

Will Changes In The Auditor's Report Affect Credit Analysis?

The U.S. Public Company Accounting Oversight Board (PCAOB) and the International Auditing and Assurance Standards Board (IAASB) have issued separate proposals to enhance the auditor's report. Their proposals share similarities and will retain the pass or fail audit opinion; provide users and investors with more information about the audit including critical audit matters (CAM) in the U.S. and key audit matters (KAM) internationally; and address the auditor's responsibility for other information outside of the financial statements contained in the annual report. We believe the proposed changes will add value to the audit and auditor's report by disclosing potentially useful information that is entity-specific that will help inform our analysis on issues identified in the audit that were significant to the auditor. This improved communication about the audit will likely enhance audit credibility and quality beyond the current pass or fail opinion.

Potential analytical impact and considerations:

- **The proposed auditor reporting models would provide greater transparency about a company.** With the information and understanding gained through the audit process, the auditor has the ability to provide entity-specific information and insight beyond the binary pass-fail opinion in areas of significant risks, judgments, estimates, and assumptions. This information would be especially meaningful to credit analysts and other financial statement users if it provides relevant information that helps to better understand financial risks, including future cash flows and prospects.
- **The proposed PCAOB auditor's report in the U.S. would include CAMs.** These are matters the auditor addressed during the audit that involved the most difficult, subjective, or complex auditor judgments; posed the most difficulty in obtaining sufficient appropriate evidence; and posed the most difficulty in forming an opinion on the financial statements.
- **Under the IAASB's audit report proposal, auditors would report KAMs.** These are matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements. The auditor selects KAMs from matters communicated with those charged with governance (i.e., the board of directors). KAMs may include areas of significant risks or auditor judgment; areas in which the auditor encountered significant difficulty, including obtaining sufficient appropriate audit evidence; and circumstances that required significant modification of the planned audit approach or significant internal control deficiency.
- **Lack of global convergence.** The PCAOB and the IAASB did not create a converged set of auditing standards. The boards define the criteria to determine CAMs and KAMs differently. We believe this proposed addition to the auditor's report is most relevant to financial statement users, and believe the Boards should avoid the possibility of different standards that could generate different audit matters reported simply because of the definitional distinctions. In our view, the lack of harmony in audit enforcement and reporting is not beneficial to global reporting and analysis.

Reporting on "Other Information"

The PCAOB has proposed that the auditor must evaluate and the audit report must communicate whether the other information included with the audited financial statements contains:

1. A material inconsistency.
2. A material misstatement of fact.

The IAASB is considering auditor reporting on "other information" in another project.

The PCAOB and the IAASB have proposed other changes. Both would require the auditor to make a statement about auditor independence. Further, the PCAOB wants the auditor to disclose the number of years that the auditor has served as auditor of the company.

The IAASB proposal also addresses:

- The appropriateness of management's use of the going concern basis of accounting and whether the auditor identified uncertainties that cast doubt on the entities ability to continue as a going concern.
- Disclosing the name of the engagement partner.
- Enhanced disclosure of the auditor's responsibilities.
- Required section titles.

View [our comment letter](#) in response to the PCAOB and IAASB audit report proposals, dated Nov. 21, 2013.

View our comment letter dated Oct. 15, 2012, "[Standard & Poor's Ratings Services Comments On "Improving The Auditor's Report,"](#)" in response to the IAASB's Invitation to Comment, "Improving the Auditor's Report."

Watch the related CreditMatters TV segment titled, "[Standard & Poor's Weighs In On "Improving The Auditor's Report,"](#)" dated Oct. 22, 2012.