Il Presidente

IAASB
International Auditing and Assurance Standards Board
529 Fifth Avenue, 6th Floor
New York, NY 10017
USA

8 October 2012

IAASB invitation to comment “Improving the Auditor’s Report”

Dear Sirs,

Assirevi is pleased to respond to the IAASB invitation to comment “Improving the Auditor’s Report”.

Assirevi is the association of Italian audit firms. Its member firms represent the majority of the audit firms registered with CONSOB (Commissione Nazionale per le Società e la Borsa) and are responsible for the audit of almost all of the companies listed on the Italian stock exchange. Assirevi promotes technical research in the field of auditing and accounting and publishes technical guidelines for its members. It collaborates with Governmental bodies, CONSOB, the Italian accounting profession and other bodies in the development of auditing and accounting standards.

Our detailed comments are set out in the attached document.

Should you wish to discuss our comments please do not hesitate to contact us.

Yours faithfully,

Mario Boella
Chairman of Assirevi
RESPONSE TO THE IAASB INVITATION TO COMMENT:
“Improving the Auditor’s Report”
(June 2012)

Responses to questions:

OVERALL CONSIDERATIONS

1. Overall, do you believe the IAASB’s suggested improvements sufficiently enhance the relevance and informational value of the auditor’s report, in view of possible impediments (including costs)? Why or why not?

2. Are there other alternatives to improve the auditor’s report, or auditor reporting more broadly, that should be further considered by the IAASB, either alone or in coordination with others? Please explain your answer.

Generally speaking, Assirevi is in favour of IAASB’s projects that improve the relevance and informational value of the auditor’s report. We believe that some of the suggested improvements will contribute to achieving the hoped-for objectives to reducing the information and expectation gaps, as defined in the Invitation to Comment: Improving the Auditor’s Report (“ITC”). We refer you to our replies to the subsequent questions for more detailed information about the changes we approve of to the auditor’s report or that we do not believe fully meet the above objectives.

We believe that any changes to the information in auditor’s reports should comply with the following overarching principles:

(i) the role of the auditor, as per its current definition, is to provide “assurance” about the information provided by directors and/or those charged with governance (“TCWG”) or to state that they have omitted significant data and information in their financial reporting. The auditor’s duties do not include the obligation to directly disclose data and information in addition to those presented by directors and/or TCWG. As a consequence, the auditor cannot be the primary source of information. Otherwise, this would undermine the segregation of roles and responsibilities among the directors and/or TCWG on the one hand, and the auditor, on the other;

(ii) measures to reduce the information gap can only be undertaken using a more comprehensive approach that involves the IAASB as well as all the affected parties (e.g., the Accounting Standard Setters such as the IASB, Regulators, management and/or TCWG and other interested parties) and considers the need to make changes to the disclosure requirements included in the reference frameworks for financial reporting rather than to information requirements of management and/or TCWG, for example, in the Directors’ report or the Management discussion and analysis (MD&A);

(iii) the expectation gap cannot be decreased or contained solely by providing greater information about the audit process in the auditor’s report. IAASB or the Regulators could evaluate initiatives such as education, training and informational publications to users of financial information aimed at increasing their knowledge about audits of financial statements.
AUDITOR COMMENTARY

3. Do you believe the concept of Auditor Commentary is an appropriate response to the call for auditors to provide more information to users through the auditor’s report? Why or why not?

The ITC states that users of financial information deem it to be important that the Auditor’s Report include more information to assist them with investment decisions. Specifically, paragraph 35 states that:

“…users have varying reasons for seeking additional information, and appear to have different views about what may have the most value:

- For example, some users have indicated that there would be considerable value in the auditor highlighting disclosures about the areas in the financial statements the auditor believes are most important. This would provide a “roadmap” to help users better navigate complex financial reports and focus them on matters likely to be important to their decision-making.

- Others believe that the “roadmap” would be more useful if the auditor were to provide additional context to the matters highlighted, such as explaining why the auditor considered the matter to be important from an audit perspective and briefly describing the auditor’s procedures and conclusions in those areas. This information has been cited as being particularly useful for areas involving significant judgments by management, which often are the subject of discussion with TCWG.

- Still others would like to understand more about how the audit was conducted, and key judgments made by the auditor in planning the audit, such as materiality, the use of experts, or the involvement of other auditors.”

We believe that use of the Auditor Commentary to emphasise information already disclosed in the financial statements by management does effectively contribute to meeting users’ informational requirements. However, the Auditor’s report is just one of the tools used to obtain this result, as explained in the replies to questions 1 and 2. Identification and indication of the most important financial statements areas are ultimately the responsibility of those in charge of financial reporting (management/TCWG). A “holistic” approach to the issue would entail the assessment by parties, such as the IASB or the Regulators, of the need to make changes to the disclosure requirements in the reference frameworks for financial reporting and/or to the information requirements to be met by management and/or TCWG, for example, in the Directors’ report or the MD&A. The parties in charge of financial reporting should be aware of the criteria to be used to identify and prepare such information about the most important financial statements areas.

That being said, based on the current ISA, the modality by which auditors emphasise information already disclosed in the financial statements is to include an emphasis of matter paragraph, currently regulated by ISA 706 which defines “Emphasis of Matter paragraph - A paragraph included in the auditor’s report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor’s judgement, is of such importance that it is fundamental to users’ understanding of the financial statements.”

So as to avoid issues of comparability of Auditor’s Reports, Assirevi believes that this auditing standard should be enriched with additional guidance to identify when this paragraph is to be used and what information should be provided in the different circumstances identified.

We do not agree that the Auditor Commentary should be used to provide information about the audit process as this approach does not assist a reduction in the expectation gap but, rather, may enlarge it, as it makes Auditor’s Reports less comparable and more incomprehensible.
Accordingly, Assirevi believes that:

- it is difficult, if not impossible, to appropriately summarise the audit procedures carried out to, for example, make estimates or assess significant risks in a way that is understandable for the users of the auditor’s report;
- it is unclear whether information about the audit procedures performed does improve the users’ understanding of the reliability of the information to which the procedures refer and the reliability of the financial statements as a whole;
- there is a risk that the users may understand a different level of assurance based on the information provided about the audit procedures to that intended by the auditor that expresses their opinion on the financial statements as a whole. This risk may mean that the user wrongly understands that the auditor has expressed a partial opinion on certain specific financial statements captions/disclosures or that certain information provided may undermine the opinion as a whole and, therefore, may detract value from the Auditor’s Report.

Finally, Assirevi holds that it is important to emphasise that preparation of an Auditor Commentary requires more work by the auditor in terms of the time incurred directly by the individuals carrying out the audit procedures and those that review the auditor’s reports, as part of the internal quality control procedures as well as the time incurred to discuss the commentary with management/TCWG. This aspect and the related costs should be considered against the effective benefits that the users of financial statements and the auditor’s report may reap.

4. Do you agree that the matters to be addressed in Auditor Commentary should be left to the judgment of the auditor, with guidance in the standards to inform the auditor’s judgment? Why or why not? If not, what do you believe should be done to further facilitate the auditor’s decision-making process in selecting the matters to include in Auditor Commentary?

Assirevi agrees that the matters to be addressed in the Auditor Commentary should be left to the judgment of the auditor. Nevertheless, as already noted in the reply to question 3 and solely with respect to the aspects already disclosed in the financial statements by directors/management pursuant to the reference framework, Assirevi believes that the current ISA 706 should be revised to provide specific guidance to auditors about what should be addressed in the Auditor Commentary and how it should be presented.

5. Do the illustrative examples of Auditor Commentary have the informational or decision-making value users seek? Why or why not? If not, what aspects are not valuable, or what is missing? Specifically, what are your views about including a description of audit procedures and related results in Auditor Commentary?

Assirevi agrees that the illustrative examples include information useful to users. However, as noted in the reply to question 3, Assirevi is not in favour of including information about the auditors’ assessment of risks, procedures performed, opinions and findings about the specific audit engagement in the Auditor Commentary.

With respect to the proposed examples for a possible improved auditor’s report, Assirevi has the following comments:

*Outstanding litigation*

We agree that the approach adopted is suitable. See also below.
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Goodwill
We agree that the approach adopted is suitable. Moreover, we note that this approach is more comprehensive than the previous one. Assirevi prefers this approach to that proposed for the Outstanding litigation, as it gives greater value to the information presented in the Auditor’s report. Assirevi reiterates the need to provide auditors with guidance about the issue, as noted in the reply to question 3, in order to ensure comparability of the auditor’s reports issued by different auditors in similar circumstances.

Valuation of Financial Instruments
Here the Auditor Commentary includes information about aspects presented in the audited financial statements relating to captions characterised by significant estimation uncertainty and about the related risk of material misstatement. However, it also includes information that relates to the auditors’ responses and findings of the audit procedures. Assirevi does not believe the latter information should be included in the Auditor Commentary for the reasons already set out in the reply to question 3.

Audit Strategy Relating to the Recording of Revenue, Accounts Receivable and Cash Receipts
It is unclear why information about the new IT system is useful for financial statements users and how it should be used to better understand the financial statements. Moreover, this example also includes information about the audit approach which is not useful to the user.

Involvement of Other Auditors
Please see our reply to question 13.

6. What are the implications for the financial reporting process of including Auditor Commentary in the auditor’s report, including implications for the roles of management and those charged with governance (TCWG), the timing of financial statements, and costs?

We believe that greater resort to the emphasis of matter paragraphs, as described in the reply to question 3, would necessarily entail greater dialogue between the auditors, management and TCWG about the most relevant information in the financial statements.

Generally speaking, we note that introduction of the Auditor Commentary would involve:
- greater time by the audit team spent in meetings with management and TCWG to present the reasons for its audit approach;
- additional quality control processes with additional time being incurred by the most senior members of the engagement team;
- a more iterative process to finalise the auditor’s report which may affect the timing of the release of the financial statements and auditor’s report, with the related impact on the audit cost.

7. Do you agree that providing Auditor Commentary for certain audits (e.g., audits of public interest entities (PIEs), and leaving its inclusion to the discretion of the auditor for other audits is appropriate? Why or why not? If not, what other criteria might be used for determining the audits for which Auditor Commentary should be provided?

In principle, Assirevi believes that any change aiming to reduce the information gap, such as, for example, providing the Auditor Commentary in the Auditor’s Report, considering however our comments to the previous questions, needs to be adopted only for listed entities, given the large number of stakeholders involved and the special need for reliable information, especially considering the objective of correct
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working of markets. Conversely, we believe the information gap has a relatively smaller relevance for non-listed entities, particularly SMEs, as the users of their information are usually less in number and can obtain such information through alternative channels, primarily through direct contact with the entity.

GOING CONCERN/OFFER INFORMATION

8. What are your views on the value and impediments of the suggested auditor statements related to going concern, which address the appropriateness of management’s use of the going concern assumption and whether material uncertainties have been identified? Do you believe these statements produce useful information and are appropriate? Why or why not?

We agree with the proposal in the ITC to include a specific subparagraph in the auditor’s report setting out the auditor’s conclusions about the appropriateness of management’s use of the going concern assumption to prepare the financial statements, as long as the reference accounting framework suitably regulates the going concern issue, indicating what is meant by the appropriate use of the going concern assumption and what information should be disclosed in the various circumstances in the financial statements. This is the case in financial statements prepared under IFRS, where management is already required to disclose the use or not of this assumption. Indeed, IAS 1.25 states that: “When preparing financial statements, management shall make an assessment of an entity’s ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or circumstances that may cast significant doubt upon the entity’s ability to continue as a going concern, the entity shall disclose those uncertainties…”

The current guidance in the accounting framework for financial statements prepared under Italian GAAP is very synthetic and does not provide for either specific definitions about the going concern assumption or what information should be disclosed in the various circumstances. Therefore, as disclosure requirements similar to those of the IFRS for management do not exist, a paragraph on management’s responsibilities about the use of the going concern assumption as proposed by the Illustration of a Possible Improved Auditor’s Report in the auditor’s report would not be appropriate. Similarly, the auditor’s formulation of a statement like that provided for in the subparagraph “Use of the going concern assumption” of the same Illustration of a possible improved auditor’s report would be improper.

At present and due to the reasons set out below, we are not in favour of including an additional subparagraph on “Material uncertainties related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern” where the auditor specifies that, based on his work, no significant uncertainties were identified that would cast doubt on the entity’s ability to continue as a going concern.

The auditor should not be the primary source of information. Therefore, they cannot disclose information in their report that has not already been presented in the financial statements. At present, neither the IFRS nor the EU/Italian financial reporting frameworks require management to specify that no material uncertainties have been identified that could cast doubt on the entity’s ability to continue as a going concern. Indeed, the IFRS solely require management to identify the possible existence of material uncertainty that could cast doubt on the entity’s ability to continue as a going concern.

Assirevi believes that the inclusion of the subject subparagraph in the auditor’s report would require amendment in the IFRS and EU/Italian regulations in order to provide that management states in the notes to the financial statements that the financial statements have been prepared on a going concern basis and
also specifically that there are no significant doubts that would cast doubt on the entity’s ability to continue as a going concern.

We recommend the following improvements to the auditor’s report:

- inclusion of a caveat on the non-suitability of the procedures performed to guarantee the entity’s ability to continue as a going concern;
- inclusion in the paragraph “Respective responsibilities of Management, [Appropriate Title for Those Charged with Governance] and the Auditor” of a definition of management’s responsibilities in respect of the going concern assumption; this definition would clearly have to be adapted to the local situations to provide for different legislative and regulatory requirements. Most of management’s responsibilities listed in the subparagraph “Management’s Responsibilities Relating to Going Concern” in Italy are not specifically covered by the applicable reporting framework. Therefore, it would not be currently possible to include this paragraph in an auditor’s report on financial statements prepared under Italian GAAP.

We agree with the proposal set out in paragraph 34 of the ITC about development of a more “holistic” approach to the going concern issue to resolve potential conflicts between auditing standards and reporting standards due to the fact that the current ISA 570 requires greater disclosures than those presently required by the IFRS and Italian GAAP. We recommend the IAAASB and IASB take steps to promote consistency between the requirements of auditing standards and those of reporting standards.

Finally, we note that paragraph 24 of the ITC also refers to the draft EU regulation about the legally-required audit of public-interest entities. Its content would seem to require more than the straightforward confirmation of the appropriateness of use of the going concern assumption when preparing financial statements, as it requires the auditor to issue a statement similar to a solvency report, which is not provided for by auditing standards.

9. What are your views on the value and impediments of including additional information in the auditor’s report about the auditor’s judgments and processes to support the auditor’s statement that no material uncertainties have been identified?

Assirevi is contrary to the inclusion of information in the auditor’s report about the audit procedures and judgements for the same reasons set out in the reply to question 3, when the auditor has stated that no material uncertainties have been identified upon completion of the audit even when there are events or circumstances that could cast doubt on the entity’s ability to continue as a going concern.

10. What are your views on the value and impediments of the suggested auditor statement in relation to other information?

We agree with the proposal to include a specific paragraph in the auditor’s report about the procedures performed on the other information included in the financial report comprising the audited financial statements in order to reduce the expectation gap, as these procedures are already performed for audits carried out pursuant to the ISA.

We agree with the other recommendations of the ITC, as long as:

- this procedure is performed in compliance with IAS 720, i.e., by reading other information;
- the paragraph only contains references to material inconsistencies with the financial statements, excluding material misstatements of facts;
the auditor’s reports include a caveat specifying that the other information has not been audited and that, therefore, the auditor does not express an opinion thereon.

However, we believe it would not be appropriate to include a sort of negative assurance in the paragraph, as provided for in the Illustration of a possible improved auditor’s report and that the paragraph should solely describe the work performed and any inconsistencies identified. Accordingly, the paragraph should be formulated as follows:

“As part of our audit, we have read [clearly identify the specific other information read, e.g., the Chairman’s Statement, the Business Review, etc.] contained in [specify the document containing the other information, e.g., the annual report], for the purpose of identifying whether there are material inconsistencies with the audited financial statements. However, we have not audited this information and accordingly do not express an opinion on it.”

We believe that the proposed changes to the auditors’ statements on other information with respect to the paragraph in the ITC would allow to avoid unintentionally misunderstanding by the users about the auditor’s conclusions on the other information. Additionally the proposed reformulation would allow to better differentiate the statement on other information and the specific opinion which the auditor expresses on the consistency of the Directors’ report with the financial statements pursuant to EU regulations adopted in Italy. This opinion also covers certain parts of the corporate governance and ownership structure report for listed entities.

CLARIFICATIONS AND TRANSPARENCY

11. Do you believe the enhanced descriptions of the responsibilities of management, TCWG, and the auditor in the illustrative auditor’s report are helpful to users’ understanding of the nature and scope of an audit? Why or why not? Do you have suggestions for other improvements to the description of the auditor’s responsibilities?

Assirevi approves initiatives aimed at improving users’ understanding of the responsibilities of management, TCWG and the auditors and the nature and scope of an audit. However, we agree with the IAASB that attempts to describe these responsibilities of management and TCWG in an auditor’s report capable of global application is difficult; as responsibilities vary significantly among jurisdictions; accordingly we expect that a localisation by National Standard Setters would be necessary.

Enhancement of the paragraph in the Illustration of a possible improved auditor’s report about the auditor’s responsibilities and the nature and scope of audits would assist a reduction in the expectation gap but should not be considered the sole remedy. For this purpose, initiatives such as education, training and informational publications to users of financial information might be more useful.

12. What are your views on the value and impediments of disclosing the name of the engagement partner?

Indication of the engagement partner’s name at the foot of the audit report is consistent with Italian legislation about auditors’ responsibilities. However, this disclosure is not fundamental as the engagement partner’s responsibilities are defined by the reference legislation and the ISA, which are not affected by disclosure or non-disclosure.
13. What are your views on the value and impediments of the suggested disclosure regarding the involvement of other auditors? Do you believe that such a disclosure should be included in all relevant circumstances, or left to the auditor’s judgment as part of Auditor Commentary?

Assirevi understands that some users may be interested in obtaining information on involvement of other auditors as this provides a better understanding about how the audit in a large group is performed and how other auditors are involved.

However, if the objective of the disclosure in the Auditor Commentary of the Illustration of a possible improved auditor’s report is to reduce the expectation gap, Assirevi does not understand how its formulation, including, for example, quantitative information about the hours incurred, is of use to the financial statements user. Furthermore, the suggested disclosure regarding the involvement of other auditors does not comply with the current ISA 600.11 which states that “...the auditor’s report on the group financial statements shall not refer to a component auditor, unless required by law or regulation to include such reference. If such reference is required by law or regulation, the auditor’s report shall indicate that the reference does not diminish the group engagement partner’s or the group engagement partner’s firm’s responsibility for the group audit opinion”.

In any case, Assirevi does not agree with the inclusion, in the Auditor Commentary, of a paragraph about the involvement of other auditors as the Commentary should only refer to specific aspects already presented in the financial statements, as noted earlier.

14. What are your views on explicitly allowing the standardized material describing the auditor’s responsibilities to be relocated to a website of the appropriate authority, or to an appendix to the auditor’s report?

We believe that the standardised material describing the auditor’s responsibilities should be maintained in the auditor’s report. Indeed, we believe that the proposal to relocate such material to a website of the appropriate authority or to an appendix to the auditor’s report would definitely result in an undesired expansion of the expectation gap.

FORM AND STRUCTURE

15. What are your views on whether the IAASB’s suggested structure of the illustrative report, including placement of the auditor’s opinion and the Auditor Commentary section towards the beginning of the report, gives appropriate emphasis to matters of most importance to users?

Italian legislation about statutory audits (Legislative decree no. 39/2010) does not set particular constraints as it requires a minimum of content but does not impose a specific presentation order.

The prominence given to the auditor’s opinion paragraph, presented at the start of the auditor’s report in the Illustration of a possible improved auditor’s report, is undoubtedly due to its importance. Therefore, the proposed structure is reasonable and acceptable, without prejudice to our comments on the content of certain paragraphs set out elsewhere in this document.

16. What are your views regarding the need for global consistency in auditors’ reports when ISAs, or national auditing standards that incorporate or are otherwise based on ISAs, are used?

17. What are your views as to whether the IAASB should mandate the ordering of items in a manner similar to that shown in the illustrative report, unless law or regulation require
otherwise? Would this provide sufficient flexibility to accommodate national reporting requirements or practices?

We believe that global consistency is of fundamental importance, especially with respect to the auditor’s report as it is the “external” evidence of the audit. The use of a auditor’s report model which is similar from country to country improves the comparability of financial statements of entities active internationally as it allows the easy identification of important issues, independently of whether the ISAs are used or other auditing standards that are consistent with the ISAs.

We agree that the existence of different national regulations that may be difficult to change in the short term could hinder use of a standard auditor’s report. ITC’s proposed approach is a reasonable compromise: the mandatory ordering of items and the minimum content of the elements set out in appendix 4 would allow sufficient flexibility to comply with national requirements.

18. In your view, are the IAASB’s suggested improvements appropriate for entities of all sizes and in both the public and private sectors? What considerations specific to audits of small and medium-sized entities (SMEs) and public sector entities should the IAASB further take into account in approaching its standard-setting proposals?

In principle, Assirevi believes that any changes aiming to reduce the information gap with reference to the content of the auditor’s report can be adopted only for listed entities, given the large number of stakeholders involved and the special need for reliable information, especially considering the objective of correct functioning of markets.

Conversely, we believe the information gap has a relatively smaller relevance for non-listed entities, particularly SMEs, as the users of their information are usually less in number and can obtain such information through alternative channels, such as direct contacts with the entity and its management and TCWG.

As a consequence of the above, we believe that the Auditor Commentary should be included in the auditor’s report only for listed entities while the other changes outlined in the ITC are relevant to all entities, subject in any case to comments and improvements suggested in this letter.

Milan, 8 October 2012