



Statement on Auditor's Reporting Model

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SPEAKER: Daniel L. Goelzer, Board Member
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I want to begin by underscoring the importance of this project. Investors have been loud and clear in telling the Board that they want more from the auditor than the traditional pass/fail report. For example, at the meeting last week of the Board's Investor Advisory Group, the Board heard the results of an informal survey conducted by several IAG members. They found that nearly half of respondents believe that the current audit report does not provide valuable information that is integral to understanding financial statements. Almost one in five thought that the standard, unqualified report was of no use to them at all. If these conclusions are representative of the views of financial statement users generally, they should be alarming to the audit profession and a call to action for the Board.

I do not think that the traditional auditor's report should be abandoned, but I do agree that the Board needs to look seriously at how it can enhance auditor communications with financial statement users. We will not be alone. Several other groups, including the International Auditing and Assurance Standards Board and the European Commission are already studying whether to expand the auditor's obligation to communicate information about the audit or about the financial statements.

We may all agree that there is considerable hunger for more insight and information from the auditors. I believe, however, there are some fundamental issues that still need to be resolved before we fashion a new reporting model.

In particular, I have reservations about whether the auditor should become an independent source of information about the company's financial statements, including about the risks that are inherent in them or the judgments and decisions that went into preparing them. In my view, information of that type should in the first instance be management's responsibility. The auditor's core function should continue to be to attest to the accuracy and completeness of information management provides, not to provide a competing view of the company's financial reporting through the eyes of the auditor.

This does not mean that auditors should confine themselves to the conventional pass/fail opinion or that they should not provide new forms of information to help users understand the financial statements. The auditor could, without supplanting managements' role, provide information about what the auditor did in performing the audit. Discussion about the auditor's view of the significant audit risks, and how the auditor addressed those risks,

might provide users with fresh insight into the issues surrounding the company's financial reporting. Risk, including the risk of fraud, is something that the auditor is already forced to think about in planning and performing the audit. Requiring the auditor to tell users what it concluded and how it responded would dovetail with the risk assessment standards the Board adopted last year.

Auditors might also be required to make greater use of emphasis paragraphs in their opinions or to indicate in other ways which of the things that management has disclosed are, in the auditor's view, the most significant to understanding the company's financial reporting. In that vein, the French have adopted an approach under which the auditor provides "justification" for his or her opinion, but does so by referring to particular disclosures the company itself has made.

In addition, the scope of the audit could expand. Today, the auditor is responsible for expressing an opinion on the financial statements, including the disclosures in the notes. However, as to accompanying financial information, such as the Management Discussion and Analysis, the auditor's responsibility is limited. Requiring an auditor's opinion on the accuracy and completeness of the MD&A might be a way of leveraging the attest function to provide investors with more assurance about management's assertions and managements with more incentive to fully comply with MD&A. This idea could be extended to other information outside of the financial statements, such as an expanded, risk disclosure-oriented, audit committee report.

I am looking forward to a concept release that will expose these ideas and others to discussion and debate. Along those lines, I want to end with a couple of words about the transparency of our process. In the past, public Board meetings on standard setting matters have been limited to situations in which the Board was voting on a proposed release or a final standard. Critics have said that these limited public opportunities to hear Board interaction with the staff are not adequate to permit a full understanding of Board standard setting. This meeting, in which the staff is briefing the Board on the results of its outreach and seeking guidance on whether and how to move to the concept release stage, is an effort to cure that. I hope we will make it routine to have discussions like this in public in the future.

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Before I turn to questions, I want recognize the hard work that has gone into reporting model research and outreach and into preparing for the discussion this morning. In addition to our Chief Auditor, Marty Baumann, the team includes Jennifer Rand, Deputy Chief Auditor, who serves as the project leader; Associate Chief Auditors Jessica Watts and Dan Mutzig; and Assistant Chief Auditor Diane Jules. I know that you have already put in many late nights and week-ends — and, of course, the reporting model project is still just at its beginning. Thanks to all of you.

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