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

Joe Carcello (Co-Lead)  Norman Harrison
Sarah Deans (Co-Lead)  Michael Head
Mary Bersot  Bess Joffe
Grant Callery  Anne Simpson
Linda de Beer
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
Auditor’s Reporting Model

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
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.
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.
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
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”
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.
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.
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.
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.
Questions