Comment Letters to proposed statement on standards for attestation engagements: Management's discussion and analysis

American Institute of Certified Public Accountants. Accounting Standards Board

College of Charleston

Benjamin Podgor

Arkansas Society of Certified Public Accountants

V. L. Auld & Associates

See next page for additional authors

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Authors
Thank you for allowing me to make some observations. What is the motivation behind this effort? Is it the investing community who demands the professional's association with MD&A? I think not. It is the SEC and/or other regulatory agency which is demanding this association? I think not. The SEC has considered in the past whether the professional should be associated with interim financial reporting and decided in the negative. I personally think the accountant frequently is doing a review or some form of a review of the quarterlys now. Most registrants have their independent accountant associated to some extent with the quarterly financials before they are filed with the SEC—my opinion. Yet, the SEC has decided that this association is not needed. If this is correct, why should the AICPA decide that the association is needed? Apparently, no one else has. Hopefully, this is not an effort to offer another service in an effort to generate additional fees.

I would suggest that the AICPA lobby the SEC to require a review of the financial statements in the 10 Q before they independently suggest association with quarterly MD&A. As it currently appears, this effort seems so self-serving. It appears that you want to provide a service the regulatory agency does not recognize as needed and the investing community has not cried to receive. Again, thank you.

Bob Rouse
Department of Accounting and Legal Services
The College of Charleston
Charleston, SC 29464
Paragraph 5 states in part: "In determining whether to accept an engagement, the practitioner should also consider whether management (and others engaged by management to assist, such as legal counsel) has the appropriate knowledge of the published SEC rules and regulations to prepare MD&A." This paragraph appears to expect the practitioner to practice law. To make the practitioner responsible for the legal knowledge of the management personnel and counsel is a set-up for a malpractice claim. Paragraph 9 has the same redundant statements. Benjamin Podgor, 32 Abbey Street, Massapequa Park, NY 11762. Telephone: 516 541 9292. E-mail PodgorBen@msn.com
May 21, 1997

Jane M. Mancino, Technical Manager
Audit and Attest Standards
File 3507
American Institute of CPAs
1211 Avenue of the Americas
New York, NEW York 10036-8775

Dear Kim:

Attached are comments from the Arkansas Society on the AICPA Exposure Draft - Proposed Statement on Standards for Attestation Engagements - Management’s Discussion and Analysis.

Sincerely,

Barbara S. Angel
Executive Director

/enclosures
EXPOSURE DRAFT

PROPOSED STATEMENT ON STANDARDS FOR ATTESTATION ENGAGEMENTS

MANAGEMENT’S DISCUSSION AND ANALYSIS

MARCH 7, 1997

Prepared by the AICPA Auditing Standards Board for comment from persons interested in auditing and attestation issues

Comments should be received by June 16, 1997, and addressed to Jane M. Mancino, Technical Manager, Audit and Attest Standards, File 3507 AICPA, 1211 Avenue of the Americas, New York, NY 10036-8775 or via the Internet to JMANCINO@AICPA.ORG
Proposed Statement on Standards for Attestation Engagements: Management’s Discussion and Analysis

1. Paragraph 2. Provision should be made to enable practitioners to examine or review MD&A of non-public companies that may elect to prepare them differently (e.g., scope of issues), than Item 303 of Regulation S-K. Such a service could be very valuable to users and if the CPA profession declines such a service, others are likely to fill the void. Footnote 7 implies that such engagements may be undertaken.

2. Paragraph 3(b): The statement is made that this statement does not “Apply to situations in which the practitioner is requested to provide management with recommendations to improve the MD&A and not to provide assurance.” This statement is confusing. It has two “nots.” Not to provide assurance to management, users? Does this statement acknowledge that MD&A examinations and reviews are a form of assurance services?

3. Formatting is confusing. For example, the way “Review” is presented in paragraph 8, it is implied that “Review” is the heading for paragraph 8 only since it is a run-in title. It also implies that it is a subset of the section on “Examination”, which is used as a free-standing (higher order) heading on page 15.

4. Paragraph 72. This paragraph assumes that lack of adequate support for a significant representation would be a misstatement of fact. There could be a difference in an unsupported representation and a misrepresentation. For example, management may state an opinion of “cause and effect,” e.g., “sales declined because of an increased competitive environment.” How can one be assured of the cause? Although the practitioner may not be able to conclude conclusively the reason for the decline, it does not necessarily represent a misstatement of fact.

5. Once the standards are issued, the ASB should be prepared for the SEC to require an “examination” of MD&A for public companies.
May 25, 1997

Ms. Jane M. Mancino, Technical Manager
Audit and Attest Standards, File 3507
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Mancino:

RE: Comments to the Proposed Statement on Standards for Attestation Engagements, Management's Discussion and Analysis

Comments follow the respective paragraph numbers in the exposure draft.

4 and 8. The heading “Examination” is set apart (¶4), while the heading “Review” is underlined and in the body of the paragraph (¶8). This makes the proposal difficult to follow.

10 to 15. In these paragraphs the terms jump back and forth between public and non-public. This mixture is tedious to grasp. It would be better to separate the public from the non-public in a logical order. Also, the term “predecessor” is pretentious, use “prior.”

28. As written, last sentence:

Therefore, the subsequent discovery that a material misstatement exists in the MD&A does not, in and of itself, evidence . . .

Re-written:

Therefore, a finding of a material misstatement in the MD&A does not evidence . . .

(The original sentence lacks conciseness; the re-written sentence omits needless words.)

35. Wordy, wordy, wordy. Is it necessary to drone on in a big sentence? For example, using a string of words like “events, transactions, conditions, trends, demands, commitments, or uncertainties,” did someone just discover the thesaurus?

This proposed statement is loaded with poor writing. Most people write badly because they cannot think clearly. I fail to understand what makes the accounting standards so dull but whatever it is, it works!
The opening summary uses the fashionable words "proactive" and "forward-looking." Good writers ban these words. Do you say, "We are forward-looking to seeing you" or "We look forward to seeing you"? The difference is obvious to the ear.

Expanding the auditors work to MD&A will open new fields of litigation. I believe, it is bad idea for auditors to examine or review any MD&A unless necessary for the SEC. The auditor should take an active approach and distance himself from all management speculation. Therefore, a statement of non-examination or non-review is appropriate.

Already, the audit faces the problem of proving its worth, without the compounding difficulty of judging the bias of management's comments. I recommend this statement be withdrawn.

Sincerely,

Van L. Auld, C.P.A.

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1Kenneth Roman and Joel Raphaelson, WRITING THAT WORKS, Harper Paperbacks, New York, N. Y., January 1995, Second edition, pp. 11. "As we write, a leading offender is "proactive"—supposedly indicating the opposite of "reactive." Try "active" (the real word) or, for more emphasis, "take the initiative."
BY HAND

Ms. Jane M. Mancino,
Technical Manager,
Audit and Attest Standards,
American Institute of Certified Public Accountants,
1211 Avenue of the Americas,
New York, New York 10030-8775.

Re: File 3507 — Exposure Draft on Management’s Discussion and Analysis

Dear Ms. Mancino:

We are writing to advise that our firm presently intends to submit a comment letter on the above-referenced Exposure Draft, but that we may be unable to submit it by June 16, 1997, the stated deadline. On behalf of ourselves and our clients and other interested parties who may require more time, we respectfully request that the Auditing Standards Board extend the deadline by 60 days.

The proposed standard described in the Exposure Draft will affect underwriters and investors in SEC-registered and non-registered offerings. We applaud the intentions of the ASB in seeking to provide a higher level of assurance to interested parties. However, we believe that underwriters and other parties requesting comfort letters may be harmed if an MD&A report cannot be issued, because under the proposed standard the comfort letter could no longer cover MD&A information. This may be a particular hardship in the context of offerings involving non-U.S. issuers. We do not believe the ASB intends this possible result and we intend to elaborate on the problem and possible solutions in our comment letter.
We note that these affected parties are, of course, not AICPA members and may only have become aware of the Exposure Draft's existence through its publication in the official list of exposure drafts outstanding that appears in the monthly Journal of Accountancy. The May 1997 issue was the first one that included this information, which is unreasonably short notice. We further note that the timing problem is exacerbated for interested parties involved in foreign issuer offerings. Although AICPA standards do not literally apply to foreign affiliates of AICPA member firms, we are aware that the foreign affiliates of Big Six and many other firms apply SAS 72 and other similar guidance as a matter of internal policy as though they were AICPA members. Such a short comment deadline for foreign interested parties seems most unfair.

If you have any questions concerning this request, please contact John T. Bostelman (212-558-3840) of our New York office.

Very truly yours,

Sullivan & Cromwell

cc: Mr. Edmund R. Noonan,
Chair, Auditing Standards Board, AICPA

Mr. Dan M. Guy,
Vice President - Professional Standards and Services, AICPA

Mr. Thomas Ray,
Director - Audit and Attest Standards, AICPA
June 4, 1997

Ms. Jane Mancino, Technical Manager
Auditing Standards
American Institute of CPAs
1211 Avenue of the Americas
New York, NY 10036

Re: Exposure Draft: Proposed Statement on Standards For Attestation
Engagements, “Management’s Discussion and Analysis”

Dear Ms. Mancino:

One of the objectives that the Council of the American Institute of CPAs established for the Private Companies Practice Executive Committee is to act as an advocate for all local and regional firms and represent those firms’ interests on professional issues, primarily through the Technical Issues Committee (“TIC”). This communication is in accordance with that objective.

TIC has reviewed the above referenced exposure draft and is providing the following comments and suggestions for your consideration.

General Comment

The members of TIC realized that this document was written with SEC requirements in mind, however the ASB believes that this proposed standard would provide a framework that may be useful in providing assurance services in the future as companies experiment with new forms of financial presentations, such as the Comprehensive Model for Business Reporting. If this proposed standard is to provide a framework for future assurance services, it must be developed with both public and private companies in mind. The members of TIC are concerned that a document driven by SEC regulation will be used for such a general framework.
Audit of Financial Statements Required for Review of MD&A

Paragraph 14 of the exposure draft states that a practitioner cannot perform a review of MD&A for an annual period unless the annual financial statements for the most recent year have been audited. This would be the normal situation for a public company that is required to have annual audits. The members of TIC feel that the practitioner should be able to review the MD&A of a non-public company if the most recent year’s financial statements of the non-public company have been reviewed. They feel that a review of the financial statements provides sufficient understanding to do a review of MD&A. Furthermore, there is precedent in the standards applicable to proforma financial information (See SSAE AT§300.07), for review level services on a reviewed financial statement base. A similar precedent exists for Prospective Financial Information (See AAG-PRO 15.11). The members of TIC also wonder about the implications for a first time audit. If a client were to have a first time audit, with the previous years having been reviewed, would the auditor be precluded from reviewing MD&A?

Likely Misstatements in the Financial Statements

Paragraph 42, the third bullet-point, discusses likely misstatements that are not corrected in the financial statements that may affect MD&A disclosures. The members of TIC believe that this paragraph was meant to describe a situation where there might be a material misclassification between two accounts which is invisible on the face of the financial statements because the two accounts are summed together into one line item. This misclassification may affect MD&A disclosures. However, the members of TIC believe that this paragraph appears to imply a different level of materiality for MD&A disclosures and the financial statements, when a difference in materiality levels is not necessarily appropriate. The members of TIC recommend that this paragraph be rewritten to more clearly reflect the type of scenario that the Board had in mind.

Materiality

The members of TIC feel that paragraphs 21-28 give a very good discussion of materiality. They feel that this discussion is very valuable, and should be published, not only in this statement, but also where auditors looking for a good discussion of materiality can easily find it, perhaps in connection with AU §150.04.

Other Comments

Paragraph 7c requires the auditor to perform procedures that would provide the practitioner with a basis for expressing an opinion as to whether the underlying information and assumptions of the entity provide a reasonable basis for the disclosures contained therein. The members of TIC feel that this document might be more “user friendly” if some examples of those procedures could be provided.

The members of TIC feel that Paragraph 7 would be more clear if it were changed as follows: “When a predecessor auditor has audited the financial statement for a prior period covered by the MD&A but has not examined the MD&A for that period, the successor practitioner should also consider...”
We appreciate the opportunity to present these comments on behalf of the Private Companies Practice Section. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

James A. Koepke, Chair
PCPS Technical Issues Committee

JAK:ses

cc: PCP Executive and PCPS Technical Issues Committees
June 5, 1997

Jane M. Mancino, Technical Manager, Audit and Attest Standards
AICPA
1211 Avenue of the Americas
New York, N.Y. 10036-8775

Re: Exposure draft of a Proposed Statement on Standards for Attestation Engagements-
Management’s Discussion and Analysis-File No. 3507

Dear Ms. Mancino:

The New York State Society of Certified Public Accountants is pleased to submit the
attached comments on the above exposure draft. The comments were developed by the Society’s
Auditing Standards and Procedures Committee.

We hope these comments will be helpful. If you wish to pursue further any of these
issues, please let us know and we will have someone from the Committee contact you.

Very truly yours,

Julian Jacoby, CPA
Chair, Auditing Standards
and Procedures Committee

Walter M. Primoff, CPA
Director, Professional Programs

cc: Accounting & Auditing Committee Chairs
We note the following relating to the explanatory summary.

- **Independence** - The explanation relates to AICPA independence rules. Obviously the proposed service would be encompassed by SEC independence rules. The most practical issue that could be worth mentioning is that under SEC rules the practitioner would be precluded from assisting the registrant from developing and or preparing the information content of MD&A.

- The chart comparison is useful. We note the column under “Review” that indicates “further inquiry may be needed.” We believe that such inquiry might also necessitate other procedural/detail tests as well.

- The first explanation under Examination states apply Analytical and Corroborative Procedures. An analytical procedure can be a primary and/or a corroborative procedure.

- In the examination column we suggest guidance be included on the development of expectations by the practitioner when applying analytical procedures.

The following comments relate to the Standard itself:

- In para. 8 we suggest adding the word ‘ordinarily’ before “contemplate a test of accounting records through inspection…..” (see our comment above).

- Para. 21 discusses planning materiality. In an auditing context, one of the ways materiality is used is to establish the precision of an analytical test used as a substantive procedure, we assume this statement would also be relevant in the planning of an attest examination.

- In para. 23 we believe inclusion of the language “or element within an assertion” after “Or misstatement of an individual assertion” is appropriate since the information content is sometimes made below the assertion level and the guidance should all inclusive.

- Para. 32 should contain an “and/or” in the second sentence. “As assessed inherent and/or control risk decreases.”

- Presentation and disclosure has been omitted as an assertion in para. 33.

- The word “properly” should precede the word “described” in the MD&A presentation in para. 35.

- The theoretical underpinnings of this document are problematic if the expectation developed in para. 37 are basic to the service proposed. (Perhaps it’s only the language). How can an explanation logically be tested for completeness when the underlying data may be incomplete? The document has provided a strong link between the audited financial statements and performance of a review or examination of MD&A sufficient to provide the type of assurance to
be asserted in the report. Perhaps this paragraph should emphasize that, for example, assurance for completeness of revenue or for existence of inventory would have to be achieved as part of the audit, and that the need for an audit base (in the current year at least) results from that necessity, in providing these (proposed) services.

- The discussion of multiple components in para. 44 should be expanded. There should be a caution to practitioners that the audit base should be consistent with the MD&A components that are disclosed. If that is not done the likelihood of relevant and consistent information base might be missed. The caution might include mention of a planning element in the audit that would provide for coverage of the anticipated MD&A component disclosures.

- The Board should communicate with AICPA counsel and or the SEC Regulations Committee with regard to the issue described in para. 71. It might be a violation of law (the '33 or '34 acts) if inaccurately described data or unreasonable or inconsistent assumptions are used in MD&A. (an illegal act). That would trigger the provisions of article 10A of the '34 act that resulted from the recent Securities Reform Act, and would have other implications for the practitioner (special communication responsibilities etc.)

Our committee is split about the cost/benefit that will inure to the public and to the practitioners who will provide this service.
June 6, 1997

Jane M. Mancino, Technical Manager
Audit and Attest Standards, File 3507
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

RE: Response to the following Exposure Draft:

Proposed Statement on Standards for Attestation Engagements
- Management’s Discussion and Analysis

Dear Jane:

The following is the comment on the above exposure draft from our Accounting & Auditing Committee. It is their understanding that this draft may be accepted by the Securities and Exchange Commission making it a mandated standard. If this is the case, than compliance is the rule and not something to be commented on as if the AICPA can make an adjustment or election.

Sincerely,

Marlene Gazda
Executive Director

MG/ams
June 9, 1997

Ms. Jane M. Mancino, Technical Manager
Audit and Attest Standards
File 3507
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Mancino:

The Financial Reporting Committee of the Institute of Management Accountants appreciates the opportunity to respond to the Auditing Standards Board’s proposal, “Management’s Discussion and Analysis.”

The Committee does not object to the contents of the proposal, provided that engagements to examine or review the MD&A are voluntary. We do not believe that these services should be required because it is not at all clear that users’ needs would justify the additional costs to preparers. Further, we believe the current requirements for audit or involvement with MD&A pursuant to SAS 8 are adequate to appropriately protect investors.

Sincerely,

L. Hal Rogero, Jr.
Chairman

frc/comment.aicpa.3507
EXPOSURE DRAFT

PROPOSED STATEMENT ON STANDARDS FOR ATTESTATION ENGAGEMENTS

MANAGEMENT'S DISCUSSION AND ANALYSIS

Dated: March 7, 1997
Comment Date: June 16, 1997
No.: 800111

Jane M. Mancino, Technical Manager
Audit and Attest Standards, File 3507
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Response prepared by: Accounting and Auditing Standards Committee
Society of Louisiana CPAs
Van L. Auld
Keith A. Besson
John D. Cameron
James M. Campbell
Judson J. McCann, Jr.

Specific paragraphs:

2 - One member was unclear as to when an examination or review is required for public or nonpublic entities and whether this is governed by the SEC.

21 - One member agreed with the content of the last sentence of the paragraph and suggested this information also be communicated to the users by management, in addition to within the auditor's report.

28 - One member felt guidance should be offered in the event a subsequent discovery of a material misstatement is made.

67 - A blank line is needed between items d and e.

68, 74, 75, 89, 90, 95, and 97 (Explanatory paragraph in each report example) - One member indicated the ASB may consider adding a final sentence to the explanatory paragraph of the report examples included in the exposure draft addressing the auditor's responsibility to update his or her report if changes do occur after the report date. The wording can be the same as used in AT Section 200 - Financial Forecasts and Projections, which states, "We have no responsibility to update this report for events and circumstances occurring after the date of this report."

General comments:

One member indicated the ASB may consider including the report examples in an Appendix at the end of the standard for ease of reading.

One member questioned, "If the auditor prepares the MD&A and is also engaged to provide assurance on the MD&A, are additional procedures required or is this prohibited?"
One member indicated that expanding the auditor’s work to MD&A would open new fields of litigation. The member believes it is a bad idea for auditors to examine or review any MD&A unless necessary for the SEC. The member felt the auditor should take an active approach and distance himself or herself from all management speculation; therefore, a statement of non-examination or non-review is appropriate. The member stated the audit already faces the problem of proving its worth without the compounding difficulty of judging the bias of management’s comments. The member recommended the statement be withdrawn.
May 5, 1997

Jane M. Mancino, Technical Manager  
Audit and Attest Standards File 3507  
American Institute of Certified Public Accountants  
1211 Avenue of the Americas  
New York, New York 10036-8775

Dear Ms. Mancino:

I have reviewed the exposure draft of Proposed Statement on Standards for Attestation Engagements-Management’s Discussion and Analysis as prepared by the Auditing Standards Board. A summary of my comments follows.

General Comments

It appears to me that the proposed statement might be of limited application. I recognize that auditing or reviewing MD&A data provides financial statement users a higher level of confidence in the data presented. However, I wonder how many companies will find this higher level of user confidence “cost effective”.

Generally, I support the proposed statement because it appears to be “pro active” in nature. I have an idea that the proposed standards might be in anticipation of future SEC requirements in this area.

Specific Comments

Paragraph 14-For non public entities it seems inappropriate to require “audited” annual financial statements for MD&A that has been “reviewed”. A practitioner should be allowed to “review” MD&A covering “reviewed” annual financial statements of non public entities.

Paragraphs 40 and 80—There is no reference to materiality in paragraph 80 as there is in paragraph 40. References to materiality, which should be consistent with guidance in the SSARS, appear to be needed in both paragraphs.

I appreciate the opportunity to share my views and concerns relating to this exposure draft. Should you have any questions regarding my comments, please feel free to contact me at (407) 246-2294.

Very truly yours,

Lynda Munion Dennis, CPA  
c/o City Hall-Fourth Floor  
400 South Orange Avenue  
Orlando, Florida 32801
6 June 1997

Technical Manager, Jane M. Mancino  
Audit and Attest Standards, File 3507  
American Institute of Certified Public Accountants  
1211 Avenue of the Americas  
New York, New York 10036-8775

Dear Ms. Mancino,

We appreciate the opportunity to comment on the Exposure Draft, Attestation Engagements for Management’s Discussion and Analysis. Air Products is a major international supplier of industrial gases and related equipment and chemicals with consolidated annual sales exceeding $4 billion.

The existing audit requirements concerning the MD&A are certainly adequate and appropriate. The auditor is currently required to read the MD&A and consider whether the MD&A, or the manner of its presentation is materially inconsistent with information, or the manner of its presentation, appearing in the financial statements. This audit scope, combined with the review by the SEC, provides adequate assurance to readers that the MD&A is consistent with the information in the financial statements. The proposed higher level of review seems to be an unnecessary addition to the audit scope. This expansion of effort and cost is not justified by a well defined deficiency in the current audit requirements.

The exposure draft refers to the research performed by the AICPA Special Committee on Financial Reporting. In that effort, some users expressed a desire for more auditor involvement in the financial information they receive. These users have also requested more forward-looking information in the MD&A. An auditor’s review of forward-looking information would be counterproductive. By its nature, forward-looking information is based on a management judgment and not auditable facts. Management would be required to justify to the auditor their judgments which would be a time-consuming and costly exercise. Our reaction to this would be to not spend our shareholder’s money on this and reduce forward-looking information. Additionally, it is our opinion that an auditor could not attain sufficient business knowledge about our company to attest to any significant forward-looking information.
The exposure draft states that an examination of the MD&A would provide both users and preparers with an independent opinion regarding whether the presentation includes the required elements of item 303 of regulation S-K and the related SEC rules and regulations. Preparers are subject to SEC review and are provided SEC feedback on compliance. This additional scope by external auditors seems to be redundant and unnecessary.

It is stated that audit committees might benefit by the additional scope being added to the external audit. We do not believe this to be true. We follow a practice with our Audit Committee where I lead them through their own detailed review of the MD&A with our auditors present prior to our filing. We believe this procedure to be a more efficient and a more effective review for the MD&A. Our Audit Committee’s current emphasis is on the containment of audit scope and expense, not expanding it.

We do not believe the proposed standard is needed. It will not provide the readers of the MD&A with new or more useful information. The actual results would be to reduce disclosures of forward-looking information. Finally, the additional scope will only add to audit expense and produce no benefits.

We again thank you for the opportunity to express our views on this accounting issue.

Sincerely,

Paul E. Huck
Vice President and Corporate Controller
Ms. Jane M. Mancino
Technical Manager
Audit and Attest Standards
File 3507
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Mancino:

We have reviewed the Exposure Draft entitled “Proposed Statement on Standards For Attestation Engagements, Management’s Discussion and Analysis” and have no comments. We appreciate the opportunity to review the Exposure Draft.

If you have any questions, please contact Herbert A. Maguire, Director of the Bureau of Audits at 717-783-0114.

Sincerely,

Harvey C. Eckert

cc: Herbert A. Maguire
June 12, 1997

Ms. Jane Mancino
Technical Manager
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Mancino:

Attached is our response to the AICPA's Exposure Draft of the proposed Statement on Standards for Attestation Engagements, "Management's Discussion and Analysis."

Very truly yours,

Richard Dieter

MRH

Enclosure
June 12, 1997

Ms Jane M. Mancino  
Technical Manager, Audit and Attest Standards  
File 3507  
American Institute of Certified Public Accountants  
1211 Avenue of the Americas  
New York NY 10036-8775

Dear Ms. Mancino:

We are pleased to respond to the Exposure Draft of the proposed Statement on Standards for Attestation Engagements, "Management's Discussion and Analysis" (MD&A).

We support the issuance of the exposure draft as a final statement. We believe it represents an appropriate expansion of the types of services that an auditor may perform. We recognise that significant demand does not currently exist for this service and only time will tell if it will develop in any significant fashion in the future. We do not believe the standard will influence the SEC in requiring explicit auditor association with MD&A. In our view, the demand for the service will come only if the market perceives value in the service.

We also believe that this standard, primarily because it deals with "less objective" information in a comprehensive manner, will serve as a guideline for auditor association with other so called soft information.

While we are supportive of the overall statement, we have significant concerns with permitting a review level service on MD&A that is associated with audited historical financial statements. We believe a real possibility of confusion to users exists as to exactly what the review report means and whether it detracts from the audit report on the historical financial statements. Readers of public company reports are generally not familiar with the review report wording and may derive more assurance from a limited review report on MD&A than is warranted.

Our strong preference would be to not permit a review of MD&A when the underlying financial statements have been audited; however, we recognise that this broad prohibition may not be acceptable to a majority of board members. Accordingly we could accomplish the same objective by prohibiting issuance of an unrestricted review report on MD&A related to audited financial statements. This would eliminate our concerns about public misunderstanding or misuse of the review report but at that same time permit the service for specified users such as
underwriters in a comfort letter environment. This proposed change would still permit a review level service on the MD&A associated with unaudited/reviewed interim financial statements.

We would be pleased to discuss our comments with the Board or the Task Force at their convenience.

Very truly yours,

ARTHUR ANDERSEN LLP

MRH
June 13, 1997

Jane M. Mancino, Technical Manager
Audit and Attest Standards, File 3507
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Mancino:

The Professional Issues Subcommittee (PIC) of the Business and Industry Executive Committee (BIEC) has considered the March 7, 1997 Exposure Draft of the Proposed Statement on Standards for Attestation Engagements, Management's Discussion and Analysis, and has prepared this letter of comment.

The BIEC represents the interests of the AICPA members employed in industry. Part of PIC's objective is to provide a resource to the AICPA's technical committees by reviewing and commenting on those developments that have significant effect on the broad range of businesses that employ members in business and industry.

In responding to the exposure draft, we are not attempting to impose any restrictions on the auditor's prerogative to establish auditing procedures, but to provide you insights on our perspective as the client. Accordingly, our response is directed to those areas for which we believe our views are most relevant.

We would like to recommend that the objectives listed for an examination in paragraph 4 and a review in paragraph 8 be included in the Comparison Table. We found the summary table to be very helpful.

Regarding the proposed independent accountant's report, we would like to recommend that the second sentence of the introductory paragraph be shortened to read as follows, "Management is responsible for the preparation of the Company's Management's Discussion and Analysis." This revision would make the wording consistent with the management representation made in an unqualified audit opinion where we refer to management's responsibility without listing pursuant to generally accepted accounting principles. The reference to Item 303 and the published rules is included in the opinion paragraph.

We appreciate the opportunity to comment on the exposure draft. If you would like any clarification of our response please contact me at 612-726-7295 or our staff liaison Hadassah Baum at extension 6019.

Sincerely,
Holly L. Nelson
Chair, Professional Issues Subcommittee

cc: Bob Brewer
    Hadassah Baum
    PIC members
June 13, 1997

Ms. Jane M. Mancino, Technical Manager
Audit and Attest Standards, File 3507
AICPA
1211 Avenue of the Americas
New York, NY 1036-8775

Re: Proposed Statement on Standards for Attestation Engagements
Management’s Discussion and Analysis

Dear Ms. Mancino:

The Auditing and Auditing Standards Committee (the “Committee”) of the New Jersey Society of Certified Public Accountants (“NJSCPA”) is pleased to submit its comments on the AICPA’s Proposed Statement on Standards for Attestation Engagements entitled Management’s Discussion and Analysis (MD&A). The views expressed in this letter represent the majority of a quorum of the members of the Committee and are not necessarily indicative of the full membership of the NJSCPA.

We believe the threshold issue is whether a standard on MD&A should be issued at all. We think the case for such a standard has not been adequately made in the exposure draft. However, we also recognize that a proactive stance is appropriate, and accordingly agree with the issuance of the Statement.

We agree that the two levels of assurance are appropriate.

We agree that practitioners must adequately understand the client’s operations in order to provide any assurance on MD&A. Therefore, auditing or reviewing the most recent financial statements is an appropriate requirement for performing an audit or review of the MD&A.

We also agree that a nonpublic entity’s MD&A should be prepared in accordance with SEC rules and regulations for accountants to be associated with it.
We also have the following suggestions for minor improvements:

a. Paragraph 58 should include a requirement for a representation letter, similar to paragraph 79f. This should cover more than just subsequent events (paragraph 64d).

b. Paragraphs 90, 95 and 97, scope paragraph – “We conducted our review of Management’s Discussion and Analysis in accordance…”

We would be pleased to discuss our comments with the Board or its staff.

Very truly yours,

John A. Fazio, CPA, Chairperson
Auditing and Accounting Standards Committee

cc: Kenneth W. Moore, CPA, President
    Daniel J. Meehan, CPA, President-Elect
    William M. Collister, CPA, Trustee
    John A. Demetrius, CPA, Trustee
    Joseph F. Scutellaro, CPA, Trustee
    Merryl A. Bauer, Executive Director
June 17, 1997

Ms. Jane M. Mancino
Technical Manager
Audit and Attest Standards
File 3507
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Jane M. Mancino:

This is the State of New Jersey, Office of the State Auditor's response to the AICPA Auditing Standards Board's exposure draft "Management's Discussion and Analysis".

GASB is also requiring a management's discussion and analysis section to be included with the basic financial statements in their exposure draft "Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments". Their exposure draft makes no mention of preparing the MD & A in accordance with the published SEC rules and regulations. The AICPA and GASB should coordinate their exposure drafts so that the MD & A will be in compliance with both the AICPA and GASB.

Numerous times throughout the AICPA exposure draft the MD & A is to be in compliance with "Item 303 of Regulation S-K". The nonpublic entity community is not familiar with SEC regulations. Item 303 of Regulation S-K should have been included as an appendix to the exposure draft.

If you have any questions regarding this response, please contact me at (609) 777-2889.

Respectfully submitted,

Anthony J. Glebocki, CGFM, CPA
Technical Staff Audit Manager
June 10, 1997

Ms. Jane M. Mancino, Technical Manager
Audit & Attest Standards, File 3507
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York, 10036-8775

Dear Ms. Mancino:

We are pleased to have the opportunity to comment on the Auditing Standards Board's Exposure Draft of the proposed Statement on Standards for Attestation Engagements, "Management's Discussion and Analysis." We do not believe the proposed standard should be issued for the following reasons:

1. Existing Item 303 of Regulation S-K and the related published rules and regulations of the Securities and Exchange Commission do not meet the requirements for a reasonable criterion.

SEC rules and regulations allow significant latitude in determining the information to be included in MD&A. This is done to encourage a "freer" form of reporting as opposed to less informative boiler plate. Voluntary inclusion of external and forward looking data is also encouraged. While this format is appropriate for encouraging management to be creative in better informing investors, the criterion is not sufficiently specific to allow appropriate evaluation by the practitioner. We believe that inevitably the desire of the practitioner to limit the disclosures to items for which evidence is more readily obtainable will lead to more boiler plate and less informative reporting to investors.

2. Inability to test for completion to the level normally expected in an examination level engagement.

As previously indicated, MD&A presentations often include voluntary nonfinancial information and information external to the entity. Testing for completeness of this type of information is often limited to discussions with management and attempting to compare the information to other relevant external information. Additionally, MD&A includes assertions about the reasons for certain results such as changes in financial statement amounts. The reasons often are simply based on management's opinions, which cannot be expected to consider all possible internal and external factors. In addition, these opinions vary from individual to individual as could the knowledge and support available for such opinions.

Users of an examination level report have come to expect a higher level of assurance with respect to the completeness assertion than we are capable of delivering on certain information included in MD&A.
3. The difference between the discrete annual financial statements and the cumulative three year MD&A presentation causes insurmountable practical problems.

This is particularly evident when an entity changes auditors. The proposed solution in the Exposure Draft is a good attempt at compromise. However, we believe the inherent conflict between the nature of the linked presentation (i.e., the discrete period financial statements and the cumulative three years MD&A) result in an unworkable situation that would stifle disclosure when an entity changes auditors.

We believe this standard should not be issued. We have, however, the following suggestions for changes should the Board decide to issue a final statement.

Footnote 9 on page 15 states "whether financial amounts are accurately derived from the financial statements includes both amounts that are derived from the face of the financial statements (which includes the notes to the financial statements) and those that are derived from underlying records . . ." add "and schedules" before the first parenthesis as clarification.

Paragraph 15a permits the practitioner to review a MD&A presentation for a nonpublic entity based on a SAARS review. A SAARS review does not equate to a SAS 71 review in depth of procedures performed and more importantly it does not require the practitioner to obtain an understanding of the internal control structure (AR 100.30), whereas SAS 71 requires the accountant to have "sufficient knowledge of a client's internal control structure policies and procedures . . ." If the discussion in paragraph 81 is intended to be additive to the requirements in SAARS 1, that should be carefully articulated in the document.

Paragraph 82 seems to omit any procedures related to industry trends and directions. Item 303(a)(3)(ii) requires disclosure of "any known trends or uncertainties." The staff has insisted on disclosures related to industry and market trends and paragraph 80 acknowledges the need to consider such trends. Paragraph 58h addresses procedures for an examination, but no such procedure exists for a review. Guidance should be provided on analytical procedures and inquiry procedures to be performed related to such industry and market trends in a review.

The SEC's Industry Guides require specific additional disclosures which are generally included in MD&A. Guidance should be provided in the standard on appropriate procedures to apply in examining and reviewing interest-rate and other risk management elements.

Paragraphs 98-100 in the section entitled "When Practitioner is Engaged Subsequent to the Filing of MD&A" appears unnecessarily complicated. As is required for nonpublic companies, the MD&A presentation for public companies should be updated for material subsequent events through the date of the practitioner’s report.

Secondly, footnote 17 on page 30 refers the reader to SAS No.1, section 561, Subsequent Discovery of Facts Existing at the Date of the Auditor's Report. However, there is no guidance on how to address the implications of that Statement on MD&A.
In paragraph 114, there should be a specific representation for PFI as to the consistency of the accounting principles used between the PFI and GAAP financial statements in addition to the other information in paragraph 114c.

We would be pleased to discuss our comments with you and to answer questions you may have.

Sincerely yours,

Price Waterhouse LLP
June 18, 1997

Ms. Jane Mancino  
Technical Manager  
Audit and Attest Standards  
American Institute of Certified Public Accountants  
1211 Avenue of the Americas  
New York, NY 10036-8775

Re: File 3507

Dear Ms. Mancino:

We are pleased to comment on the Proposed Statement on Standards for Attestation Engagements, *Management's Discussion and Analysis* and the proposed amendment to Statement on Auditing Standards No. 72, *Letters for Underwriters and Certain Other Requesting Parties*.

We support issuance of the proposed SSAE, and believe that a review level of service should be permitted (as proposed in the Exposure Draft) when the financial statements for such period have been audited. We believe that the client should have the ability to choose the level of assurance that they desire for their purposes and that in many situations, the desired assurance would be satisfied by a review level of service.

On a separate, but clearly related matter, we are concerned that the Securities and Exchange Commission will view attestation reports (including review reports) on MD&A as those of an expert and, therefore, such reports would be subject to the liability provisions of Section 11 of the Securities Act. The Commission has granted exemption from Section 11 liability to accountant's review reports on interim financial information and we strongly urge the AICPA to pursue similar rulemaking by the Commission with respect to independent accountant’s reports on MD&A. We would fully support such efforts by the Institute.

The attachment to this letter contains other comments for your consideration. Please contact John Fogarty at (203) 761-3227 if you wish to discuss our comments.

Sincerely,

[Signature]

Deloitte & Touche LLP
OTHER COMMENTS

General Structure

The unique features of MD&A presentations coupled with the various means by which practitioners may be involved with MD&A results in a multitude of reporting situations, each of which requires an illustrating report example. We believe consideration should be given to locating all report examples in an appendix, in a manner similar to that used in SAS No. 72, rather than dispersing the examples throughout the standard.

Paragraph 2

We believe that footnote 3 to paragraph 2 should be revised to indicate that Item 303 of Regulation S-K is interpreted by Financial Reporting Release No. 36, not amended by it. We recommend the footnote be revised to read as follows:

As of the date of issuance of this Standard, the published SEC rules and regulations for MD&A are found in Item 303 of Regulation S-K (17 CFR § 229.303–Title 17 of the Code of Federal Regulations), as interpreted by Financial Reporting Release (FRR) No. 36, Management’s Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures. Item 303 of Regulation S-K, as interpreted by FRR No. 36,...

Paragraph 5

Footnote 10 to paragraph 5 refers to restrictions on the scope of the audit of the financial statements. We believe consideration should be given to acknowledging that the SEC, generally, will not accept an auditor’s report modified for a scope limitation.

Paragraph 7

Based upon the reporting objectives outlined in paragraph 4, we believe paragraph 7 should be amended to add a new sub-paragraph following sub-paragraph b. that would read:

b. Perform the procedures that will provide the practitioner with a basis for expressing an opinion as to whether the MD&A includes the required elements of Regulation S-K and the related published rules and regulations.
Paragraph 9

As paragraph 9 relates to both examination and review engagements, we recommend that such paragraph be labeled “Engagement Acceptance Considerations” and moved to follow paragraph 15.

Paragraph 11

Because paragraphs 7 and 11 convey similar concepts, consideration should be given to conforming the style of presentation of the sub-paragraphs within paragraphs 7 and 11.

Paragraph 15

Industry practice has permitted the performance of a SAS 71 review of condensed interim financial information of a nonpublic entity that presents such condensed interim financial information in a manner prescribed by the SEC for public entities together with complete annual financial statements. Accordingly, we believe paragraph 15 a. should be modified to renumber the exiting item (2) as item (3) and add the following new item (2) as follows:

The practitioner performs one of the following (1) a review of the historical financial statements for the related interim periods under the Statement on Standards for Accounting and Review Services and issues a review report thereon, (2) a review of the condensed interim financial information for the related interim periods under SAS No. 71 and issues a review report thereon, and such interim financial information is accompanied by complete annual financial statements for the most recent fiscal year that have been audited, or (3) an audit of the interim financial statements.

Paragraphs 33 through 36

Paragraphs 33 through 36 contain descriptions and examples of the nature of assertions that are embodied in MD&A. In addition, paragraph 33 presents three broad categories into which the assertions may fall. Because management’s assertions in MD&A may include forward-looking and voluntary information and information derived from external sources, we believe that consideration should be given to including “presentation and disclosure” as one of the categories described under the heading “Nature of Assertions.”

Paragraph 35

We believe consideration should be given to revising paragraph 35 to introduce the concept of liquidity and to more closely conform the description of the required elements of MD&A to those described in Item 303 of regulation S-K. The paragraph could be changed to read:
Assertions about completeness address whether descriptions of transactions and events necessary to obtain an understanding of the entity’s financial condition (including liquidity and capital resources), changes in financial condition, results of operations, and material commitments for capital resources are included in MD&A; and whether known events, transactions, conditions, trends, demands, commitments, or uncertainties that will result in, or are reasonably likely to result in, material changes to these items are appropriately described in the MD&A presentation.

Paragraph 50

The last sentence of paragraph 50 assumes that the entity is a public company. To broaden the application of the guidance in this paragraph, we recommend that the last sentence be modified to read:

The nature and extent of procedures a practitioner performs vary from entity to entity and are influenced by factors such as the entity’s complexity, the length of time the entity has prepared MD&A pursuant to the published rules and regulations of the SEC, the practitioner’s knowledge of the entity’s controls obtained in audits and previous professional engagements, and judgments about materiality.

Paragraph 63

We believe consideration should be given to revising the introductory sentence to this paragraph to more closely conform the description of the required elements of MD&A to those described in Item 303 of Regulation S-K. We recommend that the first sentence be modified to read:

...after the end of the period addressed by MD&A and prior to the issuance of his or her report that may have a material affect on the entity’s financial condition (including liquidity and capital resources), changes in financial condition, results of operations, and material commitments for capital resources.

Paragraph 63

The criteria for the required elements of MD&A, set forth in the bullet points in paragraph 63, apply to events, circumstances and transactions occurring during the period addressed by MD&A as well as those occurring subsequent to the balance sheet date. Accordingly, we believe these criteria should be introduced earlier in the proposed SSAE, perhaps as an addition to paragraph 19.
Paragraph 68

MD&A may include information regarding the estimated future impact of transactions and events that have occurred, as well as those which are expected to occur. Accordingly, we believe the second sentence in the explanatory paragraph included in the report example in paragraph 68 (as well as other report examples in the proposed SSAE) should be revised as follows:

Management’s Discussion and Analysis includes information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties.

Paragraph 72

Although paragraph 72 was intended to cover the effect on the practitioner’s report when there is a scope limitation, the guidance should also address that the practitioner may need to withdraw from the engagement.

Paragraph 76

We believe that the example paragraph as written would be appropriate to add to a report on a review of an interim period following a pooling of interests in which MD&A for the most recent annual period is restated. However, it is unclear what the form of the practitioner’s report should be when an examination is performed for an annual period following a pooling of interests. Accordingly, we also recommend including the full report for such situation. Such report might read as follows:

[Introductory paragraphs]

We have examined XYZ Company’s Management’s Discussion and Analysis, included [incorporated by reference] in the Company’s Annual Report on Form 10-K for the year ended December 31, 19x5, prior to the restatement of the information for periods prior to January 1, 19x5 for the 19x5 pooling of interests described below. We also examined the combination of the accompanying Management’s Discussion and Analysis with respect to periods prior to January 1, 19x5, after restatement for the 19x5 pooling of interests. Management is responsible for the preparation of the Company’s Management’s Discussion and Analysis pursuant to Item 303 of Regulation S-K and the related published rules and regulations of the Securities and Exchange Commission. Our responsibility is to express an opinion on the
presentation based on our examination. The Company’s Management’s Discussion and Analysis gives retroactive effect to the merger of XYZ Company and ABC Corporation in 19x5, which has been accounted for as a pooling of interests. We did not examine ABC Corporation’s Management’s Discussion and Analysis included in ABC Corporation’s Annual Report on Form 10-K for the year ended December 31, 19x4. Such Management’s Discussion and Analysis was examined by other accountants, whose report has been furnished to us, and our opinion, insofar as it relates to information included for ABC Corporation as of and for the year ended December 31, 19x4 and prior, is based solely on the report of the other accountants.

We have audited, in accordance with generally accepted auditing standards, the financial statements of XYZ Company as of and for the year ended December 31, 19x5, and in our report dated Month xx, 19x6, we expressed an unqualified opinion on those financial statements. We also audited the combination of the financial statements of XYZ Company as of December 31, 19x4 and for each of the years in the two year period then ended, after restatement for the 19x5 pooling of interests with ABC Corporation, whose financial statements as of December 31, 19x4 and for each of the two years then ended were audited by other auditors, whose report dated Month xx, 19x5, expressed an unqualified opinion on those financial statements.

[Scope paragraph]

Our examination of Management’s Discussion and Analysis was made in accordance with standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting the historical amounts and disclosures in the presentation. An examination also includes assessing the significant assumptions and determinations made by management as to the relevancy of information. We believe that our examination and the report of other accountants provide a reasonable basis for our opinion.

[Explanatory paragraph]

The preparation of Management’s Discussion and Analysis in conformity with the published rules and regulations of the Securities and Exchange Commission requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. Management’s Discussion and Analysis
includes information regarding the estimated future impact of expected transactions and events, expected sources of liquidity and capital resources, operating trends, commitments and uncertainties. Actual results in the future may differ materially from management’s present assessment of this information because events and circumstances frequently do not occur as expected.

[Opinion paragraphs]

In our opinion, based on our examination, the Company’s Management’s Discussion and Analysis included [incorporated by reference] in the Company’s Annual Report on Form 10-K for the year ended December 31, 19x5 includes, in all material respects, the required elements of Item 303 of Regulation S-K and the related published rules and regulations of the Securities and Exchange Commission; the 19x5 historical financial amounts included therein have been accurately derived, in all material respects, from the Company’s financial statements; and the underlying information and assumptions of the Company provide a reasonable basis for the 19x5 disclosures contained therein. Also, in our opinion, the management’s discussions and analyses of XYZ Company and ABC Corporation for the periods prior to January 1, 19x5 included in the accompanying Management’s Discussion and Analysis have been properly combined.

Alternatively, the introductory paragraph of the above report might read as follows:

We have examined XYZ Company’s Management’s Discussion and Analysis, included [incorporated by reference] in the Company’s Annual Report on Form 10-K for the year ended December 31, 19x5. We did not examine information included in the aforementioned Management’s Discussion and Analysis for periods prior to January 1, 19x5, which has been restated for the 19x5 pooling of interests described below. However, we examined the combination of the accompanying Management’s Discussion and Analysis with respect to periods prior to January 1, 19x5. Management is responsible for the preparation of the Company’s Management’s Discussion and Analysis pursuant to Item 303 of Regulation S-K and the related published rules and regulations of the Securities and Exchange Commission. Our responsibility is to express an opinion on the presentation based on our examination. The Company’s Management’s Discussion and Analysis gives retroactive effect to the merger of XYZ Company and ABC Corporation in 19x5, which has been accounted for as a pooling of interests. We examined the Company’s Management’s Discussion
and Analysis included in ABC Corporation's Annual Report on Form 10-K for
the year ended December 31, 19x4 (prior to restatement for the 19x5 pooling of
interest). Other accountants examined ABC Corporation's Management's
Discussion and Analysis included in ABC Corporation's Annual Report on
Form 10-K for the year ended December 31, 19x4. The other accountants' report
has been furnished to us, and our opinion, insofar as it relates to
information included for ABC Corporation as of and for the year ended
December 31, 19x4 and prior, is based solely on the report of the other
accountants.

Paragraph 90

When a report similar to the one presented in paragraph 90 is issued for a nonpublic
entity, we believe consideration should be given to revising the introductory paragraph
to reflect that the review was conducted “...in accordance with Statements on Standards
for Accounting and Review Services issued by...” rather than “...in accordance with
standards established by the American Institute of Certified Public Accountants....”

Paragraph 114

We recommend that management be required to provide an affirmative written representation
that the MD&A has been prepared in accordance with Item 303 of Regulation S-K.
Accordingly, we propose that paragraph 114a. be revised to read as follows:

a. Management’s acknowledgment of its responsibility for the preparation of MD&A,
and a statement that management has prepared the MD&A in accordance with
Item 303 of Regulation S-K and the related published SEC rules and regulations for
MD&A.

Such revision would also negate the need for footnote 34.

Proposed Amendment to Statement on Auditing Standards No. 72, Letters for
Underwriters and Certain Other Requesting Parties

Because amendments are being proposed to SAS No. 72 to revise various paragraphs and add
Example R: Comfort Letter That Includes Reference to Examination of Annual MD&A and
Review of Interim MD&A to the appendix, we believe this is an opportunity to amend
Paragraph 6 of Example A: Typical Comfort Letter in SAS No. 72. In many instances, when
the accountant is asked to comment on subsequent changes in financial statement items for
periods for which no consolidated financial statements are available, Company officials inform the accountant that they are unable to determine whether there have been any decreases in consolidated net current assets, shareholders’ equity or in the total or per share amounts of income before extraordinary items or of net income. Accordingly, we recommend that the following language be added to the end of paragraph 6 of Example A as alternative language for such situations:

...except in all instances for changes, increases, or decreases, that the registration statement discloses have occurred or may occur [and except as disclosed in the following two sentences. Company officials have informed us that they are unable to determine whether there have been any decreases in consolidated net current assets, shareholders’ equity or in the total or per share amounts of income before extraordinary items or of net income, because consolidated financial statements are not available for such period.]
June 10, 1997

Ms. Jane M. Mancino, Technical Manager  
Audit and Attest Standards, File 3507  
American Institute of Certified Public Accountants  
1211 Avenue of the Americas  
New York, NY 10036-8775  

RE: Proposed Statement on Standards for Attestation Engagements - "Management's Discussion and Analysis"

Dear Ms. Mancino:

The Accounting Principles and Auditing Procedures Committee is the senior technical committee of the Massachusetts Society of Certified Public Accountants. The Committee consists of over thirty members who are affiliated with public accounting firms of various sizes from sole proprietor to international "big six" firms, as well as members in both industry and academia. The Committee has reviewed and discussed the Exposure Draft ("ED") Proposed Statement on Standards for Attestation Engagements - "Management's Discussion and Analysis," and the comments resulting from that discussion are summarized below. The views expressed in this letter are solely those of the Committee and do not reflect the views of the organization with which the Committee members are affiliated.

Based upon the review of the ED, the following is a list of our issues and comments:

**Issue 1: Paragraph 24 relates to the inclusion of pro forma financial information within MD&A.**

Currently, AT300, "Reporting on Pro Forma Financial Information," provides guidance for reports on an audit or a review of pro forma financial information. In considering the guidance in AT300, the question arises as to whether the full scope of AT300 needs to be followed in performing an audit or review of pro forma financial information included within MD&A. The ED under discussion does not appear to incorporate many of the requirements of AT300. There is limited guidance within the ED as to possibly modifying a report on MD&A to take into consideration AT300 requirements. For example, the standard report on examination of pro forma financial information includes a paragraph describing the objective of pro forma financial information which the ED does not address. We believe that it will be difficult for the practitioner
to comply with AT300 standards when performing an audit or review of MD&A under the current ED. Additionally, we believe that the ASB should consider the possibility of performing an audit or review of MD&A which would allow for the exclusion of the audit or review of pro forma financial information.

**Issue 2:** Paragraph 26 of the ED relates to the inclusion of forward-looking disclosures by an entity within the MD&A.

AT200, “Financial Forecasts and Projections,” provides guidance for reports on an audit or a review of forward-looking information. In considering the guidance in AT200, the question arises as to whether the full scope of AT200 needs to be followed in performing an audit or review of forward-looking information included within MD&A. The ED under discussion does not appear to incorporate many of the requirements of AT200. There is limited guidance within the ED as to possibly modifying a report on MD&A to take into consideration AT200 requirements. For example, there is little guidance relating to the minimum presentation guidelines as per AT200.67 that may need to be included in the MD&A in order to perform an examination under the ED. As with Issue 1, we believe that it will be difficult for the practitioner to comply with AT200 standards when performing an audit or review of MD&A under the current ED. Also, we believe that the ASB should consider the possibility of performing an audit or review of MD&A which would allow for the exclusion of the audit or review of forward-looking information.

**Issue 3:** Paragraphs 47 through 56 of the ED relate to the entity’s internal control structure for the preparation of MD&A.

It appears that a more appropriate title for this section as well as references throughout the ED is *Consideration of Internal Control Applicable to the Accounts and/or Elements Discussed in MD&A*. This change is proposed due to the fact that the information contained in MD&A is usually obtained from sources within the entity that is overseen by an internal control structure which is reviewed and evaluated during the audit of the entity’s financial statements. Additionally, most entities will not have a complex internal control structure relating to the preparation of the MD&A, but rather, a simple structure comprised of preparation and review by a high level of management.

**Issue 4:** Paragraphs 71 and 72 in the ED gives guidance when a practitioner deems it necessary to qualify or disclaim an opinion while Paragraph 78 discusses communication with the entity’s audit committee.

In comparing these paragraphs, we believe that there is ambiguity relating to when a practitioner issues a qualified report and the corresponding required communication with the audit committee. It appears that the conclusion in Paragraph 78 that “if the MD&A is not revised, the practitioner should evaluate (a) whether to resign from the engagement related to the MD&A, and (b) whether to remain as the entity’s auditor or stand for reelection to audit the entity’s financial
"Management’s Discussion & Analysis"

MSCPA

June 10, 1997

 McMahon & Scott

statements” would appear to preclude the issuance of a qualified or denial of opinion as sown in Paragraphs 71 and 72. The ED should be clarified to eliminate this ambiguity.

**Issue 5:** Paragraph 114 provides guidance for obtaining management’s written representations.

We believe that this paragraph should discuss in more detail representation letters obtained in the examination or review of MD&A that incorporates nonfinancial data, including examples.

**Issue 6:** The ED does not address the potential situation in which practitioners are engaged to examine or review MD&A which includes information from financial statements that were audited by a predecessor that did not examine or review that respective MD&A.

The ED identifies a situation (Paragraph 7) in which the prior year financial statements were audited, but MD&A was not. The ED continues by attempting to provide guidance on how a practitioner should gain comfort with prior year’s MD&A, but does not discuss the possibility of the practitioner being unable to do so. This inability could be particularly problematic for information that is not derived directly from the audited financial statements, such as prior year market share or plant capacity. We believe that these potential transitional situations need to be addressed within the ED and should be accompanied by examples of the appropriate wording to be included in the practitioner’s report.

In summary, although we believe that the overall direction of the ED will result in the improvement of the presentation and quality of information in MD&A, the ED, as drafted, presents possible issues of conflict relating to preexisting literature and certain transitional concerns that need to be addressed before finalization of the standard.

We appreciate the opportunity to present our comments and thank you for your consideration.

Very truly yours,

Jeffrey D. Solomon, CPA, Chairman
Accounting Principles & Auditing Procedures Committee
Massachusetts Society of Certified Public Accountants
June 13, 1997

Ms. Jane M. Mancino  
Technical Manager  
Audit and Attest Standards  
American Institute of Certified Public Accountants  
1211 Avenue of the Americas  
New York, NY 10036-8775

RE: File No. 3507

Dear Ms. Mancino:

We read with interest the Proposed Statement on Standards for Attestation Engagements, *Management's Discussion and Analysis* (the PSSAE). As a document providing technical guidance to practitioners engaged to examine or review management’s discussion and analysis (MD&A), we find no significant flaws and offer no specific comments.

We do question, however, the premise for issuing the PSSAE.

The Auditing Standards Board (ASB) states that the PSSAE provides a framework for future assurance services as companies “experiment” with new forms of financial presentations, such as the AICPA’s own Comprehensive Model for Business Reporting. Obviously, in a population as large and diverse as U.S. securities registrants, it would be surprising if some did not elect to have their MD&A’s examined or reviewed. On the other hand, we believe that these registrants will represent rare exceptions. In our view, the vast majority of preparers will conclude that the subject assurance service just doesn’t meet a market test. Our experience, in fact may be illustrative. We maintain a close liaison with our various users, but have heard nothing that would indicate their support for audited MD&A.

The ASB also asserts that management would do a better job of preparing MD&A if there were more oversight from their auditors. We should welcome the research underlying this assertion. Our intuition is just the opposite — when a party knows that a work product will be reviewed, the temptation to relax the quality standards is quite high. Given the remarkable accuracy over the years that has become associated with unaudited MD&A, this assertion needs badly to be supported with research — or dropped.
Without clear value to outweigh the cost, we would expect most companies to decline this service.

That said, our real concern is that a change in the regulatory environment could make an examination of MD&A mandatory and preclude a company’s right to make a value judgment on the merits of the service.

Our proposal is simple—we shall support your initiative to put a standard in place that allows practitioners to accommodate those companies that may find a need and justification for this service. In turn, we expect that the ASB and AICPA will make every effort to support the need for due process for the preparer community should regulators begin to move more actively in the direction of mandatory reporting on MD&A.

* * * * *

We shall be pleased to respond to any questions regarding this letter.

Sincerely,

Philip D. Ameen
June 16, 1997

Ms. Jane M. Mancino
Technical Manager, Audit and Attest Standards
File 3507
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Mancino:

We support the issuance of the proposed Statement on Standards for Attestation Engagements, Management’s Discussion and Analysis.

Within this context of support, we have the following suggestions for improvement in the Statement.

The table included in the summary section comparing procedures under SAS No. 8 to an attest engagement is a valuable aid to practitioners. We suggest that it be included as an appendix to the final SSAE. Also, it could better differentiate between the review and examination levels of service more clearly by including the scope of the service and explaining, in more detail, the level of procedures for both a review and an examination.

Paragraph 2, footnote 6 - We suggest that the phrase "follow guidance" be changed to "refer to paragraph 34, footnote 25,". Also, the phrase “agreed-upon” should be deleted. This would eliminate confusion as to what procedures may be performed in connection with a comfort letter.

Paragraph 3.b - We believe that this subparagraph should be deleted. We are concerned that this type of service is inconsistent with the SEC’s expressed concerns with accountants taking too large a role in actually crafting a client’s MD&A.

Paragraph 5, footnote 10 - We suggest deleting this footnote. It is highly unlikely that there would be a scope restriction with respect to a public entity. We believe that a restricted scope audit is not a proper basis for an examination (or review) of MD&A for a nonpublic entity.

Paragraph 42 - We suggest changing the third bullet point to "Immaterial Likely misstatements that were not previously corrected..." Uncorrected material misstatements should result in a GAAP exception in the audit report.

Paragraph 58.1 - We suggest modifying this to read, “Other public communications and other publicly available information (for example, press releases, quarterly reports, analyst reports..."
and news articles) dealing with..." Externally generated information is also useful and may, in some situations, be more objective.

Paragraph 68, footnote 18 - We suggest changing the example to that of an offering document. It is quite common for the MD&A presentation in the annual report to shareholders to be incorporated by reference in the Form 10-K, as contemplated by the sample report language.

Paragraph 76 - The illustrative report language should be indented.

Paragraph 79.g - We suggest changing the phrase "Form a conclusion" to "Consider".

Paragraph 99 - We believe that the practitioner should add the additional paragraph in his or her report any time he or she is engaged subsequent to the filing of the MD&A. The inclusion of the paragraph should not be dependent on the existence of disclosed subsequent events.

Paragraph 106 - We suggest moving the phrase "if the predecessor previously examined or reviewed MD&A" to subpart (b) of this paragraph. The inquiries in subpart (a) are valuable even if the predecessor did not perform an MD&A engagement.

Paragraph 113 - We agree that, in the case addressed in the second sentence, the other practitioner should not be referred to with respect to the reporting on MD&A. However, the practitioner may well want to refer to the other auditor in describing the audit base in the introductory paragraph of the report. This should be accommodated in this paragraph.

Paragraph 114 - We believe that an additional representation should be obtained from management on any prospective or pro forma data included in MD&A.

Appendix, paragraph 55 - We suggest that the reference to footnote 31 be moved to the end of the sentence it is now in. In addition, we suggest that the word "generally" be removed from this footnote.

Appendix, Example R - The last sentence in the first paragraph of the report should be expanded as follows, "...the company's Management's Discussion and Analysis for the three-month period ended March 31, 19X6, included in the registration statement, as indicated in our report dated May 15, 19X6,..." If you have any questions regarding our comments, please contact James S. Gerson at (201) 521-3004.

Very truly yours,

Coopers & Lybrand L.L.P.

Coopers & Lybrand L.L.P. is a member of Coopers & Lybrand International, a limited liability association incorporated in Switzerland.
June 16, 1997

Ms. Jane M. Mancino  
Technical Manager  
Audit and Attest Standards  
File 3507  
AICPA  
1211 Avenue of the Americas  
New York, N.Y. 10036-8775

Dear Ms. Mancino:

We appreciate the opportunity to comment on the proposed Statement on Standards for Attestation Engagements (SSAE), *Management's Discussion and Analysis*. We support the issuance of the proposed SSAE by the AICPA Auditing Standards Board and submit the following comments for the Board's consideration:

1. General - We believe that the differences between the procedures performed to obtain reasonable assurance in an examination engagement (paragraph 58) and the analytical procedures and inquiries performed in a review engagement (paragraph 82) could be clarified. Certain items in paragraph 82 appear to extend beyond analytical procedures, as purported in the introductory sentence. Specifically, we recommend that the Board consider the following revisions to paragraphs 82 and 58:

- **Paragraph 82 (last sentence of the introductory paragraph)** - “Procedures for conducting a review of MD&A generally are limited to inquiries and analytical procedures, rather than search and verification procedures, concerning significant matters relating to the information reported. The procedures that the practitioner should ordinarily apply are:”

- **Paragraph 82d and 58e (insert after the first sentence)** - “Inquire of management as to the procedures used to prepare the prospective financial information.”

- **Paragraph 82i** - “Inquire of management regarding the nature of public communications (for example, press releases and quarterly reports) dealing with historical and future results and consider whether the MD&A is consistent with such communications.

- **Paragraph 58e** - In the second sentence change “Consider” to “Evaluate”
• Paragraph 581 - "Obtain public communications (for example, press releases and quarterly reports) and the related supporting documentation dealing with historical and future results and consider whether the MD&A is consistent with such communications.

2. Paragraphs 5 and 9 - We believe these paragraphs should be revised to also indicate that, in determining whether to accept an engagement, the practitioner should consider whether management has the appropriate level of knowledge of the conditions within the economy and industry as they relate to the entity to prepare the MD&A.

3. Paragraph 10 - We recommend that this paragraph be revised to indicate that, in addition to the base knowledge of the entity and its operations, the practitioner should also be knowledgeable about the industry and the environment in which the entity operates in order to properly evaluate the results of the procedures performed in connection with an examination or review.

4. Paragraph 21 - There needs to be a further discussion of the qualitative aspects of materiality. We believe that the qualitative aspects of materiality refer to the relevance and reliability of the information presented. Perhaps some examples would assist in providing clarification on this concept. We recommend that the following sentence be added after the third sentence of paragraph 21:

Furthermore, quantitative information is often more meaningful when accompanied by qualitative disclosures. For example, quantitative information about market risk is more meaningful when accompanied by qualitative information about an entity’s market risk exposures and how those exposures are managed.

5. Paragraph 64 - In considering events that occur subsequent to the date of the auditor's report on the financial statements, an additional item should be added that would require the practitioner to consider changes to conditions within the economy or industry that could have a significant effect on the entity.

It is our understanding that the Auditing Standards Board’s Attestation Recodification Task Force is considering a revision to SSAE 1 which would require practitioners to specifically assess the risk of material misstatement due to fraud when performing attestation engagements. We recommend that the final issuance of the proposed SSAE be postponed until this issue is resolved.

If you should have any questions on any of the matters discussed in this letter please contact Mr. John L. Archambault at (312) 565-4731.

Sincerely,

Grant Thornton LLP
June 4, 1997

Ms. Jane M. Mancino, Technical Manager
Audit and Attest Standards, File 3507
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Ms. Mancino:

The Committee on Auditing Services of the Illinois CPA Society ("Committee") is pleased to have the opportunity to comment on the exposure draft of the "Proposed Statement on Standards for Attestation Engagements, Management's Discussion and Analysis" ("Exposure Draft"). These recommendations and comments represent the collective views of the members of the Committee. This response is presented in the following order: Overall Comments, in general support of the Exposure Draft with the suggested changes; Specific Comments, regarding certain paragraphs; and Opposing Viewpoints suggesting the proposed statement continue to be deferred.

Overall Comments

Forward-looking Information

The proposed standard refers several times to the practitioners responsibility for forward-looking information. The Private Securities Litigation Reform Act of 1995 ("Law") provides management a safe harbor and some protection in the event such statements made in presenting forward-looking information in filings and other reports to shareholders do not come true. In order to obtain this safe harbor, the filing must include a statement from management similar to the following:

Certain statements incorporated by reference from the information under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's Annual Report to Shareholders for the year ended December 31, 19XX contained herein constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance, or achievements of the Company to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. Such factors include......
The Exposure Draft does not include any discussion of the above mentioned Law nor does it explain management's safe harbor and its impact to the practitioner. Further, this Law indicates, among other items, that the safe harbor also applies to "an outside reviewer retained by such issuer making a statement on behalf of such issuer." It is unclear whether this provision applies to the practitioner who is performing a review or examination of this information. The Law specifically refers to an outside reviewer. If it does apply to a practitioner performing a review, does it apply in an examination? Again the wording in the Law makes it unclear as to whether it would apply.

The Law indicates the safe harbor applies to an outside reviewer when they are making a statement on behalf of the issuer. When a practitioner issues his opinion, is it being made on behalf of the issuer or is it made based on the level of service the practitioner performed and has nothing to do with "on behalf of management"? Clearly in a qualified opinion situation the practitioner's opinion is not on behalf of the issuer. Again, it is unclear how this Law applies to practitioners.

Assuming practitioners are covered under this Law for reviews and examinations, would readers of the practitioner's report realize that the safe harbor also applied to the practitioner? The current example reports do not include any mention of the safe harbor. Furthermore, would a court of law concur that the practitioner is entitled to this safe harbor when it is not mentioned in his/her report, the AICPA's proposed standard or in the MD&A?

The legislation described above was enacted to afford management some protection while providing the users of such information some idea of what the future outlook is for the company. Given the current language in the Law and the lack of guidance in the Exposure Draft, practitioners could be accepting risks for information prepared by management that management has only minimal risk for. Further, the Exposure Draft provides very little guidance on examining such forward-looking information. Based on the above comments, we recommend the proposed standard should specifically exclude any forward-looking information from the scope of services the practitioner is to perform.

Small Business Companies

The proposed standard indicates that the engagement could be performed simultaneously with the financial statement audit or after the audit is complete. In typical small publicly-held audit engagements, the audit is done first and the MD&A is done afterwards. Further, in many of these engagements, the MD&A is completed shortly before the due date required of 10-k filings. Given these assumptions, it would appear that this type of engagement would apply primarily to large publicly-held companies. The Committee is concerned that once large companies begin to add these types of reports by independent accountants that all publicly-held companies will be required to have these services performed, creating an undue burden on small publicly-held companies.
Materiality

The proposed standard refers throughout to the practitioners use of materiality and that the practitioner needs to consider the concept of materiality in planning and performing the engagement. This would imply that materiality applies to both financial and non-financial items, which is supported by the table in the proposed standard. Given that a typical MD&A will include dollar amounts, percentages, increases or decreases in amounts, and other non-financial data, it seems very difficult to determine materiality for each of these items. Compounding the issue is the use of subjective terminology by management to describe the above amounts, increases, decreases, and percentages. Paragraph 23 highlights the difficulty in trying to develop a useful materiality, which states "The relative, rather than absolute, size of an omission or misstatement may determine whether it is material in a given situation."

In addition, what practical guidance exists to help a practitioner define materiality for non-financial information? Materiality has always been discussed in terms of a percentage of net income, stockholders' equity, total assets or total revenue. How do you define materiality for revenue miles, rounds of golf played, units sold, etc. We believe the proposed standard should expand the discussion of materiality to include how it would be applied to the different information included in the typical MD&A. We also suggest that, as it applies to non-financial information, either specific guidance needs to be developed or such information should be excluded from the scope of the services to be provided.

Review versus Examination

There does not appear to be a significant difference between the examination and review procedures to be performed. Given the confusion by users of the meaning of a review report when the practitioner has audited the financial statements, we suggest the Auditing Standards Board ("ASB" or "Board") consider deleting the review level of service.

Due to the current litigious environment, other members of the Committee recommend deleting the examination service and allowing only the review service. While our Committee members differed on the ultimate conclusion, the main concern is with the perception users of these reports may have understanding the difference between reviews and examinations. If the ASB believes both services should remain, we recommend further clarification of the differences between these services.
Specific Comments

The following comments relate to specific paragraphs and are exclusive of the overall comments above. Should the comments above be incorporated in the final document, then some of the comments below may not be applicable.

Comparison Table - Under the sub-heading, "Test assertions", the table appears to be misleading regarding prospective information. Under both columns for review and examination it describes the same procedure. "Obtain and read available prospective information, public communications, and minutes of meetings." However, more procedures are required as are described in paragraph 58e. for examinations and 82d. for reviews. We suggest the table be modified to reflect the difference between the two levels of service.

Comparison Table - Under the examination column, one of the steps reads as follows: "Compare non-financial amounts to the financial statements or other records; perform tests on other records based on the concept of materiality." Consistent with the comment above on materiality, we find it difficult to define materiality for this type of procedure.

Paragraph 2 - The last sentence indicates that a practitioner engaged to perform agreed-upon procedures on MD&A should follow the guidance in SSAE No. 4 or SAS No. 75. Practitioners continue to have difficulty in determining which of these standards to follow when performing an agreed-upon procedures engagement. This reference only causes further confusion. We recommend the Board be specific in describing which standard would be applicable to testing which kind of data in the MD&A.

Paragraph 7c - It does not seem practical that a successor auditor would take responsibility for all periods discussed in MD&A when the successor has audited only the current period financial statements and the predecessor has audited the prior two years. For example, it is very possible for an auditor to be able to draw a conclusion about management’s explanation of why certain expenses in 1996 were different than in 1995. However, for the successor auditor to then draw conclusions regarding 1995 compared to 1994 seems very difficult to do and only feasible for large publicly-held companies. It seems that most practicing auditors would not want to assume this additional responsibility for a period that they applied no auditing procedures to.

Paragraph 9 - This paragraph indicates that the practitioner give consideration to accepting an engagement based on whether management has the appropriate knowledge of the published SEC rules and regulations to prepare MD&A. This paragraph also specifically indicates that management could engage others, such as legal counsel, to assist them in presumably understanding such rules and regulations. First, many times companies will consult with their auditors regarding the MD&A rules and regulations. Is there any reason why the Board specifically referred to legal counsel and not the companies' auditors?
Further, in many smaller publicly-held companies, management may have a general idea of the SEC rules and regulations; however, they may use the auditors to assist them in drafting the MD&A, similar to how auditors now assist management with footnote writing and implementing complex standards. This paragraph ignores this issue. We recommend that the standard include some discussion of the auditor's role in assisting management in the preparation of MD&A and that it does not prevent a practitioner from accepting an engagement to report on the MD&A.

Paragraph 21 - It doesn't seem to be appropriate to be telling users, in a standard that applies to practitioners, that they should not expect prospective information to be as precise as historical information.

Paragraph 26 - This paragraph provides no practical guidance to what the practitioner is required to do with forward-looking information. As described above in the general comments, we recommend that this information be excluded from the scope of the practitioner's engagement.

Paragraph 33 - This paragraph states that "assertions and representations of management can be either explicit or implicit." Consider the true difficulty in determining that all implicit assertions are complete, documenting that fact, and then being held accountable for such a statement. We recommend the Board reconsider the practicality of implementing this area of the Exposure Draft.

Paragraph 42, 3rd bullet - Assuming this is referring to waived adjustments and waived reclassification entries, it seems that if the amounts were waived for financial statement purposes, that the auditor would have already considered their impact on the MD&A in reaching their conclusion to waive such amounts. It appears inconsistent and puts the practitioner in a precarious position to waive an amount in the financial statement audit but then not waive it when they examine the MD&A.

Paragraphs 71 and 72 - The proposed standard includes guidance on when a client will not make a change that the practitioner believes to be material or is unable to perform procedures he or she considers necessary in the circumstances. However, since the report is not required by the SEC (at least at this point in time), what should the practitioner do if the client decides not to include the practitioner's report because the client doesn't want it with the qualifications in it? The practitioner has now found a material required element either missing or not presented correctly in the MD&A, and the client is not required to include the practitioner's report. We recommend providing guidance for this type of situation.

Paragraph 76 - This paragraph provides for a practitioner to report on the combined MD&A when other accountants had reported on the other entities in the combined report. The paragraph only provides an example of what the report should say; however, there is no other guidance provided on what procedures the practitioner should perform when performing such an engagement. We recommend that additional guidance be provided describing the procedures the practitioner should perform when reporting in these circumstances.
Paragraph 77 - This paragraph only provides one example of when a practitioner might include an emphasis paragraph. Are there other examples the Board also believes would be appropriate to include, or is this the only situation that the Board believes to be appropriate? Likewise, are there any situations that the Board believes are not appropriate to include as an emphasis paragraph that should be specifically described?

Paragraph 82 - The lead-in sentence to the examples states that "The practitioner ordinarily should apply the following analytical procedures:" Certain of these procedures, specifically f. through i., do not appear to be analytical procedures. We recommend the Board delete the word "analytical" from the lead-in sentence.

Paragraph 112 - This paragraph refers to obtaining representations from the successor. It would be useful and beneficial to provide guidance on the type of representations the predecessor should obtain similar to paragraph 114 on representations from management.

Paragraph 114 - If the Board should conclude to keep forward-looking information in the final standard, then we recommend that management should provide specific representations as to that information. For example:

The forward-looking information included in the MD&A regarding future estimates of cash availability and gross margins (the forward-looking items should be specifically described) are based on management's best estimates of expected events and operations and are consistent with budgets (forecasts or operating plans) prepared for such periods. We have provided you with the latest versions of such budgets and have informed you of any anticipated changes or modifications to such information that could impact the disclosures contained in the MD&A.

Opposing Viewpoints

The MD&A section of a corporate financial report is the responsibility of management, pursuant to Item 303 of Regulation S-K and the related published SEC rules and regulations. Management alone should bear that responsibility, hence the title MANAGEMENT'S Discussion & Analysis. Management alone should be held accountable to their shareholders and to the SEC for the content and context of MD&A. SAS No. 8, "Other Information in Documents Containing Audited Financial Statements", currently requires the auditor to read the MD&A and consider whether the MD&A is materially inconsistent with information appearing in the financial statements. As such, the current requirements under SAS No. 8 provides sufficient guidance, at this time, to the practitioner regarding MD&A. Therefore, this proposed statement should continue to be deferred.

The ASB states there should always be a relationship between the cost imposed and benefit expected to be derived from new requirements. The explanatory paragraph of both the examination and review reports for attestation engagements for MD&A specifically state "Actual results in the future may differ materially from management's present assessment of this information because events and circumstances frequently do not occur as expected." As proposed, the "higher level of assurance as to reasonableness" to be afforded by an attestation of MD&A may not seem appropriate.
The practitioner can always provide management with recommendations for improvements to MD&A, and can currently do so without the burden of any degree of assurance. Will attestation engagements for MD&A truly provide additional benefit to the reader of the financial report, or will it simply provide the public, investors and creditors with another deep pocket in yet another area?

MD&A is of potential interest to users of financial information because it contains information that cannot be found in the financial data. The content of MD&A should include coverage of any favorable or unfavorable trends and significant events or uncertainties in the areas of liquidity, capital resources, and results of operations. It is also the place to learn about the Company's management and that management's candor.

"From the CEO's letter of greeting in the annual report to the financial fine print in the proxy, nuggets of bald obfuscation, skillful omission and wishful euphemism await discovery." This quote is from an article in the April 28, 1997 edition of Crain's Chicago Business Newspaper titled "What They Say vs. What They Mean, An Annual Report and Proxy Primer for the Obfuscation-Impaired." And other articles, such as, "Annual Reports, Translated (A Guide To What Companies Really Mean)" in the August 18, 1996 edition of The New York Times will continue to keep management's honesty, or lack thereof, in front of the general public.

Recently, the SEC and the investing public seem to have begun reading the MD&A section much more critically. Reading MD&A is a good way of assessing management's integrity. It is also a great start of holding MANAGEMENT accountable for MANAGEMENT'S Discussion and Analysis.

We appreciate the opportunity to comment on the Exposure Draft. Should you have any questions regarding any of the above comments, please contact me at (630) 954-1400.

Very truly yours,

Sharon J. Gregor
Chair Auditing Services Committee, Illinois CPA Society
The Auditing Services Committee of the Illinois CPA Society (the Committee) is composed of 18 technically qualified, experienced members appointed from industry, education and public accounting. These members have Committee service ranging from newly appointed to 15 years. The Committee is a senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of auditing standards.

The Committee usually operates by assigning a subcommittee of its members to study and discuss fully exposure documents proposing additions to or revisions of auditing standards. The subcommittee ordinarily develops a proposed response which is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times, includes a minority viewpoint.
June 16, 1997

Ms. Jane Mancino
Technical Manager
Audit and Attest Standards, File 3507
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8755

Dear Ms. Mancino:

The Exposure Draft Response Committee (hereafter referred to as the “Committee”) of the Houston Chapter of the Texas Society of Certified Public Accountants is pleased to submit its selected comments concerning the exposure draft entitled “Proposed Statement on Standards for Attestation Engagements: Management’s Discussion and Analysis.” The Committee commends the Auditing Standards Board’s efforts to “provide guidance to practitioners who may be engaged to examine or review management’s discussion and analysis prepared pursuant to the published rules and regulations of the Securities Exchange Commission (SEC).”

The Committee members have expressed universal concern over the SEC’s new derivative and hedging security disclosure requirements (Item 310) and its prescribed placement within Management’s Discussion and Analysis (MD&A) in the Annual Report. The Committee feels that investors’ interests are better served by placing such disclosures in the footnotes to the financial statements. Our understanding is that the FASB’s derivative security project will address this shortcoming; however, we feel the need to state this position because it greatly affects our comments with respect to the aforementioned exposure draft. For example, we believe that several questions must be addressed prior to the standard’s promulgation. These include the following:

1. **How will the auditor’s responsibility change given the SEC requirement for increased derivative and hedging disclosures?**

   The problem is that the SEC has required key information to be included in the MD&A rather than in the footnotes to the financial statements, where it is clearly more appropriate. Under current SEC regulations, it is possible for a company to meet the SEC requirements without procuring either a review or examination of the MD&A. In this context, the auditor should
continue to adhere to SAS No. 8 (Other Information in Documents Containing Audited Financial Statements). Are the procedures under SAS No. 8 sufficient to deal with the new required information? In other words, can an auditor ensure that the MD&A information is not materially inconsistent with the audited financial statements without performing an examination or review of the derivative and hedging securities? This raises the question of whether the entire MD&A section should be included as part of a larger audit engagement, rather than as an optional engagement.

2. **Is there a demand for this type of engagement?**

   It is difficult to ascertain why a company would agree to pay for this type of engagement, especially since the SEC does not require auditor involvement with the required investment disclosures.

3. **Is there a supply for this type of engagement?**

   A firm that undertakes this type of engagement may be subject to increased litigation risk with respect to attesting to forward-looking information. While the SEC allows “safe harbor” with respect to the accountant’s association with prospective information, the validity of this defense is currently being challenged in the court system.

4. **Will investors be able to differentiate between MD&A that has been reviewed, audited, or “reviewed” under current SAS No. 8 requirements?**

   The Committee is concerned about possible investor confusion that may be created by the new engagements. Currently, no mention is made in the annual report relating to the auditor’s SAS No. 8 responsibilities with respect to MD&A. Optional engagements may result in increased investor expectations that such information has been subjected to a higher form of assurance than that actually provided.

The Committee wishes to also express its concerns with respect to the following issues:

A. **Management’s Discussion and Analysis** is placed outside of the financial statements and was designed to be a forum for management to discuss the company’s business, to analyze the financial statements and to discuss opportunities and challenges faced by the company. As such, it often contains management’s opinions and interpretations, and was never intended to be auditable. The Committee has expressed concern that auditor involvement may inhibit management’s candor. For example, the auditor may request that certain forward-looking information be limited or “toned down” to limit possible legal liability if the auditor is opining on such information, possibly limiting the usefulness of the MD&A section to investors.
B. The Committee also expresses concern that, since the MD&A engagement is to be optional, management could decide *ex-post* whether or not to disclose the auditor/accountant’s report in the Annual Report. In other words, if an adverse report is issued by the auditor on Management’s Discussion and Analysis, what prevents the company’s suppression of such a report? On an audit of financial statements, the auditor can withdraw from the engagement if the company chooses not to accept the report, and the withdrawal is communicated to the SEC and interested investors via an 8-K filing. This option is currently not available with respect to the MD&A engagement.

Given its merits and limitations, the Committee expresses neither support nor disagreement with the proposed attestation standard. The Committee does request that the ASB consider the above issues prior to formal promulgation. The Exposure Draft Response Committee appreciates the opportunity to comment on the exposure draft. Should you have any questions with respect to our response, please contact Tim Louwers at (713) 743-4848.

Respectfully submitted,

Exposure Draft Response Committee of the Houston Chapter of the Texas Society of CPAs

Elwood M. Domaschk, Jr., CPA, President

Kim Ousdahl, CPA, Committee Chair
June 20, 1997

Jane M. Mancino
Technical Manager
Audit and Attest Standards, File 3507
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Proposed Statement on Standards for Attestation Engagements, Management's Discussion and Analysis

Dear Ms. Mancino:

The Financial Accounting Policy Committee (FAPC) of the Association for Investment Management and Research (AIMR)

The Financial Accounting Policy Committee is a standing committee of AIMR charged with maintaining liaison with and responding to initiatives of bodies which set financial accounting standards and regulate financial statement disclosures. The FAPC also maintains contact with professional, academic, and other organizations interested in financial reporting.

Ordinarily the FAPC does not respond to initiatives of the AICPA’s Auditing Standards Board (ASB). In the case of the proposed SSAE, we have what we believe are important reservations and concerns to bring to the attention of the ASB. First, however, we wish to commend the ASB, its MD&A Task Force, and the AICPA staff on the quality of the content of the proposed SSAE. We believe the proposal is comprehensive, complete, and technically competent. Its guidance has the potential to be useful both to financial statement preparers and auditors. We have no suggestions as to how its substance might be improved.

The FAPC discourages attestation of the MD&A. As far as we can see, there has been little or no movement on the parts of either financial statement preparers or users to seek such attestation. Although there may be instances in which a management may decide that users of its financial statements would be well served by an audit or limited review of the enterprise’s MD&A, we believe such situations would be rare. Perhaps that might happen with a small company or one

1AIMR is a global not-for-profit membership organization of more than 70,000 members and candidates comprising investment analysts, portfolio managers, and other investment decision-makers employed by investment management firms, banks, broker-dealers, investment company complexes, and insurance companies. AIMR members and candidates manage, directly and through their firms, over six trillion dollars in assets. The Association’s mission is to serve investors through its membership by providing global leadership in education on investment knowledge, sustaining high standards of professional conduct, and administering the Chartered Financial Analyst (CFA®) designation program.
which has experienced a recent change in management; but the result would be to have management appear not to have competence or credibility. Furthermore, an attestation would engender additional financial report preparation costs. Therefore, it is difficult for us to envision any significant demand for attestation from preparers.

From the standpoint of financial statement users in general, and investment professionals in particular, we also do not foresee a demand for attestation of the MD&A. Our expectations are that a Management Discussion and Analysis will be faithful to its name and provide the views of management, including those types of assertions and insights which we find extremely useful in assessing the future, but which by their nature are not readily verifiable. Not only would the process of attestation be costly for preparers, but it has the potential to have a inhibiting effect on the free expression of management's candid views. After all, the MD&A originated because the Securities and Exchange Commission wanted financial reports to contain commentary and interpretive information that was not appropriately included in audited financial statements. Our view is that analysts are well served by the current practice in which the independent auditor reads the MD&A to determine that it is not materially misleading.

It might be useful, for example, to contrast the information contained in the MD&A with that contained in investment management performance reports prepared according to the AIMR Performance Presentation Standards (AIMR PPS®). These reports are both quantitative and prepared according to clear standards for compliance. There is also considerable demand for attestation of performance reports prepared according to AIMR PPS standards from both preparers and investors.

We also are concerned by the inference in the proposed SSAE that one of its goals is to set standards that can be extended to the audit of non-financial data, such as those discussed in the report of the AICPA Special Committee on Financial Reporting. In the proposed SSAE’s “Summary”, the second bullet point states, “...some users expressed a desire for more auditor involvement in financial information they receive.” That may be true, but the FAPC respectfully disagrees that additional auditor involvement is either necessary or desirable. We expressed our views on this subject in our July 31, 1996 comment letter to the Financial Accounting Standards Board in response to its Invitation to Comment, Recommendations of the AICPA Special Committee on Financial Reporting and the Association for Investment Management and Research. The following quotations from that letter give some of our reasoning on this matter, together with our cautionary attitude with respect to unintended consequences and costs. Emphasis is provided to highlight views pertinent to the proposed SSAE.

...[W]e believe that the 10 “elements” recommended by the Special Committee are either already provided by SEC registrants or are so broad and subjective in nature that they are outside the scope of accounting concepts and are not auditable in any traditional sense.
These things seem at best accomplished on an industry basis during the analytical give and take that happens outside the standard setting process.

...[I]t is the FAPC's opinion that a requirement to audit this information would fail a cost-benefit test...much of the nonfinancial information being considered here is useful for forecasting future revenue. It is the sense of the Committee that many audit failures result from the misapplication of basic, conceptual revenue recognition criteria. If auditors have difficulty attesting to the actual revenue generating process, it is unlikely they could add significant credibility to the statistics which precede it.

Again, we suggest that attestation services would be appropriate for non-financial information such as the portfolio composites recommended in the AIMR PPS standards. Although strictly speaking, those composites are non-financial data, they differ from other non-financial data such as market share and other industry statistics. They are a non-financial measure that serves as a prerequisite for reliable and relevant measurement of financial performance. An attestation of the appropriateness of the allocation of an account to a composite would clearly extend the audit function to non-financial information. But, such an attestation would ensure that all discretionary accounts under management by a reporting firm were included in the appropriate composite, thus serving the financial information needs of both preparers and users of performance reports prepared according to the AIMR PPS standards.

In summary, although we have no objection to the issuance of the proposed SSAE, we hope that it will not be needed. We sincerely hope this proposed SSAE will not bring unneeded and unwanted attestation to the MD&A. We also hope it will not result in extending the practice of attestation to non-financial data because we believe the costs of doing so would far exceed any potential benefits.

The FAPC appreciates the opportunity to express its views on the Exposure Draft of Proposed Statement on Standards for Attestation Engagements, Management's Discussion and Analysis. If the ASB, AICPA staff, or the MD&A Task Force have questions or seek amplification of our views, we would be pleased to provide whatever additional information you request.

Respectfully yours,

Peter H. Knutson, CPA
Chair

David A. Schwartz, CFA
Subcommittee Chair, MD&A Attestation

cc: Distribution List
Michael S. Caccese, Esq., Senior Vice President, General Counsel and Secretary, AIMR
Patricia D. McQueen, CFA, Vice President, Advocacy, Financial Reporting, AIMR
June 23, 1997

Ms. Jane M. Mancino, Technical Manager
Audit and Attest Standards, File 3507
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Proposed Statement on Standards for Attestation Engagements
Management's Discussion and Analysis

Dear Ms. Mancino:

Ernst & Young LLP generally supports the issuance of the above referenced proposal to provide guidance to practitioners who may be engaged to examine or review management’s discussion and analysis (MD&A) prepared pursuant to the published rules and regulations of the Securities and Exchange Commission (SEC). In particular, we strongly support the Board’s decision to include guidance for reviewing an MD&A presentation for an annual or interim period. We believe that a review level of service provides an appropriate alternative to the market, considering that it is not clear what level of service, if any, the market will request. In addition, a review level of service is similar to, and complements, the services we currently provide to underwriters and other requesting parties pursuant to SAS No. 72, Letters for Underwriters and Other Requesting Parties.

Our principal concern regarding the proposed Statement is how materiality is assessed in performing an examination or review of an MD&A presentation and in reporting the results of the engagement. The following comments convey this concern and our recommendations:

1. Paragraphs 21-23—These paragraphs are intended to provide guidance on applying materiality in an engagement either to examine or review MD&A. The guidance that is given, in our view, is very broad and vague and would be subject to varying interpretations by both practitioners and users, and therefore, is not operational. We believe materiality for MD&A disclosures about historical financial information and known trends and uncertainties (prospective information as discussed in FRR 36) should be assessed on the basis of the historical financial statements. We believe the MD&A rules support such an assessment (e.g., Instruction 3 to Paragraph (a) of S-K Item 303 requires the discussion and analysis to focus on “material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition”). Likewise, materiality assessments for voluntary forward-looking information, which may include prospective financial data, should be assessed in light of the
expected range of reasonableness of the information, consistent with the guidance in AT 200.05.

2. Paragraph 68—Paragraph 4 states that “the practitioner's objective in an engagement to examine MD&A is to express an opinion on the MD&A presentation taken as a whole ....” [emphasis added] We strongly agree that the practitioner's opinion relates to the MD&A presentation taken as a whole, and believe that, in order to avoid confusion about this matter, the illustrative report on an examination of MD&A also should contain this language, as follows:

[Opinion paragraph]

In our opinion, the Company's Management's Discussion and Analysis taken as a whole includes, in all material respects, the required elements of Item 303 of Regulation S-K and the related published rules and regulations of the Securities and Exchange Commission; the historical financial amounts included therein have been accurately derived, in all material respects, from the company's financial statements; and the underlying information and assumptions of the Company provide a reasonable basis for the disclosures contained therein.

3. We noted other instances in the proposed Statement where it also is necessary to add the words “taken as a whole” in order to make the guidance consistent. We also found that the phrase “in all material respects”, as used in the above excerpt from the illustrative report, is not used consistently throughout the proposed Statement. Accordingly, we suggest the following additional changes:

4. The practitioner's objective in an engagement to examine MD&A is to express an opinion on the MD&A presentation taken as a whole by reporting whether (a) the presentation includes, in all material respects, the required elements of Item 303 of Regulation S-K and the related published SEC rules and regulations, (b) the historical financial amounts have been accurately derived, in all material respects, from the entity's financial statements, ....

7. b. Perform the procedures that will provide the practitioner with a basis for expressing an opinion on the MD&A with respect to whether the historical financial amounts have been accurately derived, in all material respects, from the entity's financial statements for such period.

27. To express an opinion about whether (a) the presentation taken as a whole includes, in all material respects, the required elements of Item 303 of Regulation S-K and the related published SEC rules and regulations, (b) the historical financial amounts have been accurately derived, in all material respects, from the entity's financial statements, ....

39. g. Form an opinion about whether the MD&A taken as a whole includes, ....
The practitioner should consider the concept of materiality discussed in paragraphs 21 through 23, and the impact of any modification of the auditor’s report on the historical financial statements in forming an opinion on the examination of MD&A taken as a whole, including the practitioner’s ability to evaluate the results of inquiries and other procedures.

In order for the practitioner to issue a report on an examination of MD&A taken as a whole, the financial statements for the periods ....

The practitioner’s report on an examination of MD&A taken as a whole should include--

The practitioner should modify the standard report in paragraph 68, if any of the following conditions exist:

- The presentation taken as a whole excludes, in all material respects, a material required element under Item 303 of Regulation S-K and the related published SEC rules and regulations (paragraph 71)
- The historical financial amounts have not been accurately derived, in all material respects, from the entity’s financial statements (paragraph 71)

We also have the following comments that we believe should be reflected in the final document.

4. Paragraph 16—The second sentence of this paragraph should be revised to make it clear that it is management’s responsibility to accurately derive the data presented in MD&A from the company’s financial statements and underlying books and records by adding after “interpret the criteria,” the following: “accurately derive the historical amounts from the Company’s books and records,”. Paragraphs 66.g. and 88.h. also should be amended to include a similar reference to management’s responsibility for the accurate derivation of data. The explanatory paragraphs in the example practitioner’s reports in paragraphs 68, 74, 75, 89, 90, 95 and 97 also should be revised accordingly.

5. Paragraph 2—In discussing the term “published SEC rules and regulations,” footnote three states that SEC Financial Reporting Release (FRR) No. 36 amended Item 303 of Regulation S-K. In fact, FRR 36 was an interpretive release that did not actually amend Regulation S-K. Instead, the guidance in FRR 36 is included in Section 501 of the Codification of Financial Reporting Policies, together with other MD&A-related commentary published by the SEC. Accordingly, we recommend that any final statement clarify that the term “published SEC rules and regulations” is intended to mean Item 303 of Regulation S-K, or Regulation S-B if applicable, and Section 501 of the Codification of Financial Reporting Policies.

With respect to the term “published SEC rules and regulations,” we also recommend that any final statement include a footnote similar to footnote 21 in SAS No. 72 that states, “the term ‘published’ is used because accountants should not be expected to be familiar with, or express assurances on compliance with, informal positions of the SEC staff.” Such a statement is
important because the SEC staff frequently comments on its expectations regarding registrants' disclosures in MD&A. These comments may take various forms, none of which bear the Commission's official approval, including Staff Accounting Bulletins, speech outlines published by the Office of the Chief Accountant and the Division of Corporation Finance, speeches by SEC staff members, and staff training materials. Accordingly, we believe that any final statement should make clear that the term “published SEC rules and regulations” includes only official Commission publications and not publications of the SEC staff.

6. Paragraph 7—Items b. and c. in this paragraph are, for the most part, consistent with the second and third engagement objectives, as set forth in paragraph 4, items (b) and (c). We believe the first engagement objective as set forth in paragraph 4 item (a) also should be included here, by inserting new paragraph 4.b., as follows:

   b. Perform the procedures that will provide the practitioner with a basis for expressing an opinion whether the MD&A presentation taken as a whole includes, in all material respects, the required elements of Item 303 of Regulation S-K (S-B) and the related published SEC rules and regulations.

Existing paragraphs 4.b and 4.c. would be renumbered as 4.c. and 4.d., respectively.

7. Paragraph 12—We suggest that the following example be included in item a. (1) of this paragraph to make this condition for acceptance more clear.

   The practitioner performs either (1) a SAS No. 71 review of the historical financial statements for the related interim periods and issues a review report thereon (e.g., for an engagement to review the MD&A presentation of a public entity at June 30, 2000, the practitioner reviews both the June 30, 2000 and 1999 interim financial statements and issues a report thereon), or (2) an audit of those interim financial statements.

8. Paragraph 26—This paragraph addresses the practitioner’s responsibility regarding forward-looking information included in the MD&A presentation. However, the proposed guidance does not discuss the potential implications of a practitioner’s association with forward-looking information in a general-distribution review or examination report on MD&A. Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 provide a safe harbor from liability in private litigation with respect to forward-looking statements. These Sections apply to, among other things, forward-looking statements made by “an outside reviewer retained by such issuer making a statement on behalf of such issuer.” We believe, consistent with the legislative history of the Private Securities Litigation Reform Act of 1995, that a practitioner issuing a review or examination report on MD&A could be eligible for safe harbor protection under these Sections to the extent the MD&A presentation includes forward-looking statements. We recommend that any final statement refer to the potential safe harbor protection in these circumstances. Because the practitioner’s report on MD&A does not restrict its distribution (and particularly if the practitioner’s report is publicly
distributed, whether in an SEC filing or otherwise), we believe any final statement also should
direct the practitioner to consider whether the MD&A includes, or makes reference to,
"meaningful cautionary language" that would qualify any forward-looking statements for safe
harbor protection. While the determination of whether an issuer's forward-looking statements
qualify for safe harbor protection is a legal matter, the practitioner would be well advised to
consider the legal implications of association with any forward-looking statements included in
the MD&A presentation.

Given the nature and extent of forward-looking information that may be included in MD&A,
we believe that paragraph 26 should refer to SSAE No. 1, *Financial Forecasts and
Projections (AT section 200)*, for practitioners performing procedures with respect to forward
looking information. Reference to SSAE No. 1 could be accomplished in a manner similar to
the reference in paragraph 24 for the inclusion of pro forma information in MD&A.

9. Paragraphs 61 and 62—These paragraphs provide limited guidance on determining the nature
of procedures that should be applied to nonfinancial data included in MD&A. Since the
accountant would be expected to perform such tests as are necessary to conclude that such
nonfinancial data are reasonable in the context of MD&A taken as a whole, and accountants
have historically not been associated with such data (other than to the extent required by SAS
No. 8), we suggest that the Board expand the guidance in these paragraphs to provide
examples of substantive procedures that would be appropriate for nonfinancial data that are
outside the entity's controls over financial reporting.

10. Paragraphs 63 and 69—Paragraph 63 of the proposed Statement states that, "as there is an
expectation by the SEC that MD&A consider events through a date at or near the filing date."
Further, footnote 14 of the proposed Statement provides that "a registration statement under
the Securities Act of 1933 speaks as of its effective date." Based on these facts, we believe
paragraph 63 should include additional guidance for situations where a practitioner's report
on MD&A will be included (or incorporated by reference) in a 1933 Act document filed with
the SEC that will require a consent. Accordingly, we suggest that the following sentence be
added at the end of paragraph 63, and that paragraph 99 include a cross reference to
paragraphs 63 and 64.

When the MD&A will be included or incorporated by reference in a 1933 Act document
that is filed with the SEC, the practitioner's procedures should extend up to the filing date
or as close to it as is reasonable and practicable in the circumstances. If a public
company's MD&A presentation is to be included only in a filing under the Securities
Exchange Act of 1934 (e.g., Forms 10-K or 10-KSB), the practitioner's responsibility to
consider subsequent events does not extend beyond the date of the report on MD&A.

11. Paragraphs 67, 68, 88, 89, and 99—Paragraph 99 provides guidance for practitioners who are
engaged to examine (or review) an MD&A presentation of a public entity that has already
been filed with the SEC (or other regulatory agency). For situations where subsequent events
of a public entity are appropriately disclosed in a Form 8-K or 10-Q, it directs the practitioner
to add the following paragraph to his or her examination or review report following the opinion or concluding paragraph, respectively:

The accompanying Management’s Discussion and Analysis does not consider events that have occurred subsequent to Month XX, 19X6, the date as of which it was filed with the Securities and Exchange Commission.

We believe that this statement applies to all public entities, not just in the situations described above, and provides useful information to readers. Therefore, we suggest that the illustrative reports in paragraphs 68 and 89 be revised to include this sentence after the third and second sentences in the introductory paragraphs of the respective reports. In addition, paragraphs 67, 88, and 99 should be revised to reflect this change.

12. Paragraphs 98 and 99—We believe that these paragraphs should recognize that material subsequent events also may be disclosed in other SEC filings. For example, a registration statement that includes or incorporates the MD&A presentation being reported on may appropriately disclose a material subsequent event that has not yet been disclosed in a Form 8-K or 10-Q.

In addition, we suggest that paragraph 99 include a cross reference to paragraphs 63 and 64 for guidance relating to events subsequent to the balance-sheet date.

13. Paragraph 114—We suggest that management’s written representations include a statement that the MD&A presentation includes the required elements of Item 303 of Regulation S-K (S-B) and the related published rules and regulations of the SEC. This statement is included in the accountant’s opinion, and accordingly, also should be included in management’s written representations. This change is consistent with the Board’s proposed revisions to AU Section 333, Client Representations.

14. Paragraph 55 of the proposed amendment to SAS No. 72—The proposed footnote 31 to SAS No. 72 would allow the accountant to comment on the agreement of non-financial data within MD&A that are not subject to the entity’s controls over financial reporting to corresponding data elsewhere in a registration statement, provided that the accountant had issued an examination or review report on the MD&A presentation. We disagree with this proposed amendment because it seems inconsistent to prohibit reporting on the results of agreed-upon procedures with respect to such data in comfort letters, but allow the accountant to comment on the tracing or agreement of such data to MD&A. The practitioner’s objective in an engagement to examine or review MD&A is to assess the MD&A presentation taken as whole, not to report on individual elements or disclosures in it. Thus, we are concerned that the accountant’s association with such non-financial data, even through the mere tracing and agreement of such data, may inappropriately convey a level of association and assurance with respect to the specific items traced or agreed that would be misunderstood by the recipients of comfort letters. Accordingly, we recommend that proposed footnote 31 be removed, or changed to specifically prohibit the tracing or agreement of such data to the MD&A.
We would be pleased to discuss our comments and recommendations with members of the Auditing Standards Board or its staff.

Sincerely,

Ernst & Young LLP
June 26, 1997

Jane M. Mancino  
Technical Manager  
Audit and Attest Standards  
American Institute of Certified Public Accountants  
1211 Avenue of the Americas  
New York, NY 10036-8775  

Re: File 3507  

Dear Ms. Mancino:  

The Committee on Corporate Reporting (CCR) of the Financial Executives Institute (FEI) has reviewed the Exposure Draft (ED) of the proposed Statement on Standards for Attestation Engagements, Management’s Discussion and Analysis, and appreciates this opportunity to present our views for your consideration.  

As you know from meetings with CCR’s AICPA Liaison Subcommittee and our previous letters to the AICPA on Auditing Standards, CCR has a long standing opposition to auditor involvement with Management’s Discussion & Analysis (MD&A) beyond the auditing procedures described in AU Section 550, "Other Information in Documents Containing Audited Financial Statements".  

We believe that the very aspects that make MD&A so valuable to readers of financial statements, namely the flexibility for management in its own words to explain the relevant events, trends, and factors influencing the results of operations, financial position and cash flow, would be diminished if auditors issued a separate report giving either positive or negative assurance regarding MD&A. Furthermore, we have seen no evidence that the cost of capital would be reduced by auditor involvement with MD&A and we believe that any benefit provided to the readers would be exceeded by the attestation fees paid to the CPA firms.
We acknowledge that the ED does not mandate auditor involvement in MD&A. However, since there are currently few, if any, situations where auditor attestation is present, the ED seems to be a solution seeking a problem. Moreover, simply by virtue of its existence, there could arise a statutory or bureaucratic demand for its application. We are strongly opposed to any effort that might result in mandatory attestation of MD&A whether by examination or review. We believe this type of engagement should be at the option of the company, based on its individual facts or circumstances.

Lastly, we take specific exception to paragraph 12 of the proposed standard. It could be the case that the same CPA firm that just completed the annual audit would be engaged to give negative assurance on MD&A for an interim period. In our view, it may not be necessary for the regular auditor to perform a SAS 71 review and issue a report in order to give such negative assurance. Mandating a SAS 71 review rather than allowing the auditor to make a professional judgment on a case-by-case basis appears excessive.

In conclusion, we question the need for this attestation standard and certainly believe it should not be issued as an auditing standard. We would be pleased to discuss our comments further with you or your staff. This response was developed by Fred J. Hirt of Pharmacia & Upjohn. Should you have any questions, please contact him at (616) 833-6445.

Sincerely,

Susan Koski-Grafer

kad
June 27, 1997

Jane M. Mancino
Technical Manager, Audit and Attest Standards
File 3507
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8755

Re: Exposure Draft on Proposed Statement on Standards for Attestation Engagements “Management’s Discussion and Analysis”.

Dear Ms. Mancino:

We appreciate the opportunity to respond to the AICPA Auditing Standards Board Exposure Draft with respect to the Proposed Statement on Standards for Attestation Engagements “Management’s Discussion & Analysis” (MD&A). We are writing this letter to express our position related to independent auditor involvement with MD&A.

Overall we feel the current level of audit involvement in MD&A as prescribed in AU Section 550, “Other Information in Documents Containing Audited Financial Statements” is both appropriate and adequate. We believe the flexibility of management’s “own words” in MD&A presentations is valuable to readers of financial statements, and that flexibility would be diminished if auditors issued a separate report giving either positive or negative assurance to MD&A presentations. We also feel that the cost of having auditors issue a separate report on MD&A would exceed any benefit provided to the readers of financial statements.

While we understand that issuance of a standard for attestation engagements related to MD&A would not require companies to engage their independent auditors to perform a review or examination of MD&A, we are concerned issuance of such standard may result in underwriters or other parties seeking more “protection” in securities offerings. We oppose efforts that could result in mandatory attestation of MD&A.

Based on the above concerns, we oppose any issuance of a standard for attestation engagements related to MD&A.

If you would like to discuss any of these comments further, please call me at 607-974-8242.

Sincerely,

[Signature]

Kathy A. Asbeck
June 18, 1997

Ms. Jane M. Mancino, Technical Manager
Audit and Attest Standards, File 3507
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Mancino:

The Accounting Policy Committee (APC) of The Robert Morris Associates (RMA) is pleased to comment on the Auditing Standards Board's (ASB) Proposed Statement on Standards for Attestation Engagements, "Management's Discussion and Analysis"(ED). RMA is an association representing over 18,000 lending and credit risk officers from institutions across North America responsible for approximately eighty percent of total banking assets. The APC is the RMA committee charged to work for the continuous improvement in the quality of financial information available to credit grantors. Our responses on accounting and financial reporting issues are, therefore, primarily from the financial statement users' perspective and, more particularly, from the perspective of those who lend or participate in the lending and credit process.

The Accounting Policy Committee has some concerns about the issuance of this proposed SSAE. Historically, we have not supported auditor involvement with areas outside those "...Directly Affected by Existing FASB Standards." The following paragraphs are reproduced from two of our previous comment letters that relate to this area.

July 31, 1996 letter to the FASB re. Invitation to Comment Recommendations of the AICPA Special Committee on Financial Reporting and the Association for Investment Management and Research

The FASB's role should be limited to setting standards for the measurement, recognition, display and disclosure of factual information. With reference to the "comprehensive business reporting model," we have in mind FASB involvement with only the first and second elements (paragraph 17 in the ITC). The other elements involve communications between management and users about management's analysis, plans, and other insights. We believe standard setting for that type of information not only is difficult, but may well be counterproductive. It is our experience that attempts to codify such disclosures more-frequently-than-not end up producing essentially meaningless boilerplate. As a case in point, we can cite the disclosures emanating from implementation of the recent AICPA Statement of Position on Disclosures of Material Risks and

Uncertainties. Most of those disclosures, quite simply, do not reveal much that a sensible user does not already know.

Although we agree that standards should be set for the reporting of nonfinancial data, in most cases we do not believe that such data need be audited. Currently, the FASB presides over the promulgation of generally accepted accounting principles (GAAP). If it expands its scope to standard setting for nonfinancial data, it should make clear that those data are part of the body of GAAP, but that external auditors need not be required to attest to an enterprise's adherence to them, even when the financial statements and related disclosures are audited.

On occasion, a lender or other user may wish to have certain nonfinancial data audited. That can be arranged on a private basis; it need not be a blanket requirement for all enterprises and all users. It is the standard that is important. Today, many lenders seek nonfinancial data and may require it to be audited, but they (the bankers) have to set the standards on an ad hoc basis.

July 21, 1993 letter to AICPA (Mr. Frederick Gill) re. Proposed Statement of Position, Disclosure of Certain Significant Risks and Uncertainties and Financial Flexibility

As the quantity of required disclosures increases, the number of businesses and not-for-profits and governmental entities that choose to pay the costs of providing them has and undoubtedly will continue to diminish. Furthermore, we would expect those who choose the "no-disclosure" route to be the entities for whom disclosure would be most needed by credit evaluators. We believe issuance of the proposed SOP would exacerbate that situation and the result of its issuance for lenders would likely be the receipt of less financial information, not more.

Significant of Examinations (Audits) of Financial Statements to Lenders

The APC wishes to emphasize as strongly as possible its belief that audited financial statements bring the finest quality of financial information to the credit evaluation process. We cannot conceive of any way to add more value to financial reports than that provided by an attestation backed by a professional examination. If fact, we lament the trend we have observed and documented toward fewer and fewer borrowers being willing to provide audited financial statements for credit purposes. It is with that point of view that we comment on the proposed SSAE.

One of our concerns about the proposed SSAE is its potential to raise indirectly the costs to borrowers of having their financial statements audited. Perhaps the major objection to audited financial statements by prospective borrowers is the cost of providing them. Furthermore, in recent years we have experienced: (1) aggressive competition among lenders for profitable loans; (2) growth in "credit scoring" as banks and their loan portfolios have increased in size; and (3) an increased presence in the market by non-bank asset-based lenders. Those factors have combined to reduce the ability of banks to demand audited financial statements of their customers as a condition of lending. Every time we discuss this matter among ourselves, we hear of higher and higher loan thresholds for demanding audited financials.
Our second concern is that we believe the benefits of auditing MD&A are small in relation to its cost. [See the quotation from our July 31, 1996 letter to the FASB, above.] If an MD&A is prepared properly to suit its intended purpose, much of it is inherently unauditable. Management has that forum to state its views—and it is very important for financial statement users to know what those views are, unencumbered either by an imposed format or by the imprimatur of an auditor. We believe the current review process prescribed by SAS No. 8 provides us sufficient protection from outright falsehood and fraud. Contrarily, we believe that the forthrightness of management could well be stifled if MD&A were to be overseen and attested to by outside accountants.

We realize that today there is no requirement for having MD&A audited. We believe there should be no such requirement. Perhaps there is no harm in issuing the proposed SSAE, but the APC does not believe it is necessary.

On behalf of RMA, the Accounting Policy Committee appreciates the opportunity to respond to the Accounting Standards Executive Committee's Proposed Statement on Standards for Attestation Engagements, “Management’s Discussion and Analysis.” We would be pleased to answer any questions you or the members of ASB may have concerning our views.

Yours very truly,

Douglas F. Nelson, CPA
Chairman, Accounting Policy Committee

June 18, 1997

Director of Research
Project No. 3-4E
Governmental Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

Dear Sir:

The Accounting Policy Committee (APC) of RMA (formerly The Robert Morris Associates) is pleased to comment on the Governmental Accounting Standards Board's Exposure Draft, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments. (ED) RMA is an association representing over 18,000 lending and credit risk officers from institutions across North America responsible for approximately eighty percent of total banking assets. The APC is the RMA committee charged to work for the continuous improvement in the quality of financial information available to credit grantors. Our responses on accounting and financial reporting issues are, therefore, primarily from the financial statement users' perspective and, more particularly, from the perspective of those who lend or participate in the lending and credit process.

Our overall reaction to the ED is to congratulate the Governmental Accounting Standards Board (GASB) on the huge step forward accomplished by this landmark project. Although the final standard has yet to be issued, that day appears not to be far off. We are impressed not only by the effort that has gone into producing this proposed Statement of Governmental Accounting Standards, but even more so by its accomplishment. For reasons set forth in more detail below, the Accounting Policy Committee believes the GASB's proposals will produce a quantum increase in the usefulness of financial information to the credit evaluation and lending process. It also will aid the citizenry of all government jurisdictions to be better informed about their finances. In addition to our comments that endorse the GASB issuing this proposed statement, we also have in this letter a few suggestions for improvements as the project is completed.

Credit Evaluation and Financial Information

In the past, RMA has provided formal comments to the GASB only infrequently. Therefore, we believe it useful to explain briefly here how we evaluate credit and the types of financial
information that are useful in that process. Our primary need is to assess the ability of potential borrowers to service their debts, that is pay the interest and principal when they are due. Our first and preferred source of repayment is from the future free cash flows of a going concern. Therefore, we seek information that aids us in estimating the amounts, timing and uncertainties of those flows. Our secondary source of repayment is from liquidation of the borrower's assets. Therefore, we seek information from potential borrowers about the types of assets they hold, their availability to creditors, and the amounts of cash that they might produce in liquidation. Credit evaluators also need information about income (operations) so they can evaluate better the extent to which a period's cash flows have been generated by economic activity of that period versus being collections or payments associated with the past or future. That is an extremely brief summary, but it points out the major financial parameters of the credit assessment process.

Financial analysis is based largely on comparisons — among enterprises for a single period of time, over time for a single enterprise, and both over time and among enterprises. For comparisons to be valid, they must be based on data that reflect real economic differences as opposed to the effects of alternative accounting methods and/or presentations. Comparisons sometimes are made between and among individual enterprises, and sometimes they are made by comparing a specific enterprise to a set of norms, such as the current edition of RMA's Financial Statement Studies. We believe the GASB's proposed standard will have a notable and salutatory effect on the comparative quality of the financial data reported by state and local governments.

How the Proposed Standard Serves Credit Evaluation

There are several features of the proposed standard that will serve well the needs of credit evaluators. Overall, it brings a level of standardization to governmental financial reporting that will provide sorely-needed comparability to the credit evaluation process. It has many specific features to serve that overall end. We discuss each of them in turn briefly.

Direct Format for Cash Flow Presentation
This is not one of the major provisions in the ED. But we address it first because of its importance to RMA. We have been insistent in our "Summary of Positions Relating to Accounting Principles and Auditing Standards," our letters of comment to the FASB, our input to the AICPA Special Committee on Financial Reporting (the Jenkins Committee), and elsewhere; that the direct format for presenting cash flows from operating activities is essential to credit evaluation. As far as we know, the GASB is the first standards-setting body in the world to require use of the direct method to the exclusion of the indirect. We note that fact with appreciation and hope that it will become a precedent that eventually will be followed by accounting standard setters everywhere, most specifically your colleagues at the Financial Accounting Standards Board.

1We are enclosing also for your information and files, the latest version (April, 1997) of the Accounting Policy Committee's "Summary of Positions Relating to Accounting Principles and Auditing Standards."
On the other hand, we are disappointed that the entity-wide perspective does not include a cash flow statement in its requirements (paragraph 28). It is just as important, if not more so, for lenders to have an overall picture of entity-wide cash flows as it is to observe entity-wide financial position and results of activities. One of the costs of obtaining the benefits of accrual accounting is that it obscures cash movements unless they are reported separately. It is of vital importance to lenders to know how government officials have managed the most liquid of assets entrusted to them. [Also, see “Suggestions for Improvement” later in this letter.]

Dual Presentation of Financial Statements
This requirement of parallel reporting is an imaginative, sensible, and quite useful solution to an accounting dilemma. Once again, you have transcended the FASB\(^2\) in your approach by having a single financial report include two sets of financial statements that separately describe both the economics of government activities and the legal boundaries within which those activities take place. The proposed reporting will allow lenders and credit evaluators first to form an overall picture of how well a government is managing the resources at its disposal, the demands it makes of its taxpayers and other sources of revenue and the types and costs of the services it delivers. The overall picture will show changes in the government’s financial status and credit worthiness, both over time and in comparison with others.

We are pleased to see accrual accounting principles being applied to governmental enterprises. We have observed in the past notable instances of governmental “fiscal wizardry” which were based on a manipulation of cash-basis accounting to shift real economic costs of current periods’ activities to the financial statements of future periods when they would have to be paid by future administrations. Although lenders seek information about cash flows, we also believe it imperative that any potential confounding of cash flow data with performance data be eliminated. The proposed statement promises to do precisely that.

On the other hand, RMA endorses the modified cash flow basis of the “Fund Perspective Financial Statements.” That basis promises to provide useful information about the needs of individual governmental units to borrow and their ability to repay. It is a useful presentation because there may be legal impediments to relying on the full faith and credit of the government as a whole for the repayment of many types of loans, particularly tax anticipation borrowings and other loans in anticipation of future receipts as well as loans relating to specific physical assets or separate enterprise activities.

Recording Infrastructure Assets and Depreciation
Depreciation accounting is fundamental to the integrity of reporting economic performance. Without it, financial reporting fails to adhere to the concept of a going concern. That concept does not have direct application togovernment, which embodies the power to tax. But, it is vital

for assessing the financial performance of elected and appointed government officials. Depreciation accounting allows those who would lend to governments to assess whether their asset bases are being maintained, are increasing or are deteriorating. Whether permanent collections of assets should be recorded is a debatable point — but this is neither the time nor occasion to argue it. In any event, such restricted collections seldom if ever would be appropriate as collateral for government borrowings.

Management Discussion and Analysis
In the case of publicly-owned profit-seeking enterprises the Management Discussion and Analysis (MD&A) required by the regulations of the United States Securities and Exchange Commission (SEC) is the source of much information useful in credit analysis. The APC is pleased to see that the GASB recognizes that value and has included an MD&A requirement in the ED. We hope that it is as effective as the MD&A disclosures we see for corporations. In order for it to be as effective as possible, we recommend the following actions on the part of the GASB:

1. The Robert Morris Associates historically has taken the position that the type of disclosures made in the MD&A are inherently not auditable. In fact, those matters that can be attested to ought to be provided within the financial statements or the notes thereto. In the private sector, the MD&A is not audited because, as an SEC requirement, it is not part of generally accepted accounting principles (GAAP). As the ED is written, the MD&A is an integral part of the standard and it appears that it therefore will become part of GAAP. That may mean that it must be included in the scope of an audit in order for the auditor to be able to state that the financial statements are in accordance with GAAP.

   We recommend that the final standard be written to make it clear that an MD&A must be included in order for the set of financial statements to be in accordance with GAAP, but that the content and substance of the MD&A are the province of management and need only to be reviewed by the auditor to obtain assurance that data obtained from the financial statements for use in the MD&A is factual.

2. We also recommend strongly that the GASB conduct (or cause to be conducted) a monitoring and review of compliance with the MD&A requirement. Our suggestion emanates from our knowledge of the compliance problems that arose in the first few years of the SEC MD&A requirement. Perhaps the SEC would be willing to provide MD&A enforcement for those governments that raise funds by offering securities to the public.

Suggestions for Improvement

In most cases in the ED where the GASB has chosen among alternatives, we support the choices made. It is not our intention to quibble over minor points. There are a few major areas in which we believe the ED could be improved.
Entity-Wide Cash Flow Statement Needed
As stated earlier in this letter, the most important improvement, and one that the APC considers absolutely necessary, is that an entity-wide cash flow statement be required. Even though, in many cases there are legal restrictions on moving cash from one government fund to another, it still occurs. Sometimes the law can be changed or, even easier, budgets revised. In other cases, cash may be advanced from one fund to another as long as it is not permanently transferred. In any event, it is vital that credit analysts have available to them, an overall picture of cash movements into and out of the government as a whole. We estimate that the incremental cost of providing an entity-wide cash flow statement would be insubstantial in comparison to the benefits it would provide.

Management Discussion and Analysis (MD&A)
[See our comments on MD&A in the preceding section of this letter.]

Transition as Applied to Recording Physical Assets
The proposed standard requires that governments go back as far as twenty-five years to establish the cost of the physical assets they own, then record those assets at their depreciated cost on the date the government adopts this proposed statement. RMA has consistently supported the use of historic exchange values (historic cost), particularly for the valuation of nonfinancial assets. The approach recommended in the ED has the advantage of creating a physical asset valuation base for governments that is comparable to the ones lenders ordinarily receive from commercial enterprises. Thus, in principle, we support the approach taken in the ED.

The application of that approach raises some difficult problems. One of these is the potential inability of governments to reconstruct asset costs and subsequent depreciation for periods more than twenty-five years in the past. We believe there are many valuable assets that might never be recognized if the twenty-five year “bright line” is observed faithfully. It could, and probably would, produce different numbers for governments that acquired similar assets at different times — a particular aberration when infrastructure assets are maintained and refurbished on a regular basis and seldom replaced totally. It also would neither forbid nor require governments to include assets that are more than twenty-five years old, which in the case of buildings, roads, bridges, and the like, could be material to the financial statements. The decisions of some governments to include those assets, and others to omit them, could be a significant impediment to comparability of financial statements for some years to come. If the 25-year rule is not followed by all governments, then the resulting data will not be comparable across governmental units. That is, some governments may record all or substantially all their assets, others may not. The potential differences could be huge, particularly since government owned infrastructure tend to be retained for much longer periods than are the assets of commercial organizations.

One APC member has cited the example of the Brooklyn Bridge in New York City. It certainly has great value today which is unrelated to the cost of its construction more than 100 years ago. One alternative under the ED is for the City of New York to omit the Brooklyn Bridge from its financial records entirely. Another is for the bridge to be recorded at its historic cost in historic
of 880's) dollars and depreciated over an estimated useful life of several hundred years. The costs of improvements (but not repairs and maintenance) over the years since it was built would need to be added to its cost. We question whether the cost of reconstituting those ancient acquisition cost numbers does not exceed the value to lenders of the data. On the other hand, to leave the Brooklyn Bridge off New York City’s balance sheet totally would be as misleading as leaving it off a map showing the various egresses from the island of Manhattan.

Our suggestion is that the standard be rewritten with respect to assets more than twenty-five years old. It should require that they be included on government balance sheets. Their valuation should be a depreciated historic cost in cases where that cost meets both of the following tests:

1. It is feasible and economic to obtain the amounts of the costs, and

2. The cost numbers have at least some economic significance.

In all other cases, governmental physical assets acquired more than twenty-five years in the past should be valued at depreciated replacement cost. That is the amount it would cost today to reproduce or acquire the assets in their present condition. Replacement cost would be viewed as a surrogate for historic cost. It can be estimated with some reliability and serves today as the basis for insurable values for structures and other physical assets. Using replacement cost would be a feat somewhat less daunting than, but along the same lines as, the periodic reassessment for tax purposes of the real estate within a municipality. Its use would enhance the comparability of information between and among governments for some time after the new standard is adopted.

Monitoring and Assessment
Adoption of a comprehensive and completely new accounting standard, such as the one proposed in the ED, will require major good-faith efforts on the part of all GASB constituents. Although we believe its benefits in total outweigh the costs of the governments who will be adopting it, we do acknowledge that those costs will not be trivial. In the accounting periods subsequent to its effective date, it is virtually certain that some unforeseen difficulties and unexpected costs will arise in its application. We hope the GASB will be open to suggestions for amendments to the standard that will make it more effective and less costly to apply. At the same time, and more importantly, we urge that any such amendments be made for the purpose of strengthening the standard and making it work better. We are concerned that the GASB may receive proposals for change which might have the effect of weakening the standard. We encourage you to consider them on their merits, but not to compromise the high level of integrity and advancement this proposed standard brings to financial reporting for government.

Possible Field Testing
We are not aware that the GASB has had previous experience field testing its proposed standards. But, that may be because we have not always followed its activities closely. However, this proposed standard seems to be a natural for field testing. By applying its provisions in limited and controlled circumstances, many potential implementation problems could be identified and dealt with before they affect all state and local governments in the United States. We also
are aware that field testing requires volunteer enterprises willing to do the extra work that is required. Thus, our enthusiasm for field testing is tempered by our realization that it may not be feasible.

On behalf of RMA, the Accounting Policy Committee appreciates the opportunity to respond to the Governmental Accounting Standards Board's Exposure Draft, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. We would be pleased to answer any questions you or the Board may have concerning our views.

Yours very truly,

Douglas F. Nelson, CPA  
Chairman, Accounting Policy Committee

enclosure
American Institute of Certified
Public Accountants, Inc.
1211 Avenue of the Americas
New York, NY 10036-8775
Attention: Jane M. Mancino
Technical Manager
Audit and Attest Standards

Re: File 3507—Exposure Draft on Management's Discussion and Analysis

Dear Ms. Mancino:

The Capital Markets Committee of the Securities Industry Association ("SIA")* is pleased to submit this comment letter on the AICPA's exposure draft, dated March 7, 1997, of a proposed Statement on Standards for Attestation Engagements titled Management's Discussion and Analysis (the "Exposure Draft").**

* The Securities Industry Association brings together the shared interests of more than 760 securities firms throughout North America to accomplish common goals. SIA members – including investment banks, broker-dealers, specialists and mutual fund companies – are active in all markets and in all phases of corporate and public finance. In the United States, SIA members collectively account for approximately 90%, or $100 billion, of securities firms' revenues and employ about 350,000 individuals. They manage the accounts of more than 50 million investors directly and tens of millions of investors indirectly through corporate, thrift and pension plans. (Additional information regarding SIA is available on its Internet home page: http://www.sia.com.)

** As noted in our June 19, 1997 letter, we became aware of the Exposure Draft only shortly before the official comment deadline and requested an extension of the deadline in order to allow time for our Committee to prepare a comment letter. Although no formal extension was made, we understand from discussions of (continued...)
We support the Exposure Draft's establishment of the new MD&A report as creating an additional level of assurance for users of essential financial information regarding U.S. issuers and other issuers that access the U.S. capital markets. However, we have three concerns with the Exposure Draft, which are more fully discussed below. First, as currently written the Exposure Draft may create the incorrect impression that traditional comfort letter "tracing" procedures are no longer available with respect to amounts included in the MD&A section, even where no MD&A report is issued. Second, the Exposure Draft could be interpreted as precluding such tracing procedure when an MD&A report is issued. Finally, we recommend that a third type of MD&A report be permitted in cases where the procedures applied are more reduced in scope than contemplated for a limited review report.

SIA's members have a keen interest in the new MD&A report and any effect it may have on comfort letters prepared pursuant to Statement on Auditing Standards Nos. 72 and 76 (collectively, "SAS 72"). As financial intermediaries in public offerings and unregistered private placements and offshore offerings, SIA members and their affiliates regularly request comfort letters as a part of their due diligence or similar investigations conducted as part of their regular business practices and to protect against liability under applicable securities laws. The new MD&A report proposed in the Exposure Draft would provide an additional potential element of this process. SIA members, their affiliates and their customers are also important users of financial statements and related MD&A disclosures and therefore have a direct interest in the availability of the new MD&A report. Accordingly, the SIA is submitting this letter of comment on behalf of its members, who are among the public constituencies that will be affected by the Exposure Draft.


   a. Where no MD&A report is issued

   We are extremely concerned that a number of statements in the Exposure Draft are subject to a major misinterpretation that, if followed by accountants, would deprive comfort letter recipients of an important element of coverage that is currently available

   **(...continued)**

Ms. Jane Mancino and Mr. Tom Ray with our outside counsel that our comment letter will be treated as timely filed, and therefore fully considered, if submitted prior to the July 30, 1997 meeting of the AICPA’s Auditing Standards Board.
under SAS 72. Footnote 25 in the Appendix describing amendments to SAS 72 states that "Accountants should not comment in a comfort letter on compliance as to form of management’s discussion and analysis (MD&A) with SEC rules and regulations ...." While on its face this statement addresses only compliance as to form, we believe that accountants may interpret this limitation more broadly and instead take the view that it prohibits them from applying procedures specified in the comfort letter ("tracing") to amounts included in the MD&A to verify that they agree with or are accurately derived from corresponding amounts in the issuer’s financial statements or accounting records. In a conversation earlier this month with John T. Bostelman of Sullivan & Cromwell, our special counsel, Ms. Jane Mancino and Mr. Tom Ray of the AICPA staff confirmed that this interpretation was not intended. Accordingly, we strongly urge the AICPA to add clarifying language in a number of places to avoid this unintended result. Our specific suggestions are set forth below.

Based on our regular involvement in comfort letter discussions in registered and unregistered offerings, as well as informal discussions with practitioners at accounting firms, we believe there is a very significant risk of widespread misinterpretation unless the Exposure Draft is clarified along the lines we suggest.

We recommend that footnote 25 of the Appendix to Exposure Draft be revised to read as follows (new text in boldface; deletion in brackets):

25 Just as was the case prior to promulgation of SSAE no. X, Management’s Discussion and Analysis, accountants should not comment in a comfort letter on compliance as to form of management’s discussion and analysis (MD&A) with SEC rules and regulations; accountants may agree to examine or review MD&A in accordance with SSAE No. X [Management’s Discussion and Analysis]. Accountants may also comment on information contained in MD&A in accordance with paragraph 54, which has not been affected by the promulgation of SSAE No. X, regardless of whether an MD&A report is issued pursuant to SSAE No. X.

Footnote 32 of the Appendix, which is substantially identical to footnote 25, should be revised in the same way. We also recommend that the following be added to footnote 31 in the Appendix:

Accountants may comment on financial data presented in MD&A as contemplated by paragraph 54, regardless of whether an MD&A report is issued pursuant to SSAE No. X.
We also recommend that the following language be added to footnote 6 in the text of the Exposure Draft itself:

*This Standard does not amend SAS No. 72 in any manner that would reduce the procedures permitted to be performed thereunder prior to promulgation of this Standard or the amendments contained in SAS No. XX, regardless of whether an MD&A report is issued pursuant to this Standard.*

Finally, we recommend that the same addition, with appropriate modifications, be added to the first explanatory paragraph of the Appendix. (We understand the Appendix to represent the proposed text of the Statement on Auditing Standards that would amend SAS 72.)

**b. Where an MD&A report is issued**

In cases where an examination or a limited review of the MD&A section is performed in accordance with the standard proposed in the Exposure Draft and a report is issued thereon, one of the operative conclusions will address whether the historical financial amounts included in the MD&A have been accurately derived, in all material respects, from the company's financial statements. The Exposure Draft indicates that the concept of materiality should be considered by the practitioner that issues the MD&A report and that the objective is to report on the MD&A presentation "taken as a whole and not on the individual amounts and disclosures contained therein."

In light of the fact that the MD&A report does not specifically address individual amounts and the fact that materiality is a judgment over which reasonable views may differ, the issuance of an MD&A report should not preclude the ability of a comfort letter recipient to have the letter describe the traditional tracing of amounts in the MD&A section (just as would be the case if an MD&A report were not issued, as discussed in 1(a) above). Again, we do not believe that the promulgation of the Exposure Draft should be interpreted as potentially reducing the permitted scope of a comfort letter. In order to make this clarification, we have included the phrase "whether or not an MD&A report is issued pursuant to SSAE No. X" in the proposed additions to the Exposure Draft and Appendix discussed in 1(a) above.

Also, we suggest that paragraph 21 of the Exposure Draft be modified by the addition of the following language after the second sentence:

*Of course, as part of the procedures performed in the engagement, the practitioner should confirm that each individual amount included in*
the MD&A agrees with the corresponding amounts in the financial statements or accounting records (or should recompute the derivation of those amounts from such statements or records). However,

The text would resume with the first word of the next sentence “assessing.”

2. Addition of a Third Type of MD&A Report

We believe that an MD&A report issued as a result of an examination or limited review conducted in accordance with the standard proposed in the Exposure Draft will be of significant relevance to users of financial statements and to financial intermediaries involved in securities offerings. Nevertheless, we believe that not all issuers will be willing to pay for the performance of the procedures required for such a report to be issued. Accordingly, we suggest that a third type of MD&A report be authorized.

This third type of report would not express an opinion or provide negative assurance. Instead it would state the result of procedures described in the report, including inquiries of officials of the issuer who have responsibility for financial and accounting matters as to whether the three requirements of MD&A are met (i.e., inclusion of elements required by SEC Regulation S-K, accuracy of historical financial amounts and reasonableness of underlying information and assumptions). This result could be expressed in terms of “those officials stated that ....” While such a report would provide a lower level of assurance than an examination or limited review report, we believe the effort would nevertheless be worthwhile and presumably the required procedures would be less involved (and therefore less expensive). To that extent, users of financial statements will have a greater level of assurance than if no report were issued at all. This type of report is analogous to the specified procedures that SAS 72 contemplates with respect to interim financial information when a review pursuant to SAS 71 was not performed. See paragraph 36 and Example (O) of SAS 72. See also Example (Q) in SAS 76.

If the AICPA determines not to authorize this third type of report, we recommend that it at least amend SAS 72 expressly to authorize accountants to perform the procedures described in the previous paragraph (e.g., inquiries of officials of the issuer) for purposes of a comfort letter, and so to express the results thereof in the comfort letter. As noted above, this type of procedure and discussion of its results is already contemplated by SAS 72 for comfort letter discussion relating to interim financial statements when no limited review has been performed.
The Committee appreciates very much this opportunity to present our views. Should you have any questions, please feel free to communicate with the undersigned at (212) 761-6686 or Mark A. Egert, SIA Vice President and Associate General Counsel and Staff Adviser to the Capital Markets Committee, at 212-618-0508. Also, we would be happy to arrange a meeting between the staff of the AICPA and members of the Capital Markets Committee to explain our views more thoroughly.

Very truly yours,

Ralph Pellecchio,
Chairman
SIA Capital Markets Committee
July 24, 1997

BY HAND

Ms. Jane M. Mancino,
Technical Manager,
Audit and Attest Standards,
American Institute of Certified Public Accountants,
1211 Avenue of the Americas,
New York, New York 10030-8775.

Re: File 3507 — Exposure Draft on Management’s Discussion and Analysis

Dear Ms. Mancino:

We applaud the intentions of the ASB in seeking to provide a higher level of assurance to interested parties concerning MD&A information by issuing the Exposure Draft concerning Management’s Discussion and Analysis. However, we are respectfully submitting this letter in support of the comments on the Exposure Draft contained in the letter, dated July 23, 1997, of the Securities Industry Association.

Our firm regularly represents U.S. and non-U.S. issuers and underwriters in securities offerings and other transactions involving disclosure documents that contain financial statements and that may also involve delivery of comfort letters. Based on this experience, we agree with the SIA’s comment letter concerning the importance of the ASB’s confirming the continued availability of traditional comfort letter “tracing” procedures regarding amounts in the MD&A, whether or not an MD&A report is issued. We also support the suggested addition of a third type of MD&A report for the reasons summarized in the SIA letter.
Ms. Jane M. Mancino

In the interests of efficiency, we are not repeating here the reasoning contained in the SIA's letter, but do wish to confirm our strong support not only for the SIA's specific comments on the Exposure Draft but also for the related rationale for those comments.

If you have any questions concerning this letter, please contact John T. Bostelman (212-558-3840) of our New York office.

Very truly yours,

Sullivan & Cromwell
July 24, 1997

Ms. Jane M. Mancino
Technical Manager
Audit and Attest Standards
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Re: AICPA File 3507
Proposed Statement on Standards for Attestation Engagements -- Management's Discussion and Analysis (March 7, 1997) (the "Proposed SSAE")

Dear Ms. Mancino:

We are writing to provide you with comments on the Proposed SSAE of a drafting group composed of members of the Committee on Law and Accounting, Section of Business Law, American Bar Association ("ABA"). These comments reflect the overall views of the drafting group. However, our letter does not represent an official position of the ABA, the Section of Business Law or the Committee or its Subcommittees and does not necessarily reflect the views of every member of the drafting group.

INTRODUCTION

The Proposed SSAE would provide standards for examinations or reviews of Management's Discussion and Analyses of Financial Condition and Results of
Operations ("MD&A"). We believe that attest services with respect to the MD&A could be of value but that more guidance is needed in the Proposed SSAE with respect to examination or review of forward-looking information and other "soft" information which information is of significant importance to users. Assurances, under professional standards, as to this type of information should increase its predictive value.

Our experience leads us to believe that, if the Proposed SSAE is adopted, underwriters of publicly offered securities will request that issuers engage their independent auditors to report on the MD&A disclosures included or incorporated by reference in the prospectuses for those offerings. (The Auditing Standards Board ("ASB") apparently anticipates these requests as well, and has proposed a related amendment to SAS 72.) We also believe that, to a lesser extent, placement agents for private and other offerings exempt from registration under the Securities Act of 1933 (the "1933 Act") also may request these reports. The probability of such requests and other aspects of the Proposed SSAE raise legal and other issues that we address in this letter, including:

1. The applicability of the liability provisions of Sections 7 and 11 of the 1933 Act and related rules to reports issued pursuant to the Proposed SSAE that are included in registration statements filed under that Act and consideration by the Securities and Exchange Commission ("SEC") of a rule excluding these reports from the coverage of those provisions.

2. The relationships among the verbal formulation of the materiality standard used in the Proposed SSAE, related SEC and judicially developed materiality standards and the standards under SFAS No. 5.

3. The applicability of safe harbors from liability under Section 27A of the 1933 Act and Section 21E of the Securities Exchange Act of 1934 ("the 1934 Act") and the various SEC safe harbor rules under those statutes.
4. The possible impact of the Proposed SSAE's limitation on the scope of the term "published SEC rules and regulations" applicable to the MD&A.

5. The availability of standards for the preparation of the MD&A upon which practitioners may rely.

6. The possible divergence between the SEC's requirements for updating the MD&A disclosures for subsequent events and the guidance in the Proposed SSAE.

7. The proposed amendment to SAS 72 and related issues.

8. The relationship between the guidance in the Proposed SSAE and the procedures required by Section 10A of the 1934 Act and SEC Rule 10A-1 and GAAS.


10. The relationship between the guidance in SAS 82 and that in the Proposed SSAE.

11. Examination or review of forward-looking information.

Depending upon how certain of these issues are resolved, acceptance of an engagement to examine or review MD&A disclosures could increase the liability exposure under the Federal securities laws (and, perhaps state securities laws) of the practitioner performing the engagement.

**GENERAL COMMENTS**

Notwithstanding our belief that the accounting profession can provide a useful service by attesting to the accuracy and completeness of MD&A disclosures, we are troubled by the contemplated procedures and emphasis of the proposed SSAE. The SEC and the federal securities bar have long believed that the analysis and perspective contemplated by the MD&A Section is one of the most important aspects of a public company's disclosures. From the original institution of the MD&A requirement, the SEC has
continuously emphasized that MD&A disclosures should provide the reader with insight as to the significance of the reported financial data and apprise the reader of anticipated future developments that are likely to have an impact on the enterprise's operations. In short, to the extent that there has been a deficiency in MD&A disclosures, it has been in providing this type of insight and perspective.

In sharp contrast, however, the overwhelming focus of the SSAE is upon procedures designed to verify historical data (which presumably has already been subjected to comparable verification procedures) and little guidance is given to addressing management's explanations as to why operating results changed from period to period, what future trends and events are likely to have an impact on the reporting enterprise and what, if anything, the enterprise is doing to adjust for those eventualities. Thus, from our perspective, the engagements described in the Proposed SSAE could be made both more useful and cost-effective if they employed simple comparative procedures with respect to historical financial data and vigorous analytical procedures with respect to management's analysis of historical operating data, operating trends, risks and uncertainties, capital requirements, and similar matters. In addition, while the practitioner will have to rely heavily on representations of management regarding its plans for new products, marketing strategies, funding and similar matters, the SSAE should emphasize the need to corroborate management's representations insofar as feasible and to question management and other personnel employed by the enterprise regarding likely actions of competitors, the enterprise's ability to meet management's projections, and outside events that could have an impact on management's plans. These are the areas of greatest concern to the investing public and the SEC and to the directors and underwriters who are likely to consider engaging a CPA firm to provide such attestation services.

With this in mind, some of us have some difficulty making a distinction between an examination and a review engagement (at least as to a MD&A for a fiscal year), and suggest that only a single form of engagement be considered. In this sense, the engagement would resemble an examination of prospective
financial statements in which the practitioner examines the bases for management's assertions. Anything less than an examination would probably be of limited value and could create a new form of expectation gap.

I. POSSIBLE EXPERTIZATION; LIABILITY; CONSENTS.

If a practitioner's examination or review report on MD&A disclosures is included in a registration statement filed under the 1933 Act the practitioner may be deemed an expert within the meaning of the term under Section 7(a) of the Act. In this case, the practitioner's consent to being named and having the report included in the registration statement and the report would be required to be filed as an exhibit to the registration statement. Thus, the practitioner would be subject to statutory liability as an expert under Section 11 of the 1933 Act with respect to the report.¹

The ASB may wish to consider requesting relief from the SEC similar to that provided under Rule 436(c) for reports on reviews of unaudited interim financial statements. That Rule provides that those reports are not considered a part of a 1933 Act registration statement or a report of an expert for purposes of Section 7 and 11 of the 1933 Act.

II. MATERIALITY STANDARD.

The Proposed SSAE discusses materiality at paragraphs 21, 22 and 23. Paragraph 23 provides that a practitioner should consider an omission or misstatement of an assertion in the MD&A to be

¹ A practitioner also could be subject to liability with respect to a report on the MD&A included in a 1993 Act registration statement under Section 12(2) of that Act, the general antifraud provisions of Section 10(b) of the 1934 Act and Rule 10b-5 thereunder, and various state Blue Sky and other laws. Predecessor practitioners on whose reports on a MD&A for prior years the reporting practitioner relies and refers to in the report (see Proposed SSAE paragraphs 108-112) also could be subject to these liabilities.
material "if the magnitude of the omission or misstatement -- individually or when aggregated with other omissions or misstatements -- is such that a reasonable person relying on the MD&A presentation would be influenced by the inclusion or correction of the individual assertion." The practitioner should judge materiality "in light of the expected range of reasonableness for a particular assertion."2

While this materiality standard may approximate that under the antifraud provisions of the Federal securities laws adopted by the Supreme Court in TSC Industries, Inc. v. Northway, Inc.,3 as elaborated in Basic, Inc. v. Levinson,4 the verbal formulation of the standard in the Proposed SSAE differs both from those used by the Supreme Court in the opinions in

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2 Proposed SSAE, paragraph 22.

3 426 U.S. 438 (1976) ("an omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."). Compare SEC 1933 Act Rule 405 and SEC 1934 Act Rule 12b-2 ("The term 'material,' when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered.") We note that Regulation S-X, the SEC's accounting regulation, uses an even different verbal formulation ("matters about which an average prudent investor ought reasonably to be informed." Regulation S-X, Rule 1-02(o)). The materiality standard under Regulation S-K, Item 305 Quantitative and Qualitative Disclosure About Market Risk also differs from the SEC's materiality standard for MD&A disclosure. See FRR No. 48, 7 Fed. Sec. L. Rep. (C.C.H.) ¶ 72,448 at 62,272, Section VI.D.5.

4 485 U.S. 224, 258 (1988) (under the circumstances of pending merger negotiations, "materiality will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of company activity."). The SEC has declared the Basic probability/magnitude test for materiality "inapposite" to its MD&A requirements. FRR No. 36, 7 Fed. Sec. L. Rep. (C.C.H.) ¶ 73,193, n.13 at 62,843.
those cases and that used by the SEC for determining when disclosure is required in the MD&A about known trends, events, or uncertainties.  

Whether information is required to be disclosed under the Federal securities laws involves, among other considerations, two intertwined and sometimes confused concepts -- the disclosure trigger, articulated by the courts in terms of a duty to disclose and the materiality of the information to be disclosed. The SEC's MD&A disclosure requirements, to which the Proposed SSAE is addressed, and other disclosure requirements, embody both of these concepts, without a clear, articulated delineation.

The SEC does not require MD&A disclosure about a known trend, event or uncertainty, if the registrant concludes that the trend or uncertainty is not

5 The materiality standard in the Proposed SSAE also differs from the standards for disclosure about contingencies under SFAS No. 5 and about risks and uncertainties under AICPA Statement of Position No. 94-6, Disclosure of Certain Significant Risks and Uncertainties ("SOP 94-6"). Section 10 of SFAS No. 5 requires disclosure if "it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable" [and material] and accrual if it is reasonably probable that there will be an unfavorable result. See Greenstone v. Combex Corporation, 975 F.2d 22, 24 (1st Cir. 1992) (mentioning but not deciding the issue as to which verbal formulation of the materiality standard should be applied). SOP 94-6 created the concept of "severe impact" in reference to current vulnerability to certain concentrations that is a higher threshold than "material." SOP 94-6, paragraph 7. SOP 94-6 also requires disclosure if it's "reasonably possible" (i.e., more than remote but less than likely) that an estimate of the effect on the financial statements of a condition, situation or set of circumstances that existed at the date of the financial statements will change in the near term (i.e., in less than one year) and the effect of the change would be material to the financial statements.

reasonably likely to occur. If the registrant cannot arrive at that conclusion, under the SEC's two part test, it must then consider whether it is reasonably likely that that trend, event or uncertainty will have a material effect on its future financial condition or results of operations.

We are concerned that these differing verbal formulations of materiality standards could be argued to create different legal standards to suit the purposes of the person advancing the argument, thus creating litigation risk and uncertainty if a practitioner's report on the MD&A is challenged. Moreover, given the facial differences between the SEC's MD&A materiality standard and the materiality standards under SOP 94-6 and SFA5 No. 5, an issuer's compliance with GAAP may not satisfy the MD&A requirements.

We also question the value to a user of a report on the MD&A if the materiality standard applied by a practitioner is thought to be different than that required and expected to be applied by the SEC. If the standards are intended to be the same, and we believe they should be, then a practitioner in attesting to compliance with SEC requirements should test compliance against SEC enunciated standards. In order to do so, we believe that the materiality standard under the Proposed SSAE for information about trends, events and uncertainties should be the same as the SEC's, as articulated in FRR No. 36, both in substance and in verbal phraseology.


8 Id. See also, FRR No. 36, n.14.

9 A violation of the disclosure requirements for the MD&A, however, may not always be the basis for a suit claiming a violation of the antifraud provisions of SEC Rule 10b-5. See, e.g., Alfus v. Pyramid Tech. Corp., 764 F. Supp. 598, 608 (N.D.CA. 1991) and we do not believe that a separate implied private right of action has been established for violations of the requirements of Item 303 of Regulation S-K. Nevertheless, the SEC may bring actions to enforce its rules and seek monetary penalties, as well as other relief, in such actions.
III. SAFE HARBOR PROTECTION.

Section 27A of the 1933 Act and Section 21E of the 1934 Act provide safe harbors for "forward-looking statements," as defined in those Sections. The safe harbor, in the circumstances contemplated under those Sections, is available to an outside reviewer retained by an eligible issuer that makes a statement on behalf of the issuer. A forward-looking statement for those purposes includes "any report issued by an outside reviewer retained by an issuer, to the extent the report assesses a forward-looking statement made by the issuer ...." We understand that it is the intention of the Proposed SSAE that a practitioner in an engagement to report on the MD&A assess forward-looking statements in the MD&A. Specifically, under the Proposed SSAE, the practitioner is reporting whether "the underlying information and assumptions of the entity provide a reasonable basis for the disclosure contained [in the MD&A]." Accordingly, we believe that the safe harbor should be available for forward-looking statements in a report prepared pursuant to the Proposed SSAE to the extent that the report contains forward-looking statements and satisfies the conditions of the safe harbor. However, we believe it would be prudent for the ASB to solicit the SEC to exercise its rulemaking authority under those Sections to provide specifically that such reports are covered by the safe harbor.11

Paragraph 67(g)(2) of the proposed SSAE indicates that a practitioner's report on an examination of the MD&A should state that (1) in the MD&A disclosures, management is required to "make estimates and assumptions that affect reported information, and (2) actual results in the future may differ materially from management's present assessment

10 The safe harbors are not available in many circumstances where a practitioner may be called upon to report on MD&A disclosures, including initial public offerings.

11 The SEC has exercised its rulemaking authority under the safe harbor provisions only once since they were enacted. See Regulation S-K Item 305(d).
of information regarding the estimated future impact of expected transactions and events, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties. While the statement suggested by Paragraph 67(g)(2) “bespeaks caution,” it may not be sufficient to afford the practitioners' report protection under the statutory safe harbor or even the less precise, judicially developed “bespeaks caution" doctrine that also provides protection against civil liability under the Federal Securities laws for forward-looking statements accompanied by cautionary language.

The statutory safe harbor provisions require that a forward-looking statement be identified as such and be accompanied by "meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement ...." The statement suggested by the Proposed SSAE neither identifies a particular forward-looking statement nor identifies important factors that could cause actual results to differ materially from those in the forward-looking statement. Since there is no substantial body of judicial authority interpreting the statutory safe harbor provision, we suggest that the statements in Paragraphs 67(g) and 88(h) of the Proposed SSAE be revised to recommend that certain forward-looking statements in the MD&A are identified and that such statements be accompanied by such "meaningful cautionary statements."

In addition to the statutory safe harbor for forward-looking statements, SEC Rules 175 and 3b-6 provide safe harbors for “forward-looking statements,” as that term is defined for purposes of those rules. The safe harbor protections afforded by these Rules cover statements subject to the liability provisions of Sections 11, 12(2) and 17 of the 1933 Act and Sections 10(b) and 18 of the 1934 Act. Forward-looking statements that satisfy the conditions of the rules that are made by an outside reviewer retained by the issuer are covered by these safe harbors. The safe harbors provided by these rules apply to forward-looking statements included in disclosure documents filed with the SEC, including those relating to transactions not covered by the statutory safe harbor,

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12 See also, Section 88(h) of the Proposed SSAE.
such as initial public offerings. Unlike the statutory safe harbor, however, reliance on the safe harbor provided by these rules may not be a basis for dismissal of an action at the pleading stage.

Particularly if practitioners' reports prepared in accordance with the Proposed SSAE are not afforded relief from the liability provisions of Section 11 of the 1933 Act (see discussion under I above), it may be prudent for the ASB to seek to persuade the SEC to amend Rules 175 and 3b-6 to expressly cover such reports.

IV. SEC PUBLISHED RULES AND REGULATIONS APPLICABLE TO THE MD&A.

The Proposed SSAE would provide guidance for an independent auditor to report on MD&A disclosures prepared in accordance with "published SEC rules and regulations" rendering an opinion that, among other things, the MD&A presentation includes, in all material respects, the required elements of Item 303 of SEC Regulation S-K and "the related published SEC rules and regulations." Footnote 3 to the Proposed SSAE states that:

[a]s of the date of issuance of this Standard, the published SEC rules and regulations for MD&A are found in Item 303 of Regulation S-K, as amended by Financial Reporting Release (FRR) No. 36, Management's Discussion and Analysis of Financial Condition and Results of Operations: Certain Investment Company Disclosures

and further states that Item 303, as amended by FRR No. 36, provides the relevant published SEC rules and

13 We note that Item 303 of SEC Regulation S-B, applicable to small business issuers, and Item 9 of form 20-F, applicable to foreign private issuers, contain similar requirements but are not covered by the Proposed SSAE. If the ASB determines not to cover these Items, the SSAE should so state.
regulations that meet the definition of reasonable criteria in paragraphs 11 through 17 of SSAE No. 1.\footnote{AICPA Professional Standards, at §§ 100.11-100.17. We note that the Proposed SSAE indicates that a practitioner should consider whether the SEC has published additional "rules and regulations with respect to MD&A" subsequent to the issuance of the Statement. If the ASB intends that the SEC's published rules and regulations "with respect to" or "for" MD&A disclosures are and will be, limited to Item 303 of Regulation S-K, as amended from time-to-time, and related FRRs, the SSAE should so state to provide guidance to practitioners. Portions of FRR No. 36 and other material relating to the MD&A requirements are codified in Section 501 of the SEC's Codification of Financial Reporting Policies ("SEC Codification"), which represents a codification of the SEC's "current published views and interpretations relating to financial reporting" and is intended as a supplement to Regulations S-K and S-X. FRRs also may be rules of the SEC. See Regulation S-X, Rule 101(a). The ASB may wish to consider reference to the SEC Codification, rather than FRR No. 36, as one of the criteria to be addressed under the SSAE.}

We recognize that a practitioner, in attesting that an MD&A disclosure includes the required elements, should have reasonable, readily available and acceptable criteria to make the judgments required by the Proposed SSAE.\footnote{Cf. AICPA Professional Standards, AU Section 800, Compliance Auditing.} However, we are concerned that the limitations on such criteria imposed by the Proposed SSAE would reduce the value of the attestation to users and raise issues as to the possible exposure of the practitioner rendering a report under the SSAE to liability under the Federal securities laws, even if the engagement is conducted in compliance with the SSAE.\footnote{Cf. U.S. v. Simon, 425 F.2d 796 (1969) (holding that the law, and not GAAP determines whether financial misstatements are materially misleading).}
"is capable of evaluation against reasonable criteria that . . . have been established by a recognized body. . . ." 17 Criteria issued by regulatory agencies, such as the SEC, normally would be considered reasonable criteria. 18 However, the attestation standards contain a due process element, including broad distribution of proposed criteria for public comment. 19 The interpretations of the MD&A discussed below (and those in FRR No. 36, we might add) ordinarily would not satisfy such a due process criteria. Moreover, reasonable criteria must be capable of reasonably consistent estimation or measurement using those criteria and competent persons using the same or similar measurement and disclosure criteria ordinarily, but not always, should be able to obtain materially similar estimates or measurements. Due to the generality of the SEC's MD&A requirements and the judgments involved, we question whether these general attestation standards can ever be satisfied by a practitioner engaged to attest as to the inclusion in an MD&A presentation of all of the required elements of the SEC's MD&A requirements.

Our concerns are based principally on our experience that the SEC and its staff have interpreted the MD&A in arguably "published" sources other than FRR No. 36, subsequent to the issuance of FRR No. 36, 20 including Staff Accounting Bulletins ("SABs"), 21 SEC

17 AICPA Professional Standards, AT § 100.11a.
18 AICPA Professional Standards, AT § 100.13.
19 Id.
20 FRR No. 36 itself reflects a codification of prior interpretations by the SEC and its staff of the MD&A requirements.
21 See, e.g., SAB No. 88, SABs Topic 1:D (as referred to in FRR No. 48, n.71 and accompanying text) (foreign companies); SAB No. 84, SABs, Topic 5:H (sale of stock of subsidiaries); SAB No. 87, SABs, Topic 5:W (property-casualty insurance reserves); SAB No. 92, SABs, Topic 5:Y (loss contingencies); SAB No. 93, SABs, Topic 5:Z (discontinued operations), question 6 and interpretive response; SAB No. 94, SABs, Topic No. 5:AA (early extinguishment of debt). We have used as examples only
releases announcing the proposal or adoption of disclosure rules or regulations and other interpretive releases \textsuperscript{22} and SEC Industry Guides. \textsuperscript{23} The views of the SEC staff on the requirements for the MD&A also are expressed by less formal means, including "no action" letters, \textsuperscript{24} standardized SEC staff comments issued in reviewing disclosure filings \textsuperscript{25} and in speeches of

those SABs issued subsequent to the issuance of FRR No. 36 on May 18, 1989, although certain SABs issued prior to that date, \textit{e.g.,} SAB No. 73; SAB No. 74, addressed MD&A requirements. We recognize that, technically, Staff Accounting Bulletins are not rules of the Commission but, in practice, they are followed by the staff in reviewing financial statements and MD&A disclosures, as if they were rules; and we are not prepared to say that interpretations in SABs would not be persuasive to a federal court or to the SEC in an administrative proceeding.

\textsuperscript{22} \textit{See e.g.}, Securities Act of 1933 Release No. 7386 (January 31, 1997), FRR No. 48 (discussed below); Securities Act of 1933 Release No. 7355 (October 9, 1996) (not issued as an FRR) (likely material effects of recently consummated business combination required to be disclosed in MD&A, even if separate financial statements of the acquired businesses and related pro forma data are not required to be included in the filing by Regulation S-X). Since FRR No. 36 codified past SEC releases containing interpretation of its MD&A requirements, we do not believe it is necessary to address these past releases in any detail except by way of example of the numerosity of SEC pronouncements addressing the MD&A requirements. \textit{See, e.g.}, Securities Act of 1933 Release Nos. 6231 (September 2, 1980); 6349 (September 28, 1981); 6436 (November 18, 1982, n.8, n.10; 6711 (April 20, 1987); 6728 (August 6, 1987); 6791 (August 1, 1988).

\textsuperscript{23} \textit{See, e.g.}, Industry Guide 3 (bank holding companies); Industry Guide 6 (property-casualty insurance companies).


\textsuperscript{25} Standard staff comments, during various time periods, have related to disclosure in the MD&A about derivatives, industry specific issues (such as those relating to defense
individual SEC Commissioners and staff members to industry groups. A number of these pronouncements were issued subsequent to May 18, 1989, the date of FRR No. 36, and others may be issued prior to the ASB's adoption of the Proposed SSAE. Some could take the position that these pronouncements, or at least certain of them, are modifications of FRR No. 36. A good example of this type of pronouncements can be found in the release announcing the adoption of the SEC's derivatives disclosure requirements. Indeed, since many of the derivatives disclosure requirements called for in this release may be satisfied by disclosure in the MD&A, perhaps, it too should be added to the list contractors) and corporate restructurings.

We note that Footnote 22 to the proposed revisions to SAS No. 72 (Appendix to the Proposed SSAE) states that "[t]he term published is used because accountants should not be expected to be familiar with, or express assurances on compliance with, informal positions of the SEC staff." We believe that this "head-in-the-sand" position may expose practitioners reporting on the MD&A disclosures to unexpected liability and diminish the value to users of these reports.

26 Securities Act of 1933 Release No. 7386 (January 31, 1997), also issued as FRR No. 48. The release announcing the proposal of the derivatives disclosure regulations also contained guidance concerning compliance with the MD&A requirements. See Securities Act of 1933 Release No. 7250 (December 29, 1995). We note that SEC release proposing rules and regulations are not issued as FRRs. Thus, restricting published rules and regulations applicable to the MD&A for purposes of the Proposed SSAE to FRRs may be too limiting.

27 See FRR No. 48. In Section IV.B of FRR No. 48, and footnote 71 thereto, the SEC refers foreign companies to SABs, Topic 1:D to determine whether information regarding accounting policies for derivatives should be provided in the MD&A. Section V of FRR No. 48 states that disclosure in the MD&A about the interest costs of debt instruments should include disclosure about the effects of derivatives. Section VI.D.5 of FRR No. 48 contains a comparison of the materiality standards under the MD&A requirements and the
in the SSAE of published SEC rules and regulations applicable to the MD&A.

The SEC's views on its MD&A disclosure requirements also may be expressed in administrative and civil enforcement proceedings, some of which are well publicized.\(^{28}\) Indeed, FRR No. 36, in footnotes, refers to various SEC enforcement proceedings in support of interpretations enunciated in that release.\(^{29}\) Accordingly, examples of enforcement proceedings reflecting the SEC's views of its MD&A requirements cited in footnote 29 to this letter include only proceedings completed subsequent to the issuance of FRR No. 36 on May 18, 1989.

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derivative disclosure requirements, which have a lower materiality threshold. FRR No. 48 also indicates that material market and other risks not required to be disclosed pursuant to derivatives disclosure requirements or associated with instruments or transactions not subject to those requirements nevertheless may be required to be disclosed in the MD&A. See e.g., FRR No. 48, footnote 56; footnote 60 and accompanying text; Section IV.A.


\(^{29}\) See FRR No. 36, notes 23, 26, 32, 33, 36, 37, 39, 40, and 48.
The point we wish to make, however, is that the SEC undoubtedly believes that such statements in its opinions in administrative enforcement proceedings reflect interpretations of its MD&A requirements with which registrants must comply. Moreover, the SEC has been successful over the years in convincing the courts and administrative law judges that those interpretations and applications of its "published rules and regulations" should be accorded similar weight.

In view of the discussion above, we believe that even if a practitioner concludes that an MD&A was prepared in accordance with "published SEC rules and regulations," as that term is defined in the Proposed SSAE, the SEC or a court, based on publicly available interpretations of the SEC and its staff, could nevertheless conclude that the MD&A was not in compliance with SEC MD&A requirements or other SEC rules or regulations. Such a conclusion also could be based on the application of a materiality standard different from that used in the Proposed SSAB or the failure to update the independent auditor's attestation report to reflect events subsequent to the date of the report but prior to the effective date of the registration statement in which the report is included. Thus, the value of the independent

30 The SEC has taken the position that it has the authority to set auditing standards. See, e.g., Securities Exchange Act 1934 Release No. 38387 (March 13, 1997). It is not inconceivable that they also would assert rights to set attestation standards for reports included in filings with them. Moreover, the standard of culpability in the administrative proceeding involving professionals who fail to comply with SEC standard requirements, as viewed by the SEC, is negligence. See, e.g., In the Matter of Checkosky and Aldrich, Securities Exchange Act of 1934, Release No. 38183, AAER No. 871 (May 21, 1997).

31 E.g., 1934 Act Rule 10b-5; 1934 Act Rule 12b-20.

32 See discussion under II above.

33 See discussion under VI below.
VAUDITOR'S ATTESTATION TO ITS USERS WOULD BE
DIMINISHED.34

V. AVAILABILITY OF STANDARDS FOR INTERNAL CONTROL
APPLICABLE TO PREPARATION OF THE MD&A.

Paragraphs 47 through 56 of the Proposed SSAE
discuss the need for a practitioner to obtain an
understanding of the entity's "internal controls
applicable to the preparation of MD&A," including
controls in place not only in the last year but in
prior years, sufficient to plan the engagement and to
assess certain risks. The proposed statement also
indicates that the practitioner's responsibility to
communicate deficiencies in the design or operation of
these internal controls in an examination of MD&A is
similar to an auditor's responsibility described in SAS
No. 60, Communication of Internal Control Related
Matters Noted in an Audit. We find these references
troublesome because we are not aware of widely-accepted
standards for internal controls over the preparation of
the MD&A.

Because a requisite to rendering a report on
MD&A disclosures is that the practitioner have rendered
a report on the latest financial statements covered by
the MD&A disclosures, the practitioner would already be
required to have disclosed such deficiencies with
respect to the enterprise's internal controls over
financial statement data in connection with the
engagement to audit the underlying financial
statements. If the practitioner only issued a review
report on the MD&A, he or she would not have a basis for
detecting internal control deficiencies. Thus, insofar
as this duty pertains to the historical financial data
included in the MD&A disclosures it may be redundant.

With respect to the remaining MD&A
disclosures, there are no recognized standards for

34 Whether or not preparers of, and the attestators to
such an MD&A would be protected by a safe harbor from
liability would depend upon the coverage of the safe harbor
and whether the non-complying statement or omission related
to a forward-looking statement or to a statement of
historical fact. See discussion under III above.
public companies to assure the accuracy of such disclosures. To the extent that such controls exists, they may entail having the enterprise's senior officers and directors review the disclosures for the purpose of determining whether they are consistent with management's plans and views of likely future events. Such controls are, in effect, found in the statutory requirements that registration statements and annual reports be signed by all the directors and the enterprises chief executive, financial and accounting officers.

The COSO Report\textsuperscript{35} is recognized as a valuable contribution to the subject of, and literature about internal control within business enterprises.\textsuperscript{36} While that Report addresses controls relating to operations and compliance objectives, as well as financial reporting, it does not establish internal control standards specifically applicable to the preparation of MD&A disclosures. Similarly, the SEC, in an administrative proceeding against Caterpillar Inc., ordered Caterpillar to "implement and maintain procedures designed to ensure compliance with Item 303 of Regulation S-K..." but did not specify what those procedures were.\textsuperscript{37} The SEC, thus, missed an opportunity to provide guidance as to procedures for preparation of the MD&A that it found acceptable.


\textsuperscript{36} See, e.g., "Management" Reports on Internal Control: A Legal Perspective", Report of the Committee on Law and Accounting, Section of Business Law, American Bar Association, 49 Bus. Law. 889 (February 1994).

This is not surprising since Section 13(b)(2) of the 1934 Act only addresses internal "accounting" controls that provide reasonable assurances that "financial statements" are prepared in conformity with "generally accepted accounting principles." Although there have been court decisions suggesting that corporate directors have a common law duty to establish information and reporting systems sufficient to enable the corporation's business performance and compliance with law, those decisions provide little or no guidance as to either the nature of the controls that are required or the required quality of information they must generate.  

Similarly, the federal sentencing guidelines, while clearly designed to encourage the establishment of internal legal compliance procedures are neither addressed toward compliance with MD&A disclosure requirements nor provide any meaningful guidance for compliance.

In short, we are aware of no existing standards against which a practitioner might assess the deficiencies in a client's internal controls regarding MD&A disclosures other than those that pertain to historical financial data. Accordingly, while we believe that a CPA firm's advice regarding improvements in a client's systems for preparing and reviewing non-historical financial data disclosures in MD&A could be useful, a report detailing "deficiencies" would be too subjective in the absence of recognized standards for internal controls in this area. Moreover, imposing a duty to perform such a clearly ill-defined task would simply be an invitation to litigation.

VI. GUIDANCE FOR UPDATING.

Footnote 15 to the Proposed SSAE states that "the annual MD&A presentations would not be updated for subsequent events ... if the event has been reported

through a filing on Form 8-K." 39 In our experience, in some circumstances, this statement would be contrary to the SEC position that the MD&A must be a self contained discussion and the disclosure made elsewhere, even if in the same disclosure document, will not satisfy this requirement. 40 If the quoted statement refers to events (and reporting of those events on Form 8-K) subsequent to the filing of the document including the MD&A or, in the case of a 1933 registration statement, subsequent to its effective time, that should be clarified.

VII. THE PROPOSED AMENDMENTS TO SAS 72 AND RELATED ISSUES.

The ASB proposes to amend SAS No. 72 Letters for Underwriters and Certain Other Requesting Parties ("SAS No. 72") to reflect the relationship between the Proposed SSAE and SAS No. 72 and to make certain technical changes.

Footnotes 25 and 32 of SAS No. 72, as proposed to be amended, state that an accountant should not comment in a comfort letter on compliance as to form of the MD&A with SEC rules and regulations but that an accountant may agree to examine or review the MD&A in accordance with the Proposed SSAE. We believe that such a limitation will further encourage underwriters to request issuers to engage their accountants to examine and/or review of MD&A disclosures.

VIII. "WHISTLE BLOWING" GUIDANCE.

Section 10A of the 1934 Act 41 requires that "each audit" required by the Act "shall include, in

See also, Proposed SSAE Sections 98 and 99.


Rule 10A-1 under the 1934 Act establishes procedures for the reporting to the SEC required by Section 10A.
accordance with generally accepted auditing standards ("GAAS"), as may be modified or supplemented by the [SEC]... procedures designed to provide reasonable assurance of detecting illegal acts that would have a direct and material effect on the determination of financial accounts [and] related party transactions that are material to the financial statements or otherwise require disclosure therein..." Section 10A also requires an evaluation of whether there is substantial doubt about the ability of the issuer to continue as a going concern during the ensuing fiscal year. Section 10A further imposes certain obligations on an independent public accountant conducting an audit subject to the Section (including reporting to the SEC in certain circumstances) and permits the SEC to issue cease-and-desist orders and impose civil penalties on an independent accountant that willfully violates those reporting provisions.

An examination or review pursuant to the Proposed SSAE should not be an "audit" for these purposes. However, under Section 4 of the Proposed SSAE, as a condition to accepting an engagement to examine a" MD&A, the practitioner must have audited the financial statements of the issuer for at least the latest annual period to which the MD&A relates. Moreover, Paragraph 78 of the Proposed SSAE requires the auditor to inform the issuer's audit committee or those with equivalent authority if management refuses to take corrective action with respect to material inconsistencies among the MD&A and other information in the document containing the MD&A or the historical financial statements or material omissions or misstatements of fact in the MD&A reported by the auditors to management. If the MD&A is not revised, the practitioner is to evaluate whether to resign from the engagement related to the MD&A and whether to remain as the issuer's auditor. Paragraph 78, however, does not require reporting to the SEC.42

With respect to whistle blowing under 10A, there is no basis for applying the mandatory reporting procedures to matters discussed in an MD&A engagement,

42 Item 304 of Regulation S-K and AICPA rules, however, may require the auditor to communicate with the SEC if the auditor resigns as auditor.
just as there is no basis for applying those requirements to matters discovered in a tax or MAS engagement. The distinction is that there is a statutory requirement for a financial statement audit and there is no similar requirement for an MD&A report.

The danger, of course, is that it is much more difficult to distinguish between actions taken in connection with an audit and those taken in an MD&A engagement. Therefore, because of the danger that the information was learned in the course of a financial statement audit, the SSAE should include a warning to that effect and suggest that the practitioner should consult with counsel regarding the application of the Section 10A requirements to the discovered information.

IX. RELATIONSHIP OF THE PROPOSED SSAE TO SAS 82.

The relationship between the Proposed SSAE and SAS No. 82, Consideration of Fraud in a Financial Statement Audit, is not clear. What is the responsibility of a practitioner who is engaged to examine that issuer's MD&A and who also must have audited the issuer's financial statements to detect fraud in the course of the attest engagement? Because of the strong possibility that the SEC and damaged investors would take legal action a practitioner who discovers fraud in an MD&A engagement and did not act as required in SAS 82 (and Section 10A), we believe it would be appropriate to include in the Proposed SSAE an appropriate reference SAS No. 82.

X. SAS 12 ISSUES.

SAS No. 12, Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments, does not cover engagements to report on MD&A disclosures. We would hope that accountants would not attempt to expand their inquiry letters to cover such engagements. Lawyer's responses to such inquiries would not be permitted and the American Bar Association's 1975 Statement of Policy governing Lawyer's Response to Auditor's Requests for Information. Any attempt to expand on such requests could affect adversely the working relationship between the legal and accounting professions in this regard.
XI. EXAMINATION OF FORWARD-LOOKING INFORMATION

Paragraph 26 of the Proposed SSAE states that forward-looking information included in a MD&A "...should be subjected to the practitioner's examination ...". Paragraph 27 of the Proposed SSAE, which deals with examinations of MD&A disclosures, states that, "...underlying information and assumptions of the entity (should) provide a reasonable basis for the disclosures therein...". Paragraph 58(e) of the Proposed SSAE states that the practitioner "ordinarily" should "consider whether the underlying information and assumptions of the entity provide a reasonable basis for the MD&A disclosures of events, transactions, conditions, trends, demands, commitments, or uncertainties" and that available prospective financial information should be compared to forward-looking MD&A disclosures.

Except for an instance in which a forward-looking disclosure is deemed by a practitioner to be immaterial, paragraphs 26, 27 and 58 imply that, prior to expressing an opinion, the accountant practitioner should perform procedures to accumulate sufficient competent evidence to conclude that the assumptions underlying forward-looking disclosures are reasonable. If that is the intention of the ASB, we suggest that paragraph 26 of the Proposed SSAE be amended to say so. Instead, paragraph 26 presently says that testing of forward-looking information is "...only for the purpose of expressing an opinion... on the MD&A presentation taken as a whole" (emphasis added). The quoted language in paragraph 26 could be read to permit the obtaining of less satisfaction than that suggested in paragraphs 27 and 58 which state that the practitioner should satisfy himself (herself) that the assumptions underlying forward-looking disclosures are reasonable.

This raises a more fundamental issue. If the practitioner is obliged to obtain sufficient evidentiary matter to satisfy itself that assumptions underlying forward-looking disclosures in a MD&A are reasonable, must the practitioner effectively also perform and examination of the forward-looking
disclosures, the "taken as a whole" language in paragraph 26 of the Proposed SSAE notwithstanding?

* * *

We appreciate the ASB providing us with the opportunity to submit a letter after the deadline for comments has passed.

We would be available to meet with you to discuss the issues we have raised at your convenience.

Very truly yours,

Dan L. Goldwasser
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