Auditor Reporting – Proposed Consultation Paper

Dan Montgomery, Chairman
IAASB Auditor Reporting Working Group

IAASB Meeting, Paris
15 March 2011
Overview

Brief discussion about:

• Overall challenges
• Considerations for today’s IAASB discussion
• Contemporary information considered by the Working Group
• The “problem” to be addressed
• Key points guiding the Working Group’s approach
• IAASB CAG feedback
• IFAC SMPC feedback
• Considerations for future standard-setting
We face a number of overall challenges

- Rapidly changing landscape – “moving target”
- Diverse views from different users; much passion in their respective views
  - Need to “move the ball forward” but not widen the expectations gap in the process
- Possible areas of change and related time horizon
  - Some options for change clearly have merit, but are more complex and would require more time and effort
- Finding the right link to the Audit Quality project
Thoughts to Guide IAASB Discussion

• No established framework for the IAASB in writing this type of document
  – Critical to agree on approach and focus of the CP

• Determine whether the key points that should be made have in fact been made
  – Agree on the “problem” and options for addressing it
  – Can always move things around to improve clarity

• Further editing of current draft is needed

• Remember where we started
  – Academic research on users’ perceptions of the standard auditor’s report (ISA 700)
Contemporary information considered

- IAASB/AICPA ASB-commissioned research studies and other contemporary studies and debates on the value and relevance of the audit and auditor reporting (including among others)
  - IOSCO Consultation Report on Auditor Communications
  - EC Green Paper *Audit Policy: Lessons from the Crisis*
  - CFA surveys on auditor reporting (Feb 2008; March 2009)
  - US Department of the Treasury – Final Report of the Advisory Committee on the Auditing Profession
Simply stated, the information indicates:

- The independent auditor’s opinion on an entity’s financial statements is valued, but the report itself is not viewed as particularly useful or informative.
- Users wish to obtain more information about the entity and/or the audit process: referred to as the “information gap”
  - The “information gap” overlaps, but is distinct from the broader “expectations gap”
- Change is needed to address the “information gap” which in turn may help to address the “expectations gap”
- Many options for change, including shorter-term and longer term strategies.
- Changes in auditor reporting are part of the desired change.
Q: What contributes to the perceived gaps?
A: A lack of transparency

Expectation and Information Gaps

Key focus of CP

Audit Process

Auditor’s Report

Management Information

FS and Other Public Information

Users
Auditor Reporting and Audit Quality

- Auditors report = the main output of the audit process
- Users believe that additional information about the audit performed would lead to more informed decision-making and help to better assess quality of the audit
Evidence to date signals the need to explore changes in auditor reporting, in particular, the standard auditor’s report.

A more holistic approach to change is needed to fully address the information gap.

- Auditor and auditor reporting can only be part of the solution.

Many options for change, but focus on those that are both reasonable and practicable (and a few are “rising to the top”).

Consider first what is possible within the current scope of the financial statement audit.

Keep solutions that also involve changes in corporate reporting firmly on the agenda (e.g., audit committee reporting).

Potential effects of change need to be drawn out.
Potential Options for Change in Auditor Reporting

Format and structure of the SAR (Section III.C)

Auditor commentary/reporting on significant matters (Section III.A)

Auditor reporting on other information in documents containing AFS (ISA 720) (Section III.B)

Longer term: Expanded/enhanced scope of audit e.g., integrated audit, fraud

Additional assurance reporting /other services e.g. on:
- quality of corporate governance;
- risk management

Shorter-term focus: NO CHANGE TO SCOPE OF THE FINANCIAL STATEMENT AUDIT

Corporate Governance Reporting Model (Section IV)
“Auditor Commentary”

Suggestions for Possible Change …..

Increased use of EOM paragraphs (“plain vanilla”)

Information about the audit
- Key risks, critical accounting estimates, measurement uncertainty
- Other areas?
- Procedures and findings?

French model: “justification of assessments”

Auditor’s views or insights about aspects of the entity or its financial reporting
In general, strongly favorable reaction … but some areas to consider and to improve:

- Needs to be clear that the focus of the proposed CP is the information gap (a subset of the wider expectations gap)
- Consider further stage-setting about various users and needs
- Need to consider the separate roles of financial reporting and auditor reporting in addressing the information gap
- Important that auditor’s role is clear – auditor should not become the provider of information about the entity; do not create any impression that it might be otherwise
Key Points from CAG Discussion – continued

• Corporate governance models differ widely across the world – model of external reporting by audit committees not widespread

• Important to continue to interact with other parties (e.g., PCAOB, FRC, EC, IOSCO) but work to minimize unnecessary differences between reporting models

• General support for the way in which the CP highlighted the issues relating to SMEs, but important to continue dialogue with both SMEs and public sector entities
IFAC SMPC Comments (March 2011)

- IAASB project should encompass consideration of issues raised in previous SMPC comments, i.e.
  - Needs of users of audit report for SMEs are different than those of users of audit reports for larger entities
  - Perception of excessive complexity in the proliferation of applicable reports in many jurisdiction; lack of clarity and guidance on which reports are relevant

- Users of audit reports of SMEs should be consulted specifically on auditor reporting in SME setting (e.g. banks, other lenders)

- Concerns that expansion of auditor reporting will negatively affect cost/benefit relationship of SME audits
Considerations for Standard-Setting

- What initiatives will the IAASB look to pursue?
- Current reporting ISAs
  - How far and how fast?
  - Moving too slowly runs the risk of others setting the future direction for auditor reporting
  - Consistency of auditor reporting globally is still a highly desired goal
- Auditor assurance on reporting by TCWG?
- IAASB Strategy for 2012 – 2014
  - Addressing need for other assurance services to meet expanded demand for assurance