SAICA
THE SOUTH AFRICAN INSTITUTE OF CHARTERED ACCOUNTANTS
develop.influence.lead.

12 September 2011

Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue,
14th Floor,
New York
10017
USA

Email: www.iaasb.org

Dear Sir

SAICA SUBMISSION ON THE IAASB CONSULTATION PAPER, ENHANCING THE VALUE OF AUDITOR REPORTING: EXPLORING OPTIONS FOR CHANGE

In response to your request for comments on the Consultation Paper, *Enhancing the Value of Auditor Reporting: Exploring Options for Change*, attached is the comment letter prepared by The South African Institute of Chartered Accountants (SAICA).

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely,

Ashley Vandiar
Project Director – Assurance and Members' Advice

cc:

Integritas, 7 Zulberg Close, Bruma Lake, 2198 POSTAL ADDRESS PO Box 59875, Kengray, 2100, Johannesburg
TEL +27 11 621 6600 FAX +27 11 621 3321 CALL CENTRE 08610 SAICA (72422) EMAIL saica@saica.co.za WEB saica.co.za | accountancysa.org.za

OVERALL COMMENTS

We believe that initiatives such as this consultation paper are vital in soliciting views regarding the perceived value of the auditor and the related audit of financial statements. It is inevitable that, as the information needs of users and the amount of information available to such users evolve, auditor reporting and/or corporate governance reporting would also need to evolve so as to ensure that users obtain the information they deem necessary to make informed decisions.

We believe that, in addressing the information needs of users, it is important to recognise that users are often seeking further non-financial information that they believe can assist them in developing insights into the sustainability of the entity, and that these needs should be considered in exploring any options for change; however, it is critical that the roles and responsibilities of management and/or those charged with governance and the auditor are not changed in response to this demand for more information. Management and/or those charged with governance should remain responsible for providing the users with the information they consider necessary, and auditors should remain responsible for enhancing the reliability and credibility of this information by performing assurance or related services thereon.

A number of models of enhanced auditor and corporate governance reporting have already been explored and/or implemented in certain countries and/or jurisdictions. We believe that it is important to understand these models and their successes and failures in assessing what further actions need to be taken to develop mechanisms that enhance the value of auditor and/or corporate governance reporting.

Our detailed comments in response to the specific questions raised in the consultation paper are set out below.

RESPONSES TO SPECIFIC QUESTIONS IN THE CONSULTATION PAPER

Issues Identified

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

   Response: We agree that an "Expectations Gap" exists and that the auditing profession, together with management and/or those charged with governance, can and should play an important role in addressing this expectation gap through a level of enhanced auditor reporting and/or enhanced corporate governance reporting.

   We further agree that, due to the evolving information needs of a wide range of users and a general lack of understanding of these specific needs, an "Information Gap" exists. Whilst we acknowledge that the auditor may have a role to play in narrowing this gap, we are of the firm belief that management and /or those charged with governance should be the major role players in addressing this information gap, and that this process should be driven by regulators if it is to be effective. We believe that auditors can assist in enhancing the perceived reliability and credibility of additional information provided by management and/or those charged with governance by performing assurance or related services type engagements on such information.

   In addressing both the expectations gap and information gap, it is important to bear in mind that enhanced reporting (by either the auditor or those charged with governance) will never be able to satisfy the information requirements of all categories of users of financial statements.

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?*

   Response: We consider that the following critical issues would need to be addressed to narrow the information gap perceived by users and/or improve the communicative value of auditor reporting:

   - The information communicated to users is not specific to the entity being audited.
   - The concept of materiality and the impact this has on an audit is often not clearly understood by users.
   - The respective responsibilities of management and the auditors with regards to specific aspects, such as fraud (and the detection thereof), independence and going concern, is not clearly communicated.
   - The negative connotations associated with "Emphasis of Matter" and "Other Matter" paragraphs in the audit opinion.

- Management and/or those charged with governance and the auditors do not always understand the information requirements of users and tend to apply a one-size-fits-all approach.

We believe that all users are affected by these issues, but that the extent of the affect of these issues on specific classes of users is dependent on their level of expertise and experience with regards to the analysis of financial statements, as well as the level of dialogue that exists currently between users, management and/or those charged with governance and the auditor. In smaller entities we would expect that there is better dialogue between all parties due to a smaller number of users and, therefore, these issues may affect such users to a lesser extent.

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

Response: We believe, if changes are to be made to auditor reporting, that these changes should be made for all types of entities. If changes to auditor reporting were to be made only for the audits of listed entities, this might have the effect of further widening the expectation gap and/or information gap of the users of financial statements of non-listed entities. Thus, it is important to maintain uniformity in auditor reporting.

Furthermore, we are of the belief that the users of financial statements of non-listed entities would in fact probably benefit more from changes to auditor reporting than users of financial statements of listed entities. The reason for this is that, due to the nature of listed entities and the regulations that often govern the reporting (auditor and other) requirements of such entities, there is often more public information available to users of financial statements of such entities that can be of assistance to them in understanding the financial statements and related auditor's report.

Stakeholders of non-listed entities could often be more at risk than those of larger entities because of the lack of diverse management and ownership that could make it easier to 'hide' things from 'outside' parties

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?*

Response: We support the suggestion that the audit opinion should be repositioned to the beginning of the audit report, as currently this is the component of the audit report from which users derive the most value. Furthermore, as discussed in our response to question 5 below, we support the suggestion that the paragraphs dealing with

management and the auditor's responsibilities should be repositioned to the end of the audit report.
The reason for is that we believe that all information specific to an entity should have prominence in the audit report so that it can be easily identified and extracted by users. All standard wording (i.e. does not change from audit to audit) should be relocated to the end of the auditor's report so that users have an option as to whether or not they wish to read that information.

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?*

   Response: We are of the opinion that the paragraphs dealing with management and the auditor's responsibilities should be retained in the audit report and, furthermore, we support the suggestion that these paragraphs could be re-positioned. Certain users of financial statements are not familiar with the matters addressed in these paragraphs and so, if these paragraphs were to be removed, such users may not be able to contextualise the other information included in the audit report, which may in turn widen their expectations gap. However, if these paragraphs are simply repositioned (i.e. after the audit opinion), it is then up to the user to decide if they wish to read these paragraphs which in turn will be dependent on their familiarity and comfort with the matters addressed in these paragraphs.

   We further believe that the content of the paragraphs dealing with management and the auditor's responsibilities should be expanded so as to clarify the responsibilities of each party with regards to such matters as fraud (and the detection thereof), independence and going concern. The responsibility paragraphs currently included in the auditor's report do not specifically deal with these matters and, unless users of financial statements have a good knowledge of the ISAs, it is expected that they would not be aware of the responsibilities of each party with regards to these matters. However, we do not believe that this expanded content should be dealt with in the auditor's report itself, as it would probably detract further from the perceived value of the auditor's report. We suggest that the expanded description of management and the auditor's responsibilities only be referenced in the auditor's report and be dealt with, together with an explanation of some of the technical words used in the auditor's report that users struggle with, in a separate document that is available to all users electronically. If this format is utilised, it is again up to the user to decide if they wish or need to read the expanded content.

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?*

   Response: We believe that some users of financial statements place undue reliance on other information included in documents containing the audited financial statements because they are of the belief that, because such information is included with the audited financial statements, it has been "audited" and is therefore accurate and reliable. On the other hand, it can be expected that certain other users may be reluctant to place any reliance on such other information as it is not specifically mentioned in the auditor's report and has therefore not been "audited" or verified. We are therefore of the opinion that the inclusion of a statement about the auditor's responsibilities regarding other information in documents containing audited financial statements in the standard auditor's report would be beneficial to users in overcoming these misconceptions.

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?*

   Response: We believe that the statement to be included in the standard auditor's report should incorporate the following:
   - An explanation of the auditor's responsibilities for other information in documents containing audited financial statements as per the ISAs;
   - A description of the work/procedures performed by the auditor on such other information;
   - A conclusion/statement as to whether the auditor has anything to report with respect to such other information; and
   - An explanation of any limitations/disclaimers on the work performed by the auditor on such other information.

   It may be impractical to include all of the above information in the auditor's report itself and therefore the aspects that are expected to be consistent across all entities (e.g. auditor's responsibilities for other information and description of work performed) may be included in the separate document that is available to all users electronically, as suggested in the response to question 5 above.

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.*

   Response: Whilst we are of the belief that the value of the auditor's report on the financial statements may be significantly enhanced through the provision of additional information about the audit in the auditor's report, there are certain key factors that need to be considered. Firstly, the concept of materiality and its impact on the audit would need to be understood by users of financial statements as the materiality figure would in all likelihood be used by the auditors as a benchmark in determining what additional information about the audit should be included in their report. Secondly, as a result of the auditor's responsibility to maintain confidentiality, any additional information about the audit to be included in the auditor's report would first need to be discussed with management and/or those charged with governance. This is unlikely to pose a major problem though as such information is generally communicated to management and/or those charged with governance as part of the audit process and is readily available. Thirdly, any information about significant audit risks and/or significant areas of judgment should also include commentary from the auditor and/or management as to how the risk and/or significant areas of judgment were responded to and what the final conclusion was. Lastly, the auditor would need to guard against creating a perception that an opinion or conclusion is only being expressed on certain elements of the financial statements or certain disclosures.

   In light of all of the above considerations, we believe that this option for enhancing auditor reporting has certain limitations and therefore is unlikely to satisfy all of the information requirements of users without the support of further mechanisms such as the enhanced model of corporate governance reporting explored in Section III, Part D of the Consultation Paper.

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.*

   Response: We believe that the example of auditor commentary currently utilised in France has some merit in that it provides users with a better understanding of specific aspects of the financial statements that were considered by the auditor in arriving at their audit opinion. However, we are of the opinion that this approach to enhancing auditor reporting will only be effective if the commentary remains specific to the entity and its particular circumstances. As soon as auditor commentary is standardised, the benefits to this approach would dissipate. Furthermore, as discussed in our response to question 8 above, we believe that this approach to enhancing auditor reporting has certain limitations.

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.*

Response: We do not support the idea that the auditor should provide insights about the entity or the quality of its financial reporting in the auditor's report. Whilst the auditor does develop some important insights about the entity and the quality of its financial reporting throughout the audit process, we believe that significant conflicts and/or complexities would arise if the auditor was required to share this information, especially with regards to the independence requirement relating to an audit. In addition, many of these insights are developed on the basis of professional judgment and are therefore not necessarily representative of the insights that users may develop if they had access to the same information as the auditor. Thus, the sharing of these insights may create additional concern around auditor liability. We believe that the responsibility for communication or disclosure of information about the entity should therefore remain the responsibility of management and/or those charged with governance. The auditor could possibly play a role in improving the quality of such communication by encouraging management and/or those charged with governance to include more robust disclosure in financial statements, especially with regards to management estimates and other financial information that rely heavily on the judgment of management and/or those charged with governance. Furthermore, in cases where an entity is a service organisation, and a limited or reasonable assurance engagement on the controls at that service organisation is performed in accordance with International Standards for Assurance Engagements 3402, "Assurance Reports on Controls at a Service Organisation" (ISAE 3402), the auditor should encourage management and/or those charged with governance to report the findings of these types of engagements to users.

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.

Response: We believe that the enhanced model of corporate governance reporting described in Section III, Part D of the Consultation Paper has a number of merits. Firstly, it encourages those charged with governance to take responsibility for providing meaningful information and insights over the financial reporting process and audit to the users of financial statements. Those charged with governance are best placed to provide this information as they have detailed knowledge of both the entity and the audit process. Secondly, as the auditor is not originating the information, auditor concerns over breach of client confidentiality and increased liability are dispelled. Thirdly, as the auditor would be required to include additional communication in their auditor's report regarding the information provided by those charged with governance, it provides users with the additional assurance and credibility they seek. However, it should be recognised that certain information or statements made by management in corporate governance reporting may be either impossible or difficult to provide assurance on, and hence this would need to be dealt with appropriately in the auditor's reporting.

We suggest that this enhanced model of corporate governance reporting be extended beyond the financial reporting process and audit to include non-financial issues, so as to provide more information to users on the long-term prospects and sustainability of an entity. Such an approach has been followed in South Africa whereby all companies listed on the local exchange are required to produce an "Integrated Report", which provides information to users on the ability of an entity to create and sustain value. We do not believe that this requirement should necessarily be applied to all entities as such reporting could be very onerous for smaller entities.

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?*

Response: We believe that one of the major challenges faced in promoting an enhanced model of corporate governance reporting is that those charged with governance may not see the benefit in such reporting and may view it as onerous and would therefore be unwilling to undertake such reporting. We are of the belief that this enhanced model of corporate governance reporting can only be effective if entities (or certain categories of entities) are required to comply by regulators and that such compliance is monitored. Further challenges that may be faced in promoting the acceptance of this model amongst users of financial statements would include a lack of confidence in those charged with governance and their ability to act in the best interests of shareholders, as well as a lack of understanding of the information that might be included in such reporting and whether it addresses the "information gap" needs of users.

We envisage that investors, shareholders and other categories of users of financial statements would need to put pressure on regulators and/or exchanges to accept and adopt this model of corporate governance reporting.

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

Response: Yes, however we believe that this assurance should not be included as part of the auditor's report on the financial statements. Instead, we suggest that assurance on the report issued by those charged with governance be provided in terms of International Standards for Assurance Engagements 3000 (Revised), "Assurance Engagements other than audits or reviews of historical financial information" (ISAE 3000). Furthermore, as discussed in our response to question 11 above, we suggest that this assurance be extended to the entire report and not just to the section(s) dealing with the financial reporting process and audit.

However, it should be recognized that certain information or statements made by those charged with governance may be either impossible or difficult to provide assurance on, and hence this would need to be dealt with appropriately in the auditor reporting.

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.*

Response:
We are of the opinion that there is certain other financial and non-financial information about an entity that may be of value to users of financial statements. The financial information included in the audited financial statements is historic by nature and does not generally provide an insight into the future profitability and sustainability of an entity. In light of recent corporate scandals and environmental disasters, it is becoming increasingly apparent that non-financial issues can have a significant impact of the future prospects and sustainability of an entity, and therefore users are placing increasing value on information that provides insight into an entity's future prospects and sustainability. We believe that auditors can assist in improving the reliability and credibility of such information by providing other assurance and related services with regards to this information. However, in providing assurance on this type of information, the auditor would need to guard against shifting the primary focus away from financial statement audits.

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

Response: We believe the following actions are necessary to influence further development of such assurance or related services:

- Regulators and/or exchanges would have to assess the level of assurance required for the type of information discussed in Section III, Part E.
- Regulators and/or exchanges would need to assess, in consultation with the IAASB, if the required level of assurance can be provided through an existing Assurance Engagement or Related Services framework.
- Regulators and/or exchanges would need to define exactly what information will be subject to such assurance engagement or related services.
- The responsibilities of management and the auditor with regards to the information would need to be defined.
- Criteria and guidance for the evaluation of the information would need to be developed.
- Concerns around the provision of assurance over forward looking information would need to be understood and addressed.

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.*

Response:

a) *Part A – Format and Structure of the Standard Auditor's Report*

The benefits that may be derived from this option include a better understanding of the respective responsibilities of management and the auditor (through expanded commentary on these responsibilities), as well as increased emphasis on the audit opinion, which is the component of the audit report from which currently users derive the most value. The costs associated with this option would be minimal, as once the expanded standard wording on the responsibilities of management and the auditor have been developed and the audit report restructured, auditors would simply need to update their existing audit reports for these changes. One of the key implications of this option is that it may have the unintended effect of increasing the information gap (maybe only temporarily) as users may view the audit opinion out of context.

b) *Part B – Other Information in Documents Containing Audited Financial Statements*

The benefit of this option is that it provides clarity with regards to the auditor's responsibility for other information in documents containing audited financial statements, and thereby enhances the ability of the user to decide if they wish to place reliance on such information. The costs associated with this option would be minimal (as already dealt with in ISA 720), as most of the commentary around the responsibilities of the auditor with regards to this other information would be standardised and would simply need to be incorporated into the audit report. One of the challenges faced with this option is deciding on the approach to be followed with regards to forward looking information included in such other information, i.e. defining and/or limiting the responsibility of the auditor with regards to this type of information.

c) *Part C – Auditor Commentary on Matters Significant to Users' Understanding of the Audit of the Audited Financial Statements*

The benefits that may be derived from this option may include an enhanced understanding by users of the significant risks and/or significant areas of judgment that have been considered and addressed by the auditor in arriving at the audit opinion, as well as an increased dialogue between the auditor and management and/or those charged with governance with regards to the additional disclosures to be included in the audit report.

We believe that the following are some of the potential challenges related to this option:

- This additional auditor commentary may become standardised over time, which would detract from its value to users
- The nature and extent of auditor commentary would be largely driven by the audit materiality and would therefore rely on the fact that users have a sufficient understanding of the concept of materiality
- Owing to the auditor's professional responsibility with regards to confidentiality, any additional auditor commentary included in the audit report would need to first be discussed and agreed with management and/or those charged with governance
- This additional auditor commentary may create the perception that an opinion or conclusion is only being expressed on certain elements of the financial statements.

We believe that if this option were to be implemented, regulators and/or standard setters would need to prescribe certain minimum areas to be addressed through this additional auditor commentary. We believe that the costs associated with this option would be dependent on the existing level of dialogue between the auditors and management and/or those charged with governance and the existing quality of reporting between these parties.

d) Part D – An Enhanced Corporate Governance Model: Role of Those Charged with Governance Regarding Financial Reporting and the External Audit

One of the key benefits associated with this option is that the line between the responsibilities of management and/or those charged with governance and the auditor is not blurred. Under this option, management and/or those charged with governance remain responsible for providing the users with the information they consider necessary and auditors remain responsible for enhancing the reliability and credibility of this information by performing assurance or related services thereon. The key challenge associated with this option is that, unless management and/or those charged with governance are compelled by regulators to undertake such enhanced corporate governance reporting, it will not be effective. The costs associated with this option would also be dependent on the existing quality of corporate governance reporting, but it is envisaged that additional costs would need to be incurred by both the entity and the auditor if this option were to be employed.

e) Other Assurance or Related Services on Information Not Within the Current Scope of the Financial Statement Audit

The major benefit of providing other assurance or related services on information not currently within the scope of the financial statement audit is that it would enhance the reliability and credibility of information that users increasingly consider important in developing insights into the future prospects and sustainability of an entity. The challenges associated with this approach include: (i) whether or not auditor possesses the necessary skills or expertise to provide assurance or related services on such information; (ii) the risk that the focus shifts away from the financial statement audit and therefore undermines the value attached to the financial statement audit. The costs related to this option would include the costs required to gather and assemble the required information in a meaningful format and the costs involved in developing and providing guidance on a model that addresses the needs of a large group of users.

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.*

    Response: No. We believe that the costs and potential challenges associated with certain of the options for change would be greater for smaller entities and that these costs and challenges would in all likelihood outweigh the perceived benefits of these options for change. Due to the nature of smaller entities, the dialogue and reporting between the auditors and management and/or those charged with governance is often done on a more informal basis and therefore a considerable amount of time and cost may be involved in addressing the additional reporting requirements explored in certain of the options for change. Furthermore, the information needs of users of financial statements of smaller entities are probably not as great as for other users because these users generally have better access to management and/or those charged with governance, and as a result the information they require to make informed decisions.

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?*

    Response: We believe that the option which would individually be most effective in enhancing auditor reporting is the option described in Section III, Part D, relating to an enhanced role for those charged with governance. Models with the characteristics of this option have already been explored and/or implemented in certain countries/jurisdictions and therefore we do believe that there are opportunities for collaboration with others that the IAASB should explore.

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?*

    Response: We do not have further suggestions for change to the auditor reporting to narrow the information gap; however, we believe that there are other mechanisms, beyond the scope of this consultation paper that may be explored to enhance the overall perception of the value of an audit and auditor reporting. Whilst changes to the audit report and/or enhancements to the model of corporate governance reporting could make inroads in narrowing the perceived "information gap", we believe that increased dialogue between users of financial statements, auditors and those charged with governance is needed in order to change perceptions.

#366767