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GOVERNANCE PERSPECTIVES

PCAOB'S PROPOSED AUDITOR REPORTING MODEL

Last month, the Public Company Accounting Oversight Board ("PCAOB") proposed new standards for auditor reports that, if adopted, would dramatically change the role and the responsibility of audit firms in the financial reporting process—and not for the better. The proposed standards would require auditors to discuss "critical audit matters" relating to the audit, which are those matters the auditor addressed that involved the most difficult, subjective, or complex auditor judgments, or that posed the most difficulty to the auditor in obtaining sufficient evidence or in forming an opinion on the financial statements. Even more troublesome, the proposed standards would also require the auditor to evaluate "other information" that is included in a company's annual report filed with the SEC in order to identify material inconsistencies between the information and the company's audited financial statements and material misstatements of fact contained in the annual report—in essence, an overall review of the entire disclosure document, including subject matters as to which the audit firm is, in our view, unexposed and unexpert. The deadline for comments to the proposed standards is December 11, 2013, and the PCAOB may hold a public roundtable in 2014 to discuss the proposed standards and the comments it receives. We intend to comment and would welcome participation by our clients.

The stated purpose for expanded reporting requirements is to make audit reports more informative and useful for investors. If adopted, however, the proposed standards would make the financial reporting process even more complex and cumbersome, without producing any information that is of real value to investors for the vast majority of publicly traded companies. Under the proposed standards, auditors would be required to disclose audit matters and information that otherwise would not have required disclosure under existing auditor and financial reporting standards, which is at best distracting, and at worst could raise significant liability issues for both the auditor and for the company. It would be difficult if not impossible for an auditor that has conducted a complex and lengthy audit to disclose each and every audit matter that required a sophisticated auditor judgment or otherwise involved a high level of difficulty, but each matter that is not disclosed presents an opportunity for investors or others to second-guess the auditor's decisions with the benefit of 20–20 hindsight. Further, the auditor's report is not intended to be a due diligence report on the company or the audit process.

Moreover, the audit process does not lend itself to this sort of one-size-fits-all disclosure; the audit process is by its nature complex and subjective, and each audit has its own difficulties and challenges based on the company, its industry, its personnel, the audit team, and myriad other factors. Disclosures focused on the process of the audit rather than the results will not be comparable among companies and, in our view, will be largely meaningless to investors. In fact, the prospect of public disclosure of sensitive details of the audit process may have a chilling effect on the disclosures a company includes in its annual report.

On a more fundamental level, the proposed standards misconstrue the role of the auditor in the financial reporting process and grossly underweight the degree of care by which most publicly traded companies already approach the SEC reporting process. The auditor's role is to attest as to financial information prepared by management; the responsibility for accurate and transparent financial reporting lies squarely with the company. Burdening audit firms with significant additional disclosure responsibilities—and potential liability—will not improve the financial statements and disclosures on which stakeholders make investment decisions, but it will most certainly impose substantial and unnecessary additional costs on public companies.

A more detailed analysis of the proposed auditor report standards is included in a *Jones Day Alert* titled "PCAOB Proposes Important Changes to Audit Reports," which was published on September 5.

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

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