

**Fact Sheet – Concept Release on Possible Changes  
To the Auditor’s Report**

1. Purpose

The Board is issuing this concept release to seek public comment on potential changes to the auditor's reporting model. As a result of the performance of required audit procedures, auditors often have significant information regarding how a company's financial statements were prepared that might be useful to investors and other financial statement users. Discussion in the auditor's report of this information also could lead to more efficient markets and improved allocations of capital. The objective of this concept release is to discuss several alternatives for changing the auditor's reporting model that could increase the transparency and relevance of the financial statements and the audit process.

2. History

The standard auditor's report identifies the financial statements that were audited, describes the nature of the audit, and presents the auditor's opinion as to whether the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of the company in conformity with the applicable financial reporting framework. 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).

For more than half a century, many groups have considered and recommended changes to the standard auditor's report to enhance the auditor's overall communication to financial statement users; however, the only change resulting from the recommendations was the addition of a paragraph explaining the scope of the audit. Subsequently, two additional changes have been made to the auditor's report, the adoption of Auditing Standard No. 1, *References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board* and Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

3. Potential Alternatives for Change to the Auditor’s Report

The concept release presents several alternatives for possible changes to the auditor's report and is seeking specific comment on these or other alternatives that could provide investors with more transparency into the audit process and more insight into the company's financial statements or possibly other information outside the financial statements. All of the alternatives presented would retain the pass/fail opinion of the standard auditor's report. These alternatives are not intended to alter, in any way, the auditor's ultimate responsibility to obtain sufficient appropriate audit evidence to support the audit opinion. Nor are these alternatives intended to qualify or piecemeal the auditor's opinion or to shift the requirement to assess the risk of material misstatement of the financial statements from the auditor to investors or other users of financial statements.

The alternatives presented in the concept release are:

A) Auditor's Discussion and Analysis

This alternative would require that an Auditor's Discussion and Analysis ("AD&A") be included with an auditor's report. An AD&A would be a supplemental narrative report to the auditor's report and would provide the auditor with the ability to discuss his or her views regarding significant matters. The AD&A could include information about the audit, such as audit risks identified in the audit, 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." An AD&A, as contemplated in the concept release, is not intended to provide separate assurance on individual balances, disclosures, transactions, or any other matters discussed. Rather, an AD&A is intended to facilitate an understanding of the auditor's opinion on the financial statements taken as a whole.

An AD&A would likely be among the most expansive form of reporting of the alternatives presented and could require the auditor to communicate some of the same information that the auditor communicates to the audit committee.

#### B) Required and Expanded Use of Emphasis Paragraphs

This alternative would require inclusion of an expanded emphasis paragraph in all audit reports that would highlight the most significant matters in the financial statements and to identify where these matters are disclosed in the financial statements. Under current PCAOB standards, emphasis paragraphs are not required but may be added, solely at the auditor's discretion, to emphasize a matter regarding 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.

#### C) Auditor Assurance on Other Information Outside the Financial Statements

This alternative would require auditors to provide assurance on information outside the financial statements, such as management's discussion and analysis (MD&A) or other information (for example, non-GAAP information or earnings releases). An auditor providing assurance on information outside the financial statements could improve the quality, completeness, and reliability of such information and provide investors and other users of financial statements with a higher level of confidence in that information.

Currently, there is no requirement for the auditor to provide assurance on earnings releases, non-GAAP information, or MD&A. However, PCAOB attest standards provide requirements for the auditor concerning the performance of an attest engagement with respect to MD&A, if the auditor is engaged to attest on MD&A. The additional reporting by the auditor on earnings releases, non-GAAP information, the entire MD&A, or portions thereof, could be based on certain aspects of the current attest standard and report, but they do not represent the only alternative for reporting on MD&A or portions thereof.

#### D) Clarification of the Standard Auditor's Report

Another potential enhancement of the current auditor's report could involve clarifying language about what an audit represents and the related auditor responsibilities. Possible language and concepts 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 preparation of the financial statements, auditor's responsibility for information outside of the financial statements, and auditor independence.

The above alternatives are not mutually exclusive. A revised auditor's report could include one or a combination of the alternatives, elements within the alternatives, or alternatives not currently presented in the concept release. These alternatives would likely require the development of additional auditing standards or rules through collaboration with the Securities and Exchange Commission.

#### 4. Outreach

The preparation of the concept release was preceded by the staff of the Board's Office of the Chief Auditor (the "staff") reaching out to investors, preparers, auditors, audit committee members, former regulators and standard-setters, and representatives of academia from October 2010 through March 2011. The participants in the staff's outreach represented a diverse group of domestic and international organizations and companies, ranging in size from small to large entities. Additionally, the staff read and reviewed publically available information related to the auditor's reporting model from U.S. and international sources.

These outreach efforts provided insight into the changes that investors and other financial statement users are seeking to the auditor's report and how those changes could be incorporated into the auditor's report or the overall auditor's reporting model. During the staff's outreach, various participants also suggested that, as a result of additional auditor reporting, there may be practical challenges and unintended consequences that may have an effect on the audit effort, the auditor's relationships, audit committee governance, liability considerations and confidentiality. The staff reported its findings to the Board at an open meeting on March 22, 2011.

##### A) Content of the Auditor's Report

During the staff's outreach, many investors expressed their belief that the audit is a valuable process. The staff observed that there was consensus among investors, that auditors have significant insight into the company and that the auditor's report should provide additional information about the audit and the company's financial statements, based on that insight, to make it more relevant and useful. Most preparers, auditors, and audit committee members indicated that management or the audit committee, rather than the auditor, should provide additional information about the company.

Some participants in the staff's outreach recommended expanding the auditor's reporting model to provide assurance on information outside the financial statements, such as MD&A, non-GAAP information, or earnings releases.

##### B) Form of the Auditor's Report

Many investors indicated that the pass/fail model and standardized language of the auditor's report provide consistency, comparability, and clarity of auditor reporting. However, many of these investors indicated that the standard auditor's report is too "boilerplate" and does not convey the significant judgments made by the auditor in forming the audit opinion. Accordingly, many investors supported a reporting format in which the pass/fail model is retained but supplemented with discussion by the auditor about the audit and the company's financial statements. They indicated that a supplement would allow the auditor to issue an unqualified opinion, but also enable the auditor to add commentary on significant matters. Many investors also suggested that clarification of some of the language in the standard auditor's report could be useful. Other outreach participants were not supportive of a supplement to the auditor's report, but they did support retaining the current pass/fail model, with clarification of certain language in the report.

5. Comments

The Board is interested in comments on the alternatives presented in the concept release and other possible alternatives in connection with its deliberations on changes to the auditor's report. The concept release is located on the PCAOB's website at: [http://pcaobus.org/Rules/Rulemaking/Docket034/Concept\\_Release.pdf](http://pcaobus.org/Rules/Rulemaking/Docket034/Concept_Release.pdf). Comments on these and other issues in connection with the Board's deliberations on changes to the auditor's report are due by no later than September 30, 2011. The Board also will hold a public roundtable in the third quarter of 2011 to discuss the alternatives addressed in the concept release or other alternatives.