reporting process (management and the audit committee). Our primary concern is that the candor and vigor of the interaction among the auditor,

management and the audit committee would be impacted negatively if the auditor included information about the company's financial statements in the audit report with a corresponding negative impact on audit quality.

## Illustration of an Auditor's Report

### Independent Auditor's Report

#### The Financial Statements that have been Audited

We have audited the accompanying Balance Sheet of X Company as of December 31, 20XX, and the related Statements of Income, Retained Earnings, and Cash Flows for the year then ended.

#### Management's Responsibility versus Auditor's Responsibility

Management is responsible for the preparation and the fair presentation of these financial statements in accordance with U.S. Generally Accepted Accounting Principles. This responsibility includes the design, implementation and maintenance of effective internal control, adopting sound accounting policies, and making accounting estimates that are reasonable in the circumstances. Our responsibility is to express an opinion on these financial statements based on our audit, to be independent of X Company, and to comply with the applicable independence requirements of the [insert, as appropriate, the PCAOB and SEC or AICPA]. We have no responsibility for information in this document outside of the financial statements such as [identify the information, for example the CEO's letter to the shareholders, MD&A, *etc.*]

#### Nature of Our Audit

We conducted our audit in accordance with auditing standards generally accepted in the U.S. Those standards require that we 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. Reasonable assurance is a high level of assurance; albeit not absolute assurance. Our audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

#### Audit Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 20XX, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the U.S.

[Signature]

[Date]