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Report from the Working Group on the Auditor's Reporting Model

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Auditor's Reporting Model

Summary of PCAOB Proposed Rule

- ❑ Enhance the form and content of the report to make it more relevant and informative to investors and other financial statement users
- ❑ Include a description of "critical audit matters" (CAMs)
 - Any matter communicated to the audit committee that relates to accounts or disclosures that are material to the financial statements and involved especially challenging, subjective, or complex auditor judgments
- ❑ Additional improvements to the auditor's report intended to clarify the auditor's role and responsibilities related to the audit of the financial statements and make the auditor's report easier to read

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Proposed Rule Requirements - CAMs

The Proposal required that the audit report:

1. Identify the CAM
2. Describe why the auditor viewed the issue as a CAM
3. Indicate how the auditor addressed the CAM
4. Refer to the financial statement line(s) and disclosure(s) that pertain to the CAM

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Working Group's Support

- ❑ The Auditor's Report Working Group believes that the Board's Proposed Auditing Standard represents a meaningful improvement from the current standard audit report
- ❑ We take no exception to the four audit report requirements for CAMs that are proposed
- ❑ The requirement to discuss CAMs will be useful to the investment community
 - Must be devoid of boilerplate language and highly bespoke
- ❑ Direct correlation between extent of CAM company-specificity and related value of the audit report

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We ask the Board to do more..

- Notwithstanding the Working Group's clear support for the Proposal, we ask the board to do more
- The Board stopped short of mandating the discussion of what the auditor ***found*** when it addressed the CAM
 - i.e., what were the results of the auditor's procedures in these areas

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Proposed Modification

- We are aware that *mandating* the disclosure of findings may be problematic
 - Neither the forthcoming IAASB standard, nor the existing FRC standard mandate the disclosure of findings
- We ask the PCAOB to consider modifying the existing Proposal to simply add one sentence:
 - **“We view the inclusion of informative, company-specific findings related to each CAM as a best practice in auditor reporting, and although the inclusion of findings is not required in this Auditing Standard we strongly encourage auditors to include such findings in their audit reports.”**
- We view including CAM-related findings as unambiguously making audit reports more informative, consistent with the Board's mission

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Justification for our Position

- The disclosure of CAMs is useful, but incomplete without also revealing the related findings
- Approximately 80 percent of investors believe that audit reports should include findings
- FRC has stated:
 - “Investors clearly valued the additional insight offered by extended auditor reporting, and have since encouraged the adoption of greater transparency, particularly in respect of auditor’s judgements and their findings”

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Justification for our Position (cont.)

- ❑ New audit reports in the UK have been so well received that the Investment Management Association (IMA) sponsors a yearly contest to recognize the best audit reports
- ❑ The IMA commended KPMG's Rolls Royce audit report:
 - “..*provided a real value add*, giving colour as to whether management's judgements were balanced, mildly optimistic, or mildly pessimistic in the view of the auditor.”
- ❑ In the UK, at least some audit firms view reports with findings as a superior market-responsive service
 - PwC has committed to including findings in its reports across the entire UK
 - Moreover, there is at least some evidence, that PwC, KPMG, and EY are now including findings in reports

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Informative & Company-Specific Information

- ❑ In reporting findings, it is essential that the auditor provide informative and company-specific information, particularly with respect to estimates and judgements
- ❑ A finding that states that an estimate is reasonable or falls within an acceptable range is already implied by the issuance of an unmodified audit report
- ❑ “Instead what is required is graduated findings that say whereabouts in a range matters sit” – Tony Cates, Head of International Markets and Government, KPMG UK
- ❑ To the extent that all information and findings provided is identical the usefulness of reports declines
 - Differentiation, by definition, is what makes information useful

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Opposition to Disclosure of Findings

- ❑ Disclosing findings would move the auditor toward providing original information and would exceed the auditor's mandate
- ❑ Some, particularly in the audit committee community, question what investors would do with the information in expanded auditor reports
- ❑ Including findings in the audit report might expose auditors to incremental legal liability
 - A decision to encourage, but not require, the reporting of findings allows each audit firm to weigh the benefits of a more useful report against the costs of potentially increased legal liability
 - The Auditor's Report Working Group supports a legal safe harbor related *only* to the inclusion of CAM-related findings in the audit report

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Conclusion

- ❑ We support the PCAOB's Proposal as a meaningful improvement in auditor reporting
- ❑ We believe that the Proposal would be substantially strengthened if the Board simply encouraged, but did not require, the inclusion of informative, company-specific findings in the audit report
- ❑ We therefore challenge the Board to take a "small step" when the preferences of the group that the Board was intended to serve, investors, are crystal clear

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Questions

