



International Federation of Accountants

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September 16, 2011

IAASB Technical Director

Dear James,

Small and Medium Practices (SMP) Committee Comments on the Consultation Paper, *Enhancing the Value of Auditor Reporting: Exploring Options for Change*

INTRODUCTION

The SMP Committee is pleased to provide comment to the IAASB on this consultation paper.

The SMP Committee is charged with identifying and representing the needs of its constituents and, where applicable, to give consideration to relevant issues pertaining to small- and medium-sized entities (SMEs). The constituents of the SMP Committee are small and medium-sized practices (SMPs) who provide accounting, assurance and business advisory services principally, but not exclusively, to clients who are SMEs. Members of the SMP Committee have substantial experience within the accounting profession, especially in dealing with issues pertaining to SMEs, and are drawn from IFAC member bodies from 18 countries from all regions of the world.

Effective changes to auditor reporting can only be made with due consideration of the needs of all major stakeholders. We note that views on auditor reporting have traditionally been dominated by investors and analysts and so, in welcoming this consultation paper, we particularly appreciate the Board's recognition of the need to consider the users of the financial statements of SMEs.

GENERAL COMMENTS

We believe decisions on auditor reporting and audit scope should primarily be made with regard to the public interest. This involves consideration of the costs and benefits to the public, including relative needs, costs and benefits to affected stakeholders, which in reality vary significantly across different stakeholder groups.

We also firmly believe that differentiation in auditor reporting by, for example, size or type of entity alone is generally not appropriate, and runs contrary to the notion that "an audit is an audit". However, this need not preclude the scope of the audit for certain kinds of entities from covering additional financial or other reporting requirements that may be required for certain entities.

SPECIFIC COMMENTS

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

In considering the perceived expectation gap and information gap, it is important to consider the roles and responsibilities of the various stakeholders and the nature and extent of the respective risks that they ought to bear.

The last sentence of paragraph 5 in the consultation paper states that “Existing shareholders, potential investors and others look to reduce the level of uncertainty in their decisions by seeking information they consider to be relevant and reliable”. However, a distinction needs to be made between inherent uncertainties, which cannot be reduced because there is no adequate evidence available to do so, and those risks that can be mitigated by means of evidence. Auditors can only provide comfort in relation to the latter, but users often expect comfort in relation to the former, which is an unrealistic expectation that contributes to the expectations gap.

Furthermore, the increasing volume and complexity of financial reporting standards may further contribute to this expectation gap, and we would caution against an underlying message in this debate that such increasing volume and complexity can be addressed by means of enhanced auditor reporting.

An expectation gap is therefore likely to persist, irrespective of changes to auditor reporting.

Likewise, an information gap will also persist unless both entities and auditors provided complete access to all of their information to users. The frame of reference is the financial statements, as they drive audit procedures and hence the audit report. Furthermore, we believe it is crucial to maintain the existing delineation between entity and auditor, whereby entity information should originate from the entity through management or those charged with governance, either in the financial statements or through other entity reporting, to then be opined on by the auditor.

For most SMEs, the information gap is not really an issue. There are often only a small number of users of SME audited financial statements, typically owner managers, lenders and tax authorities, all of whom can obtain the information they need, if not from the audit then from other means.

The August 2011 SMP Committee Quick Poll¹ asked respondents whether they felt there were significant expectation and information gaps for SME audits and, if so, whether they could be addressed by changes to auditor reporting. The provisional results, drawn from 789 respondents, revealed that 33.7% felt there is no significant expectation gap for SME audits, while a further 27.9% felt there is a significant expectation gap for SME audits but which cannot be addressed by changes to auditor reporting. Similarly, 34.8% of respondents felt there is no significant information gap

¹ The final results of the Quick Poll will be posted on the SMP Publications and Resources area of the IFAC website at www.ifac.org.

for SME audits, while a further 24.6% felt there is a significant expectation gap for SME audits but which cannot be addressed by changes to auditor reporting.

Looking forward, any change in the auditors' report which would require more detailed reporting of the auditor's assessment of risk, procedures performed, etc. may actually result in an increase in the expectation and information gaps. To a reader of an audit opinion that does not necessarily understand the requirements of auditing standards, discussion of these topics may result in their interpretation of the work performed providing a higher level of assurance than intended. Additionally, to the extent that different auditors may describe their work effort differently, readers may interpret these differences in providing varying levels of assurance, when in fact, they do not. These considerations may have a disproportionate effect on the users of SME audited financial statements, as those users may well have a lesser understanding of auditing standards.

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?***

The issues raised in this paper are largely relevant to listed and larger entities. We believe there is little in the way of an information gap for smaller entities and would therefore not welcome their auditors being burdened with reporting requirements that produce little or no benefit to SMEs or the users of SME audited financial statements.

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

Whilst in agreement with the statement in paragraph 27 regarding the complexity of financial statements of smaller entities, as well as the accessibility of management to the users of those financial statements, we do, however, caution against oversimplifying the needs of the SME/SMP constituency. There are also a significant number of non-public interest entities that do enter into the types of transactions that have increasing complexity, etc., and that are provided to users (i.e. prospective investors, venture capital firms, etc.) that may not have similar access to management – perhaps the “medium” sized entities in the SME population.

While many of the issues raised in the paper seem to be concentrated on larger companies, we believe that any changes that may come out of this consultation should, in principal, apply all sizes of entity since a variation in how auditors report under the same sets of auditing standards will only result in confusion for users and thereby increase the expectation/information gaps.

However, as is the case with the design of all ISAs, it is important that the issue of proportionality is given due consideration. We believe the way forward should therefore be to explore ways of developing proportionality for the audit report, without contradicting the notion of “an audit is an audit.”

We would not, for example, support a differentiation in auditor reporting that might lead to perceptions of first and second class audits under ISA. We would also not

support auditor reporting being tailored towards the type of recipient, for example between sophisticated investors, banks or other credit institutes, the public at large etc.

We do believe that some degree of proportionality could be achieved by maintaining a standard audit report, but with differing disclosure requirements being developed around subject specific information in order to meet the needs of the users. For example, to the extent that user needs could be satisfied by additional financial reporting requirements for larger companies, that may in turn require specific mention in the auditor's report, clearly the auditor's report for smaller companies would be lighter.

- 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 believe the options for change regarding the format and structure of the standard auditor's report would generally have, at best, a neutral impact on SME audits and are therefore unnecessary.

Whilst we agree that the use of technical language should be limited to only what is considered necessary, and that consideration may be given to providing further explanation of some of these terms in the auditor's report, we also believe that there is a baseline expectation of a level of knowledge for the users of the financial statements.

- 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 believe that the assumption in paragraph 42 that "readers are already sufficiently well-informed about the matters addressed in those paragraphs ..." is flawed and runs contrary to the concerns expressed as to whether or not current auditor reporting provides users with the necessary information. As such, we agree with the notion expressed in paragraph 44 that this approach has the potential effect of increasing the expectation gap, rather than reducing it.

- 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?**

We do not have any concerns about the auditor's report containing a statement regarding the auditor's responsibility regarding information in documents containing the audited financial statements, as long as that statement is clear with respect to the limited responsibility the auditor is taking. We do not support an expansion of the auditor's responsibility for this information. Additionally, consideration needs to be

given to the fact that, at the time of an audit, particularly for SMEs, the auditor (or management) may not be aware that the audited financial statements may ultimately be included in such a document.

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?***

We are neutral on this issue.

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.***

While we support the notion of increased auditor commentary of some sort in the auditor's report, an increased use of emphasis of matter paragraphs to refer the users of audited financial statements to matters of significance per se would reduce the effectiveness of such emphasis. For this reason, we believe that this can only be practically applied in areas where such reporting is required (going concern, error corrections, significant related party transactions, etc.) or in those circumstances in which a matter is of particular significance. To do otherwise would result in variations in auditor reporting, again potentially increasing the expectation/information gaps, rather than lessening them. We note too that auditors currently have the option of using emphasis paragraphs, however rarely do so unless there is a requirement to do so or in rare circumstances when a matter is of particular significance.

Exploring whether a summary of significant audit risks of material misstatement identified during the audit may be appropriate. This would cover most areas of significant audit judgment and significant audit difficulty. We believe that any requirement for the auditor to make disclosures on these matters should be proportionate in nature, as they would be most relevant in audit reports for companies where a high level of transparency is requested by users of the financial information, for example for listed companies.

We do not support the notion of discussing auditor judgments on materiality considerations as this has the potential to reduce the effectiveness of the audit. We also believe that reporting on materiality or significant internal control deficiencies within the audit report would bring a high risk of misunderstanding, given the complexity of both matters and the need for context.

More generally, we caution against further cluttering what is already a lengthy report, especially for smaller entities.

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.***

The SME/SMP perspective is essentially covered by our response to Q8 and Q10.

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.

The notion of the auditor's report including auditor opinions on the quality of internal controls, management's conservatism or aggressiveness in financial reporting, assessment of ranges of significant estimates, etc., is flawed in that the audit is not designed to achieve this level of reporting. We also believe that this type of reporting would potentially suggest a higher level of assurance than the audit is currently designed for, thus increasing the expectation gap, rather than lessening it.

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.

This notion of auditor's reporting on the appropriateness of an entity's corporate governance structure, or the reasonableness of audit committee reporting extends far beyond the current responsibility of an auditor. If the Board believes that there is a need for such reporting, we suggest that be considered a related project under other assurance standards rather than as a part of auditor reporting. If the Board considers it necessary to address this as part of auditor reporting, recognition would need to be given to the fact that many, if not most, SMEs do not have a formal corporate governance structure.

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?

See our response to Q11.

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

See our response to Q11.

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.

We believe that such services should be separate from the audit and should be mandated only for appropriate publicly accountable entities.

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

We believe the development of a suite of suitable international standards covering all other assurance (i.e. non-audit) and related services engagements should facilitate the uptake of such services, to the extent demanded by SMEs.

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.

While we believe that there is merit in considering change to the format and structure of the audit report, the benefits will be limited as the value of the audit report lies in what it signifies in terms of pass/fail, rather than what it says. This however changes if auditor commentary on matters such as significant audit risks is included. The costs of the latter should not be underestimated and the likelihood that it will, over time, be reduced to boilerplate for the sake of consistency within entities is significant.

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.

Any changes introduced should be proportionate. The implications should therefore also be proportionate as this will entail that no unduly administrative burdens are placed on companies where benefits are not expected to materialise.

The costs of any change are likely to be greater for smaller entities and the benefits very limited, if they exist at all.

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?

We have no comments beyond those already expressed elsewhere in this letter.

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?

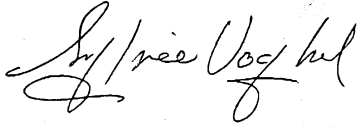
The consultation paper does not address the basic premise as to what minimum level of knowledge will be necessary for the readers of auditor's reports and related financial statements. We believe that this is a factor to be considered in determining whether significant changes in the reporting model are necessary.

CONCLUDING COMMENTS

We hope the IAASB finds this letter helpful in developing a wider understanding of the usefulness of auditor reporting and exploring options to enhance the quality, relevance and value of auditor reporting. In turn, we are committed to helping the IAASB in whatever way we can to build upon the results of this consultation paper. We look forward to strengthening the dialogue between us.

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

Sincerely,

A handwritten signature in black ink, reading "Sylvie Voghel". The signature is written in a cursive style with a large initial 'S' and a decorative flourish at the end.

Sylvie Voghel,
Chair, SMP Committee