8 October 2012

Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th floor
New York, New York 10017
USA

Via website: www.iaasb.org

Dear Sir/ Madam,

Consultation Paper – Improving the Auditor’s Report

Thank you for providing us with the opportunity to provide comment on the Consultation Paper: Improving the Auditor’s Report (Consultation Paper) issued in June 2012. We understand the International Auditing and Assurance Standards Board (IAASB) has encouraged a variety of stakeholders to comment on this Consultation Paper.

The Australian Institute of Company Directors (Company Directors) is the second largest member-based director association worldwide, with over 32,000 individual members from a wide range of corporations; publicly-listed companies, private companies, not-for-profit organisations, charities and government and semi-government bodies. As the principal Australian professional body representing a diverse membership of directors, we offer world class education services and provide a broad-based director perspective to current director issues in the policy debate.

The board of directors is responsible for approving an entity’s financial report as well as oversight of the audit process, Company Directors is committed to ensuring that auditor reporting continues to be of a high standard and that the audit regulation framework in Australia and internationally strikes the appropriate balance between business efficiency and regulatory compliance.

1) Summary

In summary the Australian Institute of Company Directors comments are as follows:

a) the Auditor Commentary seems to take away from the company control of the public messaging around its accounts – this effectively re-defines the roles and responsibilities of auditors, management and directors. Such redefinition may not be consistent with other legal and regulatory definitions of duties and obligations;

b) we are concerned that the inclusion of the Auditor Commentary in the auditor’s report would not provide any information additional to what should be included in the financial statements;

c) we believe the Auditor Commentary may be subject to misuse and misunderstanding by commentators, including politicians, competitors, analysts and media;

d) the inclusion of an Auditor Commentary may change the scope of the audit and increase the liability of the auditor in relation to the disclosures made;
e) we are concerned that the Auditor Commentary is being used as a mechanism to “manage” complexity in financial reporting;

f) auditors will need to build new skill sets, for example the ability to defend their commentary publicly with media, analysts and at shareholder meetings; and

g) give auditors responsibilities and powers they may not be able to discharge properly, at a very high liability.

Below are our responses to the questions posed in the Consultation Paper.

2) Overall considerations

*Overall, do you believe that 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?*

No, Company Directors is concerned the changes proposed in the Consultation Paper to auditor’s report are being used a mechanism to manage the issue of increasing complexity in financial reporting. These suggested improvements would cause the auditor’s report to be used as a “roadmap” to highlight those issues in the financial statements and accompanying notes in the judgement of the auditor are fundamental to the users understanding of the financial statements.

The financial statements are the responsibility of the entity and approval of the financial statements is the responsibility of the board of directors. Company Directors is concerned that the IAASB’s suggested improvements may change the scope of the audit and introduce a series of new discussions between the entity and the auditors. This potentially increases the risk of the auditor’s liability should something be omitted from the audit report, and it is later determined that the information omitted was significant. The auditor would potentially be liable for losses suffered by the person/ persons who relied upon the audit opinion. Company Directors is concerned that this will give rise to inefficiencies and probably disruption as auditors and entities strive to reach agreement about the issues on which commentary is warranted.

ISA 706, *Emphasis of Matter* (ISA 706) provides the framework for an auditor to use when they have identified issues in the course of the audit which they wish to bring to the attention of users of the financial statements, but they do not believe that it is necessary to provide a qualified opinion or disclaimer. Paragraph 4 of ISA 706 states “The objective of the auditor, having formed an opinion on the financial statements, is to draw users’ attention, when in the auditor’s judgement it is necessary to do so, by way of clear additional communication in the auditor’s report to:

(a) A matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users’ understanding of the financial statements; or

(b) As appropriate, any other matter that is relevant to users’ understanding of the audit, the auditor’s responsibilities or the auditor’s report.”

We question whether current ISA 706 Emphasis of Matter paragraph is the appropriate mechanism for an auditor to communicate such information that they believe is fundamental to the users understanding of the financial statements and which the Consultation Paper proposes to include in the Auditor Commentary.

The Emphasis of Matter paragraph within the audit report has been mostly used to highlight issues surrounding going concern. The IAASB should encourage auditors to extend the use of this paragraph to highlight broader issues that are fundamental to the user’s understanding of the financial statements.
The objective of an audit is stated in ISA 200, *Overall objectives of the independent auditor in the conduct of an audit in accordance with international standards on audit*, which states in paragraph 11, that “In conducting an audit of financial statements, the overall objectives of the auditor are:

(a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and

(b) To report on the financial statements, and communicate as required by the ISAs, in accordance with the auditor’s findings.”

Should the changes to the audit report as highlighted in the Consultation Paper be accepted this objective of the audit may need to be amended.

*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.*

The expectation gap and information gap that has been highlighted in the Consultation Paper has existed for decades. Increasing the length or information contained in the audit report will not materially narrow these gaps. The education of users of financial reports as to the role and responsibilities of the auditor and the inherent limitations of the audit process will over time have a much better chance of narrowing the expectation and information gaps in more meaningful ways.

Over time the audit report was amended to include statements that identified the responsibilities of the directors and those of the auditors in the preparation and review of the financial information.

Company Directors do not believe that making changes to the content or structure of the audit report will have a significant impact on both the expectation gap and information gap; any changes to the audit report structure should be the result of stringent analysis in a wholistic manner and individual add-ons should only be made if they demonstratively result in enhancing the value of the audit report.

3) Auditor Commentary

*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?*

Company Directors do not believe that the Auditor Commentary, as set out in the illustrative audit report in the Consultation Paper, is providing any further information that should not already be in the financial statements. We are concerned that the introduction of an Auditor Commentary will result in increased costs and time commitment in the performance of an audit.

The Auditor Commentary will also result in the auditor having to discuss and agree with the entity as to what information should be included in the commentary. Auditors are not equipped to make business judgements in respect of the entity.

The Consultation Paper in paragraph 48 states that “the IAASB believes Auditor Commentary should be tailored to the facts and circumstances of the entity to avoid being boilerplate”. However, these disclosures will over time tend towards boilerplate.
The use of “boilerplate” may become a mechanism to manage the increased risk faced by the auditor and the audit firm as a whole. An unintended consequence of introducing the Auditor Commentary may be an extension to the scope of the audit. The financial statements are the responsibility of the entity, the responsibility of the auditor is to obtain sufficient appropriate audit evidence to support the audit opinion on these statements. Any requirements beyond this may be an extension of the auditor’s responsibility.

The proposed Auditor Commentary undermines the entity’s ability to manage the message around their financial statements as it blurs the responsibilities of the directors and auditors with respect to the financial statements.

Currently in Australia, the auditors of listed entities have an obligation under the Corporations Act, 2001\(^1\) to appear and answer questions of the shareholders at the entity’s Annual General Meeting (AGM). Shareholders may make inquiries of the auditor at the AGM about the content of the auditor’s report and/or the conduct of the audit of the financial report\(^2\).

The examples in the illustrative audit report in the Consultation Paper deal with matters that are the entity’s responsibility and the commentary is effectively repeating the comments of the entity or at worst conflicting or probably making them more ambiguous.

We need to address the issue of complexity in financial reporting at its source, namely the accounting standards. Company Directors encourages the IAASB to highlight these issues with the International Accounting Standards Board.

It may be more valuable and useful to a user of financial statements to include within the Auditor Commentary disclosures concerning the work performed by the auditor in coming to their audit opinion.

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

The audit report is the primary communication tool of the auditors and they should be able to determine what to include. However, the introduction of the Auditor Commentary section may change that. In future, the entity and the auditor would be required to reach agreement about inclusions in the commentary. The Consultation Paper states in paragraph 30 “The overarching objective of such a new Auditor Commentary section in the auditor’s report is to provide transparency about matters that are in the auditor’s judgement, likely to be most important to user’s understanding of the audited financial statements or the audit”. We query whether this is not already available to the auditor in the current ISA 706.

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1 Section 250RA Auditor required to attend listed company’s AGM
2 Section 250PA Written questions to auditor submitted by members of listed company before AGM
**Do the illustrative examples of the auditor commentary have 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?**

Company Directors believe some of the information included in the Auditor Commentary is a repetition of information already found in the financial statements. We doubt whether the inclusion of such disclosures in the auditor's report would provide any further information or significantly improve the decision-making ability of the users.

We believe the audit report should focus on the work of the auditor, and where information is fundamental to a user's understanding of the financial statements that should then be disclosed.

**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?**

Company Directors is concerned that the introduction of the Auditor Commentary is likely to increase both the costs and time needed to finalise the audit. These costs and timing constraints would need to be absorbed by either the entity or the external auditor.

We also need to consider the costs associated with the auditor agreeing the form and content of the Auditor Commentary with the entity and the benefit to the user of this information. Particularly, if this information is already included elsewhere in the financial statements, are we really achieving the objective of providing transparent disclosures to improve the decision making capability of the users?

We are further concerned that the inclusion of the Auditor Commentary would result in additional discussions between the entity and the external auditors as to what information the external auditors should include therein.

One of the arguments provided in the Consultation Paper is that the Auditor Commentary would include information specific to the entity and would thus not result in “boilerplate” disclosure. However, we do not necessarily believe that this will hold true, as there may be a tendency over time for these disclosures to become “boilerplate” as a means to protect the auditor from potential additional liability.

**Do you agree that providing Auditor Commentary for certain audits (e.g. audits of public interest entities (PIEs)), and leaving its inclusion in 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 Audit Commentary should be provided?**

Given the likely costs and timing implications, Company Directors believe that should the Auditor Commentary be included in the audit report, that it should be focussed on listed Public Interest Entities. Should other entities wish to voluntarily include an Auditor Commentary they should be able to do so.
4) Going concern/ Other information

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?

The going concern assertion is fundamental to the preparation of the financial statements and the work of the external auditor. We need to carefully consider whether the inclusion of a standard clause in the auditor report may have the unintended consequence of desensitising users to the importance of the assessment of going concern. This may result in users not appropriately identifying when going concern is an issue and skimming over the auditors assessment thereof in the audit report.

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

We are particularly concerned about the following statement included in the illustrative audit report, “Because not all future events or conditions can be predicted, this statement is not a guarantee as to the Company’s ability to continue as a going concern.” Company Directors believe the inclusion of such an explicit statement in the auditor’s report will add confusion about the role and responsibilities of the auditor and the line between directors / management and auditors, for little purpose.

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

We believe that it may be appropriate for the inclusion of a clause dealing with the auditor’s responsibility to review the broader annual report and ensure that the financial information disclosed therein and ensure that there are no material inconsistencies, as required by ISA 720, The Auditor’s Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements.

5) Clarifications and Transparency

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?

Company Directors believe the inclusion of this information may be helpful to users in understanding the roles and responsibilities of management, those charged with governance and the external auditor.

This information should be written in “plain” English to allow users to easily understand the varying roles of those involved the preparation, review, audit and approval of financial statements.
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 be included in the all relevant circumstances, or left to the auditor’s judgement as part of Auditor Commentary?

Company Directors does not believe that this disclosure is relevant. The auditor of the group is required to apply ISA 600, Special Considerations – Audits of Group Financial Statements (including the work of component auditors)(IAS 600). They need to satisfy themselves that they have gathered sufficient appropriate audit evidence to express an opinion on whether the group’s financial statements are prepared in all material respects in accordance with the relevant financial reporting framework. The group auditor is required to have audit procedures in place to satisfy themselves that they are able to rely on the work of other auditors that may have been engaged to perform the audit of underlying entities operations within a group structure. Paragraph 43 of the ISA 600 states “if the group engagement team concludes that the work of the component auditor is insufficient, the group engagement team shall determine what additional procedures are to be performed, and whether they are to be performed by the component auditor or by the group engagement team.” The result of this disclosure would also increase the red tape and cost for little benefit.

We question whether providing this information may unnecessarily highlight the work of the other auditor and result in users misinterpreting the component auditors role and the degree of responsibility assumed.

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 an appendix to the auditor’s report?

It may be appropriate to reference the role and responsibilities of the auditor to an external website. Ideally, this information should be on the website of the relevant regulator or standard setter in each jurisdiction. There may over time be a tendency that users would not routinely refer to this external information and may not be adequately informed when changes are made.

This information should be written in “plain” English and may be included in a comprehensive authoritative guide that details the responsibilities of all involved in the preparation, review, audit and approval of financial statements.

6) Form and structure

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

Company Directors do not have a particular preference with respect to the placement of the auditor’s opinion and the proposed Auditor Commentary section.

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

International Standards on Auditing (ISA) are already in law in Australia. We believe that all jurisdictions should follow ISAs to avoid inconsistencies in the understanding of the audit.
What are your views as to whether the IAASB should mandate the ordering of items in a manner similar to the shown in the illustrative report, unless law or regulation require otherwise? Would this provide sufficient flexibility to accommodate national reporting requirements or practices?

Company Directors do not have a view on the IAASB mandating the ordering of items in the audit report.

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, medium-sized entities (SME’s) and public sector entities should the IAASB further take into account in approaching its standard-setting proposals?

The IAASB needs to be cognisant that the recommendations in the Consultation Paper may result in increased costs for all entities, and therefore it may be appropriate to consider limiting some of the recommendations to listed Public Interest Entities.

We hope that our comments will be of assistance to you. If you are interested in any of our views please do not hesitate to contact me on +61 3 8248 6600.

Yours sincerely,

[Signature]

John H C Colvin
Chief Executive Officer &
Managing Director