Auditor's report needs significant changes

January 31 2012, By Sean Nealon

Every year public companies release a financial statement that includes a report from an auditor. That report provides assurance about the quality of the financial information and is meant to help the company attract investors, obtain loans and improve public appearance.

A recently published paper co-authored by a University of California, Riverside auditing professor, found those reports are often misunderstood, misinterpreted or not even read and that they are in need of “significant changes.” The findings come from focus group discussion with chief financial officers, bankers, analysts, non-professional investors and external auditors.

The paper, co-authored by Ted Mock, a distinguished professor of audit and assurance in the UC Riverside School of Business Administration, is meant to help U.S. and international auditing standard setting agencies modify the auditor’s report in light of alleged auditing and accounting scandals at Enron, WorldCom, Ahold and elsewhere.

“This paper documents that there are important misperceptions about auditor’s reports,” said Mock, who has been involved with auditing research since its infancy more than 30 years ago. “In a sense, the findings in this paper serve as an incentive for the profession to improve.”

The paper was published in December in Accounting Horizons, a journal of the American Accounting Association. Mock’s co-authors were Glen L. Gary, a professor at California State University, Northridge, Paul J.

Coram, an associate professor at the University of Melbourne in Australia, and Jerry L. Turner, a professor at Texas Christian University.

In 2002, following financial reporting scandals at Enron and Worldcom, and the subsequent collapse of Arthur Andersen, one of the Big Five auditing firms, Congress passed the Sarbanes-Oxley Act. The act created the Public Company Accounting Oversight Board (PCAOB), a nonprofit corporation that oversees the audits of public companies to protect investors and further the public interest.

The PCAOB, along with its international counterpart, the International Auditing and Assurance Standards Board, is seeking to change auditor's reports to communicate better and to include more information about risks that auditors face in the audit and judgments and estimates management use in the financial statements.

The researchers broke up their results into three themes:

One, overall perceptions regarding the auditing process and resulting audit report: Among the key points were: the audit is valued, but that value is very difficult to measure; the report typically is considered boilerplate and not read; but users do look to see if the report includes an unqualified audit opinion and whether a Big Four audit firm conducted the audit.

Two, perceptions concerning the of key terminology and concepts that exist or could exist in the auditor's report: Among the key findings were: the concepts of "level of assurance," "reasonable assurance" and "high level of assurance" are not well understood; if the report doesn't mention fraud, users believe auditors tested for it thoroughly (they are not required to); most users believe the modern PCAOB audit, with its explicit requirement for an internal control opinion, is superior to audits conducted using prior American Institute of Certified Public

Accountants' audit standards.

Three, suggestions and challenges for improving the auditor's report, which include: include the auditor's signature; say something explicit about fraud; and add granularity, such as grading scheme, instead of merely a pass/fail opinion.

Provided by University of California, Riverside