

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

Dear Sir/Madam

IAASB Consultation Paper, *Enhancing the Value of Auditor Reporting: Exploring Options for Change*

Thank you for the opportunity to provide a submission on the Consultation Paper.

We have provided responses to the questions in the Consultation Paper in the attachment to this letter.

Introductory Comments

The question that has often been asked of the auditing profession recently is why didn't we see the global financial crisis coming? We may not have seen the global financial crisis coming but we must certainly have been aware of some of the unsustainable business practices that allowed it occur.

In our opinion, it would be useful for the IAASB to reflect on the reasons why the auditing profession was silent during the period leading up to the global financial crisis. The answers to that question may lead to a fundamental reappraisal of what 'serving the public interest' really means.

A fundamental component in serving the public interest is auditor independence. Whilst the IAASB is not responsible for setting the independence standards, it is our opinion that this is a fundamental pre-condition to carrying out an assurance engagement and cannot be ignored in attempting to address the concerns the Consultation Paper has identified and is looking to solve. In our opinion, to properly serve the public interest it is necessary for the International Federation of Accountants to fundamentally reassess the application of independence to assurance engagements.

Our Understanding of the Problem

We understand that the users of general purpose financial statements have expressed concern that the auditor's report does not provide them with the information they require (which will vary depending on their particular interests), and feel frustrated that the auditor is not able to report other 'useful' information that the auditor may have obtained during the audit. The Consultation Paper introduces the notion of an 'information gap' which appears to be the difference between what the auditor reports and what the auditor knows.

It would seem that the Consultation Paper has been prepared for the purpose of assessing if an audit of general purpose financial statements, carried out in accordance with International Standards on Auditing, can deliver additional useful information to users, over and above the information that is currently provided in the 'boiler plate' audit report, and thereby bridge the 'information gap'.

Whilst we acknowledge the concerns that the Consultation Paper is seeking to address, we consider that an audit of general purpose financial statements carried out in accordance with the International Standards on Auditing is not designed to provide the "additional" information sought by users. In our opinion the Consultation Paper is attempting to make auditors more relevant to users (in essence "to be all things to all men") on the basis of a process that has a specific purpose, being to provide assurance on general purpose financial statements that have been prepared in accordance with a generally accepted basis of financial reporting.

A possible solution to the concern the Consultation Paper is seeking to address, and one that has been used by Auditor's-General over many years, is to review and reflect on the audits that have been completed during the year and to report the auditor's observations and conclusions publicly. Such reporting need not specifically identify a particular entity that has been audited and need not be constrained by such things as a generally accepted basis of financial reporting (which may be deficient in certain respects, in the view of the auditor), or be limited to the past. For example, having completed a number of audits in the banking sector an audit firm may have some observations in the form of industry risks, deficient or misdirected accounting practices, or other matters of concern or interest that may be relevant to the various users in the banking sector. In fact, one could argue that such a report would serve the public interest to a much greater extent than the auditor's report on a particular entity's general purpose financial statements.

In expressing our thoughts in another way:

1. The original purpose of an audit of general purpose financial statements was to assist those owners of an entity, who did not have the ability to directly access the information they wanted from the entity, to hold the entity's managers to account. The auditor's role in this situation was to give independent assurance to this category of owner that the financial information provided by entity management was reliable, based on the procedures carried out by the auditor.

The original purpose of an audit of general purpose financial statements hasn't fundamentally changed over time, although greater emphasis has been placed on the managers of an entity providing information to a much more diverse range of users. Nonetheless there is dissatisfaction with the information conveyed in the audit report.

The fact that dissatisfaction exists, in our opinion, arises because users do not understand (or do not want to understand) the purpose of the audit of general purpose financial statements.

It would therefore seem to us that the most fundamental question that needs to be asked is whether an audit of general purpose financial statements carried out in accordance with the International Standards on Auditing is something that users want. If the answer to that question is "yes" then it would seem that there is little scope for the auditor to do otherwise than to report that the financial statements are reliable, or otherwise.

2. An audit of general purpose financial statements requires the auditor to attest to statements made by entity management. Any requirement for an auditor to provide additional observations, or to comment on management's assertions in the auditor's own words, confuses the reasonably clear responsibility (that currently exist in an audit of general purpose financial statements carried out in accordance with the International Standards on Auditing) between management and the auditor. For example the auditor may comment on a matter that complies with generally accepted accounting practice for instance, but the accounting treatment of this a matter may be something with which the auditor disagrees. Such a situation will confuse users and opens the auditor up to criticism and, possibly, to a breach of their ethical obligations to their profession, and legal liability.

Some Immediate Solutions

If audits of general purpose financial statements continue to be carried out in accordance with the International Standards on Auditing then we consider the wording of the audit report can be improved to be more meaningful to users. Our suggestions in this regard are to:

1. Allow the auditor to report their opinion, and any other findings, at the start of the audit report; and
2. Require the auditor, unless directed to do otherwise by law, to express separate opinions on whether:

- the entity's financial statements comply with the applicable accounting framework;
and
- the entity's financial statements give a true and fair view.

Furthermore, we believe that the audit report should require the auditor to assert their independence.

We are also of the opinion that when an auditor encounters matters that the auditor considers should be included in the auditor's report, that the auditor is encouraged to present such matters in a fulsome manner and to avoid the use of technical explanations.

We note that International Standard on Auditing (ISA) 706: *Emphasis of Matter Paragraphs and Other Matters Paragraphs in the Independent Auditor's Report* permits the auditor to report on matters that are of special relevance to users of general purpose financial statements by way of 'emphasis of matter' and 'other matter' paragraphs. In our opinion the use of such reporting options should be encouraged as they convey important information to users, and we believe such reporting is becoming increasingly important in an environment of complexity.

A Summary of our Response

In summary, it is our opinion that the Consultation, in seeking to explore the possibilities for additional reporting by auditors (in the context of an audit of general purpose financial statements in accordance with International Standards on Auditing), has revealed and implicitly challenges the fundamental issues underlying an assurance engagement. We believe that the role and relevance of the auditing profession has, once again, been challenged because of the silence leading up to the global financial crisis. Specifically we believe that a fundamental reappraisal is needed to address the following issues:

- What does serving the public interest really mean?
- What changes need to be made so that auditors are truly independent?
- Establishing if users value an audit of general purpose financial statements carried out in accordance with International Standards on Auditing,
- Determining if users concerns about the information gap can be addressed by assurance engagements other than an audit of general purpose financial statements carried out in accordance with International Standards on Auditing,

We are also of the opinion that some changes can be made to existing practice that may provide relevant information to users (in addition to the auditor's report on general purpose financial statements) and to improve the presentation of the auditor's findings in the auditor's report:

- Consideration of auditors providing an annual 'results of audit' report in a similar manner to such reports that are prepared by many Auditor's-General.
- Introducing flexibility into the ISAs on audit reporting to allow auditors to report in a way that best meets the needs of users. For instance introducing minimum requirements but enabling flexibility on format and presentation of audit reports.

Should you have any questions concerning our submission, please contact either myself or Roy Glass (roy.glass@oag.govt.nz).

Yours sincerely

Greg Schollum
Assistant Auditor-General (Accounting and Auditing Policy)
Office of the Controller and Auditor-General of New Zealand
Email: greg.schollum@oag.govt.nz

Submission of the Office of the Controller and Auditor-General (New Zealand)

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

Our specific responses to the IAASB Questions

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

Response

We support any moves to improve the usefulness and quality of auditor reporting,

Nevertheless, in our opinion, such improvements should be made in the context of an audit of general purpose financial statements carried out in accordance with the International Standards on Auditing. If users are dissatisfied with the auditor's report arising from such an audit then we must ask the fundamental question as to whether this is an audit that users actually want.

In our opinion, an audit of general purpose financial statements carried out in accordance with the International Standards on Auditing is not designed to provide the additional information that the Consultation Paper suggests is required by users. If users require such additional information then it is our opinion that this should be provided by way of a separate engagement.

We consider that improvements to reporting the results of audits of general purpose financial statements, carried out in accordance with the International Standards on Auditing, can be made through:

1. Allowing the auditor to report their opinion, and any other findings, at the start of the audit report; and
2. Requiring the auditor, unless directed to do otherwise by law, to express separate opinions on whether:
 - the entity's financial statements comply with the applicable accounting framework; and
 - the entity's financial statements give a true and fair view.

Furthermore, we believe that the audit report should require the auditor to assert their independence.

We disagree that the auditor's report should be used as a basis for assessing audit quality, as is suggested in paragraph 16 of the Consultation Paper. Assessing audit quality is an extremely difficult process that must consider a significant range of factors, most of which are beyond what is (or should be) communicated in the auditor's report. In our opinion, auditors have enough difficulty in communicating their opinion on general purpose financial statements without reporting additional matters that are intended to serve other purposes.

- 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?*

Response

As referred to above, in our opinion an audit of general purpose financial statements, carried out in accordance with the International Standards on Auditing, is not

designed to address the information gap. If users require additional information then this should be provided by way of a separate engagement.

Which classes of users are, in the view of respondents, most affected by these issues?

Response

The answer to this question is dependent on the nature of the entity and the interests of the users. For example investors and potential investors of 'for profit' entities will be making economic assessments about financial performance. Other users, such as governments, may wish to assess if the entity is operating in a sustainable manner – for instance to assess whether the entity's activities are producing undesirable social and/or environmental impacts.

Are there any classes of users that respondents believe are unaffected by these issues?

Response

It is very difficult to respond to this question in a generic way. In our view it is inappropriate to say a particular class of user is unaffected by these issues without understanding the nature and purpose of the reporting entity.

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

Response

As referred to above, in our opinion an audit of general purpose financial statements, carried out in accordance with the International Standards on Auditing, is not designed to address the information gap. If users require additional information then this should be provided by way of a separate engagement.

We consider that improvements should be made in reporting the results of audits (carried out in accordance with the International Standards on Auditing) of all entities that prepare general purpose financial statements. Specifically we believe the existing standards should be amended to:

1. Allow the auditor to report their opinion, and any other findings, at the start of the audit report; and
2. Require the auditor, unless directed to do otherwise by law, to express separate opinions on whether:
 - the entity's financial statements comply with the applicable accounting framework; and
 - the entity's financial statements give a true and fair view.

Furthermore, we believe that the audit report should require the auditor to assert their independence.

- 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?*

Response

In our opinion, the form, content and presentation of the auditor's report should not be over prescribed in auditing and assurance standards. For example, we consider that ISA 700: *Forming an Opinion and Reporting on Financial Statements* is too prescriptive in its requirement to present the results of an audit in a certain order and format. We would prefer the standard to specify minimum reporting requirements and to give the auditor a certain amount of discretion to determine the most appropriate way to present the results of the audit. Such discretion enables the auditor to adapt their audit reporting to the environment in which they are operating with a view to best meeting the needs of the users of the audit report.

Specifically, we consider that improvements should be made in reporting the results of audits (carried out in accordance with the International Standards on Auditing) of all entities that prepare general purpose financial statements. We believe the existing standards should be amended to:

1. Allow the auditor to report their opinion, and any other findings, at the start of the audit report; and
2. Require the auditor, unless directed to do otherwise by law, to express separate opinions on whether:
 - the entity's financial statements comply with the applicable accounting framework; and
 - the entity's financial statements give a true and fair view.

Furthermore, we believe that the audit report should require the auditor to assert their independence.

We are supportive of the ability of the auditor to include "emphasis of matter" and "other matter" paragraphs under ISA 706: *Emphasis of Matter Paragraphs and Other Matters Paragraphs in the Independent Auditor's Report*. Such permissive requirements do allow the auditor to communicate additional matters arising from their audit that are regarded by the auditor to be of value to users.

- 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?*

Response

In our opinion, the repositioning of the responsibilities paragraphs is unlikely to widen the expectations gap. We would not support the removal of the responsibilities paragraphs however.

We do not believe it is necessary to expand the content of the responsibilities paragraphs.

- 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 beneficial to users?*

Response

We would not support including a statement about the auditor's responsibilities regarding other information in documents containing audited financial statements. The auditor's opinion is provided on the entity's general purpose financial statements that are identified within a page range in the auditor's report. To then suggest that the 'other information' accompanying the audited general purpose financial statements had been read by the auditor to check for consistency with the audited general purpose financial statements would, in our opinion, confuse users and possibly further widen the expectation gap.

The reasons for our opinion are:

1. Users might gain the impression that the 'other information' had been subject to more extensive audit examination than 'a read' and might therefore place unwarranted reliance on the 'other information'; and
2. The auditor carries out a whole range of different work in performing an audit. To select one aspect of the auditor's work over another risks emphasising this aspect over another possibly more important aspect. For instance the auditor needs to form an opinion on whether the entity is, and will continue to be, a going concern. Whether the entity is regarded by the auditor to be a going concern may be the primary point of interest to a user of the entity's general purpose financial statements. And more important than what the auditor has done with the 'other information'.

- 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 the audited financial statements? Should there be an explicit statement as to whether the auditor has anything to report in respect of the other information?*

Response

Refer to our response to question 6.

- 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.*

Response

We are supportive of the ability of the auditor to include "emphasis of matter" and "other matter" paragraphs under ISA 706: *Emphasis of Matter Paragraphs and Other Matters Paragraphs in the Independent Auditor's Report*. Such permissive requirements do allow the auditor to communicate additional matters arising from their audit that are regarded by the auditor to be of value to users.

Furthermore, we believe that the audit report should require the auditor to assert their independence.

- 9) *Respondents are asked for their reactions to the example of use or – justification of assessments – in France, as a way to provide additional auditor commentary.*

Response

From our reading of the Consultation Paper, the inclusion of a 'justification of assessments' section in the auditor's report is effectively requiring the auditor to share their audit planning judgements (based on the auditor's risk assessments, the auditor's evaluation of the entity's internal control and the many other factors that an auditor takes into account when designing the audit) with users. The auditor's

judgements are scoped by the International Standards on Auditing in the context of an audit of general purpose financial statements. In our opinion, a user will view the financial statements for their own purposes and it is unlikely that the users' purposes will align with the purpose underlying the design of the audit.

Without having direct experience with the 'justification of assessments' commentary used by the French, we have reservations with this option – for the following reasons:

1. We consider that there is a reasonable probability that the purpose of the auditor's judgements in designing the audit will not align with the users purpose when they read the financial statements and the auditor's report. In the event of the non-alignment of purposes there is a likelihood of the user misunderstanding the 'justification of assessments' commentary with the consequence of forming incorrect conclusions about the entity or the audit, or in taking unwarranted assurance from the auditor's commentary.
2. We also consider that the preparation of a 'justification of assessments' commentary for a lay reader of the financial statements and the auditor's report would be very onerous because the auditor would need to carefully detail the commentary in plain language, within the scope of the audit carried out in accordance with International Standards on Auditing. To achieve this objective such a commentary would be lengthy – and in our opinion much longer than the existing auditor's report.

It is for the above reasons that we do not support the inclusion of a 'justification of assessments' commentary in the auditor's report as we consider such a commentary is not helpful in meeting either the information gap or the expectations gap.

- 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.*

Response

An audit of general purpose financial statements in accordance with International Standards on Auditing is not designed to report 'auditor insights' such as those suggested in paragraph 72 of the Consultation Paper.

It is our opinion that if users want the auditor's opinion on such matters then the provision of such information by the auditor may be the subject of a separate engagement.

An alternative approach, and one that has been used by Auditor's-General over many years, is to review and reflect on the audits that have been completed during the year and to report the auditor's observations and conclusions publicly. Such reporting need not specifically identify a particular entity that has been audited and need not be constrained by such things as a generally accepted basis of financial reporting (which may be deficient in certain respects, in the view of the auditor), or be limited to the past. For example, having completed a number of audits in the banking sector an audit firm may have some observations in the form of industry risks, deficient or misdirected accounting practices, or other matters of concern or interest that may be relevant to the various users in the banking sector. In fact, one could argue that such a report would serve the public interest to a much greater extent than the auditor's report on a particular entity's general purpose financial statements.

- 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.*

Response

Our initial reaction to the enhanced model of corporate governance reporting is that it is essentially another form of 'compliance reporting' whereby the auditor will assess the entity's governance structure, systems and processes against 'best practice'. We do not believe such reporting by the auditor will address either the information gap or the expectations gap.

In the New Zealand public sector many of the entities we audit are small and unsophisticated. Corporate governance reporting would be an excessive and burdensome requirement for small entities.

- 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?*

Response

We do not support the enhanced model of corporate governance reporting. Refer to our response to question 11.

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

Response

In our opinion, for the reasons stated in our response to question 11, we do not believe the enhanced model of corporate governance reporting (including any assurance by the auditor) will address either the information gap or the expectations gap.

- 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.*

Response

In our covering letter we refer to the common practice of Auditor's-General to review and reflect on the audits that have been completed during the year and to report the auditor's observations and conclusions publicly. Such reporting need not specifically identify a particular entity that has been audited and need not be constrained by such things as a generally accepted basis of financial reporting (which may be deficient in certain respects, in the view of the auditor), or be limited to the past. For example, having completed a number of audits in the banking sector an audit firm may have some observations in the form of industry risks, deficient or misdirected accounting practices, or other matters of concern or interest that may be relevant to the various users in the banking sector. In fact, one could argue that such a report would serve the public interest to a much greater extent than the auditor's report on a particular entity's general purpose financial statements.

If the Consultation Paper is concerned to identify opportunities to bridge the information gap, then it would seem that reporting of this nature is more likely to achieve this objective. Identifying potential other assurance or related services engagements is unlikely to address users information gap needs, primarily because engagements are initiated and scoped by entity representatives in the interests of shareholders. It is highly unlikely that entity representatives would initiate an engagement that might reveal that their business model was unsustainable, and it is

highly unlikely that entity representatives would allow an adverse report on an unsustainable business model to be made public.

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

Response

Refer to our response to question 14.

- 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.*

Response

Our covering letter and our responses to earlier questions have identified some of the issues that we consider are needed to address the information gap. In summary our views can be divided between fundamental matters that require a brave and critical self-analysis of the role of the auditing profession in serving the public interest and some other matters that can be relatively easily implemented.

Fundamental Matters

- What does serving the public interest really mean?
- What changes need to be made so that auditors are truly independent?
- Establishing if users value an audit of general purpose financial statements carried out in accordance with International Standards on Auditing,
- Determining if users concerns about the information gap can be addressed by assurance engagements, other than an audit of general purpose financial statements carried out in accordance with International Standards on Auditing,

Other Matters

- Consideration of auditors providing an annual 'results of audit' report, in a similar manner to reports prepared by many Auditor's-General.
- Introducing flexibility into the ISAs on audit reporting to allow auditors to report in a way that best meets the needs of users. For instance introducing minimum requirements but enabling flexibility on format and presentation of audit reports.

- 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.*

Response

We are of the opinion that, as a matter of principle, the fundamentals underlying all assurance engagements should apply to all types of entity. The application of those fundamentals may vary depending on the size, nature or significance of a particular entity.

- 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?*

Response

Please refer to our response to question 16.

- 19) *Are there any 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?*

Response

Please refer to our covering letter and to our responses to the above questions.