September 26, 2011

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Dear Board Members and Staff

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

Grant Thornton International appreciates the opportunity to comment on the consultation paper *Enhancing the Value of Auditor Reporting: Exploring Options for Change.*

External reporting by an entity and its auditor is a complex subject. Entities strive to produce accurate and complete information, at a reasonable cost, to meet the needs of stakeholders while balancing the need to protect their business from competitors using the disclosed information to the entity's disadvantage. Auditors need to respect the confidentiality requirements of the entity and provide the stakeholders with a clear message regarding the fairness of the entity's financial statements, taken as a whole.

The foundational concept to external reporting is that management reports and auditors enhance the value of those reports by providing independent assurance. This long-standing concept and practice has served stakeholders and society well and we believe it should be retained.

Grant Thornton feels that determining the actions to take to enhance the value of auditor reporting need to be based on principles. Therefore, our responses to the discussion questions are based on the following principles:

1. A holistic approach is required to determine the actions needed to enhance external reporting. A holistic approach involves determining the incremental reporting needs of stakeholders, assessing who should be responsible for the reporting, determining the benefits and costs of the reporting and whether assurance on the reporting would add value. A holistic approach would also involve providing criteria for the incremental reporting to enable entities to meet disclosure objectives and enable auditors to opine on the information, if assurance is desired.
2. The management of the entity is responsible for meeting stakeholder's expectations regarding information about the entity. Auditors should disclose entity-specific information only when management fails to report information as required by the reporting framework or criteria.

3. The entity's auditor is responsible for disclosures about the audit process. Additional disclosures aimed at narrowing the expectation gap:
   a. Should:
      i. relate directly to the audit process. For example, stakeholders may desire greater transparency about the role of component auditors in the audit of the group and such information could be provided in the audit report.
      ii. communicate clearly the level of assurance provided, if any, on additional disclosures. The auditor's views about aspects of the entity's disclosures based on the audit procedures performed in the financial statement audit should be presented in a manner that does not mislead the stakeholder to believe that these views are presented with assurance. For example, such views could be expressed in a report that is separate from the financial statement audit opinion.
   b. Should not:
      i. be a surrogate for information about the entity. For example, one of the suggested enhancements under consideration is reporting on areas where the auditor had difficulties on reaching a conclusion. In seeking such reporting stakeholders may be less interested in the audit process and more interested in measuring an unspecified attribute about the entity. We refer to this situation as "surrogate for information about the entity." In the case of "difficult audit areas", stakeholder may be seeking information such as the complexity or aggressiveness of the entity's financial reporting or the appropriateness of the entity's resources or the adequacy of the entity's controls. Any of these items could result in audit difficulties. Consistent with principle 2, auditor disclosure of information about the entity would not be appropriate. Stakeholders would be better serviced by a direct measurement of the desired information and by having that measure performed and disclosed by management.
      ii. mislead stakeholders. For example, disclosing the auditor's quantitative materiality could mislead the reader as the application of qualitative aspects of materiality applied by the auditor during planning, execution and evaluation are omitted and the complexities associated with the application of materiality to certain measurement uncertainties may not be understood.
      iii. increase the expectation gap by confusing stakeholders or casting doubt on the appropriateness of other auditor or management disclosures.

Obviously, the board has the primary role in developing standards that enhance the value of reporting on the audit process. We also believe that stakeholders are equally interested, perhaps more interested, in incremental and different disclosures with respect to the entity. We therefore encourage the board to work with other necessary stakeholders in a holistic manner in its efforts to address the reporting expectation gap.

Our responses to the specific questions are included in Appendix I.

We would be pleased to discuss this letter with you. Please contact Richard Wood at (905) 466-8710 if you have any questions.

Sincerely,

Kenneth C. Sharp

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Issues Identified

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

Within the principles described in our main letter, Grant Thornton favors enhancements to the auditor's report that would increase the usefulness of the information provided to stakeholders. Incremental enhancements, such as the changes in report structure discussed in Section III may partially achieve this objective. An enhanced understanding of the needs of the readers of the financial statement, audit report and other information made available to stakeholders may also lead to bolder changes in the financial reporting process and the role of the auditor.

In exploring substantive change to the audit reporting, we encourage the board to develop a holistic, principles approach that we describe in our cover letter to determine the type of reporting that would narrow (and not increase) the expectations gap.

To demonstrate the effect of taking this type of approach, in the following table, we offer our views on the examples described in paragraph 23 of the consultation paper.

Key business, operational and audit risks the auditor believes exist.	Key business and operational risks are information about the entity. Therefore, the public would be served best with this information being provided in accordance with established reporting criteria, applied by management and opined on by the auditor. Consideration should be given to whether stakeholders would value assurance on such risks disclosures and whether the value of the assurance would exceed the cost. Our concern with disclosing audit risk is whether such disclosures are a surrogate for information that stakeholders seek about the entity. There is a direct relationship between financial reporting risks and audit risks. Stakeholders would be better serviced by management disclosing and analyzing financial reporting risks.
The auditor's perspective on the key assumptions underlying the judgments that materially affect the financial statements, and whether those assumptions are at the low, most likely, or high end of the range of possible outcomes.	These disclosures are information about the entity. We believe the public would be best served by the entity, instead of the auditor, disclosing such views and assumptions. In addition to the items mentioned, stakeholders may also value disclosure by management of the range of values that would be derived from using different assumptions that are reasonable in the circumstances. Consideration should be given to whether stakeholders would value assurance on such risk disclosures and whether the value would exceed the cost. With respect to the auditor providing disclosure in this area in addition to management reporting, we note that presently, assuming the auditor concludes that management's estimates are materially correct; the auditor's view is expressed positively in the opinion on the financial statements. This form of reporting is the usual outcome of the auditing process. To avoid the negative effect of increasing the expectation gap, auditor reporting in this area needs to avoid confusing stakeholders by providing incremental information, such as ranges of possible outcomes, in a manner that may be seen as contradicting the conclusion that the financial statements are appropriate in the circumstances.

The appropriateness of the accounting policies adopted, including any that are inconsistent with industry practice.	The outcome of the application of the guiding principles is the same as the topic of providing commentary on key assumptions. Auditor disclosure regarding the appropriateness of accounting policies carries the risk of increasing the expectations gap described in principle 3 (b) (iii). Normally, the auditor provides a positive opinion on the financial statements because he or she concludes that management's policies are materially in compliance with the reporting framework (i.e., they are appropriate in the circumstances). A prerequisite to this type of reporting is a clear understanding by the stakeholder of the meaning of "appropriate" in this context and how that differs from the conclusion encompassed in the opinion. We elaborate further on this point in our response to question 10.
Changes to accounting policies that have a significant impact. **The methods and the judgments made in valuing assets and liabilities.** **Significant unusual transactions.**	These disclosures are information about the entity and therefore we believe the public would be served best with this information being provided in accordance with established reporting criteria, provided by management and opined on by the auditor, if desired.
Key audit issues and their resolution which the engagement partner documents in a final, summary audit memo.	Such disclosure may arise from stakeholders' desire to obtain information about the audit process or, as described in principle 3 (b) (i), may be surrogate information about the entity. We favor an approach that establishes the real information needs of stakeholders, including an assessment on whether the entity or the auditors should be the source of the disclosure. These key items are documented for a specific purpose described in the ISAs. Auditor disclosure regarding the appropriateness of accounting policies carries the risk of increasing the expectations gap described in principle 3 (b) (iii). Normally, the auditor provides a positive opinion on the financial statements because he or she concludes that the issues identified were addressed in the audit process. Therefore reporting in this area could confuse stakeholders by providing incremental information in a manner that may be seen as contradicting the conclusion expressed in the opinion.
Quality and effectiveness of the governance structure and risk management.	These disclosures are information about the entity. We believe the public would be best served by the entity, instead of the auditor, disclosing such views and assumptions. Where assurance on this information provides economic benefit, the public would be best served with assurance in this area supported by established criteria and a related audit standard. In some jurisdictions auditor reporting in this area may not be viewed as providing incremental value as other parties presently report on governance structures and risk management of public companies.

Information about the entity that originates from the auditors may have enhanced credibility in the eyes of the stakeholders. However, one of our stated guiding principles is that the original source of disclosure about the entity should be a management responsibility. The auditor's role is to increase the credibility of that information, not to provide alternative information.

Any new role for the auditor with respect to reporting personal observations about the entity needs to avoid unintended negative consequences such as lessening the credibility added by the auditor in the current audit role. Transparency of the auditor's role is also important. Therefore, the auditor's views about the entity needs to be presented in a manner that does not mislead the stakeholder to believe that these views are presented with the same degree of assurance as the opinion on the financial statements taken as a whole. One way to accomplish this objective would be to separate any reporting of this nature from 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?

We believe the most critical issues to be addressed are a clear determination of the incremental reporting needs of stakeholders, an assessment of who should be responsible for the reporting, a determination of the benefits and costs of the reporting and a consideration of whether assurance on the reporting would add value. Please also see our response to question 3.

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

Grant Thornton believes the board should maintain a single set of high-quality standards for use by practitioners to audit all entities. That said, there are a very large number of entities where the information gap described in the consultation paper does not exist. Examples include many private companies and other entities where stakeholders are not restricted in their access to information that they desire or where the current reporting model fulfills their needs. A change in auditor reporting that imposes additional costs on entities that have no need for the incremental information would not serve a sustainable economic purpose. Therefore, we encourage the board to explore ways to balance the needs of stakeholders desiring greater transparency with stakeholders that do not. For example, the auditor should not be required to provide certain disclosures about the audit process when financial statement stakeholders agree that such disclosures are not required.

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?

The paragraphs describing the responsibilities of management and the auditor provide important information that the stakeholder needs to understand in order to understand the opinion. We support retaining this information in the body of the auditor report and having that information appear before the opinion.

We would support an approach that would provide stakeholders with the ability to easily access additional detail on management's or the auditor's responsibilities or to provide definitions on terms used 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 expectation gap? Do respondents have a view regarding whether the content of these paragraphs should be expanded?

Requiring the stakeholder to access another report increases the risk that the stakeholder will not read this information. If so, stakeholders' understanding of the responsibilities of management and auditors will decrease, thereby widening the expectation gap.

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?

Communicating the auditor's limited role with respect to the other information addressed with audit procedures and the limited nature of those procedures may help reduce the expectation gap.

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?

Perhaps the enhanced content of the responsibilities of the auditor discussed in question 4 would be one way to implement this enhancement.

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

We believe that the consultation paper captures the issues regarding additional information in the auditor's report.

We would like to comment on the examples provided in paragraph 62 of the consultation paper of "providing increased information about the audit". This paragraph provides the following five examples:

1. key area of risk of material misstatements of the financial statements identified by the auditor, including critical accounting estimates or areas of measurement uncertainty in the financial statements
2. areas of significant auditor judgment
3. the level of materiality applied by the auditor to perform the audit
4. the entity's internal controls, including significant internal control deficiencies identified by the auditor during the audit and
5. areas of significant difficulty encountered during the audit and their resolution

We note that some of these items are information about the entity and others may be surrogate attempts to measure information about the entity and still others are specific aspects of the audit process. Applying our guiding principles we note as examples:

Items 1 and 4	Such disclosures are information about the entity and stakeholders would be best served by such disclosures being made by management.
Item 5	From the stakeholder's perspective, it is not clear what these disclosures are attempting to measure. Please see our comments in guiding principle 3 (b) (i).
Items 2 and 3	Clear definitions would be needed to guide the auditor with respect to disclosure of such items. There is also risk of misleading or confusing the stakeholders (please see our comments in guiding principle 3 (b) (ii). For example, such disclosures may create the misconception that the auditor is expressing an opinion or conclusion on the disclosures and distract from (or be viewed as contradicting) the auditor's opinion on the financial statements taken as a whole.

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.

Our understanding is that a recent review of the merits of this system yielded mixed results. The mixed views of the value of the system may stem from a lack of understanding of the information stakeholders truly seek. This approach to incremental auditor reporting will not address the expectation gap until those needs are identified.

Consistent application and interpretation of the concept for "key audit areas" is a challenge. Perhaps the subjectivity associated with the determination of key areas is part of this challenge. Different stakeholders may arrive at different judgments.

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

With respect to disclosures that provide insights about the entity, we believe that reporting such information should remain the responsibility of management.

With respect to auditors providing insights about the quality of the financial reporting, we believe such reporting needs to avoid potential negative unintended consequences of increasing the expectation gap as discussed in principle 3 (b) (iii). Auditors presently opine on the fairness of the financial statements and underlying this opinion is whether the accounting principles and methods applied by management fall within a range of acceptable choices. Whether management has, in the auditor's view, applied the best principles and methods to classes of transactions or events is not an aspect of that opinion. Reporting on the quality of financial reporting means that auditors would continue to opine on whether applied principles and methods fall within a reasonable range but then also comment on the application of such principles and methods in relation to certain events or transactions. We believe that the current auditor's opinion is appropriate and useful. Disclosures, such as those described in this example, could have unintended negative consequences such as casting doubt on both the auditor's opinion and management's judgments.

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 an enhanced reporting model where the source of the disclosure of information about the entity remains the responsibilities of management and those charged with governance.

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?

Challenges include the existence of different governance models internationally, different legal liabilities applicable to preparers and auditors internationally, and the absence of criteria to achieve high-quality reporting of this nature. A large challenge will be determining the needs of stakeholders that are not presently being addressed, appropriate measurements that reflect those needs and the system necessary to provide the desired information.

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

Input from stakeholders other than auditors is more relevant in judging the economic value of such assurance. Where valuable, auditors could provide assurance on the disclosures made by those charged with governance providing suitable criteria exists on such disclosures.

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, potential value of assurance or related services on the type of information discussed in Section III, Part E.

Input from stakeholders other than auditors is more relevant in judging the economic value of such assurance.

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

As mentioned in our covering letter, we believe a holistic approach is required to determine the actions needed to enhance auditor reporting. A holistic approach involves determining the incremental reporting needs of stakeholders, assessing who should be responsible for the reporting, determining the benefits and costs of the reporting and whether assurance on the reporting would add value. A holistic approach would also involve providing criteria for the incremental reporting to enable entities to meet disclosure objectives and enable auditors to opine on the information, if assurance is desired. We therefore encourage the board to work with other necessary stakeholders to address these various requirements.

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.

The changes discussed in Parts A and B and the increase in the use of "Emphasis of Matters" paragraphs discussed in Part C could enhance the value of auditor reporting with relatively low incremental cost. However, changes discussed in the other sections of Part C and those in Parts D and E would add costs as auditors and entities presently do not address the described elements in their existing reporting processes and the reporting could be extensive.

To assess benefits, costs, unintended consequences and other implications, we believe any such changes such as those described in Parts C, D and E should be field tested and implemented on a limited basis prior to widespread adoption.

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

Please see our response to question 3.

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 Corporate Governance Reporting Model has potential.

Presently, the auditor discusses matters such as judgments relating to financial statements and risk of their misstatements with the audit committee. The auditor's views are one of several sources of insight available to those charged with governance. Those charged with governance also receive rich and extensive information from the entity's monitoring activities over internal control of financial reporting, operations and compliance functions.

Management and those charged with governance may choose (or could be required by regulation or framework) to provide this information to others, for example, through an enhanced audit committee report. Having the audit committee disclose information about the entity's financial reporting process could provide the transparency stakeholders seek. Such transparency may have an additional positive effect of potentially strengthening the effectiveness of audit committees. Assuming appropriate criteria were developed; auditors could provide assurance on this information, if stakeholders viewed assurance as having economic value.

A recognized framework for audit committee composition, performance and reporting is foundational to the success of this model. A framework would include elements such as:

- Composition, including objectivity and competencies of members
- Oversight of financial reporting risk management policies and practices
- Oversight of the financial reporting process, including reviewing the financial reporting policies and processes used by management
- Oversight of the hiring, performance and independence of the external auditors
- Oversight of monitoring the effectiveness of the entity's internal control over financial reporting, including the performance of the internal audit function
- Oversight of regulatory compliance, ethics, and whistleblower activities
- Exercising appropriate skepticism in discharging their responsibilities
- External reporting elements on how the committee discharged its responsibilities

The board may wish to consider working with organizations such as COSO in developing and promulgating a framework that is suitable for this purpose.

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 that the board's auditing standards, including the auditor's report, are high quality. We acknowledge that, even with high-quality standards, an expectation gap exists.

For some stakeholders, this gap may arise from the stakeholders' misunderstanding of the objectives of the standards. For other stakeholders, this gap may arise because the stakeholders believe the auditor's role is substantially different than the role detailed in the standards. The latter category of stakeholder may believe, for example, that the auditor's report provides absolute assurance on the continued viability of the entity or that business decisions were made optimally by management.

For stakeholders that misunderstand the objectives of the standards, changes to the auditor's report may help address the expectation gap. For the latter category of stakeholders, changes to the auditor's report will not address the expectation gap.

Knowing the underlying reasons for stakeholders' confusion or misunderstanding would contribute powerfully and positively toward identifying the measures the board should pursue to address or reduce the expectations gap.