new york state society of
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certified public accountants

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September 14, 2011

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

Submitted electronically at: www.iasb.org

Re: IAASB Consultation Paper, *Enhancing the Value of Auditor Reporting: Exploring Options for Change*

The New York State Society of Certified Public Accountants, representing more than 28,000 CPAs in public practice, industry, government and education, welcomes the opportunity to comment on the above captioned consultation paper.

The NYSSCPA's Auditing Standards and International Accounting and Auditing Committees deliberated the consultation paper and prepared the attached comments. If you would like additional discussion with us, please contact Jan C. Herringer, Chair of the Auditing Standards Committee at (212) 885-8133, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely,

NYSSCPA

Richard E. Piluso
President

Attachment

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NEW YORK STATE SOCIETY OF

CERTIFIED PUBLIC ACCOUNTANTS

COMMENTS ON

IAASB CONSULTATION PAPER, *ENHANCING THE VALUE OF AUDITOR REPORTING: EXPLORING OPTIONS FOR CHANGE*

September 14, 2011

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New York State Society of Certified Public Accountants

Comments on

IAASB Consultation Paper, *Enhancing the Value of Auditor Reporting: Exploring Options for Change*

The New York State Society of Certified Public Accountants is pleased to submit the following comments in response to the request by the International Auditing and Assurance Standards Board (IAASB) for comments on the above captioned consultation paper.

Responses to Specific Questions

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

The stated objective of the Consultation Paper is “enhancing the value of auditor reporting.” It sets forth various initiatives and provides discussion of assumed benefits.

We believe that the financial statements should be the principal source of information for investor decisions. Management’s Discussion and Analysis (“MD&A”) which may include added discussion of risks and strategies and more forward looking information than the financial statements also provides information that may be helpful to investors. It is possible that some reporting frameworks may incorporate MD&A or requirements similar to MD&A. U.S. GAAP, as it applies to governmental entities under GASB Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments* is an example under which MD&A is required supplementary information. It is possible to add such a requirement to any existing reporting framework if desired, but that is best left out of the auditing standards. The auditor’s report provides a reasonable assurance that the financial statements do not contain material misstatement(s) and are presented fairly, based on the financial reporting framework on which the auditor is reporting.

The audit report, however, does not speak to the quality of the audit. Quality is driven by many factors including the professionalism of the audit firm and the engagement team and is vetted by quality control practices of the audit firm and by external inspection and regulators. Adding content and additional reporting responsibilities will not change the basic objectives of the audit, but will in our view change the fundamental role of the auditor which is to detect material misstatements.

Question 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 the respondents, most affected by these issues? Are there any classes of users that respondents believe are unaffected by these issues?

Information about the entity should be provided by management and the audit committee or those charged with governance as appropriate. Additionally, complexity and breadth of accounting principles and required disclosure has created what some have referred to as "disclosure overload." We believe that if the financial reporting framework is not robust enough to provide information in a form that appropriately communicates the information needed by investors, then the financial reporting framework would be the place to make improvements.

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

If changes are deemed needed, we believe they are not needed to the same extent for smaller and non-complex entities whose investors and other users of the financial statements are not broad constituencies and are generally numerically limited. In addition, the level of complexity in the accounting and disclosure should be reduced for such entities. For those reasons some measure of relief is warranted as it relates to any additional requirements.

Question 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?

We have provided an illustration of an auditor's report that provides four main headings and includes report modifications including some simplifications (see **Exhibit** attached). We have added headings to make the audit report easier to understand and, to allow those users interested in the opinion paragraph only a direct pathway. We believe that emphasis paragraphs can be used when deemed necessary, but should not be used for every report and that the report section on other legal and regulatory requirements should be reported on separately.

We do not believe that the current audit report is basically deficient. If the objectives of the report are not readily understood in the marketplace, we suggest providing clarification through other means such as through educational efforts.

A glossary of terms could accompany the auditor's report until such time as users become more comfortable with the terms and concepts used.

Overall, we do not see an overriding need to revise substantively the format of the audit report, and believe that expanding the content and reorganizing the format would not have a considerable impact on the effectiveness of the audit report. We see no significant changes from recommendations to clarify the standard audit report; the definitional construct would not change the auditing standards.

Question 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.

We have changed the content of both the management and the auditor's responsibilities paragraphs (see illustrative report attached). Removing these paragraphs is contra-intuitive and we think rearranging them is unnecessary.

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

We think that a statement of what information is not covered would be helpful to a user's understanding of the "other information content," being prepared by management only.

We are generally supportive of auditor reporting of "other information" outside the financial statements. The standards for examining MD&A have been in place in the U.S. since 2001. Practitioners can examine such information and express positive assurance if:

- The presentation includes, in all material respects, the required elements of the rules and regulations adopted by the SEC,
- The historical information has been derived accurately in all material respects from the entity's financial statements, and
- The underlying information, estimates and assumptions of the entity provide a reasonable basis for the disclosures contained therein.

The reporting is driven by published rules and regulations of the Regulatory Authority; that is, the critical underpinning without which the exercise would be futile. It is interesting to note that auditors of certain governmental entities in the U.S. communicate within the auditor's report on MD&A, which is required supplemental information in U.S. GAAP for governmental entities under a Government Accounting Standards Board opinion (GASB No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*). For such an approach to work internationally a framework would need to be developed and issued by National or International standard setters.

Question 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.

While we believe that if reporting is mandated on other information there likely will be something to comment on, however, if there were no specific items on which to comment, there should be an explicit statement stating so. PCAOB Section AT 701, *Management's Discussion and Analysis*, in the U.S. attestation standards would be a good starting point to develop international guidance. We note that there has not been any extensive issuance of reports under that standard by auditors since it was issued in 2001.

Question 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.

An auditor's discussion and analysis "AD&A" which under the Consultation Paper would provide the auditor's view of significant matters and how they were addressed in the audit engagement is basically an affirmation of communications made to the audit committee and/or those charged with governance. There is a compelling difference when this document is issued to the audit committee as opposed to when it is issued to shareholders/investors. In the former situation, there is a two way dialogue; whereas in the latter situation it is a one direction communication.

Further, if there is competing or "dueling" information in which this communication results in a perceived difference about what is said in this communication and what is disclosed in the financial statements it may become a credibility issue for both the entity and its auditor. The level of detail disclosed about the audit procedures employed might result in an inference of providing assurance at the test/assertion level for the issues discussed when the level of assurance is provided only on financial statements taken as a whole.

Auditors deal with these matters during the engagement. We believe that this initiative would be the most difficult to implement, the most problematic and the least beneficial for the reasons cited. Although there is subjectivity in many pronouncements, if there is a bias or, in the auditor's judgment, an erroneous conclusion or evaluation made, this can be dealt with as a proposed adjustment or a comment or stronger communication to the audit committee and/or those charged with governance. An issue that we believe is germane is that a discussion of quality may dwell on the accounting standards at issue, and that such a discussion may be construed or implied as critical to those standards.

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

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

Based on the reporting examples provided for this discussion we do not see the value of extending the reporting requirements to encompass this issue.

Embedding any AD&A discussion in an audit report would be highly problematic because differences in levels of assurance on different content in the report would not be generally understood and might lead to confusing such an analysis with other content in the financial statements (by users) unless the intended purpose is stated as strictly (1) explanatory and (2) that the information does not impugn the integrity of decisions made during the audit engagement or information provided in the financial statements. We believe that this content may become self-serving and redundant.

Business, strategic and operational risk discussions are most appropriately part of management's discussion and analysis (MD&A). Auditors may need to understand these issues to do an effective audit, but investors will not benefit by understanding how they were used to help meet the objectives of the audit. In our view, a discussion of the matters would not be cost beneficial or productive.

A required emphasis of a matter paragraph would in many cases diminish the effect of the auditor's opinion. The current standards appropriately address qualifications and disclaimers of opinion when the adequacy of disclosures and the suitability and implementation of accounting principles are inappropriate. An auditor uses an emphasis paragraph to emphasize certain disclosure and/or very significant transactions and/or comparability if the financial information is not easily comparable. The scope and opinion paragraphs do not change. A qualified opinion would apply when the auditor is unable to obtain sufficient evidence for such things as an uncertainty and its presentation and disclosure. We assume that the use of a qualified opinion would not change with this initiative. Historically, auditors use emphasis paragraphs to highlight such matters as:

- The entity is part of a larger business enterprise
- There are significant related party transactions
- A significant subsequent event has occurred
- An accounting matter other than a change in accounting principle
- A matter affecting financial statement comparability

We believe that under mandatory use of an EOM paragraph, a significant expansion of the types of matters previously considered will be included and the intended effect of such an inclusion will dilute the reporting objectives.

Questions 11 to 13

Question 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.

Question 12. To the extent that respondents support this model, what challenges may be faced in promoting this acceptance? Also, what actions may be necessary to

influence acceptance or adaption of this model, for example, by those responsible for regulating the financial reporting process?
Question 13. Do respondents believe assurance by the auditor on a report issued by those charged with governance would be appropriate?

We believe this type of reporting could be a problematic exercise while we see some benefits exist. A report from the audit committee to shareholders/users would be the appropriate vehicle for communicating how their charge was met. Involvement by the entities' auditor in reporting and on the completeness and reasonableness of the report is appropriate to be able to provide an element of independent review. Such review may be needed to address the consistency of the content of this report with the auditor's required communication letter with the audit committee. Some form of limited assurance is our recommendation.

There are inherent conflicts that need to be overcome to enable this type of reporting. For example, it is unclear what happens when there is no unanimity on the audit committee about the effectiveness of the audit or certain elements of the audit: Would a dissenting comment be included? Further, the relationship of the audit committee and the auditor is multifaceted such that the audit committee hires the auditor and the auditor is required to evaluate the effectiveness of the committee as part of its evaluation of internal control. For example, in the U.S., under PCAOB Auditing Standard No.5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, the auditor is required to report on whether the Board of Directors or Audit Committee exercises effective oversight over financial reporting and internal control for purposes of the integrated audit. However, the audit committee hires and approves the auditor's engagement contract. We can envision a circumstance in which the auditor criticizes the audit committee and the audit committee reports on the effectiveness of the audit. Would such circumstances need to be disclosed and, if so, would such a circumstance impact the integrity of this type of reporting?

Questions 14 and 15

Question 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.

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

We would need to approach these areas with caution. We can recall a time when auditors were reporting on solvency—an issue that ultimately became intractable when lenders relied on such reports to establish privity, and to hold auditor's responsible for lending transactions which became problematic. Audit firms' consulting groups already provide services to management in many of these areas as permitted by the applicable Independence Rules of Conduct. We believe there has not been any strong imperative to provide assurance from auditors other than perhaps as it relates to internal controls implemented in the U.S. initially through PCAOB AS No.2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements*, and then superseded by AS No.5.

For large listed companies in the U.S., registered auditors provide assurance through audits of internal control over financial reporting that is integrated with their audits of financial statements for such entities. This service is provided in other countries, but the practice is not widespread. It is our belief that a usable international internal control standard would need to be developed prior to the development of any assurance or related service guidance. We believe that such audits have improved the quality of the work of auditors and that the marketplace has benefited, although there are attendant costs.

As business becomes more globalized, the demand for some of the other services being articulated will be created. We think market forces should be a key element to determine the necessity of these services being provided. We believe that the development of vetted standards which allow for such services rather than requiring them is our preferred recommendation.

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

Our response parallels the comments articulated in paragraphs 92-94 of the Consultation Paper. We are concerned about changing the fundamental role of the auditor, the auditor’s relationship with management and audit committees or those charged with governance becoming more adversarial as well as fundamental role changes for audit committees or those charged with governance and management. We also believe that in some countries litigation exposures for all those playing a role in the process will increase.

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

Changes would be driven by users. In the case of small entities, many of the suggested changes would not be necessary; nor would they be cost beneficial. Certain objectives can be met by changing existing accounting and disclosure standards and/or including a framework (such as the SEC’s framework for MD&A) to allow for a more consistent approach and evaluation.

Initial change costs for any of the undertakings (other than technical changes to report content) are always higher than continuing costs and the benefits may not be measureable. For small entities, audit costs are an issue. We would presume there would be some meaningful exclusion for extending the reach of auditor services.

Question 18. Which, if any, of the options explored in Section III, either individually or in combination, do respondents believe would be the 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&E, which envisage changes outside the scope of the existing reporting model and the scope of the financial statement audit?

We believe that the most natural service extension of the audit reporting model would be some form of attestation on MD&A. The discussion of MD&A is most useful for investors in listed companies, but we can see that type of information appropriate for private companies the ultimate goal of which is to grow their businesses with public funds.

Conclusion on Options for Change

We are opposed to changing the fundamental role of auditors which would occur if the other services discussed required some form of assurance by auditors. We believe the most onerous proposal discussed would be the Auditor's Discussion and Analysis which we oppose for the reasons discussed previously.

Exhibit

Illustration of an Auditor's Report

Independent Auditor's Report

The Financial Statements that have been Audited

We have audited the accompanying balance sheet of X Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended.

Management's Responsibility versus Auditor's Responsibility

Management is responsible for the preparation and the fair presentation of these financial statements in accordance with [the applicable financial reporting framework]. This responsibility includes the design, implementation and maintenance of effective internal control, adopting sound accounting policies, and making accounting estimates that are reasonable in the circumstances. Our responsibility is to express an opinion on these financial statements based on our audit, to be independent of X Company, and to comply with the applicable independence requirements of the [insert, as appropriate, the IESBA, PCAOB and SEC or AICPA]. We have no responsibility for information in this document outside of the financial statements such as [identify the information, for example the CEO's letter to the shareholders, MD&A, etc.]

Nature of Our Audit

We conducted our audit in accordance with [refer to the applicable auditing standards]. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Reasonable assurance is a high level of assurance albeit not absolute assurance. Our audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Audit Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 20XX, and the results of its operations and its cash flows for the year then ended in conformity with [the applicable financial reporting framework].

[*Signature*]

[*Date*]