

Auditor's Reporting Model Proposal

Jennifer Rand

*Deputy Chief Auditor and Deputy Division Director,
Office of the Chief Auditor*

Jessica Watts

Associate Chief Auditor, Office of the Chief Auditor

Disclaimer

The views expressed by each of the presenters are their own personal views and not necessarily those of the PCAOB, members of the Board, or the PCAOB staff.

SAG Discussion on the Auditor's Reporting Model

- Background of the Proposal
- Summary of the Proposed Standards
- SAG Member Discussion

Background of the Proposal

- Many investors have expressed dissatisfaction that the content of the existing auditor's report provides little, if any, information specific to the audit of the company's financial statements.
- Some investors noted that auditors gain knowledge about a company's financial statements during the audit that is not known to investors. These investors stated that they believe such knowledge would assist them when making their investment decisions.

Background of the Proposal (Cont'd)

- From October 2010 through March 2011, the Board's staff met and held discussions with investors, financial statement preparers, auditors, audit committee members, and others.
- On June 21, 2011 the Board issued a concept release to seek public comment on potential changes to the auditor's reporting model.
- The Board received 155 comment letters.
- Roundtable held September 15, 2011.

Background of the Proposal (Cont'd)

- The objective of the concept release was to seek comment on several alternatives for changing the auditor's reporting model in order to make the auditor reporting more relevant and useful to investors and other financial statement users. The concept release indicated that each of the alternatives presented would retain the pass/fail opinion. The alternatives presented were:
 - A supplemental narrative report, described as an auditor's discussion and analysis (AD&A);
 - Required and expanded use of emphasis paragraphs;
 - Auditor assurance on other information outside the financial statements; and
 - Clarification of the standard auditor's report.
- The concept release indicated that the alternatives presented were not mutually exclusive and that other alternatives could be considered.

Overview of the Proposal

- On August 13, 2013, the PCAOB proposed two auditing standards:
 - *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (the "proposed auditor reporting standard"), which would supersede portions of AU sec. 508, *Reports on Audited Financial Statements*, and
 - *The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report* (the "proposed other information standard"), which would supersede AU sec. 550, *Other Information in Documents Containing Audited Financial Statements*.
- The Board also proposed related amendments to PCAOB standards.

Overview of the Proposal (Cont'd)

- The proposed auditor reporting standard is intended to increase the informational value of the auditor's report to promote the usefulness and relevance of the audit and the related auditor's report.
- The proposed other information standard is intended to improve the auditor's procedures and to enhance the auditor's responsibilities with respect to other information, further protecting the interests of investors.

Proposed Auditor Reporting Standard

- The proposed auditor reporting standard would retain the pass/fail model and the basic elements of the current auditor's report, but would require the auditor to communicate a wider range of information specific to the particular audit.
- The proposed auditor reporting standard would require:
 - Communication of critical audit matters that would be specific to each audit;
 - Addition of new elements to the auditor's report related to:
 - Auditor independence;
 - Auditor tenure; and
 - Auditor's responsibility regarding other information that is included in documents containing the audited financial statements and the related auditor's report;
 - Enhancements to existing language in the auditor's report related to the auditor's responsibility for fraud and notes to the financial statements.
- The proposed auditor reporting standard would retain the requirements relating to explanatory language or paragraphs in the auditor's report (e.g. going concern). Also, it would retain the auditor's ability to emphasize a matter regarding the financial statements.

Critical Audit Matters

- Critical audit matters are those matters addressed during the audit that:
 - Involved the most difficult, subjective, or complex auditor judgments;
 - Posed the most difficulty to the auditor in obtaining sufficient appropriate evidence; or
 - Posed the most difficulty to the auditor in forming the opinion on the financial statements.

Critical Audit Matters (Cont'd)

- Critical audit matters ordinarily are matters of such importance that they are required to be:
 - Documented in the engagement completion document, which summarizes the significant issues and findings from the audit;
 - Reviewed by the engagement quality reviewer;
 - Communicated to the audit committee; or
 - Any combination of the three.
- The proposed auditor reporting standard provides a list of factors the auditor should take into account to determine critical audit matters.

Critical Audit Matters (Cont'd)

- The description of critical audit matters in the auditor's report would:
 - Identify the critical audit matter;
 - Describe the considerations that led the auditor to determine that the matter is a critical audit matter; and
 - Refer to the relevant financial statement accounts and disclosures that relate to the critical audit matter, when applicable.

- If the auditor determines that there are no critical audit matters, the auditor would state in the auditor's report that the auditor determined that there are no such matters to communicate.

Proposed Other Information Standard

- The proposed other information standard, among other things, would:
 - Apply the auditor's responsibility for other information specifically to a company's annual reports filed with the SEC under the Exchange Act that contain that company's audited financial statements and the related auditor's report;
 - Enhance the auditor's responsibility with respect to other information by adding procedures for the auditor to perform in evaluating the other information based on relevant audit evidence obtained and conclusions reached during the audit;

Proposed Other Information Standard

(Cont'd)

- The proposed other information standard, among other things, would:
 - Require the auditor to evaluate the other information for a material misstatement of fact as well as for a material inconsistency with amounts or information, or the manner of their presentation, in the audited financial statements; and
 - Require communication in the auditor's report regarding the auditor's responsibilities for, and the results of, the auditor's evaluation of the other information.

Request for Comment

□ Comments:

- The Board is seeking comments by December 11, 2013, on all aspects of the proposed standards and related amendments to other PCAOB standards.
- Among other things, the Board is seeking comment on economic considerations relating to the proposed standards and amendments, including potential costs.
- The Board is also requesting that commenters prepare, and forward to the Board for its consideration, examples of critical audit matters that could be communicated in the auditor's report under the proposed auditor reporting standard.

□ Roundtable Discussion:

- The Board is considering holding a public roundtable in 2014 to discuss the proposed standards and comments received.

SAG Member Discussion - Overview

- ❑ Critical Audit Matters
- ❑ New Elements of the Auditor's Report
- ❑ Other Information
- ❑ Other Topics of Interest to SAG Members

Critical Audit Matters

- Definition
- Usefulness of proposed reporting
- Determination and communication
- Documentation