

October 18, 2012

Professor Arnold Schilder

Chairman

International Auditing and Assurance Standards Board

Via email: IAASB Technical Director James Gunn at [jamesgunn@iaasb.org](mailto:jamesgunn@iaasb.org)

**Professional Accountants in Business (PAIB) Committee Comments on the *Invitation to Comment: Improving the Auditor's Report***

Dear Professor Schilder,

The Professional Accountants in Business (PAIB) Committee of the International Federation of Accountants (IFAC) is the only IFAC committee exclusively dealing with the interests of professional accountants who work in commerce, industry, financial services, education, and the public and not-for-profit sectors. We concern ourselves *inter alia* with business reporting and governance issues from the perspective of the finance functions within the management structure of organizations including those who prepare accounts. We therefore value the opportunity to comment on the International Auditing and Assurance Standards Board (IAASB)'s *Invitation to Comment—Improving the Auditor's Report*, which we inevitably do from the perspective of those who are accustomed to being audited. The PAIB Committee is committed to acting in the public interest and we make our comments accordingly.

We welcomed the opportunity to express our views directly to IAASB Deputy Director Kathleen Healy at our meeting on September 14, 2012. This response confirms and amplifies the comments made during the PAIB Committee meeting. Our main point is that it would generally be inappropriate for new information related to an organization's performance to emerge in an auditor's report: the proper place is within the organization's own reporting.<sup>1</sup>

The PAIB Committee was closely involved in the development of an IFAC interview-based report, [\*Integrating the Business Reporting Supply Chain\*](#) (2011), which captured the recommendations on governance, financial reporting, financial auditing, and broader business reporting from prominent preparers, directors, auditors, standard setters, regulators, and investors around the globe, made in light of the financial crisis. One of the main conclusions of the report was that auditor communication should be improved.

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<sup>1</sup> Unless such information is required to substantiate a qualified auditor's opinion.



### **Auditor Communication Should Be Improved**

*According to interviewees, the limited nature of an auditor's communication with stakeholders is an obstacle to increased transparency that needs to be dealt with. We should, therefore, rethink the relationship and interaction between (a) the auditor and executive management, (b) the auditor and non-executive management (including the audit committee), and (c) the auditor and the external stakeholders. The financial and other disclosures of corporate entities, including the independent auditor's report on the financial statements, are part of an organization's governance framework. The financial statement audit should have a beneficial behavioral impact on how the organization makes its judgments. To improve auditors' current position, there should be more space for them to exercise their professional judgment without fear of liability.*

*To achieve this, some form of apportionment of blame needs to be implemented. In addition, the audit profession should consider improvements to its standard reporting model. Interviewees are of the opinion that auditors' reports should be simple, so that qualifications are clear and easy to understand and interpret by all stakeholders. The auditor's report should therefore move away from a standard boilerplate, and provide more of the information that was used by the auditors to reach their opinion, such as the auditors' risk assessments, materiality, applications of professional judgment, etc. As an alternative to expanding their reports, auditors could provide more discursive board and audit committee reports to enhance the communication between the directors and the stakeholders of an organization.*

—Excerpt from [Integrating the Business Reporting Supply Chain](#)

Although the demand for improved auditor reporting might be clear to some stakeholders, the IAASB's analysis of cost and benefit of its proposals to improve the auditor's report needs to demonstrate that there is an economic benefit in excess of the cost of implementation and maintenance. The analysis of cost might also include unintended consequences of implementation, such as those arising from increased auditor liability, which might lead to higher costs. The various stakeholders need to fully understand the cost benefit equation and whether other approaches might better achieve the desired outcomes, for example, improving business reporting (including governance reporting).

### **General Comments**

As indicated above, the PAIB Committee's main comment is that all necessary information on the performance of an organization should primarily be provided by the organization rather than the auditor. The expanded auditor's report could be used to highlight matters relating to the audit process, and particularly to explain and clarify the auditor's responsibility for and, when useful, his or her opinion on financial statement disclosures and wider narrative reporting (see below). However, the IAASB should avoid expanding auditor reporting in areas that are and should be the responsibility of an organization's governing body and its management as directed by the accounting standard setters and regulators.



## Specific Comments

### Overall Considerations

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?**

Meeting user needs for information on organizational performance should be viewed within the broader context of governance and oversight of financial reporting. The provision of high-quality financial information depends first and foremost on the effectiveness of governance within organizations, including the implementation of effective reporting processes, which should ensure that all internal and external stakeholders receive appropriate high-quality business reports in a timely fashion.<sup>2</sup>

Investors' and other stakeholders' needs for information on organizational performance should be primarily met by the organization's management and governing body, supplemented, where appropriate, by other external sources. Auditors should not be expected to provide disclosures or judgments on organizational performance, which is the purview of those charged with governance.

Auditor communication could be enhanced by providing stakeholders with improved confidence in the integrity of the information. We welcome the IAASB's suggested improvements, subject to management providing the disclosures on organizational performance and the auditor's report and commentary clearly focusing on the outcomes of the audit and audit issues related to financial reporting and, where appropriate, wider business and governance reporting.

The organization should be responsible for disclosing further information that places management judgment and estimates into context. Extending the auditor communication into this domain could lead to pressure on auditors to provide inappropriate disclosures or judgments on organizational performance in the auditor's report.

Some of the suggested changes make an explicit statement of what is implied in the audit process. However, other changes introduce more technical terminology in the auditor's report without enhancing the relevance or informational value of the report. Further improvement to the auditor's report can be achieved by reducing technical terminology.

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.**

It is proposed that the IAASB also explore, for example, the relationship and interaction between the auditor and executive management and between the auditor and non-executive management, including the audit committee. In this light, it is noteworthy that in many jurisdictions, the audit committee has its own disclosure report.

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<sup>2</sup>For additional information, see the PAIB Committee's proposed International Good Practice Guidance, [Eleven Principles for Effective Business Reporting Processes](#), which helps accountants improve business reporting processes.



Another interesting initiative to enhance auditor communication, taken by the Dutch IFAC member body, Nederlandse Beroepsorganisatie van Accountants, is the development of a series of public-management letters as part of its [Knowledge Sharing Program](#). The objective of the letters is to identify, analyze, and publicly communicate findings by public accountants and professional accountants in business so as to facilitate a timely response by more parties. According to the program, “this mainly involves risks pertaining to governance, which involves the management of financial and administrative matters [and] risks of a structural nature, which point to problems that go beyond a specific organization, and, as such, are capable of having a major social impact.”

A public management letter—relating to risks in a specific sector and developed by auditors and professional accountants in business that work in that sector—could, therefore, be a useful addition to the auditor’s report on a single organization’s financial statements. The IAASB could explore the wider applicability of this initiative. Similarly, other professional accountancy bodies have also examined ways of improving the role and relevance of the external auditor’s report, which could also be included in the IAASB’s further deliberations.

*Expand the scope of the audit*

The audit engagement has a rather narrow scope at present. This limits the matters on which the auditor reports. The IAASB should, therefore, also focus some of its attention on assurance in relation to other areas of reporting that are currently outside the scope of the audit, such as narrative reporting, management commentary, and integrated reporting.<sup>3</sup> An audit opinion on these wider aspects might provide additional credibility to the information provided to stakeholders.

***Auditor Commentary***

- 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 believe auditor commentary could be an appropriate means to provide more information to users if it is about the outcomes of the audit and the audit process, and what the auditor actually did.

The responsibility of disclosing and explaining organizational performance should remain with those charged with governance, who are accountable to shareholders for the organization’s performance. The auditor should then provide assurance on the assertions of management, rather than attempt to interpret organizational performance.

- 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?***

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<sup>3</sup>This would take into account an auditor’s competence and knowledge and also cost/benefit considerations.



We believe that professional skepticism and judgment are critical to stakeholder confidence. This requires both professional accountants working as preparers in business and the auditor to have a questioning approach to the preparation and audit of financial statements.

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?***

The response from users will help provide an answer to this question. We believe that investors and other stakeholders are most likely to seek improved understanding of an organization's performance. Performance information is for the management to provide. We applaud the view that the auditor's report should not be seen as a simple 'boilerplate' statement. At the same time, we would be concerned if extension of the auditor's reporting simply created a 'boilerplate' statement with apparently wide coverage.

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?***

A practical issue is that auditors would have to take on an additional responsibility for making judgments in respect of an organization's performance and sharing those judgments with the users of the financial statements. If auditors make an error in their judgment, they are opening themselves for future litigation. This will increase insurance costs for the audit firms and, in turn, the cost of the audit.

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?***

The actual provision of auditor commentary, albeit in a structured or standardized format as to encourage global consistency (see question 16), should be at the discretion of the auditor at all times, exercising professional judgment on the needs of users in each and every specific engagement.

#### ***Going Concern/Other Information***

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?***

As noted in the invitation to comment, the appropriateness of management's use of the going concern assumption and whether material uncertainties have been identified is already implicitly included in the current audit opinion.



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?***

This statement is appropriate, as long as it is specifically about the outcomes of the audit and the audit process, and what the auditor actually did in this regard.

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

As it is already a standard procedure for auditors to review all information disclosed with the financial statements for consistency, the absence of inconsistencies is implicit in the auditor's report. Of course, if there are inconsistencies, they should be brought to the reader's attention.

If users would find it useful to have a view from the auditor about the consistency of the report with other, unaudited, information, we see no harm in providing it. However, given the limited nature of the auditor's responsibility for this "other information," there is a good chance that users could be further confused in the absence of a very carefully constructed statement.

#### ***Clarification and Transparency***

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?***

We believe these enhanced descriptions are useful to inform users of respective roles and responsibilities and, therefore, help reduce the expectation gap. However, the proposed descriptions would benefit from being more concise and to the point. Additional disclosures could possibly be done outside the auditor's report, for example, in a designated location on the organization's website.

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

Although disclosing the name of the engagement partner could potentially increase personal accountability, audit clients typically hire a firm instead of a particular partner, based on the expected quality of the entire audit staff. Additionally, disclosing the name of the engagement partner might increase insurance costs for the audit firms, which they could pass on to their audit clients. The PAIB Committee notes that disclosing the name of the engagement partner is already common practice in some jurisdictions. It would, therefore, be useful to take into account their experiences (both from the auditor and PAIB perspective) before turning this into an international requirement.

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 believe that the ultimate and undivided responsibility should be with the main auditor and that disclosing the names of subcontractors involved in the audit does not add any value to the informational content of the report (unless it is part of a qualification).

- 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 believe that many details and further explanations could be moved to a central depository website if that would contribute to a better understanding for users. See, for example, the response to question 11.

#### **Form and Structure**

- 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 have no objections to the IAASB's suggested structure of the illustrative report. However, we favor having the reference to the type of engagement included before the opinion at the start of the report.

- 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?**

We believe that this is particularly important in the environment of increased globalization.

- 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?**

We believe that this will help to standardize the reports.

- 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?**

If the proposals ultimately: a) focus solely on providing additional information on the outcomes of the audit and the audit process and what the auditor actually did; b) take cost-benefit considerations into account; and c) leave their inclusion to the discretion of the auditor, then they could apply to organizations of all sizes and types to ensure consistency across the board.





Please do not hesitate to contact me should you wish to discuss matters raised in this submission.

Sincerely,

A handwritten signature in black ink, appearing to read 'Roger Tabor', with a stylized flourish at the end.

Roger Tabor

Chairman, IFAC Professional Accountants in Business Committee