



CENTER FOR CAPITAL MARKETS
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November 20, 2013

Professor Arnold Schilder
Chairman
International Auditing and Assurance Standards Board
529 Fifth Avenue
6th Floor
New York, NY 10017

Re: IAASB Exposure Draft on *Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs)*

Dear Professor Schilder:

The U.S. Chamber of Commerce (the “Chamber”) is the world’s largest federation of businesses and associations, representing the interests of more than three million U.S. businesses and professional organizations of every size and in every economic sector. These members are both users and preparers of financial information. The Chamber created the Center for Capital Markets Competitiveness (“CCMC”) to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy.

The CCMC recognizes the vital role financial reports and external audits play in capital formation. The CCMC supports efforts to improve audit effectiveness and believes that convergence of accounting and audit standards is an important step in the evolution of global capital markets. Accordingly, the CCMC appreciates the opportunity to comment on the International Auditing and Assurance Standards Board (“IAASB”) Exposure Draft on *Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs)* (“the Proposal”).

Many of the concerns the CCMC expressed to the IAASB last year remain today. The Proposal changes the role of the auditor and obfuscates the lines of responsibility established by corporate governance policies. If enacted, the proposals would enhance the liability profiles for auditors and companies and promote a chilling

effect on the ability of auditors to exercise judgment and perform their critical duties for businesses and investors. Furthermore, the Proposal may perpetuate financial reporting complexity. This raises questions as to the utility of the Proposal and the investor interests it seeks to address. These changes to the role of the auditor and the audit report, muddying corporate governance and a lack of clear articulable investor issues raises serious concerns regarding the Proposal itself.

Our concerns are discussed in greater detail below.

Discussion

The CCMC provided comments on the Invitation to Comment and participated in the September 2012 Roundtable held in New York.¹ We continue to believe that our concerns expressed in these forums are valid and remain unaddressed. We have attached our September 5, 2012 letter for the record. Of the revisions made since last year, the most significant involves communication of key audit matters in auditor reports. Therefore, our comments focus on this aspect of the Proposal.

1. Communication of Key Audit Matters

The CCMC acknowledges that in any initiative such as this, the IAASB faces competing demands from a variety of stakeholders. In addition, the CCMC recognizes that the IAASB's deliberations have been informed by international research, public consultation, and stakeholder outreach.² As a result of this outreach, the Proposal reflects certain helpful revisions in auditor reporting from what the IAASB proposed in the 2012 Invitation to Comment. Nonetheless, many of the concerns the CCMC expressed in the 2012 Invitation to Comment remain today.

In particular, instead of including "auditor commentary"³ in the audit report, the IAASB is now recommending a requirement that the auditor's report

¹ See the September 5, 2012 letter from the United States Chamber of Commerce Center for Capital Markets Competitiveness on the IAASB Invitation to Comment on *Improving the Auditor's Report*.

² See Background in the Proposal (p. 6).

³ The CCMC has also provided extensive commentary to the PCAOB on similar proposals, i.e. - See CCMC letter of September 14, 2011 to the PCAOB on the *Concept Release on Possible Revisions to PCAOB standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards*. The CCMC will also provide a comment letter to the PCAOB on their proposed changes to the audit report.

communicate “key audit matters” for audits of financial statements of listed entities. According to the Proposal, key audit matters would be selected from matters communicated with those charged with governance. In making this selection, the Proposal states that the auditor should take into account areas of significant auditor attention in performing the audit, including:

- (a) Areas identified as significant risks or involving significant auditor judgment;
- (b) Areas in which the auditor encountered significant difficulty during the audit, including with respect to obtaining sufficient appropriate audit evidence;
- (c) Circumstances that required significant modification of the auditor’s planned approach to the audit, including as a result of the identification of a significant deficiency in internal control.⁴

The CCMC believes that the Proposal’s section on communicating key audit matters changes the role of the auditor to report beyond matters necessary to provide the level of assurance needed for users to rely on financial statements.

A fundamental precept of financial reporting is that the preparation of financial reports and disclosure of decision useful information for investors falls within the area of responsibility of management and directors. Nevertheless, in proffering the section on communication of key audit matters the Proposal requires an auditor to explain and provide insight on why an auditor considers selected portions of the financial reports to be of the most significance in the audit. The auditor is also allowed under the Proposal to provide original information to buttress this analysis even if the management and directors of a business deemed such information immaterial.⁵

This requirement morphs an auditor into an analyst, undermining the integrity of both the financial reporting process and audit function. Management and directors provide the information, auditors provide assurance that the information is reliable

⁴ See the Proposal, p. 20.

⁵ See the Proposal, p. 21.

and analysts provide interpretation of that information which investors can choose to accept or not. This is analogous to a person being the judge in a legal case and a reporter at the same time.

Indeed, how can an auditor express significant concerns of an audit and sign off on the audit at the same time?

Therefore, the Proposal seemingly undercuts the financial reporting and disclosure frameworks promulgated by the Financial Accounting Standards Board (“FASB”) under Generally Accepted Accounting Principles (“US-GAAP”) and the International Accounting Standards Board (“IASB”) under International Financial Reporting Standards (“IFRS”) and the regulatory disclosure requirements such as those of the U.S. Securities and Exchange Commission (“SEC”). For example, communication of key audit matters could involve the auditor communicating matters that are explicitly not required to be communicated by the SEC such as significant deficiencies. Furthermore, communication of key audit matters may also conflict with other legally required disclosure such as Management Discussion & Analysis (“MD&A”). This conflict also creates other unintended consequences as MD&A has safe harbors related to liability while the audited financial statements do not.

Rather than informing investors and financial statement users, the Proposal may contribute to what SEC Chairman Mary Jo White has recently called “disclosure overload”.⁶

The examples of key audit matters provided in the Proposal are very instructive in reinforcing the CCMC concerns and raise more questions than they answer. To illustrate, all three examples elevate to external disclosure matters that were resolved to the auditor’s satisfaction before the issuance of the financial statements. In particular, the second example appears to provide selective assurance and undermine the fundamental principle that the auditor expresses an opinion on the financial statements taken as whole.

⁶ See October 15, 2013 speech of SEC Chairman Mary Jo White, *The Path Forward on Disclosure*, before the National Association of Corporate Directors.

Further, the examples used in the Proposal raise a fundamental question on the usefulness of these auditor disclosures to investors and other third-party users of the financial statement. In this regard, the Proposal may actually widen the expectation gap because stakeholders likely believe that communications from the auditor will be incrementally useful relative to information now available from companies. Moreover, in regards to the examples in the Proposal, there is no indication that the company's disclosures are inadequate in regards to the key matters included in the auditor's report.

While the CCMC supports the use of judgment by auditors, if our concerns are not addressed we believe that at a minimum additional guidance would be useful on the threshold for determining the "most" significant matters in the audit of the financial statements of the current period from all the matters communicated by the auditor with those charged with governance.

As we stated last year, the CCMC also remains very concerned about the legal liability implications of the Proposal. This encompasses potential liability for what auditors communicate and what they do not. The former includes liability for being an original maker of statements and the latter includes both private legal actions and regulatory actions (e.g., through inspections and enforcement) based on second-guessing auditor judgments on matters that were deemed by the auditor not to meet the threshold of key audit matters. All things considered, the CCMC questions whether the costs of the Proposal outweigh the benefits.

2. Going Concern

The Proposal maintains the mandate from the Invitation to Comment that every auditor report would include a section on Going Concern with:

- (a) An explanation of the going concern basis of accounting in the context of the applicable financial reporting framework;
- (b) A statement that, as part of the audit of the financial statements, the auditor has concluded that management's use of the going concern basis of accounting in the preparation of the entity's financial statements is appropriate;

- (c) A statement that, based on the audit of the financial statements, the auditor has not identified a material uncertainty that may cast significant doubt on the entity's ability to continue as a going concern; and
- (d) A statement that neither management nor the auditor can guarantee the entity's ability to continue as a going concern.

Thus, the concerns expressed in our September 5, 2012 letter continue to apply, including that the auditor's Going Concern should be in a non-mandatory section of the audit report. The CCMC also raised a number of issues on Going Concern disclosures in a comment letter filed with FASB earlier this year.⁷

3. Name of Engagement Partner

Lastly, the Proposal would mandate the disclosure in the audit report of the name of the engagement partner responsible for the audit. (The signature on the audit report would be in the name of the audit firm, the personal name of the auditor, or both as appropriate for the particular jurisdiction.) The CCMC continues to believe that the naming the engagement party would obfuscate essential responsibilities harming accountability. First, the appropriate legal and regulatory entities can easily find out engagement partner. Secondly, through a naming process, under our litigious system in the United States, the engagement partner may be faced with lawsuits directed at personal liability. This will lead to a chilling effect by a reluctance of partners to be the engagement partner and create disincentives for talented people to enter the profession. Both of these will degrade audit quality harming investors and users of financial statements.

In our view, providing this information in an auditor's report under the IAASB's ISAs should be optional.

⁷ See CCMC letter to FASB on September 17, 2013 on *Presentation of Financial Statements (Topic 205); Disclosure of Uncertainties about an Entity's Going Concern Presumption* (File Reference No. 2013-300)

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Concluding Remarks

Once again, the CCMC appreciates the efforts of the IAASB with this important project and the opportunity to comment on the Proposal.

The CCMC continues to have serious concerns regarding the Proposal. Namely, that the Proposal blurs lines of corporate governance, may create duplicative disclosures and may raise liability for auditors and businesses which ultimately harms investors. We believe that these issues should be addressed before the Proposal moves forward.

Thank you for your consideration and the CCMC stands ready to assist in these efforts.

Sincerely,

A handwritten signature in black ink, appearing to read 'T. Quadman', with a long horizontal flourish extending to the right.

Tom Quadman