Re: IAASB Invitation to Comment: Improving the Auditor’s Report

Referent:
Gerhard Prachner

Dear Mr. Gunn,

KWT\(^1\) is pleased to provide you with its comments on the IAASB Invitation to Comment on Improving the Auditor’s Report.

With the unfolding of the financial crisis, the audit profession is prepared to reassess its role and how it can enhance its contribution to the economy and to society. KWT fully supports initiatives that will lead to more user friendly, relevant and informative auditors’ communication.

In this respect, we welcome this IAASB project as KWT believes that global solutions for auditor’s reports are preferable and will benefit investors and other users. Furthermore, any such global solutions should be scalable to provide for the differing information needs of the users between different market segments. Transparency and comparability would suffer from regional or segmental divergences given the globalisation of markets and of the users of financial statements.

In the broader context of the European debate on audit policy, it has become even more urgent to review at an international level whether improvements can be made as to how auditors should best communicate with their stakeholders. KWT would encourage the IAASB to work promptly with the European Institutions in order to ensure that any proposed improvements are aligned on an

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international level: we seek a compatible solution between the European Commission's (EC) Proposals and ISA 700 improvements. Otherwise, we might end up with two different auditor's report, which would be very unfortunate.

Our main comments are summarized below:

1. The project of improving the auditor's report should be dealt together with a project on auditor's reporting as a whole. The auditor's reporting consists of reporting to the public in the auditor's report (ISA 700) and also of reporting to those charged with governance of the company (ISA 260). Therefore, due consideration should be given to how this reporting has to be inter-related. This IAASB invitation to comment focuses almost solely on public auditor's reporting, but KWT strongly believes that more can be done in the area of auditor's reporting internally to those charged with governance as well.

2. It is strategically important for the future of the audit profession to respond to stakeholder's need to provide information on the appropriateness of management's use of the going concern assumption. However, the key principle is that it is the responsibility of management and those charged with governance of an entity to provide the required information. The auditor's report paragraph on going concern should be based on the information provided by the audited entity itself. Having this principle in mind, KWT believes that there is an urgent need to think about expanding the financial reporting standards related to going concern reporting by management in order to meet, at least partly, the market needs. Therefore, we encourage the IAASB to initiate discussions with the International Accounting Standards Board (IASB) in order to coordinate such financial reporting enhancements.

3. Regarding the auditor's statement on other information, KWT believes that the requirements included in ISA 720 could be further extended to make the auditor's report more informative, comprehensive and exhaustive. Therefore, we propose that auditors should also report on the consistency of other information with the financial statements based on his or her knowledge and understanding of the entity and its environment.

4. KWT fully supports standardisation of the order in the auditor's report globally for which we recommend the IAASB to propose a principles-based structure. This would help the users navigate through the auditor's report as well as it will further enhance comparability.
For further information on this KWT letter, please contact us.

Yours sincerely,

Mag. Gerhard Marterbauer e.h.
(Vorsitzender des Fachsenats für Unternehmensrecht und Revision)

Dr. Gerald Klement
(Kammerdirektor)
Appendix: Responses to Questions

Overall Considerations

Question 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?

KWT overall agrees with the project of the IAASB to enhance the relevance and informative value of auditor’s reporting. KWT fully supports initiatives that will lead to having an auditor’s report that is more user friendly, easier to understand and more informative.

The recent debate and development in the European Union have highlighted that there is a need to provide the public with more information about what an audit is and what the output of an audit is. It is the role of the profession to respond to the concerns expressed. It is also an important role of today’s profession to provide comfort on the reliability of financial reporting: the auditor’s report accompanies the entity’s financial statements and the additional auditor reporting will help to add more credibility to those financial statements and to generate confidence in the audit.

But, the IAASB should be careful not to:

- Attribute management responsibilities to the auditor: Management has primary responsibility for providing relevant information in the financial statements. The auditor has a responsibility to audit those financial statements. It is the responsibility of management to disclose all required information in the financial statements, and this should not be blurred by any requirement for the auditor to take over such responsibility. All disclosures that relate to business model, business risks, choices for options for accounting policies, sensitivity analyses etc. should therefore be disclosed by the entity itself.

- Issues encountered with the current financial reporting framework should not be transferred to the auditor. In relation to some specific topics, financial reporting has become difficult to understand for users over the last few years. Nevertheless, it should not be the role of the auditor to navigate the users through the financial statements and provide a short form of the notes in the opinion.

The general support that KWT gives to the IAASB Invitation to Comment is subject to our comments below.

Question 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.

As explained in Question 1, the proposals on auditor’s communication should be supported to make it more practicable and useful and thus KWT is in favour of the initiatives of the IAASB. However, KWT believes that the IAASB should also consider the following in further detail:
- There is an interaction between external and internal auditor reporting. Auditor’s reporting consists of:
  o Reporting to the public in the public external auditor’s report (ISA 700); and
  o Communication and/or reporting to those charged with governance of the company in an internal capacity (ISA 260).
In this Invitation to Comment, the IAASB focuses almost solely on the public reporting, but equal attention is needed to show how this impacts with the private auditor’s reporting to those charged with governance, including the audit committee. KWT strongly believes that there is room for improvements in this area. Due consideration should be given to Article 23 of the EC Proposed Regulation. Indeed, this Article asks for improved requirements in the reporting to the audit committee and KWT strongly believes that this is the way forward.

- KWT therefore believes that a comprehensive evaluation of the whole financial reporting system may be needed. The IAASB could be very instrumental in initiating such discussions, especially with the International Accounting Standards Board (IASB).

- The IAASB should also be careful not to attribute management responsibilities to the auditor. Management has primary responsibility for providing relevant information in the financial statements. The auditor has a responsibility to audit those financial statements, that means to provide assurance on financial information. It is the responsibility of management to disclose all required information in the financial statements, and this should not be blurred by any requirement for the auditor to take over such responsibility. All disclosures that relate to business model, business risks, choices for options for accounting policies, sensitivity analyses etc. should therefore be disclosed by the audited entity itself.

- Last but not least, the final revised ISA 700, which will eventually result from this IAASB Invitation to Comment, might come too late to influence the final outcome of the EC Proposals on the auditor’s report. KWT would encourage the IAASB to work with the EC to see whether this concern can be dealt with. Otherwise, we might end up with two different auditor’s report, which would be very unfortunate.

**Auditor Commentary**

**Question 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? (See paragraphs 35–64).

KWT believes that the current regulation in ISA 700 is sufficient and additional disclosure in the auditor’s report does not add any value. If necessary, information on the audit approach, more specifically audit risks, should be included in the auditor’s reporting to those charged with governance, but not in the auditor’s report. KWT is supportive of better explaining what an auditor does, while in the same time making it easier to find audit and entity-specific information by restricting the audit report and introducing an new report to those charged with governance.
KWT is concerned about including matters that are important to the users' understanding of the audited financial statements for the following reasons:

- The auditor's report should focus on significant areas of audit work or key areas of audit focus, not on accounting or financial reporting matters. This is also linked to the principle that the auditor should not report on matters that are the responsibility of management. We refer to our response to Question 1 and 2 in this respect;
- The auditor's report is not meant to navigate the user through the financial statements;
- Some of these matters should only be reported internally to those charged with governance, not publicly. We refer to our comments on the IAASB examples of Auditor Commentary to demonstrate the issues linked with reporting this in the public auditor's report;
- To clarify our views on matters which should be reported on or not, KWT also believes that the use of Emphasis of Matter (EOM) paragraph as stipulated in ISA 706 should continue and not be replaced by Auditor Commentary. Further reference is made to this in our response to Question 5.

Question 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? (See paragraphs 43–50.)

The use of professional judgement to determine what should be included in the “Auditor Commentary” section is too high level and evasive: in fact, the criteria to make such determination are too vague. This could result in significant variations and thus consistency will be lost.

As mentioned in our answer to Question 3 the “Auditor Commentary” should not be part of the auditor’s report rather be included in a report to those charged with governance.

There is also a need for principles-based criteria on what should be reported. We refer to our response to Question 5 for guidelines.

Question 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? (See paragraphs 58–61.)

As explained in our response to Question 4, KWT believes that there is a need to give principles based criteria explaining how information shall be provided in the auditor's report.

Audit work based on ISAs already addresses potential fraud risks. Such risks exist in all entities and can never be removed completely but can be mitigated by performing audit procedures that respond to the fraud risks identified. Although fraud risks are always significant risks from an ISA audit perspective, the fraud risks in a particular entity might turn out to be low.
As previously explained, KWT believes that the use of an Emphasis of Matter (EOM) paragraph should continue to be used as included in ISA 706. According to ISA 706, "the Emphasis of Matter paragraph is 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 judgment, is of such importance that it is fundamental to users’ understanding of the financial statements."

Having these developments in mind, KWT has the following comments on the Auditor Commentary examples provided:

- **Introduction paragraph**
We would recommend to delete the part of the sentence “likely to be most important to users’ understanding of the audited financial statements” and only refer to the audit. Indeed, as explained above, KWT believes that the auditor report relates first and foremost to the audit and should not be a means to navigate users through the financial statements, which we consider to be the responsibility of management of the audited company.

- **1st example: Outstanding Litigation**
According to our analysis, the explanation in this paragraph does not provide any insights into the audit procedures and work performed. We are therefore not convinced that such example should be included for consideration in an auditor’s report nor of the value this example would have for users, apart from duplicating what is already included in the financial statements.

- **2nd example: Goodwill**
As explained above, we are not supportive of reproducing substantial parts of the information already included in the financial statements in the auditor’s report. We believe that the auditor’s report should relate to the audit performed. Therefore, we are not supportive of including such examples in the auditor’s report.

- **3rd example: Valuation of Financial Instruments**
In response to the market needs and expectations of stakeholders for the auditor’s report, this example seems more appropriate.

- **4th example: Audit Strategy Relating to the Recording of Revenue, Accounts Receivable, and Cash Receipts**
If identified as such, this paragraph would be expected to be covered as a significant audit risk, in the separate report to those charged with governance.

- **5th example: Involvement of Other Auditors**
KWT is not supportive of this example as, in Austria, divided responsibility and referring to other auditors in the auditor’s report is not allowed as there is only sole responsibility for auditors.
Question 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? (See paragraphs 38 and 62–64.)

The new requirements are expected to result in a cost increase for the additional time needed and potential delays in finalizing the auditor’s report with regard to the following areas:

- Drafting the additional information to be included in the auditor’s report;
- Discussing these matters internally within the audit firm, including with the engagement quality control reviewer as required by International Standard on Quality Control (ISQC) 1; and
- Discussions with management.

Management would also spend additional time reviewing and discussing it with the auditor.

Question 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? (See paragraphs 51–56.)

As already stated in our response to question 3 KWT believes that the current regulation in ISA 570 and ISA 700 is sufficient and additional disclosure could lead to boilerplate language in the auditor’s report.

**Going Concern/Other Information**

Question 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 provide useful information and are appropriate? Why or why not? (See paragraphs 24–34.)

KWT supports improved auditor communication in line with market needs. Additional information in the auditor’s report regarding the appropriateness of management’s use of the going concern assumption seems strategically important to respond, at least in part, to issues arising from the financial and economic crisis.

Work linked to “going concern” is already performed during the audit assignment as, according to ISA 570, the auditor has to obtain sufficient appropriate audit evidence regarding the appropriateness of management’s use of the going concern assumption in the preparation of the financial statements and to conclude, in this matter, whether a material uncertainty exists as identified during the audit.

KWT emphasizes the fact that the auditor’s report should not be by itself an opinion on the going concern of the audited entity, but should be taken as a whole with the analysis performed by the entity’s management in the financial statements.
KWT believes that the current regulation in ISA 570 and ISA 700 is sufficient and additional disclosure could lead to boilerplate language in the auditor's report.

**Question 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? (See paragraphs 30–31.)

As already explained in our response to Question 1, auditors should not provide information that management should ordinarily be required to provide. Current accounting and financial reporting standards are not explicit in relation to requiring companies to disclose matters in relation to going concern issues and related material uncertainties.

Therefore, management will often be reluctant to disclose material uncertainties, by lack of a requirement in law, regulation or standards to do so. This would result in the need for auditors to put pressure on management in order to have them disclose more information in relation to material uncertainties in the financial statements.

Therefore, it might be preferable that material uncertainties should only be reported on in case of going concern issues, both by management in the financial statement and by the auditor in the auditor's report.

KWT also refers to ISA 706 which provides for possibilities to additional language in the auditor's report.

**Question 10** What are your views on the value and impediments of the suggested auditor statement in relation to other information? (See paragraphs 65–71.)

According to ISA 720, the auditor should read the other information to identify, if any, material inconsistencies with the audited financial statements. KWT believes that the requirements included in ISA 720 could be further extended, as explained below.

In order to make the auditor's report more informative, comprehensive and exhaustive, KWT agrees to add a paragraph explaining the work performed on other information, primarily consisting of the management report.

The auditor should report on the consistency of the management report with the financial statement for the same financial year and whether the management report has been prepared in accordance with the applicable legal requirements. In addition, the auditor should also state that, based on his knowledge and understanding of the entity and its environment obtained during the course of the audit, the management report as a whole suitably presents the company's position, the opportunities and principal risks and uncertainties of its likely future developments.

This would ensure that auditors:

- Not only perform a consistency check between the management report and the financial statements; but
Also state whether the management report as a whole is suitable in the context of the auditor’s knowledge and understanding of the company’s business obtained during such audit.

The consistency audit is required under Austrian law and auditors report on that in the "Other Reporting Responsibilities" section of the auditor’s support.

Clarifications and Transparency

Question 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? (See paragraphs 81–86.)

The paragraph on responsibilities of each party could be shortened: this would guard the profession against the criticism of the auditor’s report being too defensive and using boilerplate language. Additionally, we are not convinced that adding enhanced descriptions of the responsibilities of management, TCWG and the auditor would be able to address the expectation gap.

As a result, only the basic information that management is responsible for the financial statements, the related internal controls and the disclosures related to the going concern assumption would need mandating.

KWT is not supportive of expanding their description beyond what is currently required to be included in the auditor’s report.

Question 12 What are your views on the value and impediments of disclosing the name of the engagement partner? (See paragraphs 72–73.)

KWT has not identified any impediments against disclosing the name of the engagement partner in the auditor’s report. This is already required by Austrian law.

Question 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? (See paragraphs 77–80.)

As mandated by Article 27 (a) of the European Commission Statutory Audit Directive (2006/43/EC), in case of a statutory audit of the consolidated accounts of a group of undertakings, the group auditor bears the full responsibility for the auditor’s report in the relation with the consolidated accounts thus such a disclosure should not be included.
Question 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? (See paragraphs 83–84.)

Audit firms should have the option to decide how to communicate information related to such responsibilities.

Form and structure

Question 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? (See paragraphs 17–20.)

KWT is supportive of giving the opinion more prominence by placing it at the beginning of the report.

Question 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? (See paragraphs 21–23 and 87–90.)

KWT would recommend the IAASB to propose a principles-based structure (including the order and placement of the different section in the auditor’s report) for the auditor’s report which should be possible to be applied in virtually all circumstances. An ISA compliant auditor’s report is requested by the profession. It will avoid difference in interpretation across industries and jurisdictions.

Question 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? (See paragraph 17 and Appendix 4.)

In line with our response to Question 16 on having a similar structure for all auditor’s reports, KWT fully supports standardization of the order in the auditor’s report at a global level. We believe this would help to navigate users through the auditor’s report as well as helping to provide a comparison between auditor’s reports.

Question 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? (See paragraphs 91–95.)

As already exposed beforehand, KWT’s view on the appropriateness of the application of the auditor’s reporting improvements are the following:

- Other minor improvements (especially on the form of the report) as proposed in the IAASB Invitation to Comment should be applicable for all entities;
- The Emphasis of Matter paragraph should remain an option as prescribed in ISA 706;
- If an emphasis of matter is considered needed in the auditor's report, it should be reported, it should not be reported twice. Guidance may be needed in this respect.