

# Auditing Practices Board

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Technical Director  
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Dear Sir

## **Consultation Paper: Enhancing the Value of Auditor Reporting: Exploring Options for Change**

The Auditing Practices Board (APB) welcomes the opportunity to comment on the IAASB's Consultation Paper. The APB, which is part of the Financial Reporting Council (FRC), is responsible for setting high quality standards and guidance for the performance of external audit and other assurance services that are within the public interest in the UK and Ireland.

### ***APB's two phase project to improve the auditor's report***

This is an important subject which has occupied the APB and its stakeholders quite actively for a number of years. Its importance can be judged from the fact that the UK and Ireland have adopted all of the 700 series of the IAASB's clarified ISAs other than ISA 700 "The auditor's report on financial statements". With respect to audit reporting a UK bespoke ISA (UK and Ireland) 700 has been developed. Whilst largely based on the IAASB's version it establishes requirements that are responsive to the perceived needs of UK stakeholders.

With respect to ISA (UK and Ireland) 700, the APB is engaged in a two phase project to improve the auditor's report. The first phase of the project, which has been completed, sought to shorten the auditor's report. The second phase of the project is still in progress and seeks to make the auditor's report more informative for investors.

### ***The completed first phase of APB's project***

The first phase of the project streamlined the structure and wording, prescribed in the IAASB's version of ISA 700, by shortening the descriptions of the auditor's and directors' responsibilities and permitting a cross reference from the auditor's report to a "Statement of the Scope of an Audit" maintained on APB's web-site.

The first phase of this project has resulted in shorter auditor's reports and appears to have been well received. This phase of our project can be related to Option A in your paper which refers to certain aspects of this phase of our project in paragraph 41.

### ***The second phase of APB's project***

The second phase of APB's project is to better understand what can realistically be done to make auditor's reports more informative. The second phase was undertaken as part of a pan-FRC project on "Effective Company Stewardship: Enhancing Corporate Reporting and Audit". This project was not restricted to considering auditing standards in isolation but also addressed related financial reporting and corporate governance requirements.

Arising from comments received on the second phase, the APB/FRC strongly agrees with the IAASB's observation that financial statement users expect (and are demanding) richer information about the entity and the audit than is currently being provided through audited financial statements, the auditor's report and other corporate disclosure mechanisms. In this regard, the APB in particular concurs with the concept and expression "information gap" as used in the IAASB's paper and the way in which the IAASB has sought to distinguish the "information gap" from the "expectation gap".

The APB also concurs with the IAASB's view that the issues go beyond the content and structure of the independent auditor's report itself but may extend to other ways of improving the quality of information provided to financial statement users. The information gap cannot be closed by the auditor acting in isolation and it is likely, because of the different corporate governance traditions that exist, that different jurisdictions will develop different approaches. Therefore, the APB encourages the IAASB to build some flexibility into the approach that it decides to adopt and to resist imposing a rigid regime.

Consideration will, in particular, need to be given to how to deal with companies listed in more than one jurisdiction. We would suggest that one area of flexibility should be that the auditor should not be required (by rigid auditing standards) to provide information in the auditor's report that has already been satisfactorily provided in the annual report by those charged with governance or by management. This will ensure that companies with multiple listings do not find themselves boxed in to a position of having duplicate disclosures in the directors' report and the auditor's report and thus mitigate the proliferation of "clutter" in annual reports.

Although the APB perceives demand for more information it does not sense any demand in the UK and Ireland for the auditor to provide assurance or related services on matters that are not within the scope of the financial statement audit. Consequently, the APB will be interested in the results of both the IAASB and PCAOB consultations on the provision of additional assurance on such matters.

This second phase of the APB's work is depicted in the IAASB's paper in Section D "An Enhanced Corporate Governance Reporting Model: Role of Those Charged with Governance Regarding Financial Reporting and the External Audit".

### ***Responses received to "Effective Company Stewardship Paper"***

The FRC received in excess of 100 responses to its "Effective Company Stewardship" Discussion Paper and respondents were substantially supportive of the FRC's proposals generally and the FRC continues to believe that the broad approach it outlined in the Discussion Paper is correct. The FRC has, therefore, concluded that the audit committee should report to the whole board of directors and, after that report has been accepted by the whole board, it should be published in full in the company's annual report. In this way the entity (rather than the auditor) provides the information that investors and other users are seeking.

There are four principal reasons why the FRC has reached this conclusion:

- It is the company that is responsible for preparing the annual report and the financial statements. It is the company's views about the company's performance and prospects that are wanted by, and should be reported to, investors and other users. Therefore, the company, through its board of directors and management, should provide this information - not the auditor;
- The company is best placed to know what users of annual reports and financial statements are interested in – because it is the board of directors and management that have direct contact with investors, analysts and other users of the annual report and the financial statements. The auditor does not have equivalent access to such users;
- If the company provides the information, the risk of the auditor making judgments that are properly those of management is avoided; and
- The risk of yet more boilerplate is materially reduced. A report by an audit committee is more likely to be specific to the business than if it is provided by the company's auditor. If the auditor is required to provide the information, there is a real risk of standardised language to avoid the possibility of users reading unwarranted inferences into differences in language between reports by the same auditor on different companies.

#### ***APB's project to revise various ISAs (UK and Ireland)***

Implementing this will require changes to be made to the relevant provisions of the UK Corporate Governance Code, and in response to these the APB will undertake a project to revise ISA (UK and Ireland) 260 (including the application and other explanatory material). The revisions will seek to ensure that the auditor is required to provide audit committees with the information that they need to understand fully the factors that the auditor relied upon in reaching its professional judgment in the course of the audit and, in particular, in reaching its audit opinion. These are likely to include, at a minimum, the auditor's views on:

- The effectiveness of the company's controls (including their assessment of any undisclosed matters arising from the company's business model);
- The judgments made in the audit plan about what is of material significance and the implications of those judgments for the level of assurance provided by the audit; and
- The appropriateness of the accounting policies (viewed individually and in aggregate).

The information provided to the audit committee will also include:

- The auditor's overall conclusions on the valuations of the company's assets and liabilities provided by management (with particular reference to those that are significant to the financial statements); and
- Any other matters identified in the audit plan or by the audit committee as material to the proper presentation of the company's financial position.

The project will also include developing necessary revisions to ISAs (UK and Ireland) 700 and 720 to require the auditor to provide an expanded auditor's report that includes:

- A new section that addresses the completeness and reasonableness of the audit committee's report (ISA UK and Ireland 700); and

- Identification of any matters in the annual report that the auditor believes are incorrect or inconsistent with the information contained in the financial statements or obtained in the course of the audit (ISA UK and Ireland 720).

***Contacting APB***

If you wish to discuss our comments please contact Marek Grabowski (telephone +44 (20) 7492 2325).

Yours faithfully

A handwritten signature in black ink, appearing to read 'Richard Fleck', with a horizontal line underneath.

Richard Fleck  
Chairman, APB