

# **International Auditing and Assurance Standards Board Consultation Paper: Enhancing the Value of Auditor Reporting: Exploring Options for Change**

## **List of Questions in this Consultation Paper**

### **Issues Identified**

1. Do respondents have any comments about the issues identified in Section II regarding the perceptions of auditor reporting today?

NAO agrees that today the financial statement audit and the independent auditor's opinion on an entity's financial statements are valued to the extent that they provide an overall audit conclusion, based on audit evidence obtained, on whether the financial statements of the entity concerned as a whole are free from material misstatement.

NAO also opines that users believe that corporate reporting is to be enhanced to include more information about the entity and about the audit that is currently not being disclosed. Such additional information would better assist them in assessing the results of the entity, determining the quality of the audit and in their decision making. Examples of such type of information are included in paragraph 23 of the Consultation Paper.

Moreover, NAO agrees that user perceptions of audit quality are influenced by the communicative value of the auditor's report. Presently, the standard auditor's report is perceived by users to provide little information to evaluate the quality of the audit. In addition, users opine that it uses generic language to describe the auditor's work effort such that they do not get a comprehensive picture about the extent of the auditor's procedures on a particular audit. Therefore NAO is of the opinion that users believe that the communicative value of the auditor's report could be enhanced if changes were made to the structure and wording of the auditor's report.

Therefore NAO agrees that there exists a perception that there should be more transparency about the entity and its financial statements and the audit performed.

2. If respondents believe changes in auditor reporting are needed, what are the most critical issues to be addressed to narrow the information gap perceived by users or to improve the communicative value of auditor reporting? Which classes of users are, in the view of respondents, most affected by these issues? Are there any classes of users that respondents believe are unaffected by these issues?

NAO believes that changes in auditor reporting are needed to disclose more information on the audit. Such changes would incorporate reporting by the auditor on the audit procedures performed, the auditors' judgements made in forming the audit opinion, the

key audit risks, and the key audit issues and their resolution. The auditor is also to report on financial reporting issues and other issues affecting the entity and its financial statements such as key business, operational and audit risks the auditor believes exist, the appropriateness of the accounting policies adopted, changes to accounting policies that have a significant impact, the auditor's perspective on the key assumptions underlying the judgements that materially affect the financial statements, the methods and judgements made in valuing assets and liabilities, significant unusual transactions and the quality and effectiveness of the governance structure and risk management. However, the auditor is not to originate any information about the entity in the report. Such information about the audited entity is to be disclosed in a separate section in the financial statements. The auditor would then provide an opinion on whether the information presented is true and fair.

Users most affected by these issues would be shareholders, management, institutional and other investors, financial analysts, creditors, lenders, Government authorities, major customers and suppliers, competitors, and employee unions.

No class of users is unaffected by these issues.

3. Do respondents believe that changes are needed for audits of all types of entities, or only for audits of listed entities?

NAO opines that changes are needed for audits of all types of entities and not only of listed entities. This ensures consistency in auditor reporting for all types of entities. However, the implementation of changes to auditor reporting should be made mandatory to listed entities and entities with a public interest. Smaller entities and private companies may be encouraged to implement changes in auditor reporting, without this being obligatory.

## **Exploring Options for Change**

### **A. Format and Structure of the Standard Auditor's Report**

4. Respondents are asked for their reactions to the options for change regarding the format and structure of the standard auditor's report described in Part A. Do respondents have comments about how the options might be reflected in the standard auditor's report in the way outlined in Appendix 1 of this Consultation Paper?

NAO's reactions to the above have been grouped in accordance with the classification made in Part A.

### Explanations of Management and Auditor Responsibilities

The first option, namely that of relocating these paragraphs to a separate document used to communicate with users about the financial statement audit, is a feasible option. The

paragraphs could then be expanded as suggested in paragraph 40. The separate document would inform users about different aspects of the audit such as those matters identified in paragraph 23 of the document and in the replies to Question 2 to this Consultation Paper.

Under this option, it would be practicable to include the audit opinion only in the current standard Independent Auditor's Report whilst the respective management and auditor's responsibilities would be relocated and expanded on in a separate document. The fact that a separate document exists to inform users about the various aspects of the audit would reduce the expectations gap.

The second option of having an opinion only report is not advisable since information about the audit is crucial to users' assessment of the quality of the audit and to address the expectations gap.

Under the second option, the paragraphs pertaining to the respective management and auditor's responsibilities will be removed from the auditors' report and the report would contain the opinion only. Thus, important information about the audit would be missing. For instance, the report will not include information on whether the auditor obtained sufficient and appropriate audit evidence to provide a basis for the audit opinion.

NAO believes that the third option, namely that of retaining these paragraphs in the auditor's report (and, as appropriate, expand their content), but position them at the end of the report, or as appendix thereto, while highlighting that such information is an integral part of the report, is the preferred option. This will best address the expectations gap and contain all communications by the auditor into one document.

In fact, NAO is of the opinion that the current positioning of these paragraphs is to be retained in the Independent Auditor's Report under this option (before the audit opinion) and not be placed at the end of the report. However, a reference to an Appendix is also to be made in each of the paragraphs relating respectively to management and auditor responsibilities. In this Appendix, the responsibilities of management and the auditor will be expanded upon. Such an Appendix would form an integral part of the Independent Auditor's Report.

#### Use of Technical Language

NAO agrees with the Consultation Paper that certain technical words used in the Independent Auditor's Report need to be further explained in order to ensure accurate understanding by users.

NAO opines that certain explanations for technical terms such as those identified in paragraph 46 of the Consultation Paper could be included in the financial statements by way of a glossary of technical terms and not incorporated within the Independent Auditor's Report.

### Location of the Auditor's Opinion

NAO is of the opinion that giving greater prominence to the audit opinion by presenting an opinion only report as described above or by presenting the opinion in the first paragraph of the auditor's report followed by paragraphs dealing with the responsibilities of management and the auditor might be an option.

However, NAO prefers to retain the current positioning of the auditor's opinion (after the paragraphs dealing with the responsibilities of management and of the auditor) so that the opinion will be read within the appropriate context.

5. If the paragraphs in the current standard auditor's report dealing with management and the auditor's responsibilities were removed or re-positioned, might that have the unintended consequence of widening the expectations gap? Do respondents have a view regarding whether the content of these paragraphs should be expanded?

Yes, NAO is of the opinion that if the paragraphs in the current standard auditor's report dealing with management and the auditor's responsibilities were removed or re-positioned, this might have the unintended consequence of widening the expectations gap. This is because these paragraphs outline the respective obligations of both management and the auditor with respect to the preparation and review of the entity's financial statements. Thus removing such paragraphs from the audit report will result in users having less understanding of the nature of an audit, including its scope, objectives and inherent limitations.

If the paragraphs are re-positioned to the end of the report, the audit opinion will not flow naturally from the paragraphs pertaining to management and auditor responsibilities. This will also affect adversely the expectation gap.

Yes, NAO believes that the contents of these paragraphs should be expanded so that users will get a clearer picture of the respective responsibilities of management and the auditor and will thus be in a better position to assess the results of the entity and quality of the audit.

### **B. Other Information in Documents Containing Audited Financial Statements**

6. Respondents are asked for their reactions to the possibility that the standard auditor's report could include a statement about the auditor's responsibilities regarding other information in documents containing audited financial statements. Do respondents believe that such a change would be of benefit to users?

NAO opines that the standard auditor's report is to include a statement about the auditor's responsibilities regarding other information in documents containing audited financial statements. This would ensure that such information is fairly presented, free from material inconsistencies with the audited financial statements and from material

misstatement of fact. The auditor's opinion on such information would be of benefit to users as they would be in a better position to rely on the quality of such information.

7. If yes, what form should that statement take? Is it sufficient for the auditor to describe the auditor's responsibilities for other information in documents containing audited financial statements? Should there be an explicit statement as to whether the auditor has anything to report with respect to the other information?

The statement is to be divided into two parts:

1. The definition of the auditor's responsibilities with respect to other information in documents containing audited financial statements.
2. A statement as to whether the auditor has anything to report with respect to the other information (a conclusion).

Both parts are necessary to assist users in assessing whether the information in documents containing audited financial statements is reliable, fairly presented and consistent with the audited financial statements.

### **C. Auditor Commentary on Matters Significant to Users' Understanding of the Audited Financial Statements, or of the Audit**

8. Respondents are asked for their views regarding the auditor providing additional information about the audit in the auditor's report on the financial statements.

NAO opines that additional information about the audit can be included in the auditor's report on the financial statements. Such information could include key areas of the audit as identified in paragraph 62 of the Consultation Paper. Such information may help to reduce the expectation gap between what users expect from the auditor and the financial statement audit, and the reality of what an audit is. It also serves to clarify and give reasons for the audit opinion issued.

Although the Consultation Paper raises a number of concerns, especially the issue of "dueling" information as stated in paragraph 64, NAO opines that the additional information on the audit provided by such additional paragraphs is of added value to users and enhances the communicative value of the auditor's report.

9. Respondents are asked for their reactions to the example of use of "justification of assessments" in France, as a way to provide additional auditor commentary.

NAO agrees that the use of "justification of assessments" is a feasible way to provide additional auditor commentary. This would be beneficial to users as it would assist them in analysing the quality of the audit carried out by the auditor/s and enable them to obtain a better understanding of the reasons behind the statutory auditors' opinion on the financial statements. Thus the communicative value of the auditor's report would be

enhanced. NAO also concurs with the perceived benefits outlined in paragraph 68 of the Consultation Paper.

NAO believes that the benefits of using such a system outweigh the difficulties and challenges identified in paragraph 69 of the Consultation Paper namely complexity, standardisation and increased exposure to liability. Such challenges can be surmounted through enhanced user education and the exercise of professional competence and due care.

10. Respondents are asked for their reactions to the prospect of the auditor providing insights about the entity or the quality of its financial reporting in the auditor's report.

NAO is of the opinion that the auditor should provide insights about the entity or the quality of its financial reporting in the auditor's report based on the work done for the financial statement audit. However, NAO believes that the auditor is not to comment on matters and information that have not been disclosed in the financial statements by management. The responsibility for disclosure of information about the entity to users of the entity's audited financial statements remains with management.

Furthermore, NAO opines that should the auditor (in the form of additional commentary, or otherwise) be required to report on matters that are not disclosed by the entity itself, appropriate regulation is to be developed to address the challenges identified in paragraphs 73 and 74 of the Consultation Paper in this regard.

#### **D. An Enhanced Corporate Governance Model: Role of Those Charged with Governance regarding Financial Reporting and the External Audit**

11. Respondents are asked for their reactions to the options for change relating to an enhanced model of corporate governance reporting, as described in Section III, Part D.

NAO agrees with the enhanced model of corporate governance reporting, in particular the model described in paragraph 84 of the Consultation paper. This model enhances auditor reporting and effective two-way communication between the auditor and those charged with governance. Such a model would also assist those charged with governance in fulfilling their oversight responsibilities and would reinforce the entity's responsibility for full and proper disclosure to shareholders and other users as a matter of good corporate governance, without fundamentally changing the role of the independent auditor.

12. To the extent that respondents support this model, what challenges may be faced in promoting its acceptance? Also, what actions may be necessary to influence acceptance or adoption of this model, for example, by those responsible for regulating the financial reporting process?

Several challenges may be faced in promoting the acceptance of this model. One of the problems would be the added burden that would be placed on audit firms to prepare a

report on the completeness and reasonableness of the audit committee's report. This would probably result in an increase in audit procedures (that would have to be incorporated in the audit plan) reflected in an increase in fees or a reduction of audit work in other areas that may affect adversely audit quality. Therefore either the audit costs for the audited entity will rise or there might be an adverse effect on audit quality. Thus the implementation of this system could be resisted due to these factors.

Moreover, reporting by the audit committee to shareholders on the oversight of the financial reporting process and external audit will also place increased responsibilities on the audit committee due to increased procedures and additional disclosures. Thus increased time and resources will have to be dedicated by the audit committee to comply with the requirements of the corporate governance reporting model. Furthermore, due to added disclosures, open communication between officers of the audited entity and the audit committee may be weakened as officers would be very prudent in reporting results to the audit committee.

Another difficulty faced in promoting acceptance of this system could be increased exposure to auditor liability. Auditors would have to exercise professional competence and due care, within limited audit completion timeframes and resources, in reporting on the completeness and reasonableness of the audit committee's report so as not to increase exposure to auditor liability.

The actions that may be necessary to influence acceptance or adoption of this model by those responsible for regulating the financial reporting process include:

1. The performance of a cost and benefit analysis of the system to demonstrate that its strengths outweigh its disadvantages;
2. Promotion of the benefits of the system to members of the audit profession, the business community and the general public; and
3. Strengthening the role of audit committees worldwide so that this system can be implemented to the full.

13. Do respondents believe assurance by the auditor on a report issued by those charged with governance would be appropriate?

Yes, NAO is of the opinion that assurance by the auditor on a report issued by those charged with governance would be appropriate. This would ensure that further control is exercised over the financial reporting process, and provide assurance on the completeness and reasonableness of the audit committee's report and related disclosures. Therefore, as a result, users of financial statements can place more reliance on the audit committee's report and benefit from full and proper disclosure by the entity.

## **E. Other Assurance or Related Services on Information Not Within the Current Scope of the Financial Statement Audit**

14. Respondents are asked for their reactions to the need for, or potential value of, assurance or related services on the type of information discussed in Section III, Part E.

NAO opines that the potential value of providing assurance on the type of information discussed in Section III, Part E in addition to carrying out a financial statement audit would be substantial. Such assurance would help to address the expectations and information gaps. Users will better understand the reality of what an audit is. Moreover, more information will be available to them in order to make informed investment and fiduciary decisions.

However, in order to provide such assurance, audit firms would have to dedicate more time and resources in terms of additional audit planning, implementation and reporting. This would result in higher audit fees being charged to audited entities or a reduction in audit work in other areas.

15. What actions are necessary to influence further development of such assurance or related services?

A cost and benefit analysis is to be carried out to determine whether the advantages of this system outweigh the additional expenditure involved. Moreover, international standards are to be developed to provide guidance on how to provide this type of assurance and how to perform quality reviews of such assurance. In addition, auditor training is to include sessions on how to provide assurance on information not within the current scope of the financial statement audit.

## **Implications of Change and Potential Implementation Challenges**

16. Respondents are requested to identify benefits, costs and other implications of change, or potential challenges they believe are associated with the different options explored in Section III.

One of the benefits of changing the format and structure of the auditors' report (as proposed in Part A) would be to reduce the expectations gap. Moreover, such changes would help users of financial statements to better assess the quality of the audit performed by the auditor. In addition, further information on the respective responsibilities of management and the auditor would be disclosed for the benefit of users. One of the challenges of changing the format and structure of the auditors' report would be the increased exposure to liability being faced by auditors since they would be disclosing more information about the audit. Another challenge would be to train auditors to prepare this type of audit report. There will also be additional costs for entities since additional resources would be required by audit firms to prepare these reports.



The benefits of having auditors stating their responsibilities relating to other information contained in the financial statements and forming a conclusion regarding such information will result in a more comprehensive review of the financial statements and other information and provides assurance that there are no inconsistencies between the financial statements and the narrative parts of the financial statements. The challenges faced by such an approach include possible increased costs to audited entities in terms of higher audit fees to cover the additional responsibilities of the auditor or an adverse effect on audit quality due to audit work in other areas being reduced. Another challenge would be the increased exposure to audit liability that may arise out of an inappropriate conclusion.

One of the benefits of providing an auditor commentary on matters significant to users' understanding of the audit or the audited financial statements would be to address both the expectations and information gaps. Moreover, this would provide further guidance to users on how to understand and interpret financial statements and would disclose more information about the audit. The major challenge with this option is that it may be inadvisable for the auditor to originate information about the entity for users as this would undermine the importance of the division of responsibilities between the entity and its independent auditor. Another challenge might be that the additional disclosures will create confusion in the mind of readers rather than provide more guidance on how to interpret financial statements. Challenges relating to an increase in audit costs/reduction in audit quality in other areas and an increase in auditor liability apply to this case also.

As already stated in our reply to question 11, the major benefits of the enhanced model of corporate governance reporting include enhanced auditor reporting and increased dialogue between the auditor and those charged with governance. Such a model would also assist those charged with governance in fulfilling their monitoring and control responsibilities and would ensure full and proper disclosure by the entity to shareholders. The costs and challenges associated with this model comprise:

1. the added burden on auditors to prepare a report on the completeness and reasonableness of the audit committee's report. This would either result in an increase in fees or a reduction of work in other areas;
2. added responsibilities on the audit committee which require new skills and an increase in the level of involvement with the entity;
3. increased exposure to liability by both the audit committee and the auditor
4. weakened communication between officers of the audited entity and the audit committee as officers would be very prudent in reporting results to the audit committee; and
5. limited implementation of this model in the case of a weak audit committee.

The major benefit of providing other assurance or related services not within the current scope of the financial statement audit would be the added value that both the client and other users receive from such assurance, thus addressing the expectations and information gaps. Another benefit would be that full disclosure would be made of the key areas related to the success of the business. The costs and challenges pertaining to this model

include increased audit procedures that may give rise to higher audit fees and/or a reduction in audit work in other areas and increased exposure to liability by the auditor.

17. Do respondents believe the benefits, costs, potential challenges and other implications of change, are the same for all types of entity? If not, please explain how they may differ.

The benefits, costs, potential challenges and other implications of change are higher for large, listed and public entities. Users of the financial statements of such companies would reap the highest benefit from such changes in relation to the costs involved due to the complexity of their structures, business processes and financial reporting systems. However, such large companies will also be facing the major challenges associated with these options.

Shareholders, lenders and other users of smaller companies and privately owned entities with simpler operating systems will also benefit from the enhanced assurance and disclosures incorporated within these options.

18. Which, if any, of the options explored in Section III, either individually or in combination, do respondents believe would be most effective in enhancing auditor reporting, keeping in mind benefits, costs, potential challenges, and other implications in each case? In this regard, do respondents believe there are opportunities for collaboration with others that the IAASB should explore, particularly with respect to the options described in Section III, Parts D and E, which envisage changes outside the scope of the existing auditor reporting model and scope of the financial statement audit?

NAO believes that option C in combination with option E would be most effective in enhancing auditor reporting keeping in mind benefits, costs, potential challenges, and other implications in each case. The audit report would contain:

1. Increased Use of “Emphasis of Matter” Paragraphs in the Standard Auditor’s Report;
2. increased information about the audit;
3. the provision of auditor insights about the entity or the quality of its financial reporting
4. the provision of other assurance or related services on information not within the scope of the financial statement audit.

NAO is of the opinion that the above combination of options addresses both the expectations and information gap. It is hoped that users will understand more the nature of an audit and will be presented with comprehensive information about the entity on which to base their investment and fiduciary decisions. This option would also increase the communicative value of the auditor’s report.

It is important that the auditor reports on matters that would have already been disclosed by management in the financial statements.

Regarding cooperation, NAO believes that there are opportunities for collaboration with others that the IAASB should explore, particularly with respect to the options described in Section III, Parts D and E, which envisage changes outside the scope of the existing auditor reporting model and scope of the financial statement audit. Thus the provision of assurance services and the preparation of reports on company disclosures not involving the financial statement audit may be carried out by a different firm from the statutory auditor. Thus stakeholders will receive assurance from a number of auditors. However, in such a case, one of the auditors is to take the lead and co-ordinate the work of other auditors.

19. Are there other suggestions for change to auditor reporting to narrow the “information gap” perceived by users or to improve the communicative value of the auditor’s report?

NAO believes that the key audit issues raised during the audit and their resolution are to be reported upon by the auditor under Matters significant to Users’ Understanding of the Audited Financial Statements or of the audit.

Moreover, NAO opines that if Option E is implemented, the auditor’s opinion is to be expanded to provide assurance on other types of subject matter that is deemed to be of value to the management of the entity as well as external users.