

Heads Up

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PCAOB Issues Concept Release on Potential Alternatives Related to the Content and Form of the Auditor's Report

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On June 21, 2011, the PCAOB issued a [concept release](#)¹ to solicit public comment on potential changes to the auditor's reporting model. The concept release seeks direction on a possible standard-setting project that could result in amendments to [PCAOB AU Section 508](#)² and [Auditing Standard 1](#)³ or in "the development of a new auditing standard that would supersede or amend the Board's current standards on auditors' reports." Comments on the concept release are due by September 30, 2011. The PCAOB will also convene a public roundtable meeting during the third quarter of 2011 to discuss the concept release and related issues.

We encourage all financial statement stakeholders, including audit committees, company management, investor groups, and others, to study the concept release and submit comments to the PCAOB.

Background

The PCAOB is evaluating the current auditor's reporting model in response to investors' and other financial statement users' concerns about the information provided in the auditor's report in light of:

- Increasing complexity in preparing and auditing financial statements.
- Ongoing dialogue both in the United States and in Europe on the role of the auditor and the form of the auditor's report.

In developing this concept release, the PCAOB conducted extensive outreach (from October 2010 through March 2011), consulting investors, preparers, auditors, audit committee members, regulators, standard setters, and academics. The PCAOB staff gave an overview of its outreach efforts, including a summary of its findings, at its March 22, 2011, open Board meeting and at the March 24, 2011, PCAOB Standing Advisory Group (SAG) meeting. For more information, see Deloitte's April 5, 2011, [Heads Up](#).

¹ PCAOB Release No. 2011-003, *Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements*.

² PCAOB AU Section 508, *Reports on Audited Financial Statements*.

³ PCAOB Auditing Standard No. 1, *References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board*.

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Objective and Overview of Presented Alternatives

The concept release's objective is to discuss several alternatives for supplementing the current pass/fail auditor's report and to "increase its transparency and relevance to financial statement users." These alternatives, discussed in greater detail below, include:

- Inclusion of an Auditor's Discussion and Analysis (AD&A) section in a supplement to the auditor's report.
- "[R]equired and expanded use of emphasis paragraphs."
- "[A]uditor reporting on information outside the financial statements."
- "[C]larification of certain language in the [current standard] auditor's report."

As indicated in the concept release, these potential supplements are not mutually exclusive and a revised auditor's reporting model "could include one or a combination of these alternatives or elements of these alternatives." In addition, the PCAOB may, on the basis of the comments received, consider other ideas that are not addressed in the concept release.

Inclusion of an Auditor's Discussion and Analysis

An AD&A would be a supplemental narrative report that is intended to provide a view of the audit and financial statements "through the auditor's eyes." According to the concept release, this narrative could include information about audit risks identified, audit procedures and results, and independence. Such information could help investors understand a company's financial statements and related MD&A.

The concept release states that the "AD&A would likely be among the most expansive form of reporting of the alternatives presented since it would provide auditor commentary on significant matters to the users of the financial statements." If this alternative is adopted, the "PCAOB, in collaboration with the SEC, would likely need to develop new auditing standards to provide standard, objective criteria to the auditor regarding the appropriate content and level of detail to be reported in an AD&A."

Required and Expanded Use of Emphasis Paragraphs

Under the current PCAOB standards, emphasis paragraphs are not required but may be added at the discretion of the auditor. This alternative "would mandate the use of emphasis paragraphs in all audit reports." Such paragraphs would "highlight the most significant matters in the financial statements and . . . identify where these matters are disclosed in the financial statements." The concept release further states that "emphasis paragraphs could be required in areas of critical importance to the financial statements, including significant management judgments and estimates," areas of significant uncertainty, and other areas the auditor deems important to emphasize for a more thorough understanding of the financial statement presentation.

Auditor Reporting on Information Outside the Financial Statements

This alternative could be used to provide assurance on information outside the financial statements (e.g., MD&A, or portions thereof, such as critical accounting estimates). Such assurance may give investors and other financial statement users more confidence in the information provided by management and presented outside the financial statements. The concept release indicates that providing such assurance "would increase the scope of the auditor's responsibilities, require the development of new auditing standards, and might result in projects separate from the auditor's reporting model project."

Clarification of Certain Language in the Auditor's Report

Although 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." As described in the concept release, possible language that could be added to the report includes:

- The meaning of reasonable assurance, which is defined in the auditing standards as “a high level of assurance, but not absolute assurance.”
- An explanation of the auditor’s responsibility for fraud.
- Explicit reference to the auditor’s responsibility for financial statement disclosures.
- Management’s responsibility for the fair preparation of the financial statements.
- Discussion of the auditor’s responsibility for information outside the financial statements.
- A statement in the report that the auditor has a responsibility to be independent of the company and has complied with applicable independence requirements of the PCAOB and SEC.

Considerations

During the PCAOB staff’s outreach efforts, various participants suggested that certain practical challenges and unintended consequences could result from additional auditor reporting. On the basis of the questions in the concept release, the PCAOB is interested in hearing views on the following:

- General considerations related to changing the auditor’s report.
 - Retention of the current pass/fail model.
 - Need for expansion of the information provided by the auditor and what new information should be included.
 - Potential benefits and shortcomings of each presented alternative.
 - Whether a combination of the alternatives or certain elements of the alternatives would more effectively improve the auditor’s reporting model.
 - Feasibility of avoiding boilerplate language under the suggested alternatives.
 - Potential direction of and need for related standard-setting projects under the suggested alternatives.
 - Liability considerations.
 - Additional considerations/alternatives that the PCAOB should contemplate in making changes to the current auditor’s reporting model.
- Potential implications for the audit, including scope.
 - Implications for the scope of the audit or the auditor’s responsibilities.
 - Effect on audit quality.
 - Effect on the auditor’s relationships with management and the audit committee.
 - Other practical challenges.
- Effects on issuers.
 - Impacts on meeting current filing deadlines.
 - Effects on audit committee governance.
 - Confidentiality considerations.
 - Concerns regarding potential costs associated with the suggested alternatives.
 - Appropriateness of the auditor’s being the direct provider of additional information about the company’s financial statements.

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