Auditor Reporting—Summary of Significant Views, Threshold Questions and Working Group Suggestions for a Way Forward

Summary of WG Recommendations

- A standard-setting project should be commenced on a priority basis.
- The scope of the project should be intentionally broad in light of diversity of calls for change in response to the IAASB’s exploratory Consultation Paper (CP).
- Initiatives in jurisdictions aimed at meeting the information needs of users should be considered, and unnecessary differences minimized to the extent possible.
- In order to accommodate these initiatives, ISA 700\(^1\) would benefit from a “building blocks approach,” with differentiation between core required elements and those that may be appropriate for, among others, publicly-listed entities.
- Further targeted outreach with users will be necessary to ensure proposals are responsive to the calls for change.
- Broader developments in corporate governance and demand for assurance beyond the financial statement audit will likely affect the future landscape of auditor reporting and should be monitored.
- Coordination with others will be fundamental, in the short term in order to remain aligned to the extent possible in relation to reporting, but also in the longer-term to consider a more holistic approach to change.
- Full consideration of the costs and benefits of the proposals will be essential, in particular in relation to small- and medium-sized entities (SMEs).

I. Introduction

1. National and international bodies (e.g., the International Organization of Securities Commissions (IOSCO), the European Commission (EC), the U.K. Financial Reporting Council (FRC), and the U.S. Public Company Accounting Oversight Board (PCAOB)) have in recent years undertaken projects to elicit feedback about whether and how auditor reporting and, more broadly, the role of the auditor could be improved. Building on the views and perspectives of recent discussions, consultations and studies, the IAASB explored how it might best respond to such requests for additional information in auditor reporting with the issuance of a CP, *Enhancing the Value of Auditor Reporting: Exploring Options for Change*, in May 2011. The objective of this CP was to determine whether there are common views among key users of audited financial statements and other parties to the financial reporting process about the usefulness and relevance of auditor reporting, and to

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\(^1\) ISA 700, *Forming an Opinion and Reporting on Financial Statements*
obtain views about the extent to which an “information gap”\(^2\) exists. The CP also sought views about possible options for enhancing the quality, relevance and value of auditor reporting for all entities, and implications for change and potential implementation challenges.

**Working Group (WG) Responsibility**

2. This paper was prepared to facilitate the WG’s responsibility to:
   - Consider the responses received on consultation and make recommendations to the IAASB on the way forward with respect to a project on auditor reporting; and
   - Develop a project proposal (PP) for the IAASB to consider and deliberate, a draft of which is included as **Agenda Item 5-A**.

**Structure of This Paper**

3. This paper is structured as follows:
   - **Summary of Significant Views Regarding the Need for Enhanced Auditor Reporting** – Summarizes the feedback received from the respondents to the CP and, where appropriate, incorporates the views of investors and other users obtained by other groups during their outreach and consultation activities. For example, this section provides a high-level summary of user views received on the PCAOB’s Concept Release (CR) on auditor reporting.
   - **Threshold Questions and Suggestions for Way Forward** – Discusses matters and presents issues considered by the WG in developing the draft PP for the IAASB’s consideration.

**II. Summary of Significant Views Regarding the Need for Enhanced Auditor Reporting**

**Overview of Feedback Received on the CP**

**Types of Respondents**

4. The comment period for the CP closed on September 16, 2011. As of November 18, 2011, 82 responses were received.\(^3\) The respondents to the CP comprised the following:

<table>
<thead>
<tr>
<th>Category of Respondent</th>
<th>No.</th>
<th>Percentage</th>
</tr>
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<tbody>
<tr>
<td>Investors and Analysts</td>
<td>6</td>
<td>7%</td>
</tr>
<tr>
<td>Those Charged with Governance (TCWG)</td>
<td>3</td>
<td>4%</td>
</tr>
</tbody>
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\(^2\) The CP notes that users of corporate financial information point to the existence of a gap between the information they believe is needed to make informed investment and fiduciary decisions, and what is available to them through the entity’s audited financial statements.

\(^3\) See Appendix 1 for the detailed list of respondents. All responses can be accessed at www.ifac.org/publications-resources/enhancing-value-auditor-reporting-exploring-options-change.
5. The CP, as agreed by the IAASB, did not suggest specific courses of action to effect change in auditor reporting. Instead, the CP described various options that had been suggested by others and solicited views as to whether those options, individually or in combination, would address the issues identified and discussed in the CP. Another important aspect of the IAASB’s consultation was to determine whether there were common views among key groups of users globally about those issues identified and discussed in the CP and the possible approaches to address them, or whether there were factors that should lead to different solutions for different types of entities.

6. The WG has considered the responses to the CP from the various user groups as illustrated in the table above. In addition, given the importance of considering the views of users of financial statements, the WG also considered feedback from dialogue facilitated by others in national and international communities, including:

- Recent roundtables on the topic of auditor reporting conducted by various groups, including IOSCO, the Australian Auditing and Assurance Standards Board (AUASB), the PCAOB, the Association of Chartered Certified Accountants (ACCA), and the U.S. Center for Audit Quality (CAQ);

- Outreach to investors and other stakeholders in the form of surveys and focus groups by respondents in developing their response to IAASB’s CP. For example, the Canadian Auditing and Assurance Standards Board (CAASB) conducted outreach to user groups, company management, audit committees, directors, regulators, auditors and others using polling questions through interactive webinars;

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4 It is possible that because of this approach, the respondents to the CP, though supportive of changes to auditor reporting, were not as clear in describing how the auditor’s report should change, and what the extent of those changes should be.


6 Event Webcast and Transcripts available at http://pcaobus.org/News/Events/Pages/09152011_Roundtable.aspx

7 http://www2.accaglobal.com/pdfs/international/singapore/RA.pdf

Responses (including the feedback statement) to the EC proposals included in the 2010 Green Paper, *Audit Policy: Lessons from the Crisis*, with particular focus on user respondents;

- Responses to the FRC proposals included in the 2010 paper, *Effective Company Stewardship: Enhancing Corporate Reporting and Audit*, and the September 2011 feedback paper, *Effective Company Stewardship: Next Steps*, which presents the FRC’s recommendations to improve financial reporting and corporate governance as a means of improving the auditor’s reporting model;

- Views expressed at the IAASB’s Consultative Advisory Group (CAG) September 2011 panel session on auditor reporting; and

- Comment letters submitted by investors and other users to the PCAOB in response to the June 2011 CR on *Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards* (see further discussion in paragraphs 55-62).

Several respondents specifically noted they had consulted with investors and others in developing their response to the IAASB’s CP. In addition, representative groups, for example the CFA Institute, Global Audit Investor Dialogue (GAID), and the International Corporate Governance Network (ICGN), have also approached their constituents, as well as the IAASB, to bring forth viewpoints and concerns relevant to auditor reporting. Appendix 2 provides additional discussion of relevant initiatives of others in relation to auditor reporting. The WG agreed that, while further outreach particularly to investors and analysts would be appropriate going forward, the cumulative sources it had considered enabled it to be in a position to conclude on whether a project should be proposed.

**Acknowledging the Need for Change**

7. Respondents to the CP generally supported the value of the binary (i.e., pass/fail) nature of the auditor’s report, noting that a clear expression of the auditor’s opinion was beneficial as it was concise and comparable. Despite this view, users and others who responded to the CP expressed very strong support for enhancing the communicative value of auditor reporting, and adding transparency to the audit process, noting that the auditor’s report is the only tangible item that gives investors insight about an entity’s financial reporting from the perspective of an independent party. One user noted that “investor needs should be paramount when considering revisions to the auditor’s reporting model” and “requirements should be set with a view toward providing the highest quality and most comprehensive information possible for investors.” Agenda Item 5-C provides a scorecard of responses to

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10 AASB-MIA, CFA, CPAA, HEOS, HKICPA, ICAS, IPA

11 BCBS, BR, BT, CAASB, CalPERS, CAQ, CFA, CPAA, CPAB, CNCC-CSOEC, EBA, EUMEDION, FEE, FEI-C, GAO, H3C, ICAEW, ICAS, IDW, IOSCO, JICPA, NZAASB, PWC, SMPC

12 CFA
questions around the five main options explored in the CP and other key questions, at both a summary and detailed level by respondent (“scorecard”), to highlight where respondents’ support was most prevalent and provide context to the analysis in this paper.

8. Increased complexity of the financial reporting framework on which financial statements are prepared, the availability of information, and the recent events in the financial markets were cited as reasons for the IAASB to take on an initiative to reassess the appropriateness of the standard auditor’s report. However, it is important to note that, while nearly all respondents supported exploring change to some extent and many commented specifically on whether the proposals explored in the CP would be an effective means of approaching change (see Agenda Item 5-C), explicit solutions to address these calls for change were not always provided. For example, although specifically invited to do so based on the options described in the CP, not all respondents identified the option(s) they believed would be most effective in enhancing auditor reporting but rather suggested that they “would support” or “would not oppose” the IAASB exploring particular options or explained why they would not support particular options. Areas that were explicitly supported are discussed in more detail within Section B of this paper.

9. For example, a number of respondents, while supporting change in auditor reporting, offered cautionary advice to the IAASB on how best to do so in light of the options explored in the CP. Some of these respondents suggested a set of “guiding principles” to assist the IAASB in considering possible future change in relation to auditor reporting. Three guiding principles drawn implicitly from the respondents’ comments are:

- The binary nature of auditor reporting (i.e., the “pass/fail model”) has value and should be retained;
- The auditor’s report should be clear and relevant, and incremental information should not include boilerplate or other information that may appear to contradict or dilute the auditor’s opinion; and
- Management and TCWG have discrete roles for preparing the financial statements in accordance with the applicable financial reporting framework to meet the needs of users, and the auditor’s role is primarily to provide assurance on those financial statements.

Other guiding principles were specified by auditors and other professional organizations (for example, the CAQ). While the WG generally agreed with these principles and thought some of them may be useful for a project Task Force (TF) to consider in evaluating possible ways forward, it believed that care should be taken not to use such principles as a defense against taking further action to meet the information needs of users.

10. In other cases, calls for change and support for specific options explored in the CP appeared to be based on respondents’ familiarity with initiatives related to auditor reporting.

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13 AASB-MIA, ACCA, AGNZ, ASB, ASSIREVI, AUASB, BCBS, BDO, BR, BT, CAASB, CalPERS, CAQ, CFA, CGAC, CNCCC-SOEC, CNDCSC, CPAA, DTT, EBA, ESMA, EUMEDION, EYG, FEI-C, FSR, GAO, GTI, HEOS, HKICPA, ICGN, ICPAR, IDW, IIA, IOSCO, JICPA, KPMG, MAZARS, PWC, NZAASB, RSM, SEHKL.
in their particular jurisdictions (for example, respondents from the U.K. and other parts of Europe were in favor of exploring enhanced corporate governance reporting) and the desire for the IAASB’s reporting standards to be able to accommodate such approaches. In other regions where the debates about auditor reporting may not be as significant (for example, Asia Pacific), more general support for enhancing auditor reporting was noted, as compared to a specific endorsement of one or more proposals in the CP.

**Considering a Holistic Approach to Change**

11. Many respondents noted that the type of change necessary to appropriately respond to the information needs of users and narrow the expectations and information gaps would need to go beyond including additional information in the auditor’s report. Those respondents suggested that consideration of the information that is included within, and outside of, the financial statements, and the role of those charged with governance, is paramount to effective, meaningful and holistic change.

12. Accordingly, those respondents recommended that the IAASB should actively engage, collaborate and cooperate with many groups representing key participants in the corporate reporting process, including accounting standard setters, management, TCWG, regulators and other policymakers.

13. Many respondents stressed the need for the IAASB to monitor the activities of the International Integrated Reporting Committee (IIRC) regarding the development of a framework for global integrated reporting, and the International Accounting Standards Board’s (IASB) agenda consultation paper seeking input on improving financial reporting, as well as its work on a disclosure framework, in addition to engaging closely with those parties already mentioned in paragraph 6.

**Maintaining Consistency in Auditor Reporting**

14. There were mixed views among respondents regarding the need for consistency in auditor reporting. A significant number of respondents expressed a preference for consistency in auditor reporting, because of the global nature of capital markets. Those respondents argued against variation in auditor reporting, cautioning that such variation runs contrary to the notion that an “audit is an audit” and may widen the information and expectations gaps

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14 AASB-MIA, ACAG, ACCA, ASB, ASSIREVI, AUASB, BDO, BR, BT, CAASB, CalPERS, CAQ, CB, CFA, CGAC, CNCC-CSOEC, CNDEC, CPAA, CPAB, DTT, EYG, ESMA, FEE, FEI-C, FSR, GAO, GTI, HKICPA, HKID, IAIS, ICAEW, IDW, IIA, JICPA, KPMG, MAZARS, NBA, NYSSCPA, PWC, SAICA, SEHKL

15 AASB-MIA, ACAG, AGSA, AUASB, BDO, BR, CalPERS, CB, CGAC, CPAA, FAR, FEE, FEI-C, FI, FSR, HEOS, IAIS, ICGN, IDW, KPMG, NBA, PWC, SEHKL

16 AGSA, AUASB, ASB, BCBS, BDO, BR, CAASB, CalPERS, CAQ, CFA, CNCC-CSOEC, CPAB, EBA, EFAA, EUMEDION, EYG, FAR, FEE, FEI-C, FSAN, GAO, ICAEW, ICAS, IDW, IIA, IOSCO, KPMG, MAZARS, NBA, PWC.

17 It should be noted that most respondents did not articulate whether this preference related to consistency of auditor reporting for entities of all sizes or consistency in information reported for listed entities. This matter is explored further in paragraphs 67-76 of this paper.
as users try to decipher the meaning of different audit reports. A number of respondents\textsuperscript{18} recommended that the IAASB work closely with other standard setters with similar auditor reporting initiatives (i.e., PCAOB, FRC and EC) to minimize unnecessary differences.

15. In evaluating the proposals in the CP, respondents had mixed views on whether changes to auditor reporting were necessary for publicly-listed entities only or entities of all sizes (see \textbf{Agenda Item 5-C}). Some of these respondents suggested it would depend on the proposals, cautioning that some of the enhancements discussed in the CP (for example, additional auditor commentary and enhanced corporate governance reporting) may be unduly administratively burdensome and costly for SMEs. Additionally, those respondents noted that there is not a similar demand for change in auditor reporting from users of audited financial statements of SMEs and non-listed entities.\textsuperscript{19}

\textbf{Evaluating the Possible Timing of Changes to Auditor Reporting}

16. Many respondents\textsuperscript{20} suggested that effective change would involve both (i) actions within the IAASB’s control that are capable of being addressed in the short term, such as further describing the auditor’s responsibilities, clarifying technical terms and expanding the use of Emphasis of Matter (EOM) paragraphs, and (ii) longer-term actions aimed at a more holistic review and improvement of the corporate financial reporting process, including enhancing corporate governance structures, which would require collaboration with others.\textsuperscript{21} It was further suggested that the IAASB’s strategy for implementing such long-term change in auditor reporting should include educating users, field testing, academic research and auditor training.

\textbf{Determining Who Should Provide the Requested Additional Information}

17. Respondents expressed mixed views regarding who would be best placed to provide further information to users of audited financial statements, and the nature and extent of the additional information to be provided. Many respondents,\textsuperscript{22} including preparers and some users, expressed a strong view that auditors should not originate information about the entity, believing that preparers and TCWG should continue to have final responsibility for

\textsuperscript{18} Some of those respondents include: AGSA, AUASB, BCBS, BDO, BR, BT, CAASB, CalPERS, CAQ, CFA, CNCC-CSOEC, CPAB, DTT, EBA, EFAA, EUMEDION, FAR, FEE, FEI-C, FSAN, GAO, ICAEW, ICAS, IDW, IIA, IOSCO, KPMG, MAZARS, PWC, RSM

\textsuperscript{19} Some noted that this might be because users of SMEs’ and non-listed entities’ audited financial statements have easier access to information and management.

\textsuperscript{20} Those respondents include: AASB-MIA, ACCA, ASB, ASSIREVI, AUASB, BDO, BT, CAASB, CalPERS, CAQ, CFA, CNCC-CSOEC, CPAA, FEE, FEI-C, FSR, GAO, GTI, IDW, IIA, IOSCO, JICPA, KPMG, MAZARS, PWC, and SEHKL.

\textsuperscript{21} While some respondents explicitly supported the model of corporate governance reporting under consideration in the U.K., others more generally supporting changing and enhancing the role, responsibilities and compositions of Audit Committees and Boards of Directors (BoD) to facilitate better oversight of financial reporting and possibly direct reporting to users.

\textsuperscript{22} AASB-MIA, ACCA, ASB, ASSIREVI, AUASB, BDO, BR, BT, CAASB, CalPERS, CAQ, CFA, CNCC-CSOEC, CPAA, DTT, EYG, FEE, FEI-C, FSR, GAO, GTI, HKICPA, ICGN, ICPAR, IDW, IIA, IOSCO, JICPA, KPMG, MAZARS, PWC, SEHKL
preparing the financial statements and related disclosures as required by the applicable financial reporting framework. A number of those respondents\(^{23}\) often expressed a preference for expanded disclosures by management and TCWG, together with a revised auditor’s report that might include auditor commentary about objective, but not subjective, matters, and particularly did not support the auditor providing increased insights about the entity or the quality of its financial reporting.

18. Other users,\(^{24}\) principally institutional investors in the U.S., have indicated a need to obtain directly from auditors information about the entity that is not necessarily disclosed in the financial statements. Those users have typically expressed a preference for options that include in-depth auditor insights about certain matters regarding the audit and the entity in the form of an auditor’s discussion and analysis (AD&A).

### Considering the Role of the Auditor and the Scope of the Audit

19. Many respondents\(^{25}\) to the CP specifically noted that a revised auditor’s report should not introduce any new substantive audit obligations, and should be limited to enhancing auditor communications in light of the current scope of the audit. For instance, one respondent\(^{26}\) noted that a further discussion of certain matters in the auditor’s report, for example, internal control over financial reporting, may be seen as “a backdoor audit obligation” (i.e., there may be inconsistencies in auditors’ interpretation about the amount of work needed to support a discussion of such matters in the auditor’s report).

20. Conversely, other respondents\(^{27}\) agreed with the suggestion in the CP that the role of the auditor and the scope of the audit may need to be expanded to provide assurance on other information ranging from information outside the company’s basic financial statements to matters about the entity’s business and operational risks and corporate governance. These respondents recognized, however, that such change would be in the longer term, could not be enacted by the IAASB alone and would require further understanding of the users’ needs of and the implications of legislation before such change could be effected.

### Detailed Analysis of Comments on Consultation

21. The WG noted that, though user views were varied, recommendations for improving the auditor’s report and narrowing the expectations and information gaps can be categorized and summarized into the following areas:

(a) Providing more information to clarify certain aspects of audits generally;

(b) Improving transparency about the audit process;

\(^{23}\) ASB, BDO, BR, BT, DTT, EYG, GTI, HKICPA, IDW, IIA, KPMG, PWC

\(^{24}\) BR, CalPERS, CFA, ICGN

\(^{25}\) AASB-MIA, ACCA, ASB, ASSIREVI, AUASB, BDO, BT, CAASB, CalPERS, CAQ, CFA, CNCC-CSOEC, CPAA, FEE, FEI-C, FSR, GAO, GTI, HEOs, IDW, IIA, IOSCO, JICPA, KPMG, MAZARS, PWC, SEHKL

\(^{26}\) HEOs

\(^{27}\) BM, CAQ, FAOA, H3C, HKICPA, ICGN, ICAS
(c) Providing in-depth insight into the auditor’s judgments and views on certain entity-specific matters; and

(d) Expanding the reporting roles of all stakeholders involved in the corporate reporting process, through a focus on corporate governance reporting and future assurance needs.

These areas are explored in more detail below, and represent the basis on which the WG has developed the draft PP, including its recommendations for the way forward and the proposed timing thereof. Should the IAASB approve the PP, it is anticipated that the project TF will further consider the detailed responses received on consultation in deliberating issues for presentation to the IAASB in 2012.

A. Providing More Information to Clarify Certain Aspects of Audits Generally

22. Nearly all respondents28 to the CP, including users, auditors, regulators and preparers, suggested that (i) including additional information in auditor’s reports to further describe the auditor’s responsibilities in certain areas and (ii) clarifying technical terms, together with educating users about the nature and purpose of an audit, would contribute positively to narrow the expectations gap and improve auditor reporting. Some of these respondents suggested that such additional information would add greater transparency into the audit process and also allow users to obtain more insights into the qualitative aspects of an audit, and would be beneficial to investors to fully understand the role of the auditor and the extent of the work the auditor is performing during the financial statement audit.29 Examples of areas for which there was the strongest support are discussed below.

23. In addition, many respondents,30 particularly regulators, supported exploring whether the location of the opinion could be changed to make it more prominent within the auditor’s report, although significant support for an “opinion only” report was not noted.

24. Some respondents31 did not support exploring change to the format and structure of the standard auditor’s report. Of these respondents, some were of the view that making changes in this area (i.e., changes of a cosmetic nature) would not have a significant impact on either the expectations gap or the information gap, and suggested that any changes to the audit report structure should be the result of detailed analysis and only made if they demonstratively result in enhancing the value of the audit report. They generally favored other enhancements to auditor reporting as a more meaningful way to address the expectations and information gaps. Responses from preparers32 indicated that they were not

28 All respondents except CNRL and ENMAX
29 Some respondents to the PCAOB CR, e.g. PCAOB Investor Advisory Group (IAG) and the CAQ, were also supportive of similar changes to the auditor’s report that further described and clarified the auditor’s responsibility.
30 ACAG, ACCA, AGNZ, AGSA, ASSIREVI, AUASB, CAASB, CB, CNCC-CSOEC, CPAB, DTT, EBA, EFAA, ESMA, FAOA, FAR, FEE, FI, FSAN, FSR, HEOS, HKICPA, IAIS, ICAP, ICPAR, IIA, IPA, KPMG, MAZARS, NBA, NZAASB, PWC, SAICA, SEHKL, ZICA
31 AGQ, AICD, CNRL, ENMAX, FEI-C, ICGN, KICPA, SMPC
32 CNRL,ENMAX
convinced that an information gap existed, in light of increased disclosure requirements, and suggested that this and the expectations gap were perceived and theoretical, while another preparer\(^{33}\) pointed out that no amount of additional information can ever completely eliminate the risk associated with investing in equities.

### Describing the Auditor’s Responsibility for Other Information

25. The majority of respondents\(^{34}\) in all categories were supportive of including a statement in the auditor’s report describing the auditor’s responsibility to read the other information presented in documents containing audited financial statements for material inconsistencies with the audited financial statements.\(^{35}\) Many respondents\(^{36}\) supported an explicit auditor conclusion based on those procedures performed, which is already being done in some jurisdictions, including Europe (as required by the Fourth Directive) and Australia. Some of these respondents also suggested that the information read by the auditor should be explicitly noted.

26. Several respondents\(^{37}\) suggested that exploring whether the auditor could provide assurance on all or some parts of the other information (for example, on the critical accounting estimates included in management’s discussion and analysis (MD&A)) may be a useful way to respond to the need for more emphasis on the important judgments made in preparing the financial statements while preserving the auditor’s attest role on information provided by management. Those\(^{38}\) that did not support including a statement about the auditor’s responsibilities for other information in the auditor’s report thought doing so would add to the length of the report with little benefit, although some of these respondents were not averse to such responsibilities being described in a separate location. It was also noted that because such information is not audited, drawing attention to it in the auditor’s report without adequate context could unduly emphasize it and possibly widen the expectations gap.

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\(^{33}\) 100 Group

\(^{34}\) AASB-MIA, ACCA, AGQ, AGSA, AICD, APB, ASB, ASSIREVI, AUASB, BDO, BR, CAASB, CalPERS, CAQ, CB, CFA, CGAC, CHA, CM, CNCC-CSOEC, CNRL, CPAA, CPAB, DFSA, DTT, EBA, EFAA, ENMAX, ESMA, EUMEDION, EYG, FAOA, FEI-C, FI, FSAN, GAO, GTI, H3C, HEOS, HKICPA, IAIS, ICAEW, ICAM, ICAP, ICAS, ICPAR, IDW, IIA, KPMG, JICPA, LADM, MAZARS, NAO, NYSSCPA, NZAASB, PWC, RM, RSM, SAICA, SEHKL, SMPC, ZICA

\(^{35}\) In accordance with ISA 720, The Auditor’s Responsibility Related to Other Information in Documents Containing Audited Financial Statements. The IAASB has a project on its current standard-setting work program to revise ISA 720 to consider whether the standard continues to specify appropriate responsibilities of the auditor relating to the range of other information in documents containing or accompanying the audited financial statements and the auditor’s report thereon – including disclosures made by the entity in, for example, its annual report that are beyond the requirements of the financial reporting framework. The documents to be included in the scope of proposed revised ISA 720 is a matter for consideration by the ISA 720 TF.

\(^{36}\) AASB-MIA, AGQ, CAASB, CB, CGAC, CM, CNCC-CSOEC, EBA, ESMA, EYG, FSAN, H3C, HEOS, IAIS, ICAM, ICAS, ICPAR, IIA, MAZARS, NAO, NYSSCPA, NZAASB, SAICA, ZICA

\(^{37}\) ASSIREVI, BM, BR, CAQ, CPAB, ESMA, FEE, MAZARS, NBA, NYSSCPA, PWC, SEHKL

\(^{38}\) ACAG, BT, KICPA, PP
Describing the Auditor’s Responsibilities with Respect to Fraud

27. Many respondents,\textsuperscript{39} including users, auditors, regulators and preparers, expressed support for including standard wording in the auditor’s report that highlights the auditor’s responsibility for planning and performing the audit to obtain reasonable assurance that the financial statements, taken as a whole, are free of material misstatement, “whether due to error or fraud.”\textsuperscript{40} There was some suggestion that part of the expectations gap results from the incorrect assumption that auditors have a broader responsibility to detect fraud (rather than fraud in the context of material misstatements), and that clarification of the responsibilities within the auditor’s report, combined with other educational initiatives (as described in paragraph 34), may assist in this regard.

Describing the Auditor’s Responsibility for Financial Statement Disclosures

28. Several respondents\textsuperscript{41} expressed support for including a statement in the auditor’s report that clarifies that the auditor’s opinion on the financial statements as a whole encompasses the accompanying disclosures to the financial statements. Those respondents noted that the context in which disclosures have been audited is not always clear to users of financial statements, even though:

- The ISAs require auditors to address disclosures in planning and performing the audit, including identifying and assessing the risks of material misstatement at the assertion level for disclosures;
- ISA 700 specifically requires auditors to consider whether the overall presentation of the financial statements, including the related notes (disclosures), represents the underlying transactions and events in a manner that achieves fair presentation; and
- Reference to the related notes is already included in the introductory paragraph of the auditor’s report.

Describing the Responsibility of TCWG regarding Financial Reporting and the External Audit

29. In some jurisdictions, for example Australia and the U.K., the auditor’s report includes a statement describing directors’ responsibilities. Inclusion of this type of a statement complements the existing paragraphs in the auditor’s report that explain the responsibilities of management and the auditor, which some respondents to the CP favored retaining. Accordingly, including a statement that further describes the responsibility of TCWG regarding financial reporting and the external audit could be a potential enhancement to the standard auditor’s report.

\textsuperscript{39} ASB, ACAG, BR, CalPERS, CAQ, CFA, CNDCEC, EYG, FI, GAO, HKICPA, IAIS, ICAC, ICAP, JICPA, KPMG, LADM, SAICA, SEHKL

\textsuperscript{40} ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing, paragraph 11

\textsuperscript{41} ACCA, BCBS, BDO, BR, CalPERS, CAQ, CFA, FEI-C, GAO, ICGN, KPMG
Describing the Auditor’s Responsibilities to Evaluate an Entity’s Ability to Continue as a Going Concern

30. Several respondents\textsuperscript{42} raised suggestions on improvements to auditor reporting in light of their experiences with the financial crisis.\textsuperscript{43} Those respondents noted that more information about the auditor’s work in relation to the use of the going concern assumption in the preparation of financial statements would make auditors’ reports more informative. Suggestions for change ranged from (i) including a factual statement describing the auditor’s responsibilities under ISA 570\textsuperscript{44} for evaluating management’s use of the going concern assumption, to (ii) including more information about the auditor’s procedures and conclusions with respect to going concern. For example, a user\textsuperscript{45} suggested it would be beneficial for auditors to given an indication of the auditor’s view in respect of his responsibility, whether in the form of negative or positive assurance or statements. Other respondents suggested that auditors should provide insights about the future viability or financial health of the entity, which would be an expansion of the scope of an audit.

31. One respondent\textsuperscript{46} explicitly suggested that a better response to users’ request for more insight about the future viability or financial health of an entity would be for entities to have improved disclosures about those matters, rather than changing auditor reporting requirements or the scope of the audit. The respondent suggested that using EOM paragraphs to highlight management’s disclosures with respect to the entity’s ability to continue as a going concern would address the incorrect assumption that auditors opine on the financial health of the entity and may help address the expectations gap in this area.

Clarifying or Simplifying Technical Terms

32. There was support among a majority of respondents\textsuperscript{47} for clarifying or simplifying technical terms currently used in the auditor’s report, although views on the extent to which this would narrow the expectations gap varied. Some of the terms that have been identified as needing further clarification include:

- Reasonable assurance – Some suggested that the auditor’s report explicitly state that reasonable assurance is a “high level of assurance, but not absolute assurance.”

- Material misstatement.

\textsuperscript{42} ACCA, CAASB, CalPERS, CFA, EBA, ESMA, HEOS, ICAP, ICAS, ICGN, PWC, SAICA

\textsuperscript{43} Some have challenged the traditional role of auditors with respect to going concern in light of their experiences with the financial crisis, suggesting that they would have expected more signals from auditors in this regard.

\textsuperscript{44} ISA 570, \textit{Going Concern}

\textsuperscript{45} HEOS

\textsuperscript{46} ESMA

\textsuperscript{47} ACAG, ACCA, AGSA, APB, ASSIREVI, AUASB, BCBS, BDO, BM, BR, BT, CAASB, CalPERS, CAQ, CHA, CM, CNCCC-SOECC, CPAA, CPAB, EBA, EFMA, ESMA, EUMEDION, EYG, FAOA, FAR, FEE, FEIC, FI, FSAN, FSR, GAO, GTI, HEOS, HKICPA, IAIS, ICAC, ICAEW, ICAP, ICAS, ICGN, ICPAR, IDW, IIA, IOSCO, JICPA, KPMG, LADM, NAO, NBA, NYSSCPA, NZAASB, PP, PWC, RM, RSM, SAICA, SEHKL, ZICA
33. However, a few respondents\(^\text{48}\) were skeptical that adding more words to describe the technical terms used in the auditor’s report would be useful. Those respondents cautioned that including further descriptions of terms would lengthen the auditor’s report and could possibly detract from the auditor’s opinion. There were suggestions made for including definitions and further descriptions of those technical terms in a location other than the auditor’s report (such as a glossary or website), the location of which could be referenced in the auditor’s report as is currently done in U.K. auditors’ reports.

Educating Users about the Nature and Purpose of an Audit

34. Many respondents,\(^\text{49}\) including auditors and some regulators, highlighted the need to educate users about the nature and purpose of an audit.\(^\text{50}\) One respondent\(^\text{51}\) noted that, although there are many notable investor education resources, they typically do not focus on the audit process, and that there is an immediate need for “easily accessible and digestible” public information about the auditor’s role in the financial reporting process, particularly for listed entities.\(^\text{52}\)

B. Improving Transparency about the Audit Process

35. Users indicated in their responses to the CP that they believe that the auditor possesses a great deal of information about the entity and the audited financial statements that would be of value to them in their decision-making. Though unified in their request for change in auditor reporting, these users had varied views about how to effect this change. For example, some users want more information about what the auditor does (i.e., risks identified and how the auditor responded to those risks), while others want more information about the conclusions the auditor draws in support of the audit opinion (i.e., significant judgments made).

36. Users also called for enhanced disclosures by management and the BoD, and more information from auditors to clarify and further describe the “process of the audit,” because “significant efforts and costs go into an audit, yet investors are provided very little information in the report provided by the current standard auditor’s report.”\(^\text{53}\) One user\(^\text{54}\)

\(^{48}\) ASB, BT, HEOS

\(^{49}\) ACAG, ACCA, ASSIREVI, AUASB, AICD, CAASB, CAQ, CB, CGAC, CHA, CM, DTT, EFAA, ESMA, EYG, FAR, FEE, FSR, H3C, HKICPA, HKID, ICPAR, IDW, IOSCO, IPA, JICPA, KICPA, KPMG, LADM, MAZARS, NYSSCPA, NZAASB, PP

\(^{50}\) The IAASB’s 2009-2011 *Strategy and Work Program* acknowledged the need to develop of a publication to describe in plain-English the meaning of an audit.

\(^{51}\) CAQ

\(^{52}\) As further discussed in Appendix 2, as part of a broader initiative aimed at educating investors, the CAQ published a plain-English *In-Depth Guide to Public Company Auditing* describing the audit process, beginning with how a public company audit firm decides to accept a new audit engagement, how it assesses risks that the financial statements contain material misstatements as part of determining the audit’s scope, and how the auditor performs and reports their findings. This guide, and other information designed to further educate users of audited financial statements about the audit, is accessible via the CAQ’s website at: [http://www.caqforinvestors.org/](http://www.caqforinvestors.org/)

\(^{53}\) CalPERS, CFA, EUMEDION, HEOS, ICGN
suggested that an expanded auditor’s report should include a discussion of matters such as “the quality of the financial statements, including a statement on the level of conservatism in accounting decisions and analyses of risks.” Another user expressed a strong need for “auditor commentary that provides objective additional information [that] could facilitate understanding of the financial statements taken as a whole.” As a result of this variation in user needs, ascertaining and meeting the needs of users, particularly investors, with respect to improving transparency about the audit, will undoubtedly prove challenging to the IAASB as it progresses a project.

37. The explicit and implicit options that those respondents suggested for change in this area ranged from increased use of EOM paragraphs to more substantive auditor insights. This could take the form of clarified and expanded language in the auditor’s report to external parties, enhanced reporting about the audit by auditors to TCWG to help them discharge their responsibilities, or an AD&A as proposed by the PCAOB.

38. Some users, particularly investors and analysts, noted that, given the increased complexity of financial reporting and the volume of disclosures that form part of the financial reporting package, a “roadmap” from auditors would be useful to assist them in navigating the financial statements and other information (for example, MD&A) and determining where to focus their attention. Recognizing this demand, auditors, among other respondents, have suggested that EOM paragraphs may be a meaningful approach to “shine light” on significant judgments made by the auditor and management, or more broadly to significant matters in the entity’s financial statements (for example, accounting policies and management’s critical accounting estimates), preserving management’s responsibility for the original disclosure of such information.

39. Though it does not mandate the use of EOM paragraphs, ISA 706 permits auditors to use additional paragraphs in the auditor’s report to draw users’ attention to matters presented or disclosed in the financial statements that, in the auditor’s judgment, are of such importance that it is fundamental to user’s understanding of the financial statements. However, responses to the CP indicated that EOMs are not being used on a widespread basis, and that there is not a consistent understanding of the purpose of EOM paragraphs as defined by the ISAs.

40. Some respondents indicated that the usefulness and relevance of auditor’s reports would be further enhanced if auditors highlighted certain matters about the audit of the entity, using EOM paragraphs or other means. Examples of those matters include:

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54 ICGN
55 BR
56 BR, EUMEDION, ICGN
57 AGNZ, ASSIREVI, BDO, BR, CAQ, CPAB, ESMA, EUMEDION, EYG, FAOA, FI, GAO, HKICPA, ICGN, IIA, KPMG, MAZARS, NBA, PWC
58 ISA 706, Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report
59 BR, CalPERS, CFA, ICGN
Details about the quantitative and qualitative materiality levels and factors that the auditor considered in establishing materiality levels used in conducting the audit.

- Matters related to auditor independence, for example, the identification of significant services provided to related parties outside of the corporate audit that may not be otherwise publicly disclosed.
- The auditor’s work relating to unusual transactions and other significant changes in the entity’s financial statements.

41. Other respondents, particularly regulators, supported exploring the use of the “justification of assessments” model, similar to what is required in France for all statutory auditor reports. This model allows the auditor to highlight key areas, and provide further details about the work performed on important aspects of the financial statements. Despite support by several respondents for the use of justification of assessments, others expressed concern that such “justification of assessments” are likely to become boilerplate over time. A recent survey among groups of users in France indicated mixed reactions regarding the usefulness of this model. One respondent noted that the principal consideration regarding expanded “disclosure” of the audit findings and the audit process should be the content, irrespective of where the information is reported.

C. Providing In-Depth Insight into the Auditor’s Judgments and Views on Certain Entity-Specific Matters

Significant Risks

42. Users, regulators and audit oversight bodies, among others, suggested the auditor should communicate in the auditor’s report the significant audit and financial statement risks specific to the entity under audit, particularly those areas (i) requiring significant judgment, or (ii) with significant measurement uncertainty, including a discussion about how the auditor responded to those risks. However, users and others have in some cases used the term “significant risk” to describe broader categories of “financial statement” or “business” risks.

43. Some respondents further noted that the auditor should (i) explain how the auditor has identified and assessed the reasonableness of management’s estimates and judgments and other inputs that underlie the preparation of the financial statements, and (ii) describe the auditor’s process for arriving at those assessments, including those about going concern as discussed above.

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60 AASB-MIA, BR, CB, CGAC, CNCC-CSOEC, CPAB, EBA, EFAA, ESMA, FAR, FEE, FI, FSAN, H3C, IAIS, ICAC, ICAM, ICPAR, MAZARS, NAO, NBA, ZICA

61 CFA

62 BCBS, BR, CalPERS, CFA, CGAC, CHA, CPAB, EBA, ESMA, EUMEDION, FAOA, FSAN, H3C, HEOS, IAIS, ICAC, ICGN, IDW, IOSCO, SAICA, SEHKL

63 BCBS, BR, CalPERS, CFA, ICGN
44. Several respondents cautioned, however, that the scope of matters that might be emphasized in relation to significant risks is very broad and may lead to inconsistency in audit reports if left to auditor discretion (i.e., if criteria were not set to enable auditors to judge what should be discussed). The resulting lack of comparability between audit reports may lead to confusion for users, particularly if users are not familiar with the application of a risk-based approach, or the definition of significant risks in ISA 315.

Management’s Use of Judgment

45. Related, a few respondents suggested that the auditor’s report should include a discussion of the auditor’s perspective on whether management’s estimates and judgments are at the low, most likely, or high end of a range of possible outcomes. One respondent explicitly noted that, given the ongoing debate about whether the basis for the appropriate application of the accounting framework should be a neutral, or a prudent/conservative approach, a better option might be to include a statement that “the accounts are a neutral representation” in the auditor’s report.

46. A few respondents, particularly institutional investors, expressed the need to obtain the auditor’s views on the preferability, not just acceptability, of an entity’s application of accounting practices and policies (for example, the auditor’s views on the reasons for changes) in the context of authoritative and regulatory guidance.

47. Respondents who felt strongly about obtaining the auditor’s views about the matters discussed above noted that auditors have the desired information because they are required to communicate those matters to TCWG and also document the matters in their working papers (i.e., the audit summary memo).

48. Regarding the demand for auditor insights in auditor’s reports, many respondents in the auditor, NSS, and other professional organizations categories expressed concern about exploring change in this area. Those respondents cited concerns with the auditor providing more in-depth entity-specific information, namely: (i) the undesirability of the auditor being the originator of information about the entity; (ii) the potential for “dueling information” provided by auditors and management; (iii) possible disconnect or confusion.

64 BT, CAASB, EYG, ICAEW, IDW, KPMG, PWC
65 ISA 315, Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment
66 CalPERS, CFA
67 HEOS
68 CalPERS, CFA, ICGN
69 Paragraph 16 of ISA 260, Communication with Those Charged with Governance, describes significant finding that the auditor is required to communicate with TCWG. This includes auditor’s views about significant qualitative aspects of the entity’s accounting practices, including accounting policies, accounting estimates, and financial statement disclosures, significant matters arising from the audit, and matters about auditor independence.
70 ACAG, AGQ, AGSA, AICD, ASB, AUASB, CAASB, CM, CNDCEC, CNRL, CPAA, ENMAX, FEI-C, FSR, GTI, IAIS, ICAP, ICAS, IOSCO, IPA, JICPA, LADM, NYSSCPA, NZAASB, PP, RSM
that may result if the auditor issues an unmodified opinion yet highlights matters in a way that might appear to contradict that opinion; and (iv) the risk that a further lack of consistency in comparability and consistency in auditor reporting would not be beneficial to users. One respondent explicitly cautioned that formalizing a process for preparing, reviewing and approving such narrative, non-standardized information for public distribution would increase the overall cost of the audit.

D. Expanding the Reporting Roles of All Stakeholders Involved in the Corporate Reporting Process through a Focus on Corporate Governance and Future Assurance Needs

Corporate Governance

49. The U.K. FRC has recently made recommendations to enhance reporting responsibilities for audit committees to the full BoD, via an expanded report made public by inclusion in the entity’s annual report. Auditors would provide an expanded auditor’s report to include (i) a new section that addresses the completeness and reasonableness of the audit committee’s report; and (ii) identification of any matters in the annual report that the auditors believe are incorrect or inconsistent with the information contained in the financial statements or obtained in the course of their audit. These recommendations are consistent with responses to the CP highlighting the need for management to enhance the communicative value of the annual report to provide narrative, non-boilerplate, relevant and reliable financial information, and the suggestion that accounting standard setters and securities regulators have a greater role to play in this regard.

50. A significant majority of respondents supported an enhanced corporate governance reporting model as a means of meeting the information needs of users. Consistent with the proposals of the U.K. FRC, there was some support for TCWG to provide an expanded audit committee report to the whole BoD of the entity about how they carried out their responsibility to oversee the entity’s financial reporting. It was acknowledged that auditor association with this report would be useful to add value to the completeness and reasonableness of the Audit Committee’s Report. Despite strong support for enhancing the corporate governance reporting model, some of the challenges noted were as follows: (i) auditor reporting on such reports would first require enhancing and standardizing the roles of corporate governance regimes in some jurisdictions; and (ii) while the IAASB has a role to play, the involvement of regulators, policymakers and others would be necessary for change to occur in this area.

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71 CAQ
72 100 Group, AASB-MIA, ACAG, ACCA, AGQ, AGSA, APB, ASSIREVI, AUASB, BCBS, BDO, BM, BT, CAASB, CalPERS, CAQ, CB, CFA, CHA, CIPFA, CNCC-CSOEC, CNDCEC, CPAA, CPAB, DFSA, DTT, EBA, ESMA, EUMEDION, EYG, FAOA, FAR, FEE, FI, FSAN, FSR, GAO, GTI, H3C, HEOS, HKICPA, HKID, IAI, ICAI, ICAC, ICAEW, ICAM, ICAP, ICAS, ICGN, ICPAR, IDW, IIA, IOSCO, KICPA, KPMG, LADM, MAZARS, NAO, NBA, NZAAASB, PWC, RM, RSM, SAICA, SEHKL, ZICA
73 Audit Committees do not exist in all jurisdictions. It is not clear from the respondents’ suggestion whether this recommendation should be extended to TCWG in jurisdictions where corporate governance structures do not require the existence of an audit committee.
Other Assurance Needs

51. In addition, one of the key messages from consultations regarding the IAASB’s Strategy and Work Program, 2012-2014, was the need for the IAASB to embrace innovation to maintain the role and relevance of assurance services in an evolving world. There is widespread recognition, however, that the IAASB alone cannot enact change in this area, and would need to collaborate with others in the corporate reporting process, as well as regulators and policymakers.

52. The CP acknowledged that some have suggested that the expectations gap or information gap will persist in the absence of the auditor being required to be involved with, or provide assurance on, other types of subject matter that are deemed to be of value to management of the entity as well as external users, including:

- Certain disclosures outside of the financial statements that provide insight into the understanding an entity’s performance (for example, key performance indicators and risk factors and other management disclosures).
- The quality and effectiveness of corporate governance structures and risk management.
- Internal control over financial reporting.

53. It is noted that certain of these engagements (for example, audits of internal control over financial reporting) are already being conducted at the national level. However, while encouraging the IAASB to monitor developments, many of these respondents thought it was either not currently feasible, or not cost-effective, to provide assurance in these areas, in part because acceptable criteria do not exist for such engagements. Others also cautioned that the provision of such assurance or related services should not be combined with the assurance given on the financial statements as doing so would bring confusion among users, particularly those with little knowledge of financial reporting.

54. Respondents generally supported the IAASB further exploring future assurance needs. However, it was widely acknowledged that such change: (i) should only be proposed in response to specific user demands; (ii) would not be without cost; (iii) may require skills that auditors do not currently possess; and (iv) would require the IAASB to develop standards for such engagements. In addition, it was suggested that any extension of the auditor’s mandate on information beyond the financial statements should be carefully considered taking into account the level of assurance that can reasonably be provided by auditors, considering also the risk of widening the expectations gap.

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74 100 Group, AASB-MIA, ACAG, ACCA, AGNZ, AGQ, AGSA, ASSIREVI, AUASB, BCBS, BDO, CalPERS, CAQ, CB, CHA, CM, CNCC-CSOEC, CPAA, CPAB, DTT, EBA, EFAA, ESMA, EUMEDION, EYG, FAOA, FEE, FI, FSAN, FSR, GTL, H3C, HKICPA, IAIS, ICAEW, ICAM, ICAP, ICAS, ICPAR, IDW, JICPA, KICPA, KPMG, LADM, MAZARS, NAO, NBA, NZAASB, PP, PWC, RM, RSM, SAICA, SEHKL, ZICA

75 The IAASB’s revision of attestation standard International Standard on Assurance Engagements (ISAE) 3000, Assurance Engagements Other Than Audits or Reviews of Historical Financial Information, is intended to provide a strengthened framework under which both reasonable and limited assurance engagements can be conducted.
Consideration of Activities of Others, including the PCAOB

55. As noted above, and discussed further in Appendix 2, consultation and standard-setting activities in other jurisdictions (for example Europe, the U.K. and the U.S.) are relevant to further understanding the global issues and threshold questions on the topic of auditor reporting, particularly as it relates to the needs of users.

56. In June 2011, the PCAOB issued a CR on possible revisions to PCAOB auditing standards related to reports on audited financial statements. Among other things, the CR used information from PCAOB staff outreach as a basis for presenting and prioritizing alternatives for change to the auditor’s report for public comment. Paragraph 13 of Appendix 2 to this paper further describes those alternatives. The comment deadline for the CR was September 30, 2011.76

57. Because of the common objectives of pursuing options for change in auditor reporting77 and questions asked, the timing of release, and the audience of the CR and CP, respondents’ feedback, particularly from users, on the CR is particularly relevant for further consideration by the IAASB, recognizing that it will need to explore a global solution.

Views of User Respondents to PCAOB CR

58. Staff78 noted that the views of user respondents79 to the PCAOB CR also varied, similar to observations made in the context of replies to the IAASB’s CP. Some users questioned the merit of changes to the auditor’s report. For example, one respondent noted that “… a financial statement user, if polled, will always be in favor of more information,” and cautioned that such “… requests must be balanced with the cost of providing additional information, as well as the potential for redundancies …” Those respondents who questioned whether it was appropriate to change the auditor’s report further noted that: (i) management is responsible for communicating information about the company, primarily through the financial statements and accompanying disclosures, including MD&A; (ii) if the auditor disagrees with management, they should report the disagreement as required under existing auditing standards; and (iii) perceived shortfalls in information regarding the entity’s business risks and areas of management judgment should be addressed by the accounting and financial reporting standard setters.

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76 The comment letters are available at the PCAOB’s website at the following link: http://pcaobus.org/Rules/Rulemaking/Pages/Docket034Comments.aspx.
77 The PCAOB CR did not explicitly recognize options relating to an enhanced corporate governance reporting model or other assurance or related services information not within the current scope of the financial statement audit.
78 References to Staff here refer to IAASB Staff.
79 Mike Mayo, CFA and Chris Spahr, CFA, Council of Institutional Investors, Hermes Equity Ownership Services Limited, State Street, Independent Community Bankers of America, Colorado Public Employee’s Retirement Association, Certain Members of the PCAOB’s IAG, Liberty Mutual Group, Investment Company Institute, American Federation of Labor and Congress of Industrial Organizations (AFL-CIO), Federated Investors, FMR LLC (Fidelity), American Bankers Association, Capital Research Management Company, CFA Institute, and Oakwood Enterprises, among others.
59. Other users favored some change to auditor reporting, noting that “… something additional can and should be communicated by auditors beyond the current pass-fail opinion.” Those respondents suggested expanding the content of the auditor’s report to further describe the auditor’s responsibilities with regard to the financial statements, particularly as they relate to fraud, financial statement disclosures, and other information outside of the basic financial statements, similar to points raised on the IAASB’s CP. Those respondents were also in support of further clarifying the language of the auditor’s report, and the use of EOM paragraphs. Those respondents were generally not supportive of an AD&A that discussed in-depth qualitative and subjective matters about the audit and the entity.

60. Users that supported the most substantive, and subjective, changes to auditor reporting were of a strong view that a supplement to the auditor’s report in the form of an AD&A should be made available to users. The purpose of an AD&A would be to discuss: (i) the auditor’s assessment of the estimates and judgments made by management in preparing the financial statements and how the auditor arrived at that assessment; (ii) the identification and a related discussion about areas of high financial statement and audit risk and the auditor’s responses to those risks; (iii) unusual transactions, restatements, and other significant changes in the financial statements and the related disclosures; and (iv) the quality, not just the acceptability, of the entity’s accounting practices and policies. Those respondents also supported expanding the content of the auditor’s report to further explain the auditor’s responsibilities with regard to the financial statements, particularly as it relates to fraud, financial statement disclosures and other information outside of the basic financial statements. These respondents noted that providing such information should not impact audit costs because auditors are already required to communicate such information to audit committees, and are required to document such matters as part of their audit working papers.

61. Some users explicitly cautioned against the use of an AD&A, noting that its use could: (i) increase the time pressures in an already tight financial reporting timeline and could potentially result in a delay in U.S. Securities and Exchange Commission (SEC) filings; (ii) increase the time and effort on the part of auditors to prepare an AD&A, which could result in increased audit costs; (iii) affect the comparability of auditor’s reports across entities; and (iv) distract the user’s attention from important disclosures about the entity and dilute the objective of the auditor’s report.

62. Other matters that some users identified for possible inclusion in the auditor’s report include a discussion of the following:

- Sensitivity analysis in significant areas of judgment;
- Quantitative and especially qualitative materiality thresholds;
- Key issues discussed in the auditor’s summary memo;
- Independence in the context of regulatory and legal requirements;
- Mandatory engagement partner signature on auditor’s reports; and
- Identification of the role of any affiliated firm in conducting the audit.
A number of these matters were also highlighted by respondents to the IAASB’s CP.

III. Threshold Questions and Suggestions for a Way Forward

63. The following threshold questions were considered by the WG in its deliberations in order to develop the draft PP for the IAASB’s consideration.

Need for a Project on Auditor Reporting

64. In considering a way forward, what has been both explicit and implicit in respondents’ feedback is that auditor reporting must evolve to reflect the expectations and business needs of users in an increasingly complex business and financial reporting environment. Equally evident is that corporate reporting will continue to evolve, possibly at an accelerated rate, over the next 10-15 years. Notwithstanding that fact, it is impossible to predict the possible outcomes from this continued evolution. The analysis prepared at Agenda Item 5-C suggests the commencement of one or more initiatives on auditor reporting, in light of the support noted for the five options for change outlined in the CP.

Working Group Discussion

65. Based on its discussions of responses to the CP, the WG agreed that there was a basis on which a project proposal could be developed. It is the WG’s view that the IAASB’s efforts in relation to auditor reporting should focus both on (i) addressing the immediate needs of those who argue that the “time for change is now,” and (ii) exploring more long-term “holistic” options, taking into account the current and future developments in corporate financial reporting, corporate governance and regulatory oversight as a whole. Accordingly, Agenda Item 5-A includes consideration of both aspects in the form of a proposed standard-setting project and the use of a more strategic group to monitor broader financial reporting developments. How these aspects will be specifically addressed is described in more detail below.

66. The WG is of the view that the IAASB should seek to continue to influence the debates on auditor reporting in light of the outcome of this consultation while proposing to move forward on a standard-setting project. The WG has also acknowledged the need for consideration as to how best to obtain appropriate input from global investor representatives and international and national bodies who have similar projects.

Balancing Calls for Consistency in Auditor Reporting with Calls for Additional Information

67. As noted in paragraphs 14-15, some respondents, particularly users, preparers, auditors and regulators, have indicated that, given the global nature of the capital markets, promoting international consistency in auditor reporting should continue to be a priority of the IAASB to minimize unintended confusion. ISA 700 was developed recognizing the desire for consistent and comparable auditor reports. Consistency in auditor reporting can be

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80 ISA 700 notes that “Consistency in the auditor’s report, when the audit has been conducted in accordance with ISAs, promotes credibility in the global marketplace by making more readily identifiable those audits that have
viewed in relation to: (i) global consistency among publicly-listed entities and more broadly “public interest entities”,\textsuperscript{81} (ii) consistency between all entities of in the same jurisdiction; and (iii) global consistency among all types of entities (for example, publicly listed entities, SMEs and public sector entities).

68. Some users expressed a preference for a standard auditor’s report that allows for comparison of listed and non-listed entities, as well as entities of all sizes in all industries, when making investment decisions. This point was particularly highlighted during the IAASB CAG’s discussions. However, discussion with NSS has indicated that ISA 700 has not been adopted in certain jurisdictions, or has been substantially modified, due to the need to provide for national circumstances (such as a corporate governance regime) and regulatory requirements (for example, reporting on other information). This would seem to support the view of some respondents who believed change was more urgently needed for publicly-listed entities to address the expectations and information gaps.

69. In addition, there was a strong view from stakeholders representing SMEs and small and medium practices (SMPs) that such entities should not be burdened with reporting requirements that would be better aimed at publicly-listed entities, although it was noted that users of these auditor’s reports would also prospectively benefit from such changes, if they were to be customized or scaled to their own specific circumstances and requirements.

\textit{Working Group Discussion}

70. The WG acknowledged the difficulties in discerning what was intended in terms of “consistency” in auditor reporting, recognizing that such consistency does not necessarily exist today. This is in part as ISA 700 has not been adopted globally and also in part because law and regulation in individual jurisdictions specify particular wording or requirements only applicable to that jurisdiction. This would continue to be a challenge as the IAASB explores how to meet requests for additional auditor insights through auditor reporting or other communications. In particular, the WG believes it will be necessary to further understand what users and others are looking for in terms of consistency in auditor reporting, as it may be that the requests are for consistency in the type and level of information provided, rather than consistency in the format.

71. The WG believes that, in weighing the available options, promoting principles of relevance and flexibility in standard auditor’s reports may outweigh the principle of consistency. However, the WG believes there is scope for ISA 700 to continue to require minimum elements within a standard auditor’s report that can then be supplemented with required elements for publicly-listed entities or accommodate other reporting responsibilities.

\textsuperscript{81} The ISAs do not define the term “public interest entities.” While there is no common global definition, the term is generally used to refer to listed entities and other entities that have regulatory and audit reporting requirements similar to those of listed entities, and is considered in the context of, among other things, regulation and ethical standards. Accordingly, there may be merit to consider reporting implications for public interest entities within this project.
72. The various emerging projects that are aimed at improving financial reporting and corporate governance are likely to require further enhancements beyond any shorter-term changes to auditor reporting the IAASB could propose. For example, one respondent\(^82\) suggested that “the IAASB should facilitate enhanced reporting of various approaches and not form a prescriptive view at this stage as to what is best practice.” The WG supports this view and therefore proposes that one objective of the proposed standard-setting project would be to determine whether and how the IAASB’s reporting ISAs, in their design, can be modified to accommodate evolving national financial reporting regimes, while at the same time ensuring that common and essential content is being communicated. The WG believes this approach would respond to concerns expressed that it would be unhelpful for the IAASB, PCAOB and EC to move in different directions in relation to auditor reporting.

“Building Blocks Approach”

73. The diversity of responses has prompted the WG to recommend a so-called “building blocks approach” to the revision of ISA 700. Such an approach would require establishing a clear understanding of what is meant by the term “building blocks approach.” A building blocks approach results from drafting the revised standard to include core requirements to be applied in all instances (i.e., for all entities and all jurisdictions) and having the ability to add supplemental requirements, for example for publicly-listed or public interest entities. Such an approach could facilitate flexibility in the form and content of auditor reporting, tailored to meet the varied needs of users. This is not a new idea, since extant ISA 700 already has such characteristics.\(^83\) The consequence of a building blocks approach is that ISA 700 could accommodate different requirements for different situations. This approach would also factor in flexibility for determining the (i) source of additional information requested (i.e., whether from the auditor, management or TCWG) and (ii) vehicle used to communicate the information (i.e., in the auditor’s report or by other means, such as a website or supplemental auditor communication).

74. The WG envisages the proposed project would explore the possibility of introducing requirements that could apply, for example:

- Where law or regulation requires information about the audit to be communicated.
- Where law or regulation requires an expanded use of EOM paragraphs for the audits of public interest entities.
- Where law or regulation requires a justification of assessments model that includes explain audit procedures applied to address certain risks.

Such an approach allows for the information needs of users to be addressed in a manner that can be tailored to reporting regimes.

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\(^{82}\) ICGN

\(^{83}\) For example, paragraph 38 in relation to other reporting responsibilities, and paragraph 43 in relation to the minimum elements of the auditor’s report when the auditor is required by law or regulation to use a specific layout or wording of the auditor’s report.
75. The WG does not consider that all ISA 700 requirements should be flexible, so this approach would involve some requirements that apply in all instances. It will be necessary for the project TF to determine the essential content of the auditor’s report that will assuage the needs of users in all audits irrespective of size, industry group or jurisdiction that could then serve as a foundation for promoting consistency in auditor reporting. This would be in line with the principles that “an audit is an audit,” and the outcome of the audit would be at the same baseline for all entities.

76. See paragraphs 22-27 of Agenda Item 5-A for further discussion.

Enhancing the Communicative Value and Relevance of the Auditor’s Report

77. While respondents asserted that the binary nature of an audit opinion continues to have merit (see paragraph 7), there is a case for providing greater transparency about the audit in view of the challenging issues facing auditors, in particular the increasing complexity of business, and the increased emphasis on fair value and risks in the financial reporting frameworks. As noted above, some users and regulators believe there is a public interest benefit in the auditor being more transparent about the specifics of the audit, in particular in commenting on their risk assessments and related procedures. These respondents believe that the auditor can add value by providing further explanation about the nature of both management’s and the auditor’s judgments to assist investors in getting a firmer grasp of the entity’s business risks, to supplement management’s disclosures. It was also noted that providing more information in auditor’s reports could also possibly improve management’s disclosures in the financial statements, by introducing “healthy tension” into the system.

78. Others, such as preparers, firms and member bodies, cautioned that including auditor insight in the auditor’s report could lead to “dueling information” and, due to the subjectivity involved, may actually widen the expectations gap if readers of the auditor report are not aware of the context in which the auditor’s approach is determined (i.e., a risk-based approach premised on the concept of materiality and the need to opine on the financial statements as a whole) (see paragraph 48). It was also suggested that requests for auditor insight may be arising as a result of incomplete or unclear disclosures by management (i.e., disclosures that are not adequate in the context of the applicable financial reporting framework).

Working Group Discussion

79. The WG is of the view that, while responses relating to the auditor providing additional insight highlight challenging aspects in developing a globally acceptable solution, the value and relevance of the auditor’s report would be best enhanced if this concept is further explored. While other enhancements to ISA 700 may be meaningful to some users and may address the expectations gap to some extent, those users, particularly investors, signaling the strongest desire for change have clearly focused on the information gap and are looking for auditors to communicate directly to them about key areas. Accordingly, another objective of the proposed standard-setting project would be to appropriately enhance the communicative value and relevance of the auditor’s report through proposed revisions to
ISA requirements that address its structure and content (see paragraphs 28-31 of Agenda Item 5-A for further discussion).

80. The WG agreed that, in order to respond to user demands for additional information, such a project would need to explore:

- Evaluating the need to include auditor insight in auditor’s reports about:
  - Estimates and judgments made by management in preparing the financial statements (including the potential for management bias) and how the auditor arrived at the auditor’s risk assessment on which the audit was conducted.
  - Areas of high financial statement and audit risk and how the auditor addressed these risk areas.
  - Unusual transactions, restatements, and other significant changes in the financial statements (including the notes).

- Increasing transparency to the audit process by:
  - Describing the auditor’s responsibilities relating to fraud, disclosures, and other information.
  - Disclosing quantitative and, in particular, qualitative materiality thresholds.
  - Identifying the role of any affiliated firm in conducting the audit.
  - Requiring the signature of the engagement partner with overall responsibility for the audit.
  - Describing / confirming auditor independence in the context of regulatory and legal requirements.

- Describing the auditor’s responsibility to evaluate management’s assessment of the entity’s ability to continue as going concern and considering whether additional discussion of judgments in this area would be appropriate.

- Clarifying the terms used in the report, such as reasonable assurance and materiality.

- Considering whether the opinion should be presented first in the auditor’s report.

The WG also believes it will be necessary for the IAASB to determine the scope and means of delivery of an initiative aimed at educating users and the public at large about the meaning of a financial statement audit (see paragraphs 53-54 of Agenda Item 5-A).84

81. Such a project might result in changes to ISAs 700, 706 and other ISAs as deemed appropriate to enhance communication requirements regarding work performed by the auditor. Due to the breadth of these matters, the WG believes the project TF should first explore areas for change in auditor reporting where there is general consensus among all users and other stakeholders, namely management, TCWG, auditors and regulators. These

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84 Such an activity might require a consideration of how such an education initiative might best reach its intended audience (for example, the development of an international investor website versus facilitating, influencing or leveraging to the extent possible activities of national jurisdictions).
areas include: (i) clarifying the content and language used in the auditor’s report; (ii) describing the auditor’s responsibilities with respect to fraud, disclosures, other information and going concern; and (iii) improving transparency about the audit process.

82. Because other NSS and policymakers are looking at enhancing auditor reporting in this area, the WG believes it will be important for the project TF to closely monitor these initiatives and seek to minimize differences in the approaches to the extent possible, recognizing that the “building blocks approach” may be a useful means of accommodating such differences.

83. The WG also believes that enhancing communications between auditors and TCWG, or promoting long-form reporting to TCWG, may be a meaningful step for the project TF to explore, in light of the proposition from users that matters that form part of required communications to TCWG could be used as the basis for the auditor more publicly providing in-depth auditor views on entity-specific matters. Doing so recognizes the role of auditor communication in enabling TCWG to discharge their responsibilities and could provide them with a stronger basis on which to do so, while being mindful of the division of responsibilities. It would also likely be beneficial in jurisdictions seeking to enhance the role and reporting responsibilities of TCWG as a means of addressing the information needs of users.

Importance of Targeted Outreach to Users, Particularly Investors, in Proposing Change

84. Due to the nature and potentially wide scope of the project, the WG believes that obtaining further stakeholder views will be fundamental to the IAASB’s objectives in undertaking the project. Responses to the CP, and feedback from dialogue facilitated by others, have provided useful insight into the information needs of key groups of users. As addressing the information needs of users will be of paramount importance in the proposed project, the WG believes the IAASB will need to consider how best to engage members of the user community, taking into account different demographics such as size, sophistication, culture and ownership/governance structures, beyond the IAASB’s ongoing outreach and liaison activities, in order to seek their input in debating the merits of particular courses of actions. In determining the nature and extent of proposed changes to the auditor’s report, the IAASB will need to explore how best to respond to, and prioritize the needs of, investors and analysts, while also taking into account the needs of regulators, TCWG, lenders, etc.

85  Paragraph 16 of ISA 260 describes significant finding that the auditor is required to communicate with TCWG. This includes the auditor’s views about significant qualitative aspects of the entity’s accounting practices, including accounting policies, accounting estimates, and financial statement disclosures, significant matters arising from the audit, and matters about auditor independence.

86  Although this may prove to be appropriate, auditors would likely need guidance to enable them to provide a sufficient level of detail and context for users to receive that information, as such users would not have the benefit of the two-way dialogue that exists between audit committees/TCWG and auditors.

87  These include the IAASB CAG, NSS, public authorities, international regulators, audit oversight bodies (including the International Forum of Independent Audit Regulators (IFIAR)), and others.
85. Because of practical challenges cited by many respondents in implementing such changes to auditor reporting (for example, impact on relationships among management, TCWG and the auditor, need for field testing, increased audit costs, need for new auditor training and education programs, and increased liability exposures), research and consultation with all stakeholders throughout the proposed project will be needed as various options in auditor reporting are explored and formal standard-setting proposals developed, in order to analyze their impacts.

86. However, it is anticipated that user reaction and necessary consideration of costs and benefits of change would only be possible when more concrete proposals are in place (for example, when examples of revised auditor’s reports are developed). The WG also agrees consideration should be given as to the need for additional consultation papers or other forms of targeted outreach (for example, focus groups or roundtables) and field testing of at various stages of the proposals.

Actions to Be Taken in Relation to ISA 720

87. As noted above, a significant majority of respondents in all categories supported including a statement in the auditor’s report about the auditor’s responsibilities regarding other information in documents containing audited financial statements, given the importance that users attach to such information in decision-making. Many suggested that simply paraphrasing the general [proposed] requirement to “read and consider” would differentiate this information from the audited financial statements. Given the plans to expose a revised ISA 720 in 2012, the WG considered whether there was be merit in developing proposed language for the IAASB’s consideration (e.g., a requirement in proposed revised ISA 720 and a conforming amendment to ISA 700) to respond to the calls for change, rather than postponing action until a broader standard-setting initiative can be undertaken. Doing so would also have the benefit of aligning the reporting responsibility with the work effort contemplated in the exposure draft (ED).

88. However, the WG also discussed potential drawbacks in considering a discrete matter such as other information in light of the requests for further information about the auditor’s responsibilities in relation to fraud, going concern and disclosures. The ISA 720 TF and the Working Group (WG) on auditor reporting concluded it is preferable that the reporting responsibility is dealt with as part of the auditor reporting project, in coordination with the ISA 720 TF, given that there may be broader discussions about the auditor’s involvement with other information that will need to be fully debated by the IAASB before putting forth proposals.

Exploring and Contributing to Holistic Change to Corporate Financial and Auditor Reporting

89. As noted in paragraphs 11-13, many respondents suggested that the IAASB should coordinate with others (such as IASB and IIRC) to affect a more holistic approach to addressing users’ information needs. Those respondents cited various emerging and existing projects with goals of improving entity-provided corporate financial reporting (both by management and TCWG) and recommended that the IAASB monitor and
contribute to those debates in order to determine their impact on the scope of the audit and the matters that are communicated in the auditor’s report. In addition, the role of policymakers and regulators in changing reporting regimes cannot be understated. While many respondents acknowledged the possible future need for, or potential value of, assurance or related services on information other than the audited financial statements (see paragraphs 51-54), there does not appear to be a need for standard-setting activity in any particular area at this time beyond the ongoing revision of ISAE 3000 to strengthen procedures for assurance engagements generally.

90. Subject to the IAASB’s deliberations on its Strategy and Work Program, 2012-2014, it is envisaged that a Strategy Working Group (SWG) will be established in 2012. The aim of this group is to further explore emerging areas such as integrated reporting, reporting on corporate governance, sustainability, internal control, and XBRL. The working group will report periodically with a view to informing the IAASB’s longer-term strategy. It may recommend specific work streams for the IAASB to pursue, avenues of cooperation with interested stakeholders, how best to gather input at earlier stages of any potential project to develop standards in these areas, and whether to develop discussion papers or thought pieces. It may also develop reports on findings that may be shared with NSS, regulators, firms and other organizations with a view to stimulating debate and collaboration.

Working Group Discussion

91. The WG believes the proposed SWG would provide the IAASB the best opportunity to proactively determine how emerging issues in corporate reporting and governance affect the future of auditor’s reports (see further discussion in paragraphs 12-13 of Agenda Item 5-A).

92. The WG agrees there may be merit in the SWG monitoring developments in relation to:

- The FRC and IIRC projects related to improving corporate reporting and disclosures.
- Changes in management and governance reporting to increase transparency, clarity and relevance of the corporate financial reporting process, and engaging in the debates as necessary.
- Demands by users and others for assurance on information not within the current scope of the financial statement audit.

Should the IAASB agree with this approach, the WG believes that close collaboration between the project TF and the SWG will therefore be necessary.

Consideration by IAASB of Significant Matters Identified by the WG

93. The significant matters the Working Group has identified as a result of its deliberations in relation to the responses received on consultation have been reflected in this paper. In the

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88 See Agenda Item 3 for the draft Strategy and Work Program, 2012-2014, which is being presented to the IAASB for approval at its December 2011 meeting.
WG’s view, there are no significant matters discussed within the WG on this project that have not been brought to the IAASB’s attention.
# Appendix 1

## List of Respondents to the Consultation Paper

<table>
<thead>
<tr>
<th>#</th>
<th>Abbrev.</th>
<th>Respondent (82)</th>
<th>Region</th>
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<tr>
<td>1.</td>
<td>BR</td>
<td>BlackRock, Inc (Investment Manager)</td>
<td>INTL</td>
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<tr>
<td>2.</td>
<td>CalPERS</td>
<td>California Public Employees' Retirement System</td>
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<td>3.</td>
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<td>CFA Institute</td>
<td>INTL</td>
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<tr>
<td>4.</td>
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<td>Eumedion (Dutch Institutional Investors)</td>
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<td>5.</td>
<td>ICGN</td>
<td>International Corporate Governance Network</td>
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<td>6.</td>
<td>HEOS</td>
<td>Hermes Equity Ownership Services</td>
<td>EU</td>
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<td>7.</td>
<td>AICD</td>
<td>Australian Institute of Company Directors</td>
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<td>10.</td>
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<td>Basel Committee on Banking Supervision</td>
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<td>Canadian Public Accountability Board</td>
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<td>Dubai Financial Services Authority</td>
<td>MEA</td>
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<td>European Securities and Markets Authority</td>
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<td>Finanstilsynet, The Financial Supervisory Authority of Norway</td>
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<td>Haut Conseil du Commissariat aux comptes</td>
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<td>International Association of Insurance Supervisors</td>
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<td>27.</td>
<td>NZAASB</td>
<td>New Zealand Auditing and Assurance Standards Board</td>
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**Accounting Firms (10)**

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<td>Ernst &amp; Young Global</td>
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<td>Grant Thornton International Ltd</td>
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<td>Mazars and Guérard</td>
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**Public Sector Organizations (7)**

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<td>Office of the Auditor General of Canada</td>
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<td>Office of the Controller and Auditor-General of New Zealand</td>
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<td>Auditor General of Quebec</td>
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<td>AGSA</td>
<td>Auditor General South Africa</td>
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<td>United States Government Accountability Office</td>
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<td>LADM</td>
<td>Legislative Audit Division, State of Montana</td>
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<td>NAO</td>
<td>National Audit Office (Malta)</td>
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**Preparers of Financial Statements (4)**

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**Member Bodies and Other Professional Organizations (29)**

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<td>Center for Audit Quality</td>
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<td><strong>Individuals and Others (5)</strong></td>
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<td>BM</td>
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<td>CB</td>
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<tr>
<td>81.</td>
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<td>Felicitas T. Irungu</td>
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Respondents by Region

- **Europe**: 34%
- **Asia Pacific**: 20%
- **North America**: 18%
- **International**: 21%
- **Middle East and Africa**: 6%
- **South America**: 1%
Activities of Others that Are Relevant to the Topic of Auditor Reporting

1. The following is a summary of the developments and activities of international and national bodies and groups since the issuance of the IAASB CP that are relevant to the project.

International Bodies and Groups

2. The international bodies and groups who have undertaken projects and conducted surveys to elicit feedback about whether, and how auditor reporting and, more broadly, the role of the auditor could be improved include:

IOSCO

3. In September 2009, the Technical Committee of IOSCO published a consultation report, *Auditor Communications*, seeking comment on whether changes to the standard auditor's report or additional auditor communications are needed to meet investor information needs.⁸⁹ IOSCO published highlights of the comments received in a summary document available on its website.⁹⁰ The summary document notes that commenters on IOSCO’s report had varying views on several of the substantive issues involved in enhancing auditor communications. However, there was general agreement and support for collaborating towards a global approach; and there was a recommendation that all parties pursuing the subject of auditors’ report, including the IAASB, consider the studies and work of international organizations.

4. A representative from IOSCO updated the IAASB CAG at its September 2011 on the organization’s activities and reiterated the need for global outreach and collaboration in exploring options to enhance the auditor’s report. The response from IOSCO to the IAASB’s CP describes four outreach sessions held in 2010 and 2011 in Asia and the Americas with individuals from (i) investor and corporate governance groups; (ii) audit firms; (iii) audit committees/TCWG from large, multinational corporations; and (iv) financial management of companies from large, multinational corporations to further its understanding of the views of relevant stakeholders.

EC

5. The EC has also been studying issues surrounding the role of the auditor and the form and content of auditors’ report. Relevant publications issued by the EC include its October 2010 Green Paper, *Audit Policy: Lessons from the Crisis*,⁹¹ and its June 2008 Green Paper, *The Role, the Position and the Liability of the Statutory Auditor within the European Union*.⁹² In its most recent October 2010 Green Paper, the EC sought views from

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stakeholders and others on general matters relating to audits of financial statements. The comment period ended on December 8, 2010. The EC published a feedback paper summarizing its over 700 comment letters from various stakeholders and interest groups, including members of the profession, investors and academics.93

6. The feedback paper noted that an “expectations gap persist between the actual scope of the audit and the public’s perception of what audits are intended for and suggests improving transparency on the conduct and outcome of the audit as a way to narrow this expectations gap.” The feedback paper further noted that investors were of the view that audit reports should be more “qualitative and the negative perceptions towards audit qualifications should be reconsidered. As a solution investors proposed more informative auditor opinions, more frequent use of the ‘emphasis of matter’ statements…” The feedback paper further noted that some investor respondents expressed the view that if the auditor’s report gave an indication on the “quality of financial statements, i.e., how far the company is pushing the boundaries of accounting standards, it would provide much more useful information to investors, and would dissuade companies from taking an aggressive stance.”

7. In a February 2011 EC-hosted conference on accounting and auditing,94 speakers debated matters related to the accounting and auditing standard-setting process in an international context, including the need for the auditor’s role to be examined, clearly defined, and better understood.

**International Federation of Accountants (IFAC)**

8. As part of its project group aimed at studying progress in areas of governance, financial reporting, and financial auditing with a focus on meeting investor needs, IFAC conducted outreach of prominent business leaders, representing preparers, directors, auditors, standard setters, regulators, and investors, on what should be done to effectively improve governance, the financial reporting process, the audit, and the usefulness of business reports in the aftermath of the financial crisis. Specific to auditor reporting, the report of the working group, *Integrating the Business Reporting Supply Chain*,95 recommended improvements to auditor communication to increase transparency and provide more information about how auditors reach their opinion. The IFAC report notes that as an alternative to expanding their reports, auditors could provide more “discursive board and audit committee reports to enhance communication between directors and stakeholders of the organizations.”

**Audit Firms and Others**

9. Several audit firms, and professional bodies representing audit firms are also researching and exploring ways to provide improved, user-friendly and information to users that is relevant to their investment making decisions.

95 The survey and report of the IFAC project working group is available at: [http://viewer.zmags.com/publication/5d630be3#/5d630be3/1](http://viewer.zmags.com/publication/5d630be3#/5d630be3/1)
10. Simultaneously, investor surveys (for example those of the CFA Institute\textsuperscript{96}) continue to reveal that, though investors view that auditor’s report as important to the analysis of entity’s financial statements, they desire more information about various aspects of the audit process and the entity’s financial statements.

**National Bodies and Groups**

**U.S. PCAOB**

11. In response to a recommendation from the Advisory Committee on the Auditing Profession convened by the U.S. Department of the Treasury (ACAP) and based on its recommendations of its Standards Advisory Group (SAG), the PCAOB added to its standard-setting agenda a project on the Auditor’s Reporting Model in 2010.

12. As part of this project, the staff of the PCAOB conducted outreach to investors, auditors, preparers, audit committee members, representatives of academia, and others to further explore potential improvements to the auditor's reporting model. The staff reported its findings to the PCAOB at an open meeting on March 22, 2011.\textsuperscript{97} Also, independent of the PCAOB Staff, a working group of the PCAOB’s IAG held a discussion regarding the auditor’s reporting model in March 2011.\textsuperscript{98} The discussion included the results of a survey that the working group conducted to solicit views regarding changes to the auditor’s report.

13. Less than a month after the IAASB issued its CP, in June 2011, the PCAOB issued a CR\textsuperscript{99} presenting and seeking comments on possible alternatives to change the auditor’s reporting model and provide investors with more transparency into the audit process, and more insights about the company. The alternatives described in the CR for changing the auditor’s report included:

- An AD&A;
- Required and expanded use of EOM paragraphs;
- Auditor assurance on other information outside the financial statements; and,
- Clarification of language in the standard auditor’s report.

To solicit further feedback on the options set forth in its June 2011 CR on possible changes to the auditor’s reporting model the PCAOB hosted a roundtable\textsuperscript{100} with 32 participants representing various stakeholders.


\textsuperscript{97} [http://pcaobus.org/News/Events/Pages/03222011_OpenBoardMeeting.aspx](http://pcaobus.org/News/Events/Pages/03222011_OpenBoardMeeting.aspx).

\textsuperscript{98} [http://pcaobus.org/News/Events/Pages/03162011_IAGMeeting.aspx](http://pcaobus.org/News/Events/Pages/03162011_IAGMeeting.aspx).


14. Also, relevant to the topic of auditor reporting and the overall role of the auditor are the PCAOB’s CR on Auditor Independence and Audit Firm Rotation and proposed amendments to PCAOB auditing standards that would require, among other things, disclosure in audit reports of the name of the engagement partner, other independent public accounting firms and other persons that took part in the audit. The comment period due dates for these PCAOB documents are December 14, 2011 and January 9, 2012 respectively.

U.S. CAQ

15. In the U.S. during 2011, the CAQ hosted four roundtable discussions aimed at examining the role of the auditor and the value of the audit with over 80 participants representing investors, preparers, board and audit committee members, academics, auditors and other stakeholders. Based on information obtained from its roundtables, the CAQ noted in their response to the CP that there are both expectations and information gaps regarding the current role of the auditor and the extent of the audit process. The CAQ further noted that the investors who participated in the roundtables uniformly expressed a view that auditor’s reports continue to have value in providing reasonable assurance on whether the financial statements comply with the applicable financial reporting framework. Those investors and other roundtable participants further noted that auditors should continue to provide a binary (pass/fail) auditor’s report, and changes thereto should supplement and not replace the current pass/fail auditor’s report. Roundtable participants representing the full range of stakeholders commented that changes to the role of the auditor without corresponding actions to improve the overall corporate financial reporting framework may not sufficiently respond to investors’ financial reporting concerns.

16. The CAQ, in an effort to narrow the expectations and information gaps, has embarked on an investor education initiative. As part of that education initiative, the CAQ published an *In-depth Guide to Public Company Auditing: A Financial Statement Audit*,101 describing the audit process in non-technical audit language, beginning with how a public company audit firm decides to accept a new audit engagement, how it assesses the risk that the financial statements contain material misstatements as part of determining the audit’s scope, and then how the auditors perform and report their findings. The CAQ also launched a “For Investors” area of the CAQ website homepage102 dedicated to (i) explaining the auditor process and how it relates to investor protection; and (ii) providing relevant facts and resources to investors regarding the U.S. public company audit and the audit process, including describing certain matters about auditor’s reports.

U.K. FRC

17. In January 2011, the FRC issued a report, *Effective Company Stewardship: Enhancing Corporate Reporting and Audit*,103 requesting feedback on several recommendations to

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102 [http://www.thecaq.org/resources/ForInvestors.htm](http://www.thecaq.org/resources/ForInvestors.htm)

financial reporting, including a recommendation for enhanced corporate governance as means of improving the auditor’s reporting model. The FRC proposals included more robust and substantive communication from Audit Committees to their shareholders (Audit Committee Report), particularly in relation to the risks faced by the entity’s business. The FRC also proposed that auditors provide assurance on the completeness and reasonableness of that improved Audit Committee Report, and include a statement regarding the work that the auditor performed in a new section of the auditor’s report. The deadline for responses to the FRC’s request for consultation was March 31, 2011.

18. The FRC received approximately 100 responses in response to the report. In a September 2011 paper, Effective Company Stewardship: Next Steps, the FRC summarized the responses received in response to its January 2011 recommendations, and stated its next steps.

19. Noteworthy from that September 2011 paper, respondents from all stakeholder groups, and in particular investors, called for greater transparency about the key issues that arose in the course of the audit, how they were addressed, and any other matters bearing on whether the financial statements give a true and fair view. There was broad support from the audit profession and institutional investors who responded to the FRC’s proposal for the principle of a greater audit committee role. Some respondents from listed companies expressed concern at the suggestion that:

- It was the role of the audit committee to hold management accountable; and
- A significant increase in audit committee responsibilities would make it difficult to attract and retain individuals to serve in that role.

20. Some respondents expressed concern that the FRC’s proposal to enhance the audit committee’s role could threaten to undermine the concept of a unified Board, and instead suggested that the expanded audit committee report come from the Board as a whole.

21. Additionally, many respondents – companies, audit committees, investors (both institutional and private), and the accounting profession – supported the FRC’s assessment that there is a need to improve the quality and relevance of financial reporting, particularly narrative reporting. Respondents also emphasized that changes should be geared to improving the quality of narrative reporting and should reduce, and not increase, boilerplate language. Also relevant was respondents’ strong support for the creation of a Financial Reporting Laboratory in which companies could discuss and try new approaches to reporting with regulators and investors.

22. In that September 2011 paper, the FRC rejected suggestions for auditor’s reports to include commentary on the financial statements. Instead, the FRC took the position that the entity’s directors and executive management should have the responsibility for communicating such information to the entity’s shareholders. The FRC expressed the view that it is the role

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104 http://www.frc.org.uk/about/respeffcompsteward.cfm
105 http://www.frc.org.uk/press/pub2632.html
of the auditor to review a company’s annual report, including its financial statements, and provide a “second” opinion on whether they have been properly prepared.

23. Also in that September 2011 paper, the FRC suggested that auditors can make valuable and important contributions in certain areas and proposed the following:

- The standards relating to auditor communications to the audit committees (such as ISA (UK & Ireland) 260) should be revised to ensure that auditors are required to provide audit committees with the information that they need to understand fully the factors that the auditors relied upon in exercising their professional judgment in the course of the audit and, in particular, in reaching their audit opinion. Those are likely to include, at a minimum, the auditor's views on:
  
  (i) The effectiveness of the company’s system of control (including their assessment of any undisclosed matters arising from the company's business model);
  
  (ii) The judgments made in the audit plan about what is of material significance and the implications of those judgments for the level of assurance provided by the audit;
  
  (iii) The appropriateness of the accounting policies (viewed individually and in aggregate);
  
  (iv) Their overall conclusions on the valuations of the company’s assets and liabilities provided by management (with particular reference to those that are significant to the financial statements); and
  
  (v) Any other matters identified in the audit plan or by the audit committee as material to the proper presentation of the company's financial position.

- Auditors should provide an expanded audit report that includes:
  
  (i) A new section that addresses the completeness and reasonableness of the audit committee’s report; and
  
  (ii) Identification of any matters in the annual report that the auditors believe are incorrect or inconsistent with the information contained in the financial statements or obtained in the course of their audit.

24. In October 2011, the FRC established a “Financial Reporting Lab” (the Lab) which is intended to act as a forum for companies and investors to identify practical solutions to current financial reporting challenges. Though the agenda and priorities of the Lab will be determined in large part by its participants, the FRC encourages participants to think broadly about the areas of corporate reporting and assurance including enhanced disclosure around business models and risks and rethinking the content of corporate governance reporting.
Association of Chartered Certified Accountants (ACCA)

25. As part of its commitment to identifying ways to closing the expectations gap, the ACCA hosted a series of 10 international roundtables discussions on the value of the audit over a 12-month period September 2009 to September 2010. A November 2010 paper, Re-shaping the audit for the new global economy, \(^\text{106}\) incorporates the feedback from those roundtable discussions. The paper notes that the participants in the global roundtable series see value in the audit, but were of the view that auditors could provide more. For example, one investor representative in Malaysia suggested that auditors should indicate the auditor’s views about the entity under audit. Others investor participants expressed a need for more real-time and relevant reporting.

26. The ACCA also prepared a report, The Value of Audit: Views from Retail (Private) Investors, \(^\text{107}\) for the Singapore regulator ACRA which examines the value of the audit as perceived by private investors. Additionally, ACCA commissioned research, A Framework for Extended Auditor Reporting, \(^\text{108}\) by Maastricht Accounting, Accounting, Audit and Information Research Center (MARc) of Maastricht University, aimed at examining a possible framework for extended audit reports.

Institute of Charted Accountants of Scotland (ICAS)

27. In December 2010, a working group of ICAS, comprising of investors, preparers, auditors and representatives from the media and the academic community issued a report, The Future of Assurance. \(^\text{109}\) This working group was established to consider some of the issues that had been raised in relation to the role of auditors in the aftermath of the financial crisis. The working group considered whether any additional reporting requirements should be the responsibility of the audit committee (TCWG) or the auditor. The working group recommended in their report expanded and more transparent audit committee (TCWG) reports, and also expanded reporting on additional matters by auditors. Those matters include: (i) an explicit opinion on whether the going concern assessment conducted by management is reasonable; (ii) an opinion based on whether the entity’s annual report is balanced and reasonable; and (iii) explicit reference in auditor’s reports to audit committee (TCWG) reports and disclosure of key areas discussed between the auditor and the audit committee (TCWG).

Other Developments

28. Other groups, including the International Accounting Standards Board (IASB) and the U.S. Financial Accounting Standards Board (FASB) have identified the need for greater guidance in the area of disclosures for example, in connection with the entity’s risk reporting and financial reporting. These groups have taken action to issue guidelines in this

\(^{106}\) http://www2.accaglobal.com/pdfs/international/singapore/RA.pdf

\(^{107}\) http://www2.accaglobal.com/pubs/general/activities/library/audit/audit_pubs/views_from_retail.pdf


regard targeted at assisting stakeholders improve the nature, timing and extent of their disclosures with particular consideration for the extant economic environment.

29. Also, the activities of the International Integrated Reporting Council (IIRC) are also relevant to the topic of auditor reporting as it explores innovative changes to reporting as a whole that seeks to better meet users’ needs, that builds on the foundations of financial, management commentary, corporate governance and sustainability. In its September 2011 discussion paper, Towards Integrated Reporting, Communicating Value in the 21st Century, the IIRC seeks public feedback on this new approach to reporting, specifically targeting investors’ and policymakers’ views on matters relevant to enhancing the communicative value of reporting.