INSTITUT DER WIRTSCHAFTSPRÜFER

Institut der Wirtschaftsprüfer
in Deutschland e. V.

Wirtschaftsprüferhaus
Tersteegenstraße 14
40474 Düsseldorf
Postfach 32 05 80
40420 Düsseldorf

TELEFONZENTRALE:
+49 (0)2 11 / 45 61 - 0

FAX GESCHÄFTSLEITUNG:
+49 (0)2 11 / 454 10 97

INTERNET:
www.idw.de

E-MAIL:
info@idw.de

BANKVERBINDUNG:
Deutsche Bank AG Düsseldorf
BLZ 300 700 10
Kto.-Nr. 7480 213

September 19, 2011

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

Dear James,

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

We would like to thank you for the opportunity to provide the International Auditing and Assurance Standards Board (IAASB) with our comments on the Consultation Paper, Enhancing the Value of Auditor Reporting: Exploring Options for Change (hereinafter referred to as the "paper").

Given the questions about the value of auditing that have arisen in the aftermath of the financial crisis, we consider the initiative by the IAASB to consult on the options for enhancing the value of auditor reporting to be timely and appropriate. We therefore commend the IAASB for addressing this issue at this time. However, the discussion of the value of auditor reporting cannot be delinked from an exploration of the added value of audits, which relates not only to reporting, but also the scope of the audit. The paper recognizes this – particularly when discussing other assurance and related services on information not currently within the scope of the audit – but, in the context of the European Commission's Green Paper on the role of the audit, further exploration of the scope of the audit beyond that in the paper is necessary. However, we do not believe that the IAASB has the authority to prescribe the scope of audits of financial statements to cover matters other than financial statements: This would not preclude the IAASB from issuing standards for

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
Dr. Klaus-Peter Feld, WP StB CPA;
Manfred Hamannt, RA

cases in which the scope prescribed by governments or regulators extends beyond financial statements. **Hence, exploration of whether and how the scope of audits of financial statements might be expanded can only take place with the participation of the major stakeholders, and in particular, audit regulators and governments that have the authority to prescribe extensions to the scope of the financial statement audit.**

Consultation with stakeholders, and in particular governments, is necessary because the issues relating to enhancing audit reporting and the scope of financial statement audits are foremost *political and legal* issues – not technical issues. Clearly, even political decision-making can only occur in the context of technical reality and therefore must be technically appropriate, but the questions about what, when, how (in a general sense) and to whom auditors should report given a particular audit scope, and whether the scope of statutory audits should be enhanced, are public policy issues that require political resolution implemented by legal means**. Such selection of public policies in relation to enhancing audit reporting ought to be decided on the basis of the public interest, which involves consideration of the costs and benefits to the public of potential policies, including the incidence of such costs and benefits among affected stakeholders**.

In this respect, we are concerned about assertions made in the paper about perceptions that auditor reporting is not meeting the information "needs" of users, that some capital market participants – investors and financial analysts, among others – suggest that auditor reporting needs to further evolve to meet user's needs, and that there is an "information gap" that needs to be narrowed by perhaps having the auditor provide further "insights" into the audited entity or the audit. First, there appears to be a presumption in the paper that only investors (and analysts) are users of audit reports. Even if one takes a very broad view of the term "investor" as including all providers of capital (that is, encompassing creditors, including suppliers providing goods or services on credit), there are other users of audit reports that are not "investors" in this broad sense, including customers, employees, governments, and other parties affected by the entity. For this reason, there needs to be a broader consideration of who the users of audit reports are. Second, without in any way suggesting that further exploration of audit reporting and audit scope issues to increase the added value of audits is not necessary – in our view, it is – we would like to note that some sophisticated investors, per se, always want more rather than less information, especially since potential (as opposed to existing) investors in entities perceive the provision of additional information as being virtually costless, and as not having an impact on the timing of communications. Hence, potential investors do not perceive that they are bearing the cost of additional information provided, which leads to a “free rider” syndrome among them. Once having obtained more information by means of regulation, such investors would still not be satisfied and then ask for even more, regardless of the cost. This is why it is important that **the selection of public policies in relation to audit reporting and scope needs to involve consideration of who all of the users of financial statements are and the actual demand for more information, as well as of the costs and benefits to the public (not just to certain investor groups) and the incidence of such costs and benefits**.

It should also be recognized that the provision of additional information in audit reports, particularly, but not limited to, information obtained by extending the scope of the audit, involves greater work effort and hence the incurrence of additional cost by auditors, which must ultimately be borne by preparers and then indirectly by other stakeholders, including investors. Calls for more information under the assumption that this would not involve significant increases in cost are not serious propositions. Nevertheless, there may be cases where the demand for more information may involve the benefits of that information exceeding the cost of providing it. **It is therefore important that legislators and regulators perform serious cost-benefit analyses to determine the need for additional information prior to prescribing its provision.**

Current discussions in the International Accounting Standards Board (IASB) and in other bodies about reducing the extent and complexity of disclosures in financial reporting suggest that most investors, other than a comparatively small group of financial analysts in certain larger financial institutions and funds, are already subject to information overload from, and have difficulty understanding, the information already provided to them. In this context, the call for “more” information may need to be interpreted as a call for “better” information by less sophisticated users, rather than for “more”. Furthermore, the provision of additional or better information may require more time, which may decrease its relevance to users. **It is therefore important for public policy decisions in relation to both financial and audit reporting to consider whether “better” information needs to be provided, rather than just “more”, and the impact of additional information provided by auditors on the timing of the**

communication of information and the ability of most users, including investors, to process that information and understand it given the increasing complexity of financial reporting. However, as the users of financial statements and auditor reporting vary considerably, it will be challenging to have concise and clear auditors' reports that meet certain users' desires for additional information without causing information overload for most users.

Audits are complex services that are difficult for laypersons to understand, even though audits play an important role in the economy and in financial markets. Given the nature of some of the suggestions in the paper for more information from auditors, it seems that many users may not fully appreciate what an audit involves or what the role of the auditor currently is, which contributes to the expectations gap. Some of the demand for more information from auditors – in particular "soft" information, such as the suggested "auditor's insights" – may in part be driven by the desire of investors to transfer investment risk from investors to other parties. Investors seek to minimize the risks arising from their investments without sacrificing returns, and ideally, would like "riskless" investments with high returns. To this effect, calls for more "soft" information from the auditor may in part reflect investors' desires to unreasonably narrow the expectations gap, which in its extreme form would involve closing the expectations gap by having auditors provide information that in effect represents a "guarantee" (i.e., have the auditors provide their views on audited entities, but make the auditors fully liable for those views). However, despite government support of financial institutions in the last financial crisis, and Eurozone support for Eurozone countries with sovereign debt difficulties to prevent greater private sector participation in losses, it is still a fundamental principle of free enterprise that those making investment decisions ought to bear the risks of those decisions. Disregarding this principle leads to moral hazard in investment decisions, which in turn leads to the gross misallocation of capital in economies, with the attendant negative macroeconomic consequences**. It is therefore important that public policy decisions in relation to audit reporting (including other communications in relation to the audit) and scope consider the proper delineation of the roles and responsibilities of audit stakeholders, including management, those charged with governance, the auditor, and users (including investors), and the appropriate nature and extent of the risks that ought to be borne by each in those roles and responsibilities to facilitate the efficient and sustainable operation of capital markets.**

In this context, communication by auditors with those charged with governance represents an important factor in aiding those charged with governance in meeting their oversight responsibilities, including their oversight responsibilities over financial reporting and the audit. Reporting by auditors to investors plays an important role in conveying to investors the credibility that they can attribute to financial reporting by the entity. However, the role of those charged with governance is significantly different from that of investors, and therefore when making public policy decisions, legislators, audit regulators and auditing standards setters need to consider the appropriate nature and extent of information to be conveyed by the auditor to those charged with governance compared to investors. Just because information is made available by auditors to aid decision-making by those charged with governance, who are subject to confidentiality requirements, does not mean it is appropriate for all of that information to be made publicly available for investors. **It is therefore critical that, when considering enhancements to the nature and extent of audit reporting to users, including investors, based on information that is made available by the auditors to those charged with governance, policymakers consider the nature and extent of that information that is important for investors without having auditors make public information that may unduly impair the operations of the entity.**

At a technical level, public policy decision-making in relation to audit reporting and scope also needs to take into account that some of the "softer" information that some investors would like to have does not have the same quality of evidence available to support that information and therefore may not be as reliable as information currently subject to audit under the International Standards on Auditing (ISAs). If an audit of some of the "softer" information is nevertheless desired by expanding the scope of an audit**, it needs to be recognized that the "reasonable assurance" obtained in these circumstances is less than that obtained for "harder" information for which there is better quality evidence available, that the nature of this part of the audit engagement may be different, and that therefore the audit opinion in relation to such information would also need to be different to convey to users these differences. In some cases, even if it is considered valuable to have certain additional "softer" information provided by management, it may not always be useful to the public (i.e., it is a cost-benefit consideration) or possible (i.e., adequate evidence is generally not available to support an audit opinion in that respect) to have an audit of some of that information in every case.** Some jurisdictions (such as

Germany) do have experience with the audit report extending to softer information, such as in the management report.

However, we note that the quality of an individual audit is not apparent from the auditor's report, which often leads to the value of the audit not being properly recognized, and at worst may lead to the audit being viewed as a commodity. Including more information pertinent to each individual audit within the auditor's report may be a means of customising audits for specific major issues, and also allow insight into how the auditor addressed those issues in forming his or her opinion on the financial statements**. In this context, we believe that differentiation in auditor reporting to the public by size or type of entity is generally not appropriate, and continue to support the premise "an audit is an audit". Nevertheless, this does not preclude the scope of the audit for certain kinds of entities (e.g., public interest entities, such as publicly listed entities, banks or insurance companies) from covering additional financial reporting required for those entities, which means that the information provided by auditor reports may not be the same by type of entity due to differing financial reporting requirements for different entities.**

In summary, the principles upon which we base the responses to the questions posed in the paper are:

- For financial statement audits, the exploration of means of improving auditor reporting by potentially extending audit scope can only take place with the participation of the major stakeholders, and in particular, audit regulators and governments that, unlike the IAASB, have the authority to prescribe extensions to the scope of the financial statement audit.
- The selection of public policies in relation to enhancing audit reporting and audit scope ought to be decided on the basis of the public interest (not just the interests of certain investor groups), which involves consideration of who all of the users of financial statements are as well as of the costs and benefits to the public of potential policies, including the incidence of such costs and benefits among affected stakeholders.
- It is important for public policy decisions in relation to audit reporting to consider whether "better" information needs to be provided, rather than just "more", and the impact of additional information provided by auditors on the timing of the communication of information and the ability of most users, including investors, to process that information and understand it given the increasing complexity of financial reporting.

- It is important that legislators and regulators perform serious cost-benefit analyses to determine the need for additional information prior to prescribing its provision.
- Public policy decisions in relation to audit reporting (including other communications in relation to the audit) and audit scope must consider the proper delineation of the roles and responsibilities of management, those charged with governance, the auditor, and users, including investors, and the appropriate nature and extent of the risks that ought to be borne by each in those roles and responsibilities to facilitate the efficient and sustainable operation of capital markets. In this context, when considering enhancements to the nature and extent of audit reporting to users, including investors, based on information that is made available by the auditors to those charged with governance, it is critical that policymakers consider the nature and extent of that information that is important for these users without having auditors make public information that may unduly impair the operations of the entity.
- When auditors opine on “softer” information, the nature of this part of the audit engagement may be different, and therefore the audit opinion in relation to such information would also need to be different; in some cases, there may be no net public benefit to having some “softer” information audited, or some “softer” information may not be auditable due to a general lack of adequate available evidence.
- Differentiation in auditor reporting to the public by size or type of entity alone is generally not appropriate: “an audit is an audit”. However, this does not preclude the scope of the audit for certain kinds of entities from covering additional financial reporting required for those entities, which means that auditor reports will be different due to varying financial reporting requirements.

We do recognize that the consultation on auditor reporting, and its relationship to the scope of the audit, is an opportunity to seek to enhance the value of audits by considering whether better information can be provided in audit reports about the current audit, and to consider whether it may be appropriate to expand the scope of the audit. To this effect, we make some specific recommendations on these matters in our responses in Appendix 1. We based our responses in Appendix 1 to the questions posed in the paper on the principles that we have described in this letter above.

Various parties are currently deliberating on audit reporting and the scope of the audit, including the Public Company Auditor Oversight Board (PCAOB) in the

U.S. and the European Commission. We also intend to respond to the PCAOB Concept Release No. 2011-003, which deals with audit reporting, and would encourage both the IAASB and the PCAOB to strive for consistency between their respective future standards in this regard. It is crucial that the IAASB consult on auditor reporting, and in particular, the scope of the audit, with regulators in the world's major jurisdictions – especially with the European Commission and the PCAOB.

We hope that our views will be helpful to the IAASB. If you have any questions relating to our comments in this letter, we would be pleased to be of further assistance.

Yours truly,

Klaus-Peter Feld
Executive Director

Wolfgang P. Böhm
Director, International Affairs

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APPENDIX 1:

Responses to Questions Raised in the Consultation Paper By Section

Issues Identified

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

   The last sentence of paragraph 5 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 reduce such uncertainties, and "mitigatable risks" – that is, 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. Financial reporting standards setters help contribute to this expectations gap when they do not consider whether adequate evidence is available to support items in the primary financial statements, for which recognition or measurement under great uncertainty becomes meaningless even with disclosures about the uncertainty.

   Paragraph 8 mentions legal limitations on the auditor's ability to obtain and disseminate information. The former (limitations on obtaining information) becomes relevant when management integrity is an issue, because other than some auditors in the public sector, auditors do not have the right to force the production of documents or to require the testimony of witnesses. However, auditors may be able to issue a disclaimer of opinion or withdraw from the engagement if permitted by law or regulation.

   The latter (limitations on dissemination of information) is a real barrier to some of the suggestions made by some users that the auditor provide more information about the entity and its financial statements. In many jurisdictions, management or those charged with governance have legal control over the information about an entity or its financial statements obtained from within the entity: it is the entity's information and only management or those charged with governance have the legal right to determine which information from the entity may be made available to third parties unless such information is clearly required to be made available by law or regulation. Even if management consents to the auditor providing additional information, data protection laws in the EU member states and other jurisdictions may hinder the provision of certain entity information. Hence, in these jurisdictions auditors providing more information not provided by management or those charged with governance about the entity or its financial statements would likely be illegal without the introduction of specific laws or regulations to change this situation. The successful introduction of such laws or regulations is very unlikely because business and other enterprises would not be in favour of such legislation or regulation. This legal situation may also present a barrier to the auditor being able to provide information about the audit performed, including key areas of audit risk, because this information is often indistinguishable from information about the entity or its financial statements. It will therefore be very difficult for the IAASB to promulgate an international standard requiring such disclosures by the auditor internationally without a provision for an exception due to law or regulation, which would essentially cause that requirement to be ineffective in many jurisdictions.

Legal considerations aside, having the auditor provide information about the entity or its financial statements is not in consonance with the role of auditors vs. management or those charged with governance. An audit is, by definition, an attestation engagement in which the auditor opines on information provided by management or those charged with governance; an audit is not a direct engagement (see current Exposure Draft of ISAE 3000), in which the practitioner performs the measurement or evaluation and reports the resulting subject matter information about the entity. Hence, by suggesting that auditors provide information about the entity or its financial statement directly, users are confusing the relative roles of auditors vs. management or those charged with governance.

In this respect, the bullet point list in paragraph 23 looks like a "wish list" without consideration of whether it is legally possible for the auditor to provide some of the information (the first two items in the first bullet point, and the fourth, fifth and sixth bullet points) because the information is under the control of management or those charged with governance without enabling legislation or regulation, or of whether the margin benefit to the public of providing that and the other items in the bullet points exceeds the margin cost. This is not to say that some of the items that are clearly audit-related (e.g., the second last bullet point) may not be useful to users, but the costs and benefits as a whole need to be considered. Furthermore, the "wish list" does not consider the information overload of users, as we note in the body of our comment letter. Nevertheless, consideration might be given to exploring as to whether the auditor's report might highlight a summary of significant risks of material misstatement identified during the audit that are identified as significant financial reporting issues in the financial statements by management. However, it would have to be clear from the report that any such information did not represent any form of piecemeal opinion on isolated aspects of financial statements – the auditor opines the financial statements as a whole – and not individual financial statement items. It does not appear to be appropriate to have auditors opine on the quality and effectiveness of the governance structure as suggested in the last bullet point of paragraph 23, particularly when those charged with governance are responsible for engaging the auditor and overseeing the audit in many jurisdictions, which would lead to a conflict of interest situation.

As we note in the body of the comment letter, the expectations gap addressed in paragraphs 13 to 17 will persist because ultimately investors seek a transfer of investment risk to other parties, such as auditors, even though investment risks must stay with investors: auditors cannot provide an investment guarantee. Likewise, unless both entities and auditors provided complete access to all of their information to users – which is an unreal proposition – the information gap described in paragraphs 18 to 23 will also persist. We would also like to point out that since audit procedures are driven primarily by what is or should be in the financial statements, information about audit scope, process and findings are basically indistinguishable from entity information, whereas the pyramid suggests only a slight overlap between auditor and entity information that is private and undisclosed. Furthermore, even the auditor's report, which opines on the financial statements and is available to users, in fact overlaps with entity information available to users.

In conclusion, unless management or those charged with governance decide otherwise (e.g., voluntary direct engagements), we believe that 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 this effect, investors do not appear to criticize financial reporting standards sufficiently for the supposed information gap if they do not appear to be receiving the entity information that they believe that they need.

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 most critical issue is to increase the value of audits to users by reducing the impression that audit is a commodity. As noted in our response to Question 1, it may be useful to consider exploring whether, in the standard auditor's report, auditors might address in a short, summarized fashion significant risks of material misstatement identified during the audit that are identified as significant financial reporting issues in the financial statements by management without leaving the impression that the auditor is opining on these matters rather than on the financial statements as a whole. This may reduce a small part of the "information gap" about audits, but the "information gap" about entities needs to be solved by financial reporting standards.

   In addition, many users appear to have misconceptions about audits and the role of auditors, which contribute to the expectations gap and the information gap about audits. These misconceptions could be addressed by increasing user education about audits, using plain language in the auditor's report when audit – rather than accounting – jargon is used, explaining in the auditor's report what an audit does not do (e.g., ISA 200.A1), and explaining in the auditor's report the inherent limitations of an audit.

   We do not believe that some third-party users are more affected than others (or that some are unaffected) in this respect: when it comes to lending credibility to financial reporting, all third-party users must be treated equally. In this context, and in line with our analysis of user "needs" in the body of our comment letter, we do not believe that further developments in auditor reporting can be driven solely by certain users' expectations – and certainly not solely by a small group of financial analysts from larger financial institutions and funds, who will always seek more information and may wish to transfer investment risk to third parties.

However, there is a case that those charged with governance, who, in many jurisdictions, are responsible for engaging the auditor and for overseeing the audit as part of their governance responsibilities, may require more detailed information for their oversight responsibilities than is provided to third-party users. In this respect, the IAASB may wish to consider whether ISA 260 needs further strengthening. Certainly in Germany the long-form auditor's report to those charged with governance has proved to be a useful instrument in aiding those charged with governance in their oversight roles.

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

   As we noted in the body of our comment letter, since the concept of reasonable assurance is the same for all audits of all types of entities, any changes in audit reporting should, in principle, be made for all audits without differentiation. However, financial reporting requirements for certain kinds of entities (e.g., listed entities) may be different or more extensive, and in these cases the scope of the audit (that is, which financial reporting matters are subject to audit) can be different.

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?*

   No question was asked in the paper about the wording of the report, so we address this issue in this question.

   We believe that many users continue to find the "binary opinion" (unmodified vs. modified) useful, and would therefore support its retention. We also agree that it is helpful for auditor reports to have consistency from jurisdiction to jurisdiction, and in this context accept that standardization in wording is unavoidable.

However, although a largely standardized form of audit report remains advantageous for comparability reasons, one disadvantage of standardization is that it does not facilitate an appreciation of the value of an individual audit. Standardisation makes it difficult for audit report users to evaluate the quality of the individual audit, which could lead to public perceptions that the product "audit" as just another replaceable commodity.

Complexity of the standardized language used is also an issue that means that many addresses lacking specialized technical skills may find the text hard to understand. However, we note that the terminology specified as technical language in paragraph 46 (fair presentation, materiality, misstatement) in fact stems from financial reporting frameworks such as IFRS (the first two) or from law (negligent or gross "misstatement") and is not solely "auditor jargon". To this extent, users' misunderstanding the auditor's report due to the use of technical language is actually indicative of a lack of understanding by users of the applicable financial reporting framework and basic legal concepts underlying financial statements, which is not something that enhancing audit reporting would resolve. However, where pure "auditing jargon" (e.g., "reasonable assurance") is used, further clarification, or use of plain language to the extent possible, may need to be considered.

In respect of placement of the opinion paragraph, we tend towards the view that although it is a key element in the report, it does need to be understood in the right context, as outlined in paragraph 50. Moving the opinion right after the introductory paragraph also leads to the strange situation that in the case of modified opinions, the Basis for Modifications Paragraph would immediately precede the introductory paragraph. Where would emphasis and other matter paragraphs be placed so as to not indicate that they affect the opinion? Will users understand the change, especially for reports with modified opinions or emphasis or other matters paragraphs? It is not clear whether placing the opinion paragraph (almost) first rather than (almost) last really adds anything to the readability or understandability of the report and it may cause other difficulties as noted: in such a case, it is probably better to stick with tradition, rather than moving things around for changes sake.

On the whole, we believe that instruments such as emphasis and other matter paragraphs have worked well because they have not been overused. We believe that these paragraphs ought to be clearly distinguished from any other additional "auditor commentary" that might be provided in the report, if the IAASB were to choose to include such an item in the 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?*

   As noted in paragraphs 44 and 45 of the paper, we firmly believe that one of the main purposes of the auditor's report is to reduce the expectations gap by clarifying to users what the role and responsibilities of the auditor are. The fact that paragraph 42 states that even sophisticated users are not sufficiently well informed about matters addressed in such paragraphs lends support to this view. This is especially the case if the auditor's report were to be expanded to provide additional auditor commentary. In this case, there may even be a need to include further clarification of responsibilities so that users do not misperceive the role of the auditor.

   One of the main issues in this respect is that the financial statements are management's financial statements – not the auditor's financial statements. Consequently, a description of management's responsibilities is crucial to contrast the responsibility of the auditor from that of management. Likewise, removing the description of what an audit involves would only serve to increase the expectations gap. We would therefore not support removing the paragraphs on the responsibilities of management or the auditor. We are less concerned about their positioning within the auditor's report, as long as there is a logical structure to the components of the report such that users are not confused by the report. However, we would not support repositioning these paragraphs to an appendix outside of the body of the report because it diminishes the delineation of responsibilities between management and the auditors, which would serve to increase the expectations gap.

   With one exception, we do not believe that these paragraphs need to be expanded. The one exception is that we believe that the third sentence of ISA 200.A1 explaining what an audit is not and a description of the inherent limitations of an audit ought to be added to the description of the auditor's responsibilities in a prominent place, because it is apparent that many users still have misconceptions about these matters. We note that even proposed ISAE 3410 includes a statement on the inherent limitations of GHG statements (which thereby becomes an inherent limitation of the assurance engagement): there is no good reason not to be as clear about these matters in audits of financial statements. Explaining reality to users is not a defensive statement!

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?*

   Such a statement would be useful, provided it clarifies precisely the information for which the auditor has a particular responsibility, and the nature and extent of that responsibility. Otherwise such a statement may serve to widen the expectations gap. Care would need to be taken to exclude such information from other information that is required to be audited in certain jurisdictions. For example, in Germany, with certain exceptions, the information in the *Lagebericht* (management report) is subject to audit and this fact is clearly stated in the auditor's report pursuant to IDW Auditing Standards. Modifications to the auditor's opinion that relate solely to the *Lagebericht* are also clearly identified as such within the auditor's report.

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

   The statement should be a factual and clear explanation of the responsibility of the auditor in this respect, as noted in our response to question 6, and the fact that the auditor will report material inconsistencies in the report when these are not corrected by management. However, reporting in this respect should be on a "by exception basis". If the auditor recognises there is a material inconsistency between the audited financial statements and other information in documents containing audited financial statements, paragraph 10 of the extant ISA 720 already requires the auditor take specific action. Any benefit of including text to explain that the auditor has nothing to report in this respect would likely be outweighed by the propensity to cause confusion to users.

   Given the difficulty the IAASB has experienced in determining the wording of the conclusion in a limited assurance engagement together with the fact that the auditor does not seek to gain assurance on such information, conveying a lack of matters to report in these circumstances would be rather difficult. In conclusion, we believe that the auditor need only take action when, in line with the auditor's responsibilities, there are matters of concern with the other information.

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.*

As noted in our responses to Question 1, as a matter of principle in the interests of improving the value of auditor's reports to users, we believe that enhancements to auditor reporting need to be explored. However, in line with the principle set out in the body of our comment letter, the nature and extent of such enhancements to audit reporting and other communications depends upon the role of the parties to the communication. Consequently, communications with those charged with governance is directed at aiding those charged with governance with their oversight responsibilities, whereas audit reporting to investors is undertaken to help investors understand the nature and extent of the credibility lent to the financial statements by the audit.

Therefore, as pointed out in our response to Question 1, it would be inappropriate for auditors to provide information in the auditor's report that originates solely from the entity or its financial statements unless there are *exceptional* circumstances (through an emphasis of matter paragraph). Expanding to the use of emphasis of matter and other matter paragraphs beyond exceptional matters would inappropriately change the nature of those paragraphs and their impact.

However, as noted in our response to Question 1, it would be legitimate to explore whether there are matters that help investors understand the audit (i.e., to increase audit transparency) that may currently be communicated to those charged with governance that could also be reported to other users, but what those matters might be needs careful consideration.

To this effect, it may be worth considering whether summary information about significant issues or significant misstatement risks encountered during the audit and the auditor's responses thereto might be addressed in the auditor's report as part of an additional "auditor's commentary" on the audit. The first two bullet points and the last bullet point of paragraph 62 appear to address these types of issues. However, the commentary needs to be clear that these auditor disclosures do not represent opinions on individual items or issues and are matters that support, rather than detract from, the opinion on the financial statements as a whole. However, we would not support disclosing materiality to users because it is likely to be misunderstood by users given the qualitative considerations (including the fact that there a wide range of users) that the auditor applied in determining that level. We would not support having auditors disclose significant deficiencies in internal control as suggested in the second last bullet point of paragraph 62 because this would involve the provision of information designed for those charged with governance being made public and because management should be the originator of entity information, rather than the auditor.

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.*

Paragraph 67 of the paper states: "A recent survey was carried out in France among groups representing a wide range of users, to obtain views about the usefulness of the additional disclosures by the auditor. The value ascribed to the additional disclosures by the auditor varied considerably among the survey respondents." Given this, together with the challenges identified in paragraph 69, including the propensity for so called boiler plating, we are not convinced that the French model is necessarily the appropriate solution. Furthermore, we note that the French model includes helping users navigate through complex financial reporting and highlighting matters of interest in the financial statements. This is appropriate to the extent that auditor highlighting of particular matters in the financial statements is related to the audit, which is why we suggest exploring whether auditors might provide a summary of significant risks of material misstatement that are identified as significant financial reporting issues in the financial statements by management. While this may end up helping users navigate through the financial statements, it is important that additional auditor commentary not seek to mitigate poor financial reporting, which would blur the distinction between the roles of management and the auditor.

However, in line with our comments above, we agree with the contention in paragraph 71 that the concept of auditor commentary in some form is worthy of further consideration as described in our response to Question 8 and above.

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.*

    This question addresses two distinct matters; information about the entity, and information about the quality of its financial reporting.

    As we noted in our responses to previous questions, providing insights about the entity to third parties is likely to be illegal in some jurisdictions and is not appropriate given the relative roles of management and the auditor. Therefore, insights into the entity should be given by management, which, if there are net benefits to the public, may be audited if this is possible given the nature and extent of evidence available. Furthermore, the provision of auditor insights on the entity without a clear limitation of liability tends towards the shifting of investment risk from investors to auditors by moving towards a "guarantee" by auditors for the investment. Therefore, this approach does not appear to be conducive to the long term sustainable operation of capital markets.

    Providing information in the auditor's report to third parties about the quality of financial reporting beyond the unmodified/modified opinion dichotomy depends upon the development of suitable criteria for the evaluation of such quality. Such criteria would need to be developed by accounting standards setters, which they have not yet done. Consequently, until such criteria have been developed, it does not appear reasonable to have auditors provide an evaluation of such quality.

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.*

Given the statement in paragraph 86 recognizing that the differences in national corporate governance models call the practicability of application of the UK proposals into question, we do not understand why the IAASB is soliciting comments on only this one proposed model from the U.K., rather than exploring options in general.

The first sentence in paragraph 9 states: “Auditor reporting is only one element of the broader corporate reporting process, but plays an important role in communications with users.” The IDW agrees with this but, in this same context, also believes that auditor communications with those charged with governance is an area that should also be considered within the debate on auditor reporting, as the auditor plays a valuable role in supporting those charged with governance in their oversight role.

As we noted in our response to Question 2, the IAASB should consider whether ISA 260 needs to be strengthened. As a matter of principle, significant matters related to the audit should be communicated to those charged with governance first to aid them in their oversight function. Based on this principle, only those matters of particular significance communicated to those charged with governance may be considered to be included in an “auditor’s commentary” in the auditor’s report that is disseminated to third party users.

Paragraphs 78 and 79 of the Consultation Paper briefly describe the practice in Germany, whereby the auditor communicates in greater detail about the audit to those charged with governance than in the auditor’s report. This has been required pursuant to the German Commercial Code for a long time. As we pointed out in our comment letter to the EU Commission dated December 8, 2010 in respect of the green paper on auditing, we believe this form of differentiated reporting has a number of benefits, including protection of the legitimate interests of the entity. The publication of sensitive internal information alluding to business risks, for example, could lead to disproportionate or irrational reactions by affected parties that may lead to the precipitation of certain business risks into actual untoward events that would otherwise not have occurred without such disclosure to third parties (much like “self-fulfilling prophecies”). In direct contrast, such sensitive information may be useful to those charged with governance, as it would allow them to oversee management’s plans to steer the entity towards mitigating those risks and potentially avert otherwise detrimental events from occurring.

However, we do not support the model proposed in the U.K. for wider application. Systems of corporate governance differ between jurisdictions. In Germany, in addition to forming an opinion on the financial statements, through the long-form audit report and other communication responsibilities, the auditor also aids supervisory board in its governance role. Consequently, having the auditor publicly report on the completeness and reasonableness of an audit committee's report that covers their oversight responsibilities over the audit would involve a conflict of interest for the auditor. In Germany, the supervisory board is responsible for engaging the auditor and overseeing the conduct of the audit and therefore the conflict of interest would be particularly acute: this model would endanger the relationship between the auditor and those charged with governance needed for an effective audit.

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?*

In line with our response to Question 11, we do not believe that acceptance or adoption of this model at an international level is a feasible proposition at all and do not believe that those regulating the financial reporting process in Germany, specifically, or Europe in general outside of the U.K. and Ireland, would be inclined to accept or adopt this model. Hence, no actions towards those responsible for regulating the financial reporting process would be useful to seek to influence acceptance or adoption of this model

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

No. As we explained in our response to Questions 11, and 12, the auditor would face a conflict of interest for cases in which the report covered the oversight over the audit, which may endanger the relationship between the auditor and supervisory board that is needed for an effective audit.

However, this would not preclude the auditor from reporting on activities of those charged with governance, or reports issued by those charged with governance on those activities, that are unrelated to the audit.

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.*

We would like to point out that this section goes beyond "audit reporting", and actually deals with the scope of the audit of financial statements (or for other required related services in connection with an audit of financial statements). As the second sentence of ISA 200.A1 in connection with the first sentence correctly points out, the only thing common among all audits of financial statements worldwide is the audit opinion on the financial statements, which deals with whether those statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Such an audit opinion is a prerequisite for an audit to be an "audit of financial statements". However, as the fourth sentence of ISA 200.A1 also correctly points out, applicable law or regulation in some jurisdictions may extend the scope of the audit to beyond an opinion on whether the financial statements are prepared, in all material respects, in accordance with the financial reporting framework. The IAASB should recognize that, given the differences in law or regulation in relation to financial statement audits around the world as pointed out in paragraph 89 of the paper, and the existence of a greater number of audits that are performed without statutory requirements to do so than the number performed due to statutory requirements, the IAASB is not in a legal or otherwise authoritative position to extend the scope of the audit of financial statements beyond that described in the first and second sentences of ISA 200.A1.

However, when a large number of significant jurisdictions from a number of regions around the world require an equivalent or a very similar extension to the scope of the financial statement audit beyond an audit opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework, the IAASB would need to consider whether it may be appropriate to seek to harmonize practice for such extensions by means of an additional international standard that can be adopted, transposed or applied when such equivalent or similar extensions are required. If such extensions are not required in a large number of significant jurisdictions from a number of regions around the world, it is unlikely that there is an appropriate basis for an international standard, and standards setting in this area ought to be under the purview national standards setters.

Furthermore, unless there are suitable criteria at an international level (i.e., criteria against which the entity's performance can be reliably measured or evaluated) for such areas such as prospective financial information, corporate governance, (sustainable) business models, risk management, internal control and financial reporting processes, and key performance indicators, an auditor cannot perform standardized assurance engagements on these matters. A subjective assessment by the auditor would be inappropriate because it would neither be in line with the IAASB's Assurance Framework, nor sufficiently consistent to be of benefit to users. In some cases, suitable criteria at an international level might be developed from national standards used in certain jurisdictions.

Agreed upon procedures engagements may be another option, but this would not achieve the desired international consistency at this time, so the usefulness of such an engagement to users, as discussed in this paper, would be severely limited.

Consequently, the discussion in this and the following question really represents a consultation for 1. financial reporting regulators to consider whether certain information accompanying the financial statements ought to be required, and to consider the suitable criteria for that information and the underlying subject matter, and 2. audit regulators to consider the nature and extent of an auditor's responsibilities for any such information accompanying the financial statements. The discussion does not represent a basis for considering additional international assurance or related services standards at this time because the prerequisite of wide international application (see second paragraph of the response to this Question) for such international standards has not been fulfilled for any existing extensions of audit scope in particular jurisdictions of which we are aware. Consequently, we believe that it is too early for the IAASB to be contemplating the impact of these matters on its *immediate* work plan as outlined in paragraph 90.

Two potential extensions of financial reporting and consequent potential extensions of audit scope not addressed by paragraph 88 are auditor involvement in prospective financial information and in information about business risks (as opposed to risk management), prepared by management.

In the context of international financial reporting there are currently calls for the inclusion of more prospective information. To the extent that such information were, in future, required to be disclosed in the financial statements or in information accompanying the financial statements, auditors are able to opine on whether the assumptions used by management are plausible in the circumstances, and whether the information has been appropriately prepared on the basis of those assumptions, but not on whether such forecasts will actually occur. However, if an audit engagement were to be extended to cover prospective financial information, care would be needed not to widen the expectations gap in view of the auditor's limited ability to predict the future. For example, including statements by the auditor as to the future profitability and the sustainability of the entity's business model in the auditor's report would involve the danger of increasing the expectations gap as to the ability of the auditor to predict future events. Auditors are often loath to accept assurance engagements with respect to such information in some jurisdictions because of legitimate liability concerns: therefore, liability reform is a prerequisite for auditor involvement with prospective financial information. In our comment letter to the EU Commission dated December 8, 2010 in respect of the Green Paper on auditing, we also suggested that expanding financial reporting, specifically the management report (also called "management commentary" by IFRS or "annual report" in the Fourth and Seventh EU Directives), by requiring the inclusion of more prospective information – without requiring preparers to perform impracticable tasks, or prompting so-called self-fulfilling prophecies – might also contribute to a fair presentation of the entity's actual economic situation. We also suggested that the scope of the audit in Europe include the management report, provided any legislation in this respect also includes appropriate limitation of auditor liability in this respect.

We comment in turn on the five examples of financial reporting and consequent potential audit scope extensions listed in paragraph 88 as follows:

a) Corporate Governance Arrangements

   We suspect that users' expectations as to what information might be included in the auditor's report in respect of corporate governance arrangements could vary widely, such that an expectations gap in this respect would be unavoidable. The differences in corporate governance frameworks and requirements world-wide mean that this is an area that does not lend itself to international standard setting. In our view, at this time this is a matter for national legislators, regulators and standards setters.

b) Business Model, Including the Sustainability Thereof

An entity's business model is one aspect that auditors will consider in obtaining the understanding of the entity required by ISA 315. In applying ISA 570, the auditor also considers the viability of an entity to continue as a going concern for a period of at least 12 months subsequent to the date of the financial statements. However, this is an area upon which auditors do not form an opinion specifically; rather it is considered as part of the opinion on the financial statements as a whole.

On the premise that there needs to be an understanding that the auditor cannot be expected to call the quality of management's decisions into question, we are open to reasonable suggestions relating to legal requirements to have the auditor examine the impact of the entity's business model on the economic development of its business and how related risks are disclosed in the financial statements or in accompanying information. Provided there are appropriate financial reporting requirements (suitable criteria) in this area, the auditor may be able to consider management's assessment of the opportunities and risks that result from the applied business model and consider whether their presentation in the financial statements or in accompanying information is adequate.

c) Enterprise-Wide Risk Management

In some jurisdictions there may be legal requirements for certain entities to have systems to manage risk, whilst in others there may not be. Indeed, the ISAs recognise this as a fact, as ISA 315 requires the auditor to obtain an understanding of whether the entity has a risk assessment process and – in the absence of such a process – to hold certain discussions with management and consider whether it represents a significant deficiency in internal control. Therefore, the IAASB contention in paragraph 89 ("…national auditing standards will need to be developed accordingly") applies to this aspect in so far as it goes beyond the ISA requirements.

In Germany the IDW has had such an auditing standard since 1999, as certain German entities are required pursuant to the German *Aktiengesetz* (Stock Corporation Act) to have in place a *Risikofrüherkennungssystem* (risk early recognition system), which, in respect of listed entities, the auditor is required to address within the audit of the financial statements. The auditor is required to evaluate whether the entity's management has complied with the legal requirement to establish this risk early recognition system in a suitable form and also whether that system is capable of fulfilling its role. The auditor is required to report internally (in the German long form audit report) thereon. Those entities that are not listed entities, but which have such a system because of their size or complexity, often elect to have the auditor cover this aspect on a voluntary basis.

Furthermore, under banking legislation, financial institutions are required to have the appropriateness (that is, the design and implementation, but not the operating effectiveness) of certain aspects of the institution's risk management system as required by banking legislation and regulation audited by their auditors as part of the financial statement audit.

The IDW also has a standard on assurance engagements in relation to parts of enterprise compliance management systems, which, however, is not a part of the financial statement audit.

We would like to point out that in all of these engagements, the subject matter is not the entire enterprise-wide risk management system. Due to the comprehensiveness of enterprise-wide risk management systems, extending an audit of financial statements to the entire enterprise risk management system would involve considerably greater cost. Consequently, if an audit were to be extended to risk management, cost-benefit considerations may involve considering the scope of such an engagement in relation to certain aspects of risk management.

d) Internal Controls and Financial Reporting Processes

Pursuant to ISA 315, the auditor is required to obtain an understanding of internal control relevant to the audit (ISA 315.12 et seq.) and may or may not perform tests of operating effectiveness (ISA 330.8 et seq.), depending on whether the auditor assesses misstatement risk on the expectation that controls are operating effectively, or substantive procedures alone are not capable of yielding sufficient appropriate audit evidence. ISA 265 currently requires the auditor to communicate appropriately to those charged with governance and management significant deficiencies in internal control that the auditor has identified in the audit of financial statements (as well as other deficiencies in internal control of management interest to management); a modification of the auditor's opinion in this respect would only be appropriate if such deficiencies were to render the auditor unable to obtain sufficient appropriate audit evidence.

This approach differs from the approach taken in the USA pursuant to PCAOB Auditing Standard No. 5 "An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements".

Extending the scope of the audit to internal control relevant to the audit, or aspects thereof, is not a costless undertaking, as demonstrated by the introduction of the audit of internal control through the PCAOB. If such extensions were to be contemplated, policymakers would need to consider the costs and benefits to the public of such an extension. At the present time, there does not appear to be a world-wide movement towards extending the audit to cover internal control beyond that described in the ISAs.

e) Key Performance Indicators

As financial reporting becomes more complex, users seek greater simplicity by reverting to key performance indicators (KPIs). Many of these KPIs are so-called "non-GAAP measures" – that is, they are developed by specific enterprises or represent loose industry practice. Prerequisites for auditor involvement with KPIs are suitable criteria for the development of appropriate KPIs and for their disclosure. At the present time, such suitable criteria are not yet available. However, once such criteria are available, auditor involvement may be beneficial to users. The IDW has a project addressing the accounting aspects of this issue. Once the accounting aspects have been developed, consideration will be given to the potential audit and audit scope extension implications.

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

As noted in our response to Question 14, at the present time, we do not believe that the prerequisites have been fulfilled for the development of international assurance or related services standards as part of the financial statement audit in these areas.

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.*

We will summarize our views on each of the different options explored in Section III in turn:

Format and Structure of the Standard Auditor's Report

While changes to the format and structure of the standard auditor's report cause the least direct costs to auditors, such changes are not costless. The templates for auditor's reports would need to be changed across the entire firms and their networks and for standards issued by national standards setters. Such changes also increase the likelihood of errors in the reports, which will likely cause greater quality control costs. We also note some other costs that may result from the changes proposed. In many cases, the benefits of changes other than the suggestions we make below, are likely to be marginal at best. We therefore recommend that the IAASB not make changes to the format and structure of the report simply for the sake of change, but consider the direct and indirect costs that we address together with the rather marginal benefits that arise from such changes.

Explanations of Management and Auditor Responsibilities

From our point of view, there is no benefit to removing the explanations of management and auditor responsibilities other than to make the report shorter, which, though a benefit, is a very slight benefit if the IAASB considers enhancing the report with additional auditor commentary or the like. The costs, however, are considerable because through the removal of these paragraphs there would be no clear indication in the report that the financial statements are management's financial statements and that therefore management has certain responsibilities in this regard. Furthermore, there would be no clear description of the auditor's responsibilities to contrast those with management's. If clearer communication is the goal of this consultation, then neither management's nor the auditor's responsibilities ought to be removed from the report. For the same reasons, we also believe it to be important to retain these explanations in the body of the report. As we noted, given user misconceptions about the inherent limitations of an audit and what the role of an audit is, the explanation of the auditor's responsibilities ought to be enhanced by referring to these inherent limitations (which has the added benefit of helping to explain the meaning of "reasonable assurance"), and the third sentence of ISA 200.A1 or it's equivalent ought to be added to clarify what an audit does not do.

Use of Technical Language

We note that almost all of the technical language used actually stems from financial reporting frameworks or other related sources and is not "audit jargon". Audit reporting cannot alleviate the inability of users to understand the terms used by financial reporting frameworks and other related sources, which means this matter cannot be considered through a consideration of costs and benefits. Auditors must be able to assume that users of auditors' reports (as noted in ISA 320.04) have a reasonable knowledge of business and economic activities *and accounting* and a willingness to study the information in the financial statements (and by extension, the auditor's report) with reasonable diligence. However, some of the misconceptions that users have about "reasonable assurance" and the role of auditors could be addressed by the suggestions we have made to enhance the explanation of auditor responsibilities.

Location of the Auditor's Opinion

Changing the location of the auditor's opinion is an entirely cosmetic change with questionable benefits. As we noted, there are unsolved problems with how the proposed move of the opinion to near the front of the report would have an impact on the placement of the Basis for Modifications Paragraph for modified opinions and the placement of emphasis of matter and other matter paragraphs. We would like to point out that having the opinion at or near the end of the report is, in fact, in line with the tradition of expert opinions (which is what an auditor's report is, in a legal sense), whereas placing the opinion at or near the beginning is closer to the tradition associated with court decisions. On the whole, the case for changing the position of the opinion is weaker than for keeping the opinion where it is.

Other Information in Documents Containing Audited Financial Statements

A statement of an auditor's responsibilities with respect to other information may be useful, provided it clarifies precisely the information for which the auditor has a particular responsibility and the nature and extent of that responsibility to prevent a widening of the expectations gap. In our view, the auditor should report only when there is something to report, rather than also reporting that there is nothing to report. The costs of such a change are likely to be minimal: there may be an added benefit to have users understand the auditor's responsibilities in this regard, as long as these are clearly stated to prevent a widening of the expectations gap.

Auditor Commentary on Matters Significant to Users' Understanding of the Audit or the Audited Financial Statements

Increased Use of Emphasis of Matter Paragraphs

As we noted, it is management's responsibility to help users "navigate" through complex financial reporting. As a matter of principle, the auditor's report should not be used to supplement financial reporting. However, the emphasis of matter paragraph remains a useful tool as long as its use remains exceptional. We therefore believe that increased use of emphasis of matter paragraphs blurs the distinction between the responsibilities of management and of the auditor, and therefore the costs are greater than the benefits.

Providing Increased Information About the Audit

There is a case that to prevent the commoditization of audits, there may need to be some enhancement of auditor reporting about the audit in the form of some kind of "auditor commentary". One option worth further exploration is some commentary summarizing significant risks of material misstatement that are identified as significant financial reporting issues in the financial statements by management , as long as it is clear from the narrative that these matters support, and do not detract, from the opinion, and that no separate opinion is being given on the matters addressed. We are not convinced that other matters (e.g., materiality, significant deficiencies in internal control) are suitable for such commentary. On the whole, it is unclear whether the benefits of such an approach may outweigh the increased costs that auditors would incur in dealing with such reporting, but the IAASB should consider this issue further. As a matter of principle, we believe that auditors should clarify in the auditor's report in standardized language that they have discussed significant audit matters with those charged with governance. We are not necessarily in favour of the "justification of assessments" as practiced in France because it is also used to help users navigate through the financial statements or to highlight matters in the financial statements (with which we disagree because this is management's responsibility).

Providing Auditor Insights About the Entity or the Quality of Its Financial Reporting

As noted, we do not believe it to be appropriate for auditors to provide users with their insights about the entity: this is management's responsibility and having the auditors provide such information without management approval would likely be illegal in some jurisdictions. Furthermore, as we noted in the body of our comment letter, providing such insights without a clear limitation of liability tends towards shifting investment risk from investors to auditors by moving towards a "guarantee" of the investment by the auditors. We therefore believe that the provision of auditor insights about the entity would be positively dangerous for the sustainable operation of capital markets in the long run and that therefore the costs clearly outweigh the benefits.

With respect to the provision of auditor insights on the quality of the financial statements beyond the unmodified/modified opinion dichotomy depends upon the development of suitable criteria for the evaluation of such quality. Such criteria would need to be developed by financial reporting standards setters, which they have not yet done. Consequently, until such criteria have been developed, it does not appear reasonable to have auditors provide an evaluation of such quality.

An Enhanced Corporate Governance Reporting Model: Role of Those Charged With Governance Regarding Financial Reporting and the External Audit

As noted, given our experience with the long-form audit report, we suggest that ISA 260 needs strengthening because we believe that the benefits of such strengthening is likely to exceed the costs. However, we do not support the proposal from the U.K. to have auditors report on a report from those charged with governance that covers their oversight over the audit, because this is a clear conflict of interest. That being said, this would not preclude the auditor from involvement in other reports issued by those charged with governance that do not relate to the oversight over the audit.

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

As noted, the IAASB is not in a position to make other assurance or related services a part of the current scope of the financial statement audit. Rather, only legislators and regulators are in a position to expand the scope of an audit, and then only for audits required by statute. Furthermore, in the cases noted, there may not be a need for an international standard to deal with matters that are different in different jurisdictions. Sometimes auditor involvement would be predicated on financial reporting or other standards setters promulgating suitable criteria so that an assurance engagement is possible. However, we believe that it is worth having legislators and regulators explore whether the benefits of the following potential extensions of audit scope exceed the costs:

- Auditor involvement with prospective financial information (such as in a management commentary) which is predicated on suitable criteria for the preparation of such information, the limitation of the opinion on the plausibility of the assumptions and their appropriate application, and on limitation of liability, since auditors cannot predict the future
- Auditor involvement in management disclosures of business risks, for example in a management commentary
- Auditor involvement in management disclosures of the impact of the entity's business model on the economic development of its business and how related risks are disclosed in the financial statements or in accompanying information, provided there are appropriate financial reporting requirements (suitable criteria) in this area; the auditor may be able to consider management's assessment of the opportunities and risks that result from the applied business model and consider whether their presentation in the financial statements or in accompanying information is adequate
- Certain aspects of risk management, under the presumption that suitable criteria therefor exist
- Key performance indicators, under the presumption that suitable criteria for their development and disclosure exist

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.*

Of course, on an absolute scale, the benefits and costs of some of the suggested changes will be greater for stakeholders of auditors' reports of larger entities than for smaller ones because where more money is at stake the net benefits or costs are likely to be greater. The real issue is whether the *relative costs* and benefits for different entities will be the same or different. As a rule, the fixed costs associated with change will have a greater impact on stakeholders from smaller entities because less of the variable relative net benefits would accrue to those stakeholders. Other than these differences, we do not believe that the relative costs or benefits would be different for different kinds of entities to the extent that the financial reporting for these kinds of entities are the same. When, for example, the financial reporting of certain kinds of entities (e.g., publicly listed entities, banks, insurance companies, or public interest entities) involves additional reporting instruments, then, of course, auditor involvement with those instruments as part of the financial statement audit would also be affected by any changes made. However, as a rule, we believe that "an audit is an audit" for the financial statements and any accompanying information, as the case may be.

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?*

In our view the most effective options that can be addressed by the IAASB without needing to expand audit scope (Section III, Parts A, B, and C) would be:

- Addressing user misconceptions about audits by enhancing the explanation of auditor responsibilities in the auditor's report by referring to inherent limitations (which has the added benefit of helping to explain the meaning of "reasonable assurance"), and adding the third sentence of ISA 200.A1 or it's equivalent to clarify what an audit does not do
- Including a statement of an auditor's responsibilities with respect to other information that clarifies precisely the information for which the auditor has a particular responsibility and the nature and extent of that responsibility to prevent a widening of the expectations gap

- Consideration of providing auditor commentary summarizing significant risks encountered in the audit that are identified as significant financial reporting issues in the financial statements by management

Furthermore, the IAASB ought to consider strengthening auditor reporting to those charged with governance (ISA 260), which does not affect audit scope even though it is included in Section III Part D).

The matters that affect audit scope (Section III, Parts D and E) cannot be addressed by the IAASB, but need to be addressed by legislators, financial reporting regulators, financial reporting standards setters, and audit regulators. We do not believe that seeking auditor reporting on reports by those charged with governance over governance arrangements that include oversight over audit is a viable option. We refer to our response to Question 17 on Other Assurance or Related Services on Information Not Within the Current Scope of the Financial Statement Audit for further details.

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?*

One matter that we have not addressed in the body of our letter or in the responses to the questions above is whether management ought to be required by financial reporting standards to provide an assessment of its use of the going concern assumption in every financial statement. Auditors' reports could then be required to include disclosure by the auditor of the auditor's consideration of management's use of the going concern assumption in the financial statements. However, as this is a financial reporting matter in the first instance, this issue would need further discussion with legislators, accounting regulators and financial reporting standards setters before being placed on an audit standards setting agenda.