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AMERICAN ACADEMY *of* ACTUARIES

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September 30, 2011

Office of the Secretary  
PCAOB  
1666 K Street, N.W.  
Washington, D.C. 20006-2803  
Via email: [comments@pcaobus.org](mailto:comments@pcaobus.org)

Re: PCAOB Rulemaking Docket Matter No. 34

The American Academy of Actuaries'<sup>1</sup> Financial Reporting Committee offers the following comments on the PCAOB's Concept Release.

We applaud the PCAOB's willingness to reach out and consult on the issues surrounding the auditor's report based on recent investor feedback. We believe most of the concerns of investors and other financial statement users stem from the need for enhanced disclosure of information regarding the risk and uncertainty of elements included in financial statements and reports which contain those (Financial Reports). Risk and uncertainty is the area of practice of actuaries and is a subject with which we deal constantly.

There is a dichotomy between the world of Financial Reports with its specific numbers and the world of economic reality in which there is a great deal of risk and uncertainty resulting in a range of possible values for a significant quantity of balance sheet items. Systems of financial security, such as the insurance industry, are excellent examples.

Accordingly, we strongly endorse steps to provide more disclosure by management about these matters to users of Financial Reports. Comments by management concerning the ranges of certain values shown in the Financial Statements, the methods used to determine those ranges, the methods of selecting the values shown, and the methods which might be used and reasoning for the selection of the methods chosen are some examples. However we do not believe that this information should come from the auditor. The auditor should assess the reasonableness of management's judgments without supplanting management's judgment. We instead endorse limited additional information being provided in the auditor's report as to the significant estimates in the Financial Reports, the key assumptions behind those significant estimates and the use of any internal or external specialists by the auditors to assist them in evaluating the reasonableness of management's estimates.

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<sup>1</sup> The American Academy of Actuaries ("Academy") is a 17,000-member professional association whose mission is to serve the public on behalf of the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

Overall, we believe it will enhance the user's appreciation of Financial Reports as well as enhancing the usefulness of the Financial Reports to have at the user's disposal a description of the efforts made by management, auditors, and others to provide assurance that the information used by management and others to reach conclusions is correct.

Below we provide additional comments on certain questions posed in the Concept Release.

#### 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?

**Yes, we believe the Board should undertake such an initiative to provide investors with more detail beyond the pass/fail model currently employed.**

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?

**We believe the key improvement would be for the auditor to provide limited additional information regarding significant estimates in the Financial Reports, the key assumptions behind those significant estimates and the use of any internal or external specialists by the auditors to assist them in evaluating the reasonableness of management's estimates.**

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?

**No, we do not think that the auditor should provide assurance on additional items like management's discussion and analysis (MD&A). MD&A gives management the opportunity to reflect on recent operations and discuss future goals and projects. While limited assurance could be given on factual information, MD&A will reflect the current management's style and judgment. This is something we do not think the auditor should supplant.**

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?

**Yes, we believe investors are looking for a clear signal that the financial statements are fairly stated. We would discourage any change that would bring ambiguity to such a statement, including moving away from the pass/fail model.**

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

N/A

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.

**Please see our response to question 1b.**

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.

**We believe management, executives and the Board of Directors (including the audit committee) are the appropriate sources of information within the financial statements.**

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.

**Yes, but only to the extent that it permits the auditors to comment on procedures performed, communicate what they consider significant estimates and their use of specialists to assist them in evaluating the reasonableness of recorded estimates.**

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?

**It should focus solely on the audit. See our response to question 5a.**

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?

**See our response to question 5a.**

d. If you do not support an AD&A as an alternative, explain why.

N/A

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?

**Yes, increased use of emphasis paragraphs may be another method by which the items we discussed in our response to question 1b could be communicated.**

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 1b.**

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")?

**Management, not the auditor, should be communicating on these issues.**

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?

**Business risks, strategic risks, or operational risks are best left for management to discuss. These should not be the purview of the auditor.**

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?

**Please see our response to question 1b.**

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

**No**

g. If you do not support auditor assurance on other information outside the financial statements, provide an explanation as to why.

**We are concerned that it would lead to conflict between management and the auditor on what is effectively business judgment rather than accounting judgment.**

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?

**Yes we believe the first two bulleted items would be appropriate for clarification. The third and fourth items listed might deserve some limited clarification. We have already stated our objection to auditing information outside of the financial statements and therefore do not believe clarification is appropriate. Finally, auditor independence is to be expected and therefore clarification would add little value.**

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?

**This could be detrimental to the relationship between the company and its auditors if the auditor supplants management's judgment on the business with the auditors' own judgment.**

We would be happy to participate in further discussions on this issue. If you have any questions, please contact Tina Getachew, Senior Policy Analyst, Risk Management and Financial Reporting Council by phone (202/223/8196) or email [getachew@actuary.org](mailto:getachew@actuary.org).

Sincerely,



William C. Hines

Chair, Financial Reporting Committee

Risk Management and Financial Reporting Council

American Academy of Actuaries