IPA INSTITUTE OF PUBLIC ACCOUNTANTS

28 September 2011

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

Dear James

Enhancing the value of auditor reporting: exploring options for change

The Institute of Public Accountants (the Institute) is pleased to respond to the International Auditing and Assurance Standards Board's (IAASB) consultation paper on exploring options for change in audit reports with a view to enhancing the value of auditor reporting.

We have more than 22,000 members and many of these are either auditors of smaller entities or they are users of audit and assurance services. The remarks that appear below are made by the Institute in that context. The Institute has also received feedback from members of its Faculty of Accounting Regulation, which is our consultation forum for a wide range of policy matters impacting on the accounting profession. Views of Faculty members are reflected throughout the submission.

General remarks

The Institute supports the IAASB reopening this issue for discussion. It is important for the profession to periodically reflect on its approach to the manner in which auditors tell the story about the results of a financial statement audit to stakeholders. It is necessary to test whether the profession needs to change the current format of audit reporting from time to time given the evolution of global financial markets as well as the creation of new regulation for which additional assurance is being sought.

The paper provides a useful context for the debate and revisits a range of ideas that have been canvassed by auditors from time to time. There is no harm in this as ideas that were previously rejected by parts of the profession may be deemed appropriate given the passage of time, change in regulatory environments and evolving social mores.

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Expectation gaps

The Institute acknowledges that there is a continuing gap in understanding by stakeholders of what auditors are obliged to do under the auditing standards and the expectations of some stakeholders. There are still times when we will encounter shareholders and media representatives with a belief that auditors examine all transactions undertaken by a company during the annual audit process, which is clearly not the case. This is anecdotal but it illustrates the dilemma facing the auditing fraternity. The task of achieving understanding within a skeptical community about the quality of audit is made more difficult if commentators that communicate with a wide audience lack an understanding of the audit process.

Expectation gaps related to audit cannot be eradicated. They can, however, be minimised if there is a commitment on the part of the accounting profession and the general community to increasing financial literacy. Financial statements and the audit reports that accompany them are a part of the everyday world of finance. It is critical that a strategy of educating the community more broadly about financial statements and the audit process is implemented in IFAC member countries to enhance the appreciation of the audit function by shareholders and other users of financial statements.

Information gaps

There will always be times when users want more material from a company than the information currently published in its financial statements. This is visible in the Australian marketplace when companies prepare information packs for analysts that contain the various metrics analysts want to use for their models. This is then reflected in their analysis of company performance in their updates to clients.

The consultation paper notes that there are times when there are calls for more transparency about an entity and its financial statements, particularly areas of financial reporting risk and how an entity is addressing them. It also suggests there are calls for greater clarity about the audit report and the key areas of audit risk. Care needs to be taken when this discussion moves to the notion of auditors making commentary on the accounting policies of companies as adopted in their financial statements. An entity's accounting treatment may be in compliance with the relevant financial reporting framework being used in that jurisdiction, but could be characterized as aggressive by an auditor. Such remarks could expose the audit firm to the risk of litigation if there is a major market swing against the company to which that audit firm's assessment of accounting treatments may have contributed. The same exposure could occur for auditors if they were to comment on the quality and effectiveness of an entity's governance and internal controls or assessments of the assumptions underlying the valuations used by an entity in its financial statements.

An assessment relating to the quality of a company's financial reporting policies would also take the auditor into the role of commentator rather than an assurance provider. Broader commentary within an audit report may open up the question of greater legal protection for the audit practitioner. Some form of qualified legal privilege could be necessary if audit and assurance standards were to require auditors to pass public judgment on matters such as the standard of corporate governance within an entity. The community could only expect 'boilerplate' disclosure rather than frank commentary in the situation where additional legal protection is not provided.

The auditor can find themselves caught in a legal crossfire if they bring attention to something that is detrimental to a company's share price. It is equally hazardous from a legal standpoint if an auditor fails to mention facts or analysis in an audit report and that issue later emerges as being significant for an entity that finds itself in receivership.

Restructuring the audit report

The consultation paper raises the issue of moving the audit opinion forward in the audit report. This suggestion may assist readers in obtaining information they seek more quickly but it could also result in people failing to read the other elements of the audit report that provide an explanation of the audit process. It is a change that could be worthwhile provided users are encouraged to read the full report to understand the context of the opinion.

Use of auditor's letter to management

The Institute consulted stakeholders to determine whether there was any support for elements of the auditor's letter to management to be made public in an expanded audit report. Proposals contained in the consultation paper refer to commentary on standards of corporate governance and internal controls. Some of these issues may appear in an auditor's letter to management.

The overwhelming response from members of the Faculty of Accounting Regulation consulted on this matter was that the auditor's letter to management should remain a private document so that the engagement partner is able to make a frank assessment of the issues the engagement team has come across during the audit process. One individual supported using the letter to management from the auditor as a source for material if an expanded audit report is introduced in the future. Even in this case, however, it was stated that the benefit of such letters from the audit firm is the frank assessment of the state of a company's system and that value would be lost if the letter was published in full.

Please don't hesitate to contact the Institute's Head of Research, Tom Ravlic at tom.ravlic@publicaccountants.org.au, if you have any queries with respect to our submission.

Yours sincerely

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