



**INVITATION TO COMMENT
IMPROVING THE AUDITOR'S REPORT**

RESPONSE FROM ICAS TO THE IAASB

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Background

1. ICAS welcomes the opportunity to comment on the IAASB's Invitation to Comment "Improving the Auditor's Report". Our CA qualification is internationally recognised and respected. We are a professional body for over 19,000 members who work in the UK and in more than 100 countries around the world. Our members represent different sizes of accountancy practice, financial services, industry, the investment community and the public sector. Almost two thirds of our working membership work in business, many leading some of the UK's and the world's great companies.
2. Our Charter requires its committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Key Points

We welcome this initiative by the IAASB and in particular its realisation of the need to fast track this project given that the topic of auditor reporting is currently the subject of considerable political interest around the world. Whilst we welcome the general direction of travel we would like to highlight that we believe there is a need for the IAASB to take account of differing corporate governance and reporting regimes around the globe. In this respect there may be jurisdictions in which at least some of the material which the IAASB might expect to be included in the proposed auditor commentary section of the audit report is actually included in the report produced by the audit committee of the entity concerned. We see no merit in the auditor having to repeat such content unless he believed there was merit in actually doing so e.g. to highlight or to provide additional explanation if considered necessary.

In December 2010 ICAS published its 'Future of Assurance' report. This report recommended that more information should be communicated to stakeholders via the annual corporate report. However, the preferred mechanism for delivering that information at that time was via the audit committee report to provide a greater understanding of the function of the audit committee and how they had discharged their duties. The Working Group recommended that:

- "A more transparent audit committee is achieved through greater disclosure of its activities. An expanded audit committee report is required and should include: A matrix-style report which maps the key risks disclosed by the Board in its report to the assurance processes used to gain assurance over those risks: A substantive discussion of how the audit committee satisfied itself of the appropriateness of management's judgements: Details of the key areas discussed between the audit committee and the auditors, including the main areas of audit challenge."

The Working Group also recommended that additional reporting should be required of the auditor was very much of the view that in the first instance the reporting from the directors of the entity should be increased and improved. The document can be downloaded at: <http://icas.org.uk/futureofassurance/>.

Since the publication of the report ICAS is aware of the general move towards seeking to include more and better information in the auditor's report. ICAS notes and appreciates the work that the IAASB has done in this space in relation to seeking the views of institutional investors and financial analysts. ICAS is supportive of the ultimate aim of enhancing the quality of information that is made available to shareholders and other stakeholders via corporate reports but believes that this aim can only be achieved by better reporting, both by the entity and by the auditor. In the UK we have a strong corporate governance environment in the listed company sector, but we do appreciate that this level of governance is not to be found in all of the jurisdictions in which ISAs are applied. Therefore, we are supportive of the IAASB's objective of enhancing the value of auditor reporting through the provision of additional information within the auditor's report. However, we believe that national jurisdictions might have alternative mechanisms in place which ultimately lead to the same end position in terms of the information that is provided to users of corporate reports. We therefore believe that the IAASB should take account of jurisdictions in which some of the information that it would like to see reported on by auditors is actually

delivered via the report from the audit committee or those charged with governance. We believe that such an option is paramount to developments in this area.

We would also like to take this opportunity to emphasise that the proposed revision of ISA 700 must be considered alongside that of ISA 720. We would favour a move towards requiring the auditor to provide greater assurance than merely “nothing contained in the rest of the annual report is inconsistent with the content of the financial statements”. We ultimately favour the auditor being required to opine on whether the rest of the annual report is “balanced and reasonable” although we accept in the shorter-term that there may need to be certain intermediary stages before we get to that position e.g. extending the consistency check to “not just the content of the financial statements but to the knowledge acquired by the auditor in the course of performing the audit.

We believe that only by seeking for the auditor to provide assurance on the whole of the annual report can the profession really respond to the criticisms which have been levelled at it in relation to statements such as that of the UK Treasury Select Committee which questioned the value of audit in its report of May 2009. ICAS published a research report in 2010 entitled “Meeting the Needs” by Ian Fraser and William Henry which suggested “significant demand for at least some degree of external assurance on management commentary”. The report also highlighted concern that the narrative commentary around risks and future prospects may become boilerplate or subject to management spin therefore external assurance may go some way to addressing this concern.

Our responses to the specific questions are as follows:

Overall considerations:

Q1 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 believe that the rationale behind the IAASB’s suggested improvements should enhance the relevance and informational value of the auditor’s report and should provide users with greater information and insight into the audit process.

In particular, we are supportive of the proposals in relation to enhanced reporting on management’s use of the going concern concept and on whether any material uncertainties exist in relation to events or conditions that may cast significant doubt on the company’s ability to continue as a going concern.

We do believe that there is value in signposting key accounting and auditing issues in respect of the matters included in the financial statements.

Whilst we are supportive of the concept of a section on auditor commentary we would prefer the IAASB to take account of jurisdictions where the possibility exists that at least some of the material which the IAASB might expect to feature in the auditor’s report is actually contained in the report of the audit committee/those charged with governance. Provided that the auditor was happy with the manner in which this information was presented we would not see a need for him to repeat or elaborate on any such material.

Additionally, we ultimately believe that additional reporting by the auditor in this form will not fully meet the needs of those who use annual reports. In this respect we believe that there is a need for auditors to be asked to provide greater assurance over the other information contained in the audit report and also over the information which investors and other stakeholders use to make economic decisions.

The national auditor liability regimes may act as a possible impediment to meeting these proposals.

We do not envisage that the improvements will result in significantly higher costs although there undoubtedly will be increased costs in light of the increased amount of senior audit personnel time that will be required.

Q2 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.

We appreciate that the IAASB only has the ability to exercise its influence on the information which an auditor is required to provide to stakeholders via the audit report issued by the auditor and that any standards which it proposes to issue need to be considered in that context. We would, however ask, that a principle be included in the proposed revised audit reporting standard to the effect that: "The auditor does not need to repeat matters included in other parts of the entity's annual report where he believes that the provision of such information in the auditor's commentary will not add to the information provided to users."

As stated above, we believe there should be an option whereby at least some of the material that might be expected to be included in the Auditor Commentary section could be included within the Audit Committee/TCWG report. The auditor should not be the originator of new information. This responsibility should rest with the board of the company or a subset of it, such as the Audit Committee.

Consideration should also be given to the possibility of auditors providing assurance over the whole management commentary and this could involve collaborating with ICAS on the work we are currently undertaking in this area. There may also be scope for the IAASB to collaborate with the International Integrated Reporting Council (IIRC), who are in the process of developing an integrated reporting framework and the theme of one of the topic specific projects is assurance. Whilst the additional reporting being suggested by IAASB will have benefit we firmly believe that greater focus has to be placed on the part of the annual report which is increasingly of most interest to investors, i.e. not the financial statements but rather the front half of the annual report.

Auditor commentary:

Q3 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 believe that the concept of Auditor Commentary is an appropriate response to the call to provide more information to users solely in relation to the auditor's work on the financial statements. The work supporting this commentary is already being undertaken but is not as yet made public. However, we would reiterate that we would prefer that at least some of the information was to come from within the company in the first instance. The Auditor Commentary can then be used to highlight key areas of these disclosures to increase users' awareness of, and add value to, the audit process.

The only possible impediment to the provision of this additional information is the respective national auditor liability regimes which apply.

Q4 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?

We agree that the matters to be included within the Auditor Commentary should be left to the auditor's professional judgement as these areas will be based upon his/her assessment of the significant and relevant matters that should be disclosed to users and this will vary from entity to entity. The content of this section will also depend upon to what extent there has been additional reporting by the corporate entity itself. If the corporate entity has included additional information which the auditor believes is reasonable then we do not believe that it will always be necessary for the auditor to also comment on

those particular matters. Obviously, the auditor will need to consider such matters on a case by case basis. We also believe that references to “judgement” should in fact be preferably changed to “professional judgement” to better highlight the status and societal role of the auditor. In this respect ICAS has recently published a professional judgment framework which IFAC member bodies and auditors may find useful. This focuses on not just the professional judgement to be applied by auditors but also that to be applied by preparers of financial statements as well as regulators. This document can be downloaded at: <http://icas.org.uk/pjf/>

Q5 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 question whether all of the information contained in the examples is valuable.

In certain cases, there is not really enough relevant information to enable a full appreciation of the work undertaken and the conclusions drawn. For example, the valuation of financial instruments paragraph does not go far enough to explain the nature of the financial instruments and the basis for the fair value estimate. We do however appreciate the provision of further information might be problematic in this respect.

The inclusion of the sections on audit strategy and on the involvement of other auditors is likely to be of interest to users of financial statements.

Disclosure of the materiality levels applied during the audit may also provide users with quantifiable and qualitative parameters beyond which misstatements and errors were not considered and provide them with a greater context in relation to the manner in which the audit was carried out. We appreciate that there are risks to requiring the disclosure of materiality but on balance however, the benefits of better conceptualising what an audit is outweigh the related costs.

Overall, we consider that inclusion of a description of audit procedures and related results in Auditor Commentary will give users a greater insight as to the extent of work performed by the auditor in arriving at his/her opinion and thereby enhance the perceived value of the audit.

Q6 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 there should be no significant increase in the amount of audit work required to comply with the requirements of the revised auditor report, however, additional time and costs will be required for senior members of the engagement team, including the engagement partner, to discuss some of the key issues to be disclosed in the Auditor Commentary with senior management within the entity. The additional time and costs are not expected to be significant and we believe that the benefits from the additional information should outweigh the extra costs incurred. We do not believe that the inclusion of Auditor Commentary will affect the timing of the financial statements unless on a rare occasion there is a serious disagreement between the directors and the auditor over the content.

Q7 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?

We are not convinced that inclusion of the Auditor Commentary is appropriate or useful for SMEs and some other unlisted entities, as it is unlikely to add value. However, we believe that discretion should be left to the national standard setters/regulators as they are best placed to assess the need for such commentary in entities of different sizes and different natures in their respective jurisdictions.

Going concern/other information

Q8 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?

We welcome the proposed inclusion of the auditor's statement on going concern. This was an area identified by the ICAS Future of Assurance Working Group where the auditor could provide enhanced disclosure. However, this is one area that in order to fully meet the expectations of users we believe that enhanced and better reporting will also be required of the entity.

The ICAS 'Future of Assurance' report proposed inclusion of an assessment by management (or TCWG) concluding that the business is a going concern and confirmation of whether the period considered exceeds 12 months from the date of signing the financial statements. This assessment should disclose the key assumptions on which the going concern assessment has been based; communication of the business model and strategy; a statement of the key risks facing the business and significant judgements made by TCWG when producing the annual report and financial statements. The report also recommended an explicit statement by the auditor confirming that he/she has reviewed the going concern assessment prepared by TWCG and that this is considered appropriate. These additional disclosures should provide users with greater confidence over the use of the going concern assumption and enhance the perceived value of the audit.

We appreciate that the IAASB has no powers over corporate governance or financial reporting requirements and we are therefore supportive of its proposed positive step in relation to what is required of auditors in this key area.

Q9 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?

We welcome the proposal to include additional information as an opportunity to openly communicate more details of the audit work undertaken to arrive at these judgements and that this will enhance the perceived value of the audit and outweigh any impediments. We do not consider that any costs associated with the additional disclosure will be significant. There will of course be a need for the auditor to be succinct and it will be a difficult balance to ensure that the report contains sufficient substance but is not overly long thus distracting from the value of the additional information.

Q10 What are your views on the value and impediments of the suggested auditor statement in relation to other information?

We believe that at present the proposed statement is appropriate based on the current ISA requirement to report only on material inconsistencies identified between the other information and that which is contained in the financial statements.

Research undertaken on behalf of ICAS in 2010 identified that although narrative reporting is increasing in importance it is often constrained by "boilerplate" language. Users expressed the concern that the commentary around risks and future prospects is vulnerable to management "spin" and that some form of external assurance would be desirable on such matters. The report also suggested a demand for enhanced reporting from the external auditor.

Therefore, we would like to see the scope of the auditor's work extended so that he is required to form an opinion on the other information included in the corporate report. Because there is as yet no framework to which the auditor can refer, we appreciate that it is not yet possible for the IAASB to propose such a requirement. However, we believe that the IAASB can start to move in this direction by extending what is required of the auditor in relation to his assessment of the other information contained in the corporate report. In this respect we believe that in its revision of ISA 720 the IAASB should extend the consistency

check to the knowledge acquired by the auditor in his role as auditor of the entity concerned, as opposed to merely the content of the financial statements. This would follow the approach which has recently been adopted by the UK Financial Reporting Council.

That said, in the future, it should be possible for the auditor to provide an opinion on the whole of the narrative commentary if the necessary framework is available and, as previously mentioned, both ICAS and the IIRC are currently engaged in separate projects of this nature.

Clarification and transparency

Q11 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?

We recognise that there is a balance between the inclusion of enhanced descriptions of respective responsibilities and increasing the overall length of the report. However, moving all, or at least some of the standard wording and definitions to a central location or website, would allow for enhanced descriptions of respective responsibilities.

Q12 What are your views on the value and impediments of disclosing the name of the engagement partner?

In principle we support the disclosure of the name of the engagement partner which is currently a requirement within the UK. We do however appreciate that there may well be circumstances in other jurisdictions which might act as a barrier to the introduction of such a requirement.

Q13 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 believe that disclosure regarding the involvement of other auditors will depend upon the nature of the entity and the extent and complexity of the work performed by other auditors. However, on balance we believe that users of corporate reports may find this information useful therefore we are supportive of disclosures of this nature.

Q14 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 welcome any proposal to reduce the overall length of the auditor's report and therefore support the suggestion to allow some of the more standardised material to be relocated to an appropriate website/location. In the UK some standard material can already be referred to from the audit report to the FRC's website. Whilst a number of firms do make use of this option we are aware that there a number who do not. Therefore, we believe that this matter should be left optional.

Form and structure

Q15 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 supportive of the IAASB's suggested structure as shown in the illustrative report and believe that it does provide appropriate emphasis to matters of most importance to users.

In particular we welcome the more prominent positioning of the audit opinion at the beginning of the report. This also ensures that those who favour a less detailed report from the auditor are not disadvantaged, as the opinion is clearly highlighted upfront in the report.

We also believe that positioning the Auditor Commentary towards the beginning of the report will encourage users to read further into the report and not simply focus upon the nature of the opinion.

Q16 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?

We acknowledge and support the need for global consistency in auditors' reports where ISAs are used although do recognise that some tailoring for individual jurisdictions and legislative requirements will be involved. We believe that the building blocks approach adopted by the IAASB will allow for sufficient consistency to be achieved around the globe whilst allowing flexibility for national jurisdictional requirements.

Q17 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 mandatory ordering of the headings is useful to ensure both the consistency and completeness of all the mandatory disclosures. We do not see this as a barrier to providing sufficient flexibility to accommodate national reporting requirements or practices.

Q18 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 application of the suggested improvements surrounding Auditor Commentary should be restricted to PIEs as the proposed new disclosures are likely to be of lesser value to some smaller owner-managed entities whose financial statements will not have the same level of public interest or be subject to the same level of public scrutiny. However, we consider that the proposed improved disclosure on going concern, and respective responsibilities of auditors and management would be relevant and useful for all entities regardless of size.