
PCAOB Roundtable
Auditor's Reporting Model

September 15, 2011

On June 21, 2011, the Public Company Accounting Oversight Board ("PCAOB" or "Board") issued a concept release^{1/} to solicit public comments on the potential direction of a proposed standard-setting project on the content and form of reports on audited financial statements. The Board also stated in the concept release that it will hold a public roundtable in the third quarter of 2011. The comment period for the concept release ends on September 30, 2011.

The objective of the September 15, 2011 roundtable is to obtain additional insight from investors, preparers, audit committee members, auditors, and others on the alternatives for changing the auditor's report, as described in the concept release. Additionally, the roundtable will provide participants with the opportunity to discuss other alternatives not presented in the concept release. The alternatives for changing the auditor's reporting model, as described in the concept release, include –

- Auditor's Discussion and Analysis;
- Required and expanded use of emphasis paragraphs in the auditor's report;
- Auditor assurance on other information outside the financial statements; and
- Clarification of language in the standard auditor's report.

^{1/} See *Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards* at <http://pcaobus.org/Rules/Rulemaking/Pages/Docket034.aspx>

This paper was developed by the staff of the Office of the Chief Auditor to foster discussion among the members of the roundtable. It is not a statement of the Board; nor does it necessarily reflect the views of the Board or staff.

The concept release indicates that these alternatives are not mutually exclusive and a revised auditor's report could include one or a combination of these alternatives, elements of these alternatives, or other alternatives.

All of the alternatives presented in the concept release would retain the pass/fail opinion of the standard auditor's report.^{2/} Some of the alternatives (e.g., Auditor's Discussion and Analysis, required and expanded use of emphasis paragraphs, and clarification of language in the standard auditor's report) are designed to improve communication of the auditor's current responsibilities related to a financial statement audit based on existing auditing standards. The alternative for auditor assurance on other information outside the financial statements would require an expansion of the auditor's current responsibilities, which would likely necessitate the development of additional auditing standards and collaboration with the SEC. Most of these alternatives would likely require the development of additional suitable and objective criteria for auditors to prepare consistent and comparable auditors' reports.

During the roundtable discussion, participants will be asked to address selected questions in the concept release. Additionally, for each alternative discussed, participants will be asked to describe with specificity (i) why they support or oppose the alternative, including the basis for that view, (ii) whether the alternative would benefit financial statement users, and why, and (iii) how the alternative would be implemented and whether there are implementation impediments.

Discussion Topic I: Auditor’s Discussion and Analysis

The Auditor's Discussion and Analysis ("AD&A") alternative could provide investors and other financial statement users with a view of the audit and the financial statements "through the auditor's eyes." The AD&A would be a supplemental narrative report that would accompany the standard auditor's report. See Appendix A for an illustration of a possible revised standard auditor's report and AD&A.

The intent of an AD&A would be to provide the auditor with the ability to discuss in a narrative format his or her views regarding significant matters. The AD&A could

^{2/} The standard auditor's report is commonly described as a pass/fail model because the auditor opines on whether the financial statements are fairly presented (pass) or not (fail).

include information about the audit, such as audit risk identified in the audit,^{3/} audit procedures and results, and auditor independence. It also could include a discussion of the auditor's views regarding the company's financial statements, such as management's judgments and estimates, accounting policies and practices, and difficult or contentious issues, including "close calls." Additionally, an AD&A could provide the auditor with discretion to comment on those material matters that might be in technical compliance with the applicable financial reporting framework, but in the auditor's view, the disclosure of such matters could be enhanced to provide the investor with an improved understanding of the matters and their impact on the financial statements. An AD&A could also highlight those areas where the auditor believes management, in its preparation and presentation of the financial statements, could have applied different accounting or disclosures.

Questions

1. What types of information should an AD&A include about the audit? What is the appropriate content and level of detail regarding these matters presented in an AD&A (i.e., audit risk, audit procedures and results, and auditor independence)?
2. What types of information should an AD&A include about the auditor's views on the company's financial statements based on the audit? What is the appropriate content and level of detail regarding these matters presented in an AD&A (i.e., management's judgments and estimates, accounting policies and practices, and difficult or contentious issues, including "close calls")?
3. What are your views regarding the potential for an AD&A to present inconsistent or competing information between the auditor and management? What effect will this have on management's financial statement presentation?
4. What are the potential benefits and shortcomings of implementing an AD&A?

^{3/} Auditing Standard No. 8, *Audit Risk*, describes audit risk as the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risk of material misstatement and detection risk.

Discussion Topic II: Required and Expanded Use of Emphasis Paragraphs

This alternative would require the use of emphasis paragraphs in all audit reports and expand the emphasis paragraph to highlight the most significant matters in the financial statements and to identify where these matters are disclosed in the financial statements. Emphasis paragraphs could be required in areas of critical importance to the financial statements, including significant management judgments and estimates, areas with significant measurement uncertainty, and other areas that the auditor determines are important for a better understanding of the financial statement presentation. With respect to each matter of emphasis under this alternative, the auditor also could be required to comment on key audit procedures performed pertaining to the identified matters.

This alternative primarily communicates those matters that the auditor is required to address as part of an audit pursuant to current auditing standards. See Appendix B for an illustration of a possible revised standard auditor’s report with required emphasis paragraphs.

Questions

5. What specific information should the required and expanded emphasis paragraphs include regarding the audit or the company's financial statements?
6. What is the appropriate content and level of detail regarding the matters presented in required emphasis paragraphs?
7. What are the potential benefits and shortcomings of implementing required and expanded emphasis paragraphs?

Discussion Topic III: Auditor Assurance on Other Information Outside the Financial Statements

Another alternative to enhance the auditor's reporting model could be to require auditors to provide assurance on information outside the financial statements, such as management discussion and analysis (“MD&A”) or other information (for example, non-GAAP information or earnings releases). An auditor providing assurance on information outside of the financial statements could improve the quality, completeness, and reliability of such information, providing investors and other users of financial statements with a higher level of confidence in information about the company that is provided by

management. Therefore, this additional reporting could make an audit and auditor reporting more relevant to investors and other users of financial statements. See Appendix C for an illustration of an attachment to a possible revised standard auditor’s report on MD&A.

Questions

8. On what information should the auditor provide assurance (e.g., MD&A, earnings releases, non-GAAP information, or other matters)? Provide an explanation as to why.
9. If the auditor were to provide assurance on a portion or portions of the MD&A, what portion or portions would be most appropriate and why?
10. Would auditor reporting on a portion or portions of the MD&A affect the nature of MD&A disclosures? If so, how?
11. What are the potential benefits and shortcomings of implementing auditor assurance on other information outside the financial statements?

Discussion Topic IV: Clarification of Language in the Standard Auditor’s Report and Other Alternatives

A. Clarification of Language in the Standard Auditor’s Report

Another potential enhancement of the auditor's reporting model could involve clarifying language in the existing standard auditor's report. While this alternative would not significantly expand the content of the auditor's report, it could provide additional explanation about what an audit represents and the related auditor responsibilities. Possible matters that could be clarified in the auditor's report include:

- Reasonable Assurance;
- Auditor’s Responsibility for Fraud;
- Auditor’s Responsibility for Financial Statement Disclosures;
- Management’s Responsibility for the Preparations of the Financial Statements;

- Auditor’s Responsibility for Information Outside the Financial Statements; and
- Auditor Independence.

Questions

12. Would these potential clarifications serve to enhance the auditor's report and help readers understand the auditor's report and the auditor's responsibilities? Provide an explanation as to why or why not.
13. What other clarifications or improvements to the auditor's reporting model can be made to better communicate the nature of an audit and the auditor's responsibilities?
14. What are the potential benefits and shortcomings of providing clarifications of the language in the standard auditor's report?

B. Other Alternatives

While the concept release presents four alternatives for changing the auditor’s report, there could be other alternatives. Roundtable participants will be asked to describe and discuss with some specificity any alternatives not presented in the concept release that they believe the Board should consider.

Questions

15. What alternatives not mentioned in the concept release should the Board consider?
16. Would a combination of the alternatives, or certain elements of the alternatives, be more effective in improving auditor communication than any one of the alternatives alone? What are those combinations of alternatives or elements?
17. Which alternative is most appropriate and why?

Appendix A – Illustration of Possible Revised Standard Auditor’s Report and Auditor’s Discussion and Analysis

Report of Independent Registered Public Accounting Firm

[Standard Introductory Paragraph]

[Standard Scope Paragraph]

[Standard Opinion Paragraph]

Our audits were conducted for the purpose of forming an opinion on the financial statements, including related disclosures, taken as a whole. The accompanying Auditor’s Discussion and Analysis provides additional analysis.

[Signature]

[City and State or Country]

[Date]

Auditor’s Discussion and Analysis

This discussion should be read in conjunction with the accompanying auditor’s report on the financial statements. We considered the matters discussed below in rendering our opinion on the financial statements taken as a whole. This discussion does not represent separate assurance on individual account balances, disclosures, transactions, or any other matters discussed below. It is not a substitute for the user’s full reading and review of such financial statements, including related disclosures, and the auditor’s report.

[Auditor discussion concerning the audit or the company’s financial statements could be included under headings or in sections of an AD&A such as those set out below. Following each heading is the concept for a possible instruction for drafting the discussion. The potential drafting instructions are intended only to illustrate the possible content of each section; if the Board pursues an AD&A approach, complete requirements would be proposed for public comment.]

Information about the Audit

Audit Risk

[Provide a discussion of significant risks identified by the auditor.^{1/} This discussion should include the factors the auditor evaluated in determining which risks are significant (see paragraphs 70-71 of Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement*). Describe why the risks are considered significant to the company's financial statements.]

Audit Procedures and Results

[Provide a discussion of the audit procedures responsive to the significant risks discussed in the audit risk section above, why the procedures are responsive to such significant risks, and the results of those procedures (see Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement*).]

Auditor Independence

[Provide a discussion of matters that were reported and discussed with the audit committee concerning independence under PCAOB Rule 3526, *Communication With Audit Committees Concerning Independence*, and the related resolution of those matters. Provide affirmation of auditor independence.]

Information about the Company's Financial Statements

Management's Judgments and Estimates

[Provide a discussion of the critical accounting estimates that were communicated to the audit committee and assumptions underlying the critical accounting estimates (see proposed Auditing Standard,

^{1/} Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement*, describes significant risk as a risk of material misstatement that requires special audit consideration.

Communications with Audit Committees^{2/}). The discussion also should address how the critical accounting estimates are susceptible to change.]

Accounting Policies and Practices

[Provide a discussion of the company's critical accounting policies and practices, including significant unusual transactions that were communicated to the audit committee. This discussion should include the reasons the auditor considers certain policies and practices to be critical, including those that management does not consider critical. Also, provide a discussion of alternative accounting treatments permissible under the applicable financial reporting framework for policies and practices related to material items that have been discussed with management, including the ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the auditor.^{3/}]

Difficult or Contentious Issues, Including "Close Calls"

[Provide a discussion of the difficult or contentious issues or "close calls" that arose during the audit and the final resolution of the issue. These issues might include, among other things, the following –

- Those accounting matters that required significant deliberation by the auditor and management before being deemed acceptable within the applicable financial reporting framework.
- Those matters related to internal control over financial reporting that required significant deliberation by the auditor and management.

^{2/} See proposed auditing standard related to communications with audit committees at: <http://pcaobus.org/Rules/Rulemaking/Pages/Docket030.aspx>.

^{3/} See Rule 2-07(a)(1) of Regulation S-X, 17 CFR §210.2-07(a)(1), which requires the auditor to report the critical accounting policies and practices and alternative accounting treatments to the audit committee.

- A financial statement issue that had a potential material impact to the financial statements and was corrected prior to the end of the period.]

Material Matters

[Describe those material matters that are in technical compliance with the applicable financial reporting framework, but in the auditor's view, the disclosure of such matters could be enhanced to provide the investor with an improved understanding of the matters and their effect on the financial statements, or those areas where the auditor believes management, in its preparation and presentation of the financial statements, could have applied different accounting or disclosures.]

**Appendix B – Illustration of Possible Revised Standard Auditor’s Report with
Required Emphasis Paragraphs**

Report of Independent Registered Public Accounting Firm

[Standard Introductory Paragraph]

[Standard Scope Paragraph]

[Standard Opinion Paragraph]

Required Emphasis Paragraph[s]

[Emphasize those matters that are important in understanding the financial statement presentation, including significant management judgments and estimates and areas with significant measurement uncertainty. Discuss the audit procedures performed on these significant matters. This discussion should not include matters that the company has not disclosed in the financial statements and should make reference to the notes in the financial statements that disclose each matter.]

[Signature]

[City and State or Country]

[Date]

Appendix C – Illustration of Attachment to Possible Revised Standard Auditor’s Report – Standard Examination Report on Management’s Discussion and Analysis (MD&A)

Standard Examination Report on Management's Discussion and Analysis ("MD&A")^{1/}

AT sec. 701, *Management's Discussion and Analysis*, establishes requirements concerning the performance of an attest engagement with respect to MD&A prepared pursuant to the rules and regulations adopted by the Securities and Exchange Commission, which are presented in annual reports to shareholders and in other documents.^{2/}

Independent Accountant's Report

[Introductory paragraph]

We have examined XYZ Company's Management's Discussion and Analysis taken as a whole, included [incorporated by reference] in the Company's [insert description of registration statement or document]. Management is responsible for the preparation of the Company's Management's Discussion and Analysis pursuant to the rules and regulations adopted by the Securities and Exchange Commission. Our responsibility is to express an opinion on the presentation based on our examination. We have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the financial statements of XYZ Company as of December 31, 20X5 and 20X4, and for each of the years in the three-year period ended December 31, 20X5, and in our report dated [Month] XX, 20X6, we expressed an unqualified opinion on those financial statements.

^{1/} AT sec. 701.114.

^{2/} AT sec. 701.01.

[Scope paragraph]

Our examination of Management's Discussion and Analysis was conducted in accordance with attestation standards established by the Public Company Accounting Oversight Board (United States) 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 determinations made by management as to the relevancy of information to be included and the estimates and assumptions that affect reported information. We believe that our examination provides a reasonable basis for our opinion.

[Explanatory paragraph]

The preparation of Management's Discussion and Analysis 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 transactions and events that have occurred or are expected to occur, 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 paragraph]

In our opinion, the Company's presentation of Management's Discussion and Analysis includes, in all material respects, the required elements of the rules and regulations adopted by 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, determinations, estimates, and assumptions of the Company provide a reasonable basis for the disclosures contained therein.

[Signature]

[City and State or Country]

[Date]