



Tel: +1 212 885 8000
Fax: +1 212 697 5076
@: bdo@bdointernational.com
www.bdointernational.com

BDO International Limited
Contact:
100 Park Avenue
New York, NY 10017-5001
United States of America

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

By email

16 September 2011

Dear Sir,

Consultation Paper - Enhancing the Value of Auditor Reporting: Exploring Options for Change

BDO is pleased to have the opportunity to comment on the above consultation issued by the International Auditing and Assurance Standards Board (IAASB). We note that the PCAOB has issued a concept release on the same subject and we encourage the IAASB and PCAOB to work together to ensure convergence on auditor reporting so differences are minimised to the extent possible. We also encourage the IAASB to work with other standards setters to harmonise the nature of the auditor's report.

We support the IAASB's initiative to reassess the appropriateness of the current form and scope of auditor reporting, given the increasing complexity of the financial reporting framework on which financial statements are prepared, the recent events in the financial markets and the current economic environment in which financial statements are used by investors. The value of auditor reporting is derived from the usefulness of the information it communicates and legitimate user needs must be fulfilled in order to sustain and enhance this value. We believe that users'¹ demands for more information about an entity reflects both (a) an information gap between what they need to evaluate an entity and what is required by financial reporting and regulatory standards and rules and (b) an expectation gap between their understanding of the auditor's role and the auditor's professional responsibilities. In that regard, we strongly support objective consideration of changes that would enhance the transparency and relevance of auditor reporting.

As described below, we are confident that some changes could be implemented in the short term that would enhance auditor reporting and narrow the expectation gap at an insignificant cost. Other positive changes may require rulemaking by market regulators and participation by others in the financial reporting community and, as such, could be considered as a subsequent phase of this initiative. This will entail a holistic approach that reflects the relationships among market participants.

As part of this initiative, we also believe it is important to consider how changes in the auditor's reporting model might impact the entity's and the auditor's liability.

Set out below are our responses to the IAASB's specific questions raised in the consultation paper. These responses are intended to be consistent with the following overarching principles:

¹ In the context of this letter the term 'users' refers to investors and other interested parties.

- (1) Management and/or those charged with governance (e.g. the audit committee), rather than the auditor, should be the original source of information about the entity;
- (2) Auditor reporting should focus on objective matters;
- (3) Changes should not detract from audit quality; and
- (4) Changes should enhance transparency in a way that does not promote information overload.

In addition, we believe that any changes to the reporting model should be responsive to the underlying objectives of reasonable user demands and be cost beneficial and practical to implement.

Issues Identified

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

As noted in our overall comments we support the initiative to consider improvements to the audit reporting model and appreciate the recognition in paragraph 12 of the consultation paper that the current auditor's opinion is valued.

With respect to users' demands for "richer information", we strongly believe that financial reporting should reflect management's responsibility for providing information about the entity and that the responsibility of the auditor is to provide assurance on that information, rather than providing such information to users directly.

We do not believe that the ability to assess the quality of the audit is a realistic primary goal of changes to the auditor reporting model. The audit process is highly complex and requires a comprehensive understanding of the entity's business and control environment and the extensive dialogue and risk considerations that take place throughout an audit. Whilst some changes to the model could potentially enhance the value of an audit to users, we believe it is not feasible to develop changes that would provide a significant incremental understanding of the complete audit process for a particular entity. There are existing mechanisms in place for diligent oversight by regulatory processes and those charged with governance to assess the quality of audits that should be relied on for that purpose, or enhanced if considered necessary. Accordingly, we believe the focus of any changes to the reporting model should be on narrowing the expectation gap and improving the communicative value of the audit report.

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?**

In general, users need information to enable them to assess the existing financial position/operating results and future prospects of an entity. In determining how to narrow the information gap, the nature and extent of the additional information to be provided to users should be determined after obtaining direct input from a representative sample as to their specific needs and from preparers of financial information as to the cost and practicability of providing such information, including potential adverse effects on the business from disclosure of competitive information. In that regard consideration should also be given the extent to which auditors need to be associated with and can practicably provide any such information.

We believe that the critical issues to be addressed in improving the communicative value of auditor reporting include the need to maintain management's primary responsibility

for entity-specific information, whether the auditor has sufficient expertise to provide assurance on information, and the degree of assurance that the auditor is able to provide based on the nature of the information.

It is not practical to distinguish which classes of users would be most affected by these issues, although a primary focus of some of the more extensive changes is likely to be on reporting related to public interest entities. We are not aware of any classes of users that are 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?

The question as to whether changes are needed for different types of entities depends on the nature of the changes. Whilst certain changes (e.g. clarifying language in the auditor's report of the nature of management's and the auditor's responsibilities) would apply to all types of entities, the demand for other changes, such as describing the auditor's responsibility for other information contained in documents that include audited financial statements would be directed primarily to listed companies and perhaps to other public interest entities. Accordingly, as a first stage of the change process, we suggest that changes that clearly apply to all types of entities (e.g. the clarifying language referred to above) be applied to them and other changes be applied initially only to listed entities and perhaps other public interest entities. This phased approach would allow for the experience gained in implementing the changes on audits of listed companies and other public interest entities to be applied in considering whether any further changes are needed for other entities. In that regard, it may also be beneficial to further subdivide this phased approach to listed companies and other public interest entities so that it is applied initially to larger entities.

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?

Whilst we support consideration of the options detailed in paragraph 36 for improving the communicative value of the current audit reports, any such changes need to ensure that they do not unintentionally widen the expectation gap.

We believe it is important for there to be a common understanding of the meaning of technical terms used in the report to ensure there is greater clarity to the users. In that regard, it may be useful to include a cross reference to a glossary that explains terms such as "reasonable assurance" in a similar manner to the approach adopted by the Auditing Practices Board in the UK which provides a dedicated area for information about the scope of the auditor's report on its website. We believe this could provide a basis for improved comprehension of the auditor's report.

With respect to consideration of the most appropriate location of the auditor's opinion, we question whether moving it to the beginning of the report would have the impact required or whether it would instead have the result that information subsequent to this is given less emphasis by the users, which could have the unintended consequence of substantively moving towards something akin to an opinion-only report.

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 are open to the suggestion of the above mentioned paragraphs being moved if this is considered necessary to improve user understanding of the report; however we believe the removal of these paragraphs may widen the expectation gap, especially for reports relating to smaller entities where the users may not be as familiar with differing responsibilities of management and auditors. Instead, we suggest that paragraphs containing the explanatory information could be shortened and cross referenced to a website if it is believed that the auditor’s report is too lengthy to be carefully digested by users.

We believe the description of the auditor’s responsibilities should further emphasise that the opinion is expressed on the financial statements as a whole, especially if there is an increase in the use of emphasis of matter paragraphs as detailed in our responses to questions 8 and 9.

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?**

We support the inclusion of a statement of the auditor’s responsibilities regarding other information in documents containing audited financial statements as this practice is already in use in a number of jurisdictions.

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 believe it would be appropriate for the responsibility to be described in a separate paragraph of the auditor’s report in a manner consistent with the existing ISA. Whilst the auditor has an existing responsibility to describe any material inconsistency between the audited financial statements and other information, we do not believe it is appropriate to provide an explicit statement where there is nothing to report, given the limited nature of the auditor’s procedures under the existing ISA. However, if it is determined that the auditors should report on certain types of other information (e.g. MD&A, emphasis of matters, critical accounting estimates), then there should be explicit reporting on such information, regardless of the findings.

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.**

Whilst we appreciate the rationale behind users’ calls for additional information about the audit, certain of the matters mentioned in paragraph 62 of the paper (e.g. areas of significant audit judgment and areas of significant difficulty encountered during the audit) are highly subjective and cannot be explained succinctly in any meaningful manner. Accordingly, these matters are typically discussed in depth between the auditor and

management/those charged with governance in the context of a dialogue where all of the relevant considerations can be explored. As such, any additional information provided in the audit report is unlikely to be understood by users who would not possess a comprehensive knowledge of all of the attendant facts and circumstances, including expert knowledge as to how to conduct an audit.

We also believe any such information included in the auditor's report should be provided in the context of reporting on information already provided by management so as not to widen the expectation gap regarding auditor responsibility. In this way, the need to include additional information about the audit would not drive the information that the entity describes within the financial statements but, instead, would work in reverse whereby the auditor comments on information that management has provided. This approach preserves the distinction between the entity and the auditor, whereby management prepares the financial statements and the auditor expresses an opinion through the auditor's report.

We would also be concerned with the unintended consequences of disclosing certain additional information about the audit as we believe this may limit the robustness and candour of discussions between the auditor and management/those charged with governance. Such candid discussions are essential to the deep understanding of the entity and its financial information that is required in a high quality audit.

The following are specific comments on particular areas covered by question 8:

Emphasis of matter paragraphs

We believe that mandated use of "emphasis of matter" paragraphs in the audit report could enhance the quality of financial reporting. Pointing out areas of audit emphasis that are described in the financial statements should sharpen users' focus on these matters in helping them to understand the financial statements. In that regard, we believe these disclosures should be factual and objective descriptions of matters that are included in the financial statements or notes thereto. In providing such reporting, we would not support inclusion of a description of related audit procedures performed since they would not likely be understandable to users without the full context of the complex conduct of an audit, such as knowledge of the risks, controls and quality of the audit evidence obtained.

A requirement to include emphasis of matter paragraphs will necessitate the development of a suitable framework and implementation guidance for auditors to ensure consistency in identification of relevant matters for inclusion therein. In crafting the framework, care should be taken to ensure the users understand that such paragraphs are written in the context of the financial statements taken as a whole.

Materiality

The determination of audit materiality is a highly complex process that considers both quantitative and qualitative aspects that are dependent on the facts and circumstances of the entity. We question whether inclusion of information on the level of materiality applied in performing the audit would be helpful without there being substantial explanation of the context in which materiality was determined for all areas of the audit, including qualitative considerations in respect of disclosures in the financial statements. Moreover, since materiality is also an accounting concept, any such explanation by the auditor would probably need to be supplemental to a discussion by management as to how it assessed materiality. Since the nature of the assessments by the auditor and management might differ, this would have the potential for confusing users. In addition, expansion of such information in a fully comprehensive manner could expand the length of the auditor's report excessively, exacerbating the current perception of too much information being provided. As an alternative, it may be beneficial to include or provide a

link to some high level information on the framework for determining financial statement materiality to enhance users' understanding of the concept.

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

The French model is somewhat similar in certain respects to an approach contemplating a mandatory emphasis of matter paragraph and, as described in our response to question 8, we believe this approach could be helpful. The justifications included under this approach must enable the users of the report to obtain a better understanding of reasons supporting the opinion, but are not intended to have the auditor provide information that is not already disclosed by the entity, which is consistent with the overarching principles expressed earlier in our letter.

However, we note that the French model calls for a summary of the audit procedures performed and, as indicated in our response to question 8, we do not believe this information is helpful, particularly when it is in summary form. Furthermore, we also note that the French model requires inclusion of a statement to the effect that the assessments dealt with in the justification were made as part of the audit of the financial statements taken as whole. If the IAASB decides to include a summary of audit procedures in a new reporting model, such a statement should be extended to state that it does not provide assurance on individual accounts or disclosures.

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.

We are in favour of consideration of auditor reporting on an entity's disclosure of critical accounting estimates provided that applicable rules and a suitable framework can be developed by accounting standards setters/regulators for use by management in preparing such disclosures. We believe auditor reporting could enhance any disclosures by the reporting entity in this key area. Any auditor reporting should clearly describe the different responsibilities of management and the auditor with respect to these disclosures.

We would strongly support providing an auditor's opinion on an entity's internal controls for listed companies and other public interest entities. Since the strength of an entity's internal controls is generally directly related to the reliability of its financial statements, we believe auditor reporting on internal controls can provide valuable information to users. In that regard, existing models for auditor reporting (e.g. PCAOB AS 5) can be evaluated in developing any new model. We would expect that any auditor reporting on internal controls would require actions by applicable regulators.

However, we believe that certain of types of auditor insights and perspectives suggested in paragraph 72 of the paper do not meet the overarching principles expressed earlier in our letter. Moreover, even if these matters would be required to be disclosed by the auditor, they would necessitate development of disclosure frameworks to enable consistent assessments to be made in an infinite variety of circumstances. In that regard, it is also likely that auditor disclosures would be different in some respects from those of management, which could be confusing to users and create the impression that a difference of views represents a qualified opinion. Conversely, to the extent that management would feel pressured to have its disclosures mirror those of the auditor, this would seem to dilute management's primary responsibility for financial reporting.

As we indicated in our response to question 8, whilst the qualitative insights and perceptions referred to in this section of the paper are of the kind often communicated

to management/those charged with governance, they are typically done so in the context of extensive dialogue between the auditors and management/those charged with governance, which is not practical in an external communication to users within an auditor's report. In that regard, it is also important to ensure that any reporting in this area does not limit the robustness and candour of such dialogues.

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.

We support the IAASB considering an Enhanced Corporate Governance Reporting model along the lines described in that section of the paper.

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 the financial reporting process?

In developing that model, we believe it is important to consider the fine line between the benefits of disclosure of the interactions between the auditor and those charged with governance and the potential that excessive disclosure in certain areas could adversely impact the valuable communications between the parties. In that regard, we recommend that the IAASB seeks further input from key stakeholders as to what information is sought to ensure that an appropriate balance is achieved. We suggest that roundtables of relevant financial reporting constituencies be sponsored by regulators and others in the financial reporting process to thoroughly vet the implications of this model.

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

Yes, we believe it would be appropriate for auditors to provide assurance on the reasonableness and completeness of such a report provided that the report communicated factual and objective matters and was not presented at such a level of detail as to adversely impact the openness of the dialogue between those charged with governance and the auditor.

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.

Whilst we support the current projects being undertaken by the IAASB in respect of assurance on non-financial statement matters, we believe that any assurance provided should meet the overarching principles expressed earlier in our letter. In that regard, we believe that most of the examples mentioned in part E would not meet those principles. Moreover, as discussed below, certain of those matters appear to be outside the usual scope of an auditor's expertise.

However, we do believe that further consideration is worthwhile with respect to certain information of the type described in Part E. For example, providing assurance on earnings releases or non-GAAP information on a consistent basis could improve the quality of such information. Any change or consideration of assurance in such areas would need to be

driven by the users' desire for this information because of the value it provides. For example, providing some level of assurance on earnings releases needs to recognise that this information is often issued prior to the completion of the audit, so, that there is a trade-off between the timeliness of the information and the level of assurance that can be provided.

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

As previously indicated in our letter, any reporting by the auditor should relate to information disclosed by the entity. Accordingly, to the extent that such assurance or related services are ultimately required, we believe that changes by regulators and other standards setters will be needed in order to modify the reporting framework for reporting entities. In addition, where such services are outside the usual scope of an auditor's expertise, there will need to be substantial resources devoted to training people within the audit firms, within the entire profession, and at the university level to provide the requisite skills.

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.

Certain of the options in Section III have the potential to enhance the understanding and value of the audit and the credibility of the financial reporting process to users. In particular, as described above, these include: modifying the form and content of the auditor's report as discussed in Section A, expanded emphasis of matter paragraphs, and auditor's reports on critical accounting estimates.

We believe that most of the suggested changes in these areas would not increase audit costs significantly (e.g. modifying the form and content of the audit report as discussed in section A). However, other alternatives, such as certain of those described in Sections C and E would likely require significant additional effort on the part of the auditor and the entity and would therefore incur associated increased costs. In considering the costs involved in implementation of alternatives, key factors include the review and consultation processes needed to be put into place at audit firms. Such procedures would be necessary to ensure an appropriate level of consistency with respect to assurance and other commentary from entity to entity, and such decisions would often involve highly judgmental analyses that are susceptible to varying degrees of interpretation.

Challenges relating to certain of the different options, most of which are referred to above in various parts of our letter, include:

- (1) possible delays in filing documents with regulators because of (i) additional internal review processes within audit firms and (ii) extensive additional discussions between auditors, management/those charged with governance, and the entity's counsel that will likely need to take place with respect to the more judgmental types of matters;
- (2) the potential to adversely impact the robust communications that would otherwise take place between the auditors and management/those charged with governance;
- (3) excessive information that could obfuscate rather than clarify meaningful information to users;
- (4) shifting the respective roles of the auditor and management in terms of the responsibility for providing original information;

- (5) increasing the liability exposure of auditors, management, and those charged with governance to the extent that certain information is highly subjective and subject to wide variations in interpretation; and
- (6) requiring substantially new or expanded skills of auditors to evaluate matters beyond the financial statements.

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.

Certain changes (e.g. clarifying language in the auditor's report of the nature of management's and the auditor's responsibilities) are likely to impact all types of entities in a similar manner. Implications of other changes would be dependent on the specific nature of the changes and their relevance to the entities concerned.

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 believe a combination of certain of the alternatives may be the most appropriate course of action and could work together to provide users with transparency regarding the audit process and improved information. In that regard, we believe that mandatory use of emphasis of matter paragraphs and auditor reporting on critical accounting estimates would benefit users by providing insights into the more significant accounts and disclosures in the financial statements. Further, including additional clarification in the auditor's report regarding certain terms and concepts and revising the format of the report could provide a greater understanding of the audit process and the responsibilities of each of the parties involved in the financial reporting process.

As noted in our response to question 11, we also would welcome further consideration of an enhanced corporate governance reporting model described in section D.

We encourage the IAASB to collaborate with other standards setters, regulators, investors, preparers, those charged with governance, auditors, and academics to flesh out the implications of the various options expressed in the paper and to identify any others that should be considered. This collaboration could be done in the form of roundtables, which would have the benefit of clarifying differing views that might evolve into consensus positions that would be generally acceptable to a broad cross section of the financial markets participants.

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?

We believe the options described in the paper constitute a robust analysis of potential enhancements to auditor reporting and have no other suggestions at this time. Nevertheless, we remain open to further consideration of other options so that user needs are given a thorough vetting. In the final analysis, changes to auditor reporting must meet the reasonable needs of users in a manner that takes into consideration the resulting benefits, costs, and consequences of any changes.

Please contact me should you wish to discuss any of these comments.

Yours sincerely,
BDO International Limited

Wayne Kolins
Global Head of Audit and Accounting