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Professor Arnold Schilder
Chairman
International Auditing and Assurance Standards Board
529 Fifth Avenue
6th Floor
New York, NY 10017

Re: IAASB Invitation to Comment on *Improving the Auditor's Report*

Dear Professor Schilder:

The U.S. Chamber of Commerce (the "Chamber") is the world's largest federation of businesses and associations, representing the interests of more than three million U.S. businesses and professional organizations of every size and in every economic sector. These members are both users and preparers of financial information. The Chamber created the Center for Capital Markets Competitiveness ("CCMC") to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy.

The CCMC believes that businesses need to have systems of strong internal controls and recognizes the vital role external audits play in capital formation. Accordingly, the CCMC supports efforts to improve audit effectiveness and appreciates the opportunity to comment on the International Auditing and Assurance Standards Board ("IAASB") Invitation to Comment on *Improving the Auditor's Report* ("the Proposal").

While the proposal is an important step in achieving that goal, the CCMC believes that several issues must be addressed for the proposal to move forward. Generally, the CCMC believes that certain aspects of the proposal may increase complexity, force auditors to engage in activities outside of their purview, blur boundaries between auditing and corporate governance, increase liability for auditors and reduce accountability.

These concerns are discussed in more detail below.

Discussion

The CCMC has been a strong supporter of high quality global auditing standards through the convergence of Public Company Accounting Oversight Board ("PCAOB") auditing standards with those of the IAASB and the Auditing Standards Board ("ASB") of the American Institute of Certified Public Accountants ("AICPA"). Convergence is particularly important when it comes to the mandatory elements of the auditor's report. The CCMC applauds the IAASB for its leadership in attempting to lay a foundation for the future of auditor reporting with this Proposal—"with an eye toward a meaningful and workable global solution based on the scope of an audit under the current International Standards on Auditing ("ISAs")."[1]

The CCMC understands that the Proposal is in response to calls for changes in auditor reporting and it represents one milestone in the IAASB's process that included a Consultation Paper in 2011. The CCMC also recognizes that others such as the PCAOB and the European Commission ("EC") likewise have initiatives on auditor reporting.[2]

The CCMC appreciates that in any initiative such as this, the IAASB faces competing demands from a variety of stakeholders. While certain stakeholders are claiming that "the status quo" is unacceptable, the CCMC would like to emphasize that standards related to auditor reporting are long-standing and have served the test of time. This does not mean that improvements should not be considered, but it does suggest the need to exercise caution in implementing change. The Proposal includes an illustrative report, which helps illuminate why caution is so essential.

In proceeding, the CCMC requests the IAASB to use three important principles in moving forward: 1) Clear definition of investors and identification of

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[1] The Proposal, p. 1.

[2] The CCMC has provided comments on the PCAOB reporting initiative. For example, see September 14, 2011 letter from the U.S. Chamber of Commerce CCMC to the PCAOB on the *Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards and Notice of Roundtable (PCAOB Release No. 2011-003, June 21, 2011, Rulemaking Docket Matter No. 34)*; See also December 7, 2010 letter from the CCMC to the European Commission Green Paper, *Audit Policy: Lessons from the Crisis.*

investor interests to guarantee a broad understanding of investor needs and prevent a narrowness of effort that may adversely distort standard setting; 2) Investors need factual information to make decisions in order to further their goal—obtaining a return on their investment; and 3) Auditors must have the discretion to use judgment in auditing financial statements and avoid "check the box" activities that create rote examinations that provide little useful information to investors or businesses. Our concerns are centered on issues where the Proposal strays from those principles.

I. Financial Reporting Complexity

The Proposal states that the call for revising the auditor's report "initially came primarily from institutional investors and financial analysts who are looking to auditors to help assist in navigating increasingly complex financial statements and point out the areas on which the auditor's work effort was focused—particularly on the most subjective matters within the financial statements."[3] In response, a centerpiece of the Proposal is "Auditor Commentary," which would provide additional information that highlights matters that are, in the auditor's judgment, likely to be most important to users' understanding of the audited financial statements or the audit.

Standard setting should abide by appropriate and transparent due process.[4] Accordingly, investor outreaches for major changes in audit standards should be broad based and encompass a representative cross section of the investors globally. Discussions or outreach that is too narrow will skew the results, create misjudgments of support for changes and harm the integrity of the standard setting process.

The CCMC believes that it is important to recognize that this call for change in the auditor's report reflects a much more general user frustration with financial reporting complexity, including disclosure overload. This frustration *cannot* be solved by auditors. The solution requires a holistic approach to considering the interplay of audit and financial reporting regulation.

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[3] The Proposal, p. 3.
[4] *See* testimony of Thomas Quaadman before the U.S. House of Representatives Subcommittee on Capital Markets and Government Sponsored Enterprises regarding *Accounting and Auditing Oversight: Pending Proposals and Emerging Issues Confronting Regulators, Standard Setters and the Economy*, March 28, 2012.

To illustrate, the U.S. Securities and Exchange Commission's ("SEC") Advisory Committee on Improvements to Financial Reporting ("CIFiR") focused on financial reporting complexity and made a number of recommendations aimed at reducing it. CIFiR heard similar calls from investors to "tell us what matters" and "give us a roadmap." After extensive deliberations and public outreach, CIFiR included among its recommendations that the SEC mandate the use of an executive summary by management in the forepart of a reporting company's annual report to provide a roadmap to the fuller discussion in the report. CIFiR did not recommend that auditors step-in to fill the breach.

CIFiR went on to say that the executive summary should provide the most important information about a reporting company's business, financial condition, and operations, and provide the context for the disclosures contained in the report; should be a concise and balanced discussion that identifies the most important themes or other significant matters with which management is primarily concerned; and should include cross-references to the location of the fuller discussion in the annual report.[5] The executive summary could, for example, point to the company's SEC required Management Discussion and Analysis ("MD&A") for a more detailed discussion of its critical accounting policies, i.e., those that require estimates and a higher degree of judgment and complexity in their application, and other significant matters likely to be most important to users' understanding of the financial statements.

To summarize, CIFiR understood the need to take a comprehensive and holistic approach to overcoming the problem of financial reporting complexity. The CIFiR recommendation for an executive summary by management has not yet been implemented. However, the CIFiR recommendation demonstrates that calls to reduce financial reporting complexity should be less about asking auditors to weigh-in with their perspectives through means such as Auditor Commentary and more about auditing standards-setters (including the IAASB, ASB, and PCAOB) working together with accounting standards-setters (such as the Financial Accounting Standards Board ("FASB") and the International Accounting Standards Board ("IASB") and regulators (such as the SEC and the EC) to help fix the essential problem.

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[5] *See* the *Final Report of the Advisory Committee on Improvements to Financial Reporting* to the United States Securities and Exchange Commission (August 1, 2008, p. 16).

Standard-setters and regulators should also work together to better understand the responsibilities of users when it comes to financial reporting. The portions of the Proposal mandating items for inclusion in the auditor's report on general purpose financial statements does not fully appreciate that users are heterogeneous and, therefore, their information needs vary. General purpose financial reporting is designed to meet the needs of the broad set of all users and not the demands of any particular special interest group.

II. Preserving the Separate Responsibilities of Management, Those Charged with Governance, and Auditors

According to the Proposal, one of the guiding principles for the IAASB's deliberations was that "there is a need to preserve the separate responsibilities of management and those charged with governance ("TCWG"), as providers of original information, and the auditor, respectively."[6] The CCMC strongly agrees with this principle. Financial statements and disclosures are the responsibility of management.

However, the CCMC is concerned that the proposed Auditor Commentary is at odds with this fundamental principle. As just discussed and consistent with the CIFiR recommendation, it is management's responsibility, not the auditor's, to provide transparency about matters likely to be most important to users' understanding of the financial statements.

Further, an essential element of this fundamental premise of financial reporting is that the auditor is not an original source of information about the company. Thus, auditors should not be the originators of information on what matters most when it comes to a company's financial reporting. Any such Auditor Commentary could result in competing disclosures that will increase complexity and create confusion for investors. Even the name "Auditor Commentary" implies that this section of the auditor's report will provide original information and, therefore, exacerbates the potential for confusion and a widening of an "expectation gap" on the part of investors.

[6] The Proposal, p. 5.

Setting aside differences on fundamentals, the Proposal also does not appreciate the full range of practical difficulties from mandating Auditor Commentary that go well beyond considering time-constraints in the delivery of audited financial reports as noted in the Proposal. For example, it seems unlikely that expressing auditor perspectives on financial statement matters in Auditor Commentary could be the end of it. Investors and other parties would likely call for clarification, additional insights, and further explanations from auditors in order to understand the auditor's perspectives and to help reconcile, as necessary, such perspectives with those of management. Certainly this is the case with some of the examples presented in the Proposal. It would be inappropriate to expect management to have responsibility for responding to inquiries regarding Auditor Commentary. Would auditors then need to issue press releases and hold conference calls to meet such demands for further information?

Not only is there currently no mechanism for auditors to communicate with outside parties in this regard (except perhaps to investors during annual shareholder meetings), but confidentiality requirements generally preclude any such outside communications. Confidentiality issues would also arise with regards to information provided by the auditor in Auditor Commentary that differs from or goes beyond that of management.

Otherwise, Auditor Commentary would naturally lead to "second-guessing" auditor decisions on what to disclose. Such "second-guessing" would be exacerbated by comparisons that would naturally occur among companies in the same industry and/or of similar size.[7] Frankly, condensing "what's most important" to between two and ten items (as suggested in the Proposal) for large complex global companies seems difficult to envision and counterproductive. On the other hand, it is also problematic to assume that all companies should have between two and ten items regardless of circumstances.

This could lead to disclosures that are not relevant or helpful to users of financial information.

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[7] Ibid, p. 28

The examples of Auditor Commentary in the Proposal reveal additional problematic elements of relying on auditors for information on what is most important in the financial statements and/or audit. For example, the illustrative commentary raises the question of whether an auditor is attempting to provide a lower level of assurance on the valuation of financial instruments than that on the financial statements as a whole. This adds to concerns recognized in the Proposal that users may misinterpret or misunderstand Auditor Commentary and assume that the auditor is providing assurances on individual accounts or disclosures rather than the financial statements as a whole or that the auditor is otherwise modifying an unqualified opinion.

Difficulties likewise arise for disclosing more information about how the audit was conducted, key judgments made by the auditor, and the use of experts. For example, it is not clear how the additional, albeit very summarized, high-level information in the illustrative Auditor Commentary on audit strategy relating to the recording of revenue, accounts receivable, and cash receipts is meaningful to users. Likewise, it is not clear how user's benefit from knowing the firm's valuation specialists were used in auditing structured financial instruments and that they developed an independent range as opposed to other options that auditing standards allow. These types of disclosures would add length but not depth to the auditor's report. The IAASB's ISAs are publicly available, so users already have access to the guidance applied by auditors in auditing these areas.

Moreover, the illustrative Auditor Commentary again demonstrates a situation where a brief disclosure by the auditor, in this instance of audit details related to the valuation of structured financial instruments, raises more questions than it answers. Based on the illustration, users would likely want more information on the auditor's model and assumptions versus those of management, the range computed by the auditor (in both absolute amount and relative to materiality), where the recorded amount fell within the auditor's range not just that it did, and the list goes on.

The Proposal suggests that the IAASB would expect Auditor Commentary to include difficult or contentious matters noted during the audit, or other audit matters that would typically be discussed with an engagement quality control reviewer (EQR) or TCWG. But the benefit of such disclosures eludes when such matters are resolved to the auditor's satisfaction and the financial statements and footnotes comport with

the relevant financial reporting framework in all material respects. Indeed, requiring auditor disclosures regardless of outcome may work against achieving a desirable outcome and otherwise impede communications among auditors (including EQRs), management, and TCWG.

To be useful Auditor Commentary would need to avoid being boilerplate. Yet, legal considerations and the need for audit firms to maintain consistency across engagements and over time preclude Auditor Commentary from being a "free-writing" exercise. The Proposal acknowledges that criteria and guidance would need to be developed for auditors to help them make informed judgments about the information to include in Auditor Commentary. However, the illustrative Auditor Commentary in the Proposal is actually very helpful in demonstrating how difficult it would be to craft straightforward, brief, highly-distilled, while still useful, auditor disclosures and why this is not an idea worth pursuing. The CCMC believes that maintaining rather than eliminating the long-standing practice of using emphasis of matter paragraphs in the auditor's report, under certain limited and prescribed circumstances, avoids these difficulties and benefits users consistent with the role and responsibilities of auditors.

III. Going Concern

The Proposal would also mandate that every auditor report include a section on Going Concern. This section would have two parts: (1) the auditor's conclusion that management's use of the going concern assumption in the preparation of the financial statements is appropriate and (2) that based on the work performed, the auditor has not identified material uncertainties related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern and that the auditor believes would need to be disclosed in accordance with the IASB's International Financial Reporting Standards ("IFRS").

Under IFRS management is responsible for making an assessment of the company's ability to continue as a going concern when preparing the financial statements and to disclose material uncertainties related to events or conditions that may cast significant doubt on this ability. This means that auditors would be making a judgment on the appropriateness of management's assumption and disclosures.

However, U.S. generally accepted accounting principles ("US GAAP") do not contain any such requirements for management.

Thus, the CCMC suggests that to make the IAASB's proposed auditor's reporting model workable under any financial reporting framework, the Proposal should include the auditor's Going Concern paragraphs in the non-mandatory section of the audit report (i.e., the section with information not mandated by the IAASB). This approach also makes the Proposal responsive to proposed EC regulations concerning auditor reporting for public interest entities. Accordingly, the CCMC suggests that the IAASB maintain the current auditor reporting model for modified audit reports (emphasis of matter paragraphs) for material matters regarding a going concern problem. The CCMC notes that even under this approach additional guidance for auditors to facilitate their judgments on material uncertainties might be desirable.[8]

Finally, the CCMC agrees that auditors should not be asked to express a conclusion on the entity's future viability. These determinations are the responsibility of users, including their advisors. Auditors are not credit rating agencies and the CCMC cannot support changing the auditor's role and responsibilities to make them so.

IV. Increased Liability for Auditors

One of the challenges of global standards is the differences in legal environments around the world, particularly, a highly litigious atmosphere in the United States. The CCMC is concerned that aspects of the Proposal would likely have significant implications for auditors from the standpoint of legal liability. Mandated Auditor Commentary and Going Concern disclosures, in particular, may even create new avenues for legal actions against auditors in the United States.

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[8] Under this approach, the IAASB should also avoid suggesting additional disclosures by auditors on their significant judgments and audit procedures in situations where the auditor may have determined that no material uncertainty exists, but certain events or conditions nevertheless have been identified that may cast significant doubt on the entity's ability to continue as a going concern (p. 20). Again, disclosure of such events or conditions should be management's responsibility.

For example, the U.S. Supreme Court recently reaffirmed its decision in Central Bank[9] which precludes private securities fraud actions against secondary actors such as auditors. As previously discussed, it appears that some mandated disclosures described in the Proposal would move the auditor into the position of being an original maker of statements, as the auditor would have ultimate authority over the reported disclosures, including their content and whether and how to communicate them. As a consequence, Rule 10-b5 could then apply to auditors as plaintiffs in private actions could allege the auditor directly or indirectly made an untrue statement of a material fact in connection with the purchase or sale of securities.

V. Cost Benefit Analysis

The CCMC understands that the IAASB has taken a "value and impediments" approach to developing the Proposal, where impediments include costs. While the Proposal does not contain a cost-benefit analysis per se, the CCMC appreciates that the Proposal discusses some of the IAASB's views on benefits and costs and solicits information on these matters. The CCMC encourages the IAASB to seriously consider feedback from commenters and others on the estimated costs and burdens that will be placed upon businesses and auditors as a result of the Proposal, including those in this comment letter, and to conduct a fully informed analysis of value and impediments to make beneficial changes in the Proposal.

VI. Other Matters

The Proposal would require that the auditor's report contain a section on Other Information. This section would identify the specific additional information contained in the document (e.g., annual report) not audited but read by the auditor; would specify that the purpose of doing so is to identify any material inconsistencies with the audited financial statements; and describe the outcome of the auditor's reading the other information. The Proposal suggests that this recommendation represents a compromise in response to a variety of requests for increased auditor involvement with other information. The CCMC agrees with the IAASB that auditors should not be required to opine on other information. Accordingly, the CCMC finds the proposed disclosure to be unnecessary and potentially problematic.

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[9] *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994).

The current auditor's report clearly identifies what the audit opinion encompasses; auditing standards describe the auditor's responsibilities with respect to other information; and the proposed disclosure may increase the expectation gap by making it appear the auditor is taking some responsibility for the other information.

The Proposal also suggests altering and expanding the "boilerplate" description in the auditor's report around the auditor's responsibilities and the nature of the work performed by auditors. These suggestions represent refinements to the current auditor's report and, overall, are not objectionable in concept, although it is hard to argue the need for all of them individually.

In addition, the illustration of this section in the Proposal places this information in the mandatory portion of the report. However, some of the illustrative language is unique to the ISA's, for example the language around differential risks for the auditor detecting material misstatements due to fraud versus error (first bullet on page 12) and, therefore, should be subject to alteration and adaptation. Also, the wording in the paragraphs on the responsibilities of the auditor "to evaluate" (fourth and fifth bullets on page 12) should be conditioned on the financial reporting framework and provide for a disclosure in those paragraphs that identifies the specific framework.

Finally, the CCMC respectively requests that the IAASB reconsider *mandating* the inclusion of certain other information in the auditor's report such as the names of the engagement partner and others. The PCAOB has proposed requiring such disclosures, but the CCMC opposes any such requirement and has provided extensive public comments to the PCAOB.[10] The CCMC believes that the PCAOB proposal would obfuscate essential responsibilities harming accountability. Providing this information in an auditor's report under the IAASB's ISAs should be optional.

VII. Conclusion

Once again, the CCMC appreciates the opportunity to comment on the Proposal. The CCMC has a number of concerns that the Proposal in its current form

[10] See January 9, 2012 letter from the U.S. Chamber of Commerce CCMC to the PCAOB on Proposed Rulemaking on *Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards and Form 2* (PCAOB Release No. 2011-007, October 11, 2011 and PCAOB Rulemaking Docket Matter No. 29).

would increase complexity, expand liability of auditors and create potential overreach of certain audit functions. These issues are not insurmountable but they must be resolved in order to improve auditing on a global basis. The CCMC looks forward to working together with the IAASB to resolve these issues and promote a high quality set of global auditing standards.

Thank you for your consideration and the CCMC stands ready to assist in these efforts.

Sincerely,

Tom Quaadman