Improving the auditor's report

An invitation to comment issued by the International Auditing and Assurance Standards Board

Comments from ACCA
8 October 2012

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

We support our 154,000 members and 432,000 students throughout their careers, providing services through a network of 83 offices and centres. Our global infrastructure means that exams and support are delivered – and reputation and influence developed – at a local level, directly benefiting stakeholders wherever they are based, or plan to move to, in pursuit of new career opportunities.

www.accaglobal.com

Further information about ACCA’s comments may be obtained from:

David York
Head of Auditing Practice, ACCA
Email: david.york@accaglobal.com
ACCA welcomes the opportunity to comment on the proposals *Improving the Auditor's Report* issued by the International Auditing and Assurance Standards Board (IAASB). The ACCA Global Forum for Audit and Assurance¹ has considered the matters raised in the *Invitation to Comment* and the views of its members are represented in the following.

Our comments draw upon our world-wide membership, which includes significant numbers of members working in all aspects of the financial reporting supply chain in a wide range of industries, the public sector and small and medium-sized entities.

**GENERAL COMMENTS**

Audit has a very important place in society. It provides public value through increasing confidence in financial reporting. For global capital markets this facilitates the efficient allocation and use of capital. The benefits of audit are also strongly felt in the public and not-for-profit sectors.

The report of the auditor is the most visible output of the audit process and we welcome this initiative of the IAASB to improve that report in terms of its usefulness and relevance to shareholders and other interested parties. The project should also promote financial reporting of the highest quality.

As a result of the global financial crisis the work of auditors is under scrutiny as never before. The ultimate test is whether, with the benefit of hindsight, the changes now being proposed would have averted or at least given earlier warning of the extreme events at the root of the crisis. We think they would have helped to alert stakeholders to the truth of an entity's financial position.

The proposals are for changes to standardised information to improve understanding of the audit and, much more importantly, for a whole new part of auditor reporting termed Auditor Commentary. This responds to legitimate calls from investors and other stakeholders for more and better information to underpin the 'pass or fail' opinion from the auditors.

ACCA has carried out a body of work on the future of and value of audit² and we have been pleased to assist the IAASB in its outreach activities to help ensure that the eventual changes to ISAs are firmly based on evidence of stakeholder needs.

Although the focus of the project is on changes to public reporting we recognise that it must go wider and deeper and result in matching improvements in the ISAs that drive the auditor's behaviour in both public reporting and private communication between the auditor and the preparer. There is also a need, which we are pleased that the IAASB has fully recognised, to synchronise efforts to improve auditor reporting with improvements to corporate governance and financial reporting more broadly.

SPECIFIC COMMENTS

In this section of our response we answer the questions set out in the Invitation to Comment. We commend the IAASB for producing this document, which presents and analyses the issues for respondents in a clear and accessible way.

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?

We are generally supportive of the proposals. They are responsive to what are considered to be the needs of institutional investors and financial analysts; needs which have been confirmed in the course of ACCA’s own outreach activities.

We have some concerns about the potential for increased audit costs and the potential for litigation but such matters will depend on the detail of the proposed changes to ISAs and will be investigated by a detailed impact assessment in due course.

The prospect of longer reports by auditors on already voluminous financial statements may be daunting for many users. We believe it is essential to allow standardised material to be presented on a website in order to allow users to focus more clearly on entity-specific matters.

We agree with the IAASB's proposals that some aspects of the improvements need not be mandatory for all audits but should remain capable of voluntary implementation in all audits where appropriate.
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.

Co-operation with those responsible for standards for financial reporting and corporate governance can yield the full benefits of improvements to auditor reporting.

In the area of ISAs, the project must address the need for change in those ISAs that drive both private and public communication in areas such as going concern, other information and reporting to management and those charged with governance (TCWG). We welcome the fact, therefore, that at its September 2012 meeting, the IAASB approved an exposure draft of proposed ISA 720 (Revised) The Auditor's Responsibilities Relating to Other Information in Documents Containing or Accompanying Audited Financial Statements and the Auditor's Report Thereon.

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?

We support the concept of Auditor Commentary because it is a focussed and timely response to meet the diverse demands of stakeholders, particularly institutional investors and financial analysts. The benefits of Auditor Commentary are both direct and indirect and are relevant to all audited entities.

The Invitation to Comment reports the diverse demands of stakeholders for entity-specific information. Such demands have subsequently been confirmed and explored by IAASB outreach events and ACCA's own activities.

Auditor Commentary that meets these needs has the capacity to improve the financial decisions taken by stakeholders but it is not just the publication of comments that is important. A robust process that engages auditors and preparers in meeting stakeholder needs can act as a catalyst for improvement to corporate reporting. It is important, therefore, that auditors are able to comment on any matters that they judge to be relevant.
To achieve this, Auditor Commentary must not only signpost specific matters but explain clearly why a matter is being highlighted. Any disclosure of audit outcomes needs to include an indication of their impacts. Such communication should address the significant risks identified by auditors and focus on those items of most significance to stakeholders.

Further, the important messages for which emphasis of matter paragraphs and certain other matter paragraphs are now included in auditor’s reports must continue to be prominent. The danger that other Auditor Commentary might detract from them and reduce their apparent significance will be particularly high for PIEs, where Commentary is proposed to be mandatory and will likely be more extensive than in non-PIEs.

Implementation of the outcome of the project will be greatly assisted if the IAASB continues and extends the role it has played to educate auditors and users following the issue of the Clarified ISAs. Education of users concerning Auditor Commentary is important to address possible difficulties, such as the material being interpreted as piecemeal opinions, or there being incorrect perceptions of reporting quality between PIEs and non-PIEs simply because of the volume and nature of Commentary. This should be part of a wider educational effort to narrow the expectations gap and explain the value of audit.

In the long-term the IAASB will be concerned to see improvements in the practice and standards for corporate reporting and governance. We welcome the IAASB’s willingness to engage with relevant agencies including coordinating with the International Accounting Standards Board.

Our response to this question is also relevant to reporting on going concern and other information, which share some of the characteristics of the issues that may feature in Auditor Commentary.

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?

The inclusion of comments should be a matter of auditor judgement. A member of the ACCA Global Forum for Audit and Assurance summarised the position: ‘The auditor ought to have a free hand in crafting the story of the specific audit examination and the results therefrom. Auditors are sufficiently experienced to know what information will resonate with users.’
We see considerable merit in supporting auditor judgement by guidance on what to include (perhaps as a minimum), the likely order (if based on importance) and the level of detail that would be most appropriate. Such guidance should also address the need to identify clearly the importance of matters that are currently required to be reported as emphasis of matter or other matter paragraphs.

**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?

We recognise that the examples in the *Invitation to Comment* are not intended to portray how Auditor Commentary might be presented in the specific circumstances of an audit; instead they present a range of matters with varying levels of content.

Auditor Commentary that merely restates material in the financial statements is unlikely to add value for users. Even simple 'signposting' to parts of the financial statements (such as the comment headed 'Outstanding Litigation') could be similarly criticised if it fails to explain why users should pay particular attention to a matter.

As explained in our answer to question 3, we believe that users obtain most informational or decision-making value from comments that expose the results and impact of the auditor's work in the area concerned. A description of the audit procedures should not be included because it would not enhance the user's understanding of the results and impacts and may indeed divert attention from them.

**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?

The subject matters of Auditor Commentary are already part of the private communication between the auditor, management and TCWG. We believe that the need to consider issues for inclusion in the auditor's report will result in heightened debate that necessarily takes account of the needs of the intended users of the Commentary. This should contribute to promoting corporate reporting of the highest order.
The financial reporting process must necessarily accommodate this increased effort. Where preparer and auditor co-operate well, important issues will be addressed early and the adequacy of related disclosures in financial statements and accompanying documents will improve. Conversely, disagreement could ultimately lead to legal interventions and delay in reporting.

Particularly because debate must be at the highest level and matters may require agreement shortly before finalisation of the annual report, we anticipate that preparer and auditor costs will increase.

**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?

Constructive comments from the auditor provide value to audited entities from the largest PIE down to the smallest non-PIE.

The needs of the intended users of Auditor Commentary published in an auditor's report are diverse and in a small entity such persons are usually also TCWG or have access to information communicated to TCWG. For such people, there is little value in formal public reporting of Commentary and it is this reason, more than the fact that the cost of such reporting may fall disproportionately on smaller entities, which leads us to believe that Commentary should not be mandated for all audits.

Three quarters of the members of the ACCA Global Forum for Audit and Assurance supported making Auditor Commentary mandatory for one class of entity and optional for others as that recognises that the balance of value and cost varies considerably from entity to entity.

However, such a two-tier audit reporting system could result in the perception that those audits without Auditor Commentary are inferior. It would be better to require Commentary for all audits but provide guidance on the criteria for inclusion of comments that direct the auditor of a non-PIE to include comments only if, under the existing standards, there would have been an emphasis of matter paragraph or an other matter paragraph in the report.

If an emphasis of matter paragraph or an other matter paragraph (where relating to material inconsistency with other information) is included it should be very clearly distinguished from other comments.
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?

Following the global financial crisis, for certain stakeholders, the improvement of disclosures relating to going concern has been high on the list of matters to be addressed. This requires a holistic solution involving all parties in the financial reporting supply chain.

Within the constraint of consistency with the current requirements of ISA 570 Going Concern we support the IAASB's proposal for an explicit conclusion directed at management's use of the going concern assumption. Members of our Global Forum for Audit and Assurance gave this proposal their full support although a third felt that the statement need not be separate from Auditor Commentary.

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?

There is value in comment from the auditor as going concern is a focus for many users.

This is, however, an area in which management should take the lead by making a statement that no material uncertainties exist. In the absence of financial reporting standards or requirements to drive such disclosures it is very difficult for the auditor to provide additional insights.

The linkage between management and auditor's responsibilities and any going concern commentary must be clear and evident to users, so that any comments from the auditor are not taken out of context.

If these impediments can be overcome, it should be feasible to include relevant information in the auditor's report. It is likely that regular provision of such information will reduce negative perceptions that currently attach to any mention of going concern, but the short-term impact may be problematic.
There must be sufficient guidance for the auditor to promote a consistent approach to such entity-specific disclosures. This may best be achieved in the context of a revision to ISA 570 Going Concern and, if that is the case, there may be a more realistic prospect of matching changes to related financial reporting requirements.

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

There are similarities between the approach to other information and to going concern because in both cases the auditor is making an explicit statement about a matter that has previously been implicit.

Of the two, arguably going concern is the most important, albeit national law frequently requires explicit reporting on aspects of other information, but not on going concern.

ACCA has identified and supports calls for the auditor to do more. The forthcoming exposure draft of proposed ISA 720 (Revised) The Auditor’s Responsibilities Relating to Other Information in Documents Containing or Accompanying Audited Financial Statements and the Auditor’s Report Thereon may provide an opportunity for debate of how far the auditor can or should go to meet those calls.

In the current circumstances, we find the approach in the illustrative report acceptable.

**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?**

ACCA believes that the IAASB has an important role: to communicate the value of audit and promote an understanding of what an audit in accordance with ISAs actually involves. The improvements in the illustrative auditor's report contribute to this.

The descriptions for management and TCWG are brief but communicate the essential points, without appearing to constitute risk management by the auditing profession.
The responsibilities of the auditor are addressed at length in a manner that amounts to a report of the objective and selected processes of an audit. We would prefer such disclosures to be mainly relocated to the website of an appropriate authority as explained in our answer to question 14.

The consultation paper that preceded the Invitation to Comment reported the outcome of academic research on the usefulness of such generically-worded paragraphs. We are drawn to the conclusion that as more information is presented, the expectations gap is narrowed. However, there are diminishing returns as such wording takes up more and more of the auditor's report.

We suggest that education could be an important means to enhance these descriptions and improve user understanding. As a minimum, users should be given signposts to where educational material may be accessed. We discuss this further in our answer to question 15.

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

The Invitation to Comment sets out the relevant arguments and concludes that the disclosure of the engagement partner's name is 'in support of the broader objective of making the auditor's report and the audit process, more transparent.'

Members of our Global Forum for Audit and Assurance were not convinced that the arguments fully supported the need for a requirement, although it was acknowledged that national law or regulation requires this in certain jurisdictions.

**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?**

We disagree with mandatory disclosure by the auditor of the involvement of other auditors because (as set out in paragraph 77 of the Invitation to Comment) that would be contrary to the principle in ISA 600 Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors) that the group auditor is solely responsible.

For the same reason, we do not favour allowing such disclosures to be made routinely in the guise of Auditor Commentary.
The involvement of other auditors is, however, a matter of interest to some investors. Where considered of particular relevance, the audit committee could provide such information in their report, which could include key aspects communicated by the group auditor as required by ISA 600\(^3\). Although the information would be examined by the auditor as part of other information, it would not be originated by the auditor, so should not detract from the sole responsibility principle.

**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?

We favour allowing the bulk of the standardised material to be presented on a website. This is already an option in several jurisdictions.

We also see benefit in the appropriate authority providing web access to authoritative educational material that would allow users to develop their understanding of financial reporting, corporate governance and auditing.

**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?

We are not convinced that a change in the order of the report is necessary. The proposed structure is suited to users who have a good understanding of auditing and who are interested primarily in entity-specific information. Such users should be capable to finding the opinion and entity-specific information wherever it is in the report.

Users who read the report to gain a necessary understanding of auditing may benefit from the extant regime, whereby the opinion is given after explanation of the audit. However, the auditor’s report alone is not sufficient to educate users and as a minimum we believe that consideration should be given to referencing authoritative educational material maintained by, for example the IAASB.

---

\(^3\) Paragraph 49 of ISA 600 requires the group auditor to communicate with those charged with governance of the group certain matters relating to work performed by the component auditors on the financial information of significant components.
If it is decided to emphasise the opinion by positioning it towards the beginning of the report, we suggest that more emphasis could be achieved by amending the title of the report, or a subtitle, to refer to 'an unmodified or modified opinion' as appropriate. Similarly, the sub-heading relating to the use of the going concern assumption could indicate whether the auditor felt it necessary to emphasise any matter.

Where in the specific circumstances an emphasis of matter is included in Auditor Commentary it should be highlighted as it is particularly significant for users.

**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?

ACCA has long been a supporter of global standards for financial reporting and auditing. It is important that users are clear on the standards applied and a consistent form of auditor’s report is an important signal that ISAs have been used. Investors have commented to us that global consistency facilitates their handling of international portfolios.

**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?

Members of the ACCA Global Forum for Audit and Assurance were asked to consider whether the IAASB proposals would be capable of implementation in their national capital markets. No member considered that there would be insurmountable difficulties; hence ACCA agrees that these proposals are sufficient flexibility to accommodate national reporting requirements or practices.

**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?

We believe that, in general, the suggested improvements are appropriate for entities of all sizes and in the private, public and not-for-profit sectors. We have nevertheless commented above in relation to certain aspects where special considerations should be taken into account, for example in our response to question 7, concerning Auditor Commentary.
We identify one matter that particularly affects small entities but for which the solution is to introduce a further general improvement as set out below.

In many jurisdictions, small entities are not required by law to appoint an auditor or to have their annual financial statements audited. Such entities may voluntarily commission an audit, or a review (or another engagement).

This argues strongly that improvements to the auditor's report should be considered for implementation in other reports of professional accountants in compliance with standards issued by the IAASB.

Users of audited financial statements ordinarily rely on the registration of auditors (through law or regulation) to underpin their assessment of the quality of the auditor. This mechanism may not be present when the audit is voluntary. In such circumstances, the auditor's report is the only means by which the auditor can demonstrate credentials, such as compliance with ethical codes. Consequently, when drafting requirements for auditor reporting, sufficient flexibility needs to be allowed for such communication.

In respect of public sector entities, we do not believe that they should be regarded as PIEs as a matter of course. Indeed, as the concept of a PIE is not used in some jurisdictions, we caution that there needs to be full consideration of how to achieve the intention of proportionate application of the reporting improvements.

The financial reporting regime of public sector entities and the responsibility of their auditors should be given due consideration. The former may vary widely and include cash accounting. The proposals regarding the auditor's statement on going concern would ordinarily apply only where a ‘true and fair' opinion is concerned.

Public sector auditors may already be required to report on regularity or legal compliance and probity and to report separately on matters that might fall within the proposed definition of Auditor Commentary. For example, in the EU, reporting by the European Court of Auditors includes annexes of additional material accompanying the auditor's report.