



14 November 2012

### **Comment letter regarding the IAASB Invitation to Comment – Improving the Auditor’s Report paper**

BUSINESSEUROPE, the Confederation of European Business, represents more than 20 million small, medium and large companies working together to achieve growth and competitiveness in Europe. BUSINESSEUROPE’s members are 41 central industrial and employers’ federations from 35 countries.

BUSINESSEUROPE welcomes the initiative from the IAASB to analyze and improve the audit report. We found the “Invitation to Comment – Improving the Auditor’s Report” Paper (hereafter ITC) to be of high quality and that the points raised and discussed in the paper are clear. This allows us to understand the proposals and to give more clear reactions, even though we disagree with a number of the suggested initiatives.

BUSINESSEUROPE has consistently argued that the present audit report is difficult to read and understand for the user. It is important that the auditors work is and is perceived to be as high quality. We need to reduce the expectations gap. The audit report plays an important role in the latter, as it is the primary communication tool between the auditor and the external users. However, the audit report should never replace appropriate communication between the auditor and those charged with governance, and the audit report should not include new information not already included in the financial statements or elsewhere in the annual report. It is important to respect the fact that the annual report is the responsibility of the company (management and those charged with governance) who should be the only “original provider” of information and it is the role of the auditor to give an opinion on the financial statements. It is also unnecessary for the audit report to repeat information that is provided elsewhere in the annual report.

In our answer to the European Commission Green Paper entitled AUDIT POLICY: LESSONS FROM THE CRISIS in 2010 we highlighted, that:

- There could be a reference to the appropriate (national) website to explain what an audit actually implies and what users can expect.
- The language in the audit opinion should be revisited, as the present phrasing is very defensive and difficult to understand.
- The opinion should clearly state the responsibility of the auditor and the work performed.
- The paragraph relating to the responsibility of the management should be deleted from the audit opinion, if this information is already given by the management in the annual report.
- The general outline of the audit opinion should be identical across jurisdictions (same headings etc.)
- We are not in favour of longer audit opinions describing for instance business risks etc.



These points also apply to the proposals in the ITC.

Further, it is important to note that issues relating to the audit report (and more broadly auditor communication) should not be solved in isolation. BUSINESSEUROPE believes that some of the initiatives are rather a reaction as a result of problems in the Accounting Framework, problems that result in financial reporting itself being unnecessarily voluminous in some areas in order to meet the requirements. As a consequence, the reader is not able to see the wood from the trees. These issues should be solved within the accounting framework. Therefore we are pleased to note that both the International Accounting Standards Board (IASB) as well as European organizations such as the European Financial Reporting Accounting Group (EFRAG) and ESMA are paying attention to these aspects.

### **Guiding principles - number 2 should be removed and concerns about number 3**

Before commenting on the specific questions we would like to draw the attention to the principles on page 5 (paragraph 9) in the paper, as they are guiding the work of the IAASB.

The paper has identified the following 7 principles:

1. Change to the auditor's report must have value to users and be capable of being operationalized internationally.
2. Users have asked the auditor to enhance their ability to navigate and better understand increasingly complex financial reports.
3. More transparency is needed about key matters related to the audited financial statements and the nature of, and work performed in, an ISA audit.
4. The current scope of an ISA audit should be maintained (though the IAASB will reconsider this position if responses to the ITC-paper indicate a pervasive need to do so in light of particular options for change in auditor reporting).
5. There is a need to preserve the separate responsibilities of management and "Those Charged with Governance" (TCWG), as providers of original information, and the auditor, respectively.
6. The need for national auditing standard setters (NSS) to tailor or further specify requirements based on the national financial reporting regime should be retained.
7. A revised auditor reporting standard must be capable of being applied on a proportionate basis to all entities.

We generally support most of the 7 principles outlined. An audit report should have value to users and more transparency regarding the nature of, and work performed in, an ISA audit is relevant. We are also in agreement on the premise, especially that the current scope of the ISA should be maintained and that we have to preserve the separate responsibilities of management and TCWG on the one side and the auditors on the other side.



However, as we do not find that the auditor is responsible or should be responsible for enhancing the ability of the users to navigate financial reports, we cannot support the second principle and suggest its deletion. Navigating the annual report should be tackled by the accounting standard setters and others responsible for regulations as well as a joint effort between the preparer and user community through the development of best practices.

Further, as we have highlighted below, we should be very careful about the third principle, as it is not the role of the auditor to provide information not already provided by management in the annual report.

### **No support for the “Going Concern” and “Auditor Commentary” section**

Our concerns relating to the third principle and the fact that it is not the role of the auditor to provide information not already provided by management in the annual report have a direct bearing on our approach to the proposed audit report, especially the proposed Going Concern information by the auditor and the Auditor Commentary section. In short we do not support the approach taken.

#### *“Going Concern” section*

The proposed auditor conclusion on the appropriateness of management’s use of the going concern assumption in preparing the financial statements and the explicit statement as to whether material uncertainties in relation to going concern have been identified will present difficulties that in practice will not only lead to boiler-plate language but also to a list of material uncertainties that are likely to expand over time, because dropping certain items will only create further uncertainties and questions by users.

Given the fact that it is presently not required in all accounting frameworks to include specific information about “going concern”, we would suggest deleting the “Going Concern” section. If the regulatory environment were to require specifically company information about going concern (or the company were to voluntarily include information about going concern in the financial statements) we would - assuming a “clean” opinion in this area – suggest in these circumstances to simply include the following sentence in the opinion section: *“As part of our audit of the financial statements, we have concluded that management’s use of the going concern assumption in the preparation of the financial statements is appropriate.”* as we have indicated in Appendix 1.

#### *“Auditor Commentary” section*

If we want to narrow the information gap as it is called in the paper, then the focus should be on the work performed by the auditor. Providing a roadmap is more about managing a “reporting gap”.

We would suggest deleting the “Auditor Commentary” and instead focusing on the section regarding auditor responsibility.

To achieve this, the narrative section should explain what the auditor in the planning phase has identified to be the areas with the significant audit risk either due to this



being a requirement in the auditing standards (for instance going concern, fraud and turnover) or because of the specific business risks already highlighted by management in the risk section. It should be specifically noted if the auditing standards require certain areas like going concern and fraud to automatically be considered as areas with significant audit risk in order to inform the user of the background for the identification.

It should be noted that some of the issues listed in the example under Auditor Commentary will be covered with the above approach.

A good example is on the valuation of Financial Instruments where the text would indicate that this is an area with a significant risk of misstatement, and would thus under the ISAs pose as a significant audit risk and would be included in the risk-section of the Management report. Therefore, in this instance it would be relevant for the auditor – under the section describing auditor's responsibility – to identify the valuation of Financial Instruments as one of the significant audit risks.

Another concern with the approach taken by suggesting an "Auditor Commentary" is the potential risk that the text could be read as a hidden qualification. This would undermine the signal in the pass/fail test. Further, by reducing the level of materiality for the "Emphasis of Matter paragraph" (which in reality is what the "Auditor Commentary" is), we may actually blur the messages from the current "Emphasis of Matters paragraphs".

The wording and nature of the section on Outstanding Litigation is a good example. In the example it is not considered to be significant enough to qualify as an "Emphasis of Matter" paragraph. Therefore, we question why we would need this specific reference? If this is a material risk, then it would already be described in the "Risk-section" of the Management report, there is a specific disclosure and it would according to the above principle be covered by the narrative section of the work performed by the auditor. The same could be said about goodwill.

Therefore, to conclude, the Auditor Report should focus on the work performed by the auditor and should support the Audit Opinion. It should not provide a roadmap of the financial statements and it should not solve flaws in the accounting framework.

## **Comments on the detailed questions**

### **Overall Considerations**

*Question 1: Overall, do you believe the IAASB's suggested improvements sufficiently enhance the relevance and informational value of the auditor's report, in view of possible impediments (including costs)? Why or why not?*

No, there are some good suggestions, but also to some extent a wrong approach due to giving too much weight to one of the principles above. The auditor should report on the work performed and the emphasis should be focussed on how this section can be enhanced in order for the section to convey more meaningful information.

As we have already indicated, BUSINESSEUROPE finds that the proposed “Auditor Commentary” section reduces the overall clarity of both the audit report and the role of the auditor. Instead of the “Auditor Commentary” section more focus should be on the use of the “Emphasis of Matter” paragraph and we would suggest looking into whether this section has been used to the extent envisaged in the auditing standards or whether it should be made more clear for the auditor’s when they have to make use of the “Emphasis of Matter” paragraph. This approach will ensure that matters are only reported when they are significant and material and not simply because of a requirement to report something.

BUSINESSEUROPE does not believe the threshold as such for the use of the "Emphasis of Matter" should be lowered to the level envisaged when drafting the Auditor Commentary section. This view is also based on the ITC discussion in paragraph 41 and 42. We agree with the following statement in paragraph 41: “... - *in fact, the ISA’s note that a widespread use of Emphasis of Matter paragraphs may diminish the effectiveness of the auditor’s communication of such matters.*” Introducing another “Emphasis of Matter – light” paragraph will in our opinion diminish the effectiveness of the communication.

BUSINESSEUROPE would also like to refer to the work being conducted with regard to the IAASB Audit Quality project as this is important especially when discussing “user needs”. As part of this project, IAASB has conducted a survey between a number of stakeholders in order to gain information on what is perceived to be the most important factors relating to Audit Quality. The study highlighted the following aspects as “most important”:

Management	Audit Committees	Institutional Investors and Public Sector Stakeholders
<ul style="list-style-type: none"> <li>• Engagement efficiency</li> <li>• Engagement team competence and continuity</li> <li>• <b>Communications:</b> quality, usefulness, timeliness</li> </ul>	<ul style="list-style-type: none"> <li>• Robustness of the audit</li> <li>• <b>Communications:</b> quality, usefulness, timeliness</li> <li>• Independence from management</li> </ul>	<ul style="list-style-type: none"> <li>• Firm reputation and industry</li> <li>• Strength of regulatory framework, including quality of audit</li> <li>• Perception of independence</li> </ul>

Even though this study was conducted by the IAASB as part of the Audit Quality project it clearly illustrates the different approach and perception on audit quality. Especially important in this context is the fact, that institutional investors and public sector stakeholders did not score the communication by the auditor fairly high. Equally interesting is the fact that internal stakeholders place a higher emphasis on communication, especially the internal communication between auditors and those charged with governance.

This is important to note before beginning to revolutionize the audit report.



As indicated in the introduction, BUSINESSEUROPE supports the IAASB's efforts in looking into the audit report and auditor's reporting in general. We believe that international standards are important as:

- users need to be comfortable with the format;
- we need to retain the pass/fail test which should not be undermined with narrative sections, that could be read as a hidden qualification.

We also find it positive that the IAASB is using a "value and impediments model" in the paper in order to evaluate the proposals.

To achieve this, the narrative section should explain what the auditor in the planning phase has identified to be the areas with the significant audit risk either due to this being a requirement in the auditing standards (for instance going concern, fraud and turnover) or because of the specific business risks already highlighted by management in the risk section. It should be specifically noted if the auditing standards require certain areas such as going concern and fraud to automatically be considered as areas with significant audit risk in order to inform the user of the background for the identification.

As we indicated above in relation to the guiding principles, we agree that the change in the audit report should not broaden the scope. A change in scope would first of all potentially reopen the ISAs (making this a long term project) and would in certain areas be beyond the role of IAASB.

We agree that the changes once agreed should all be introduced with the same effective date and not as incremental changes. Thus we agree with paragraph 1 as we believe in tackling this once rather than changing the format of the report on an ongoing basis.

The audit report is in our view an important tool used to explain the work performed and thus, hopefully, reduce the expectations gap defined as the difference between what users expect from the auditor and the financial statements audit and the reality of what the audit is. However, an important aspect is to also understand that to avoid bad audits - regardless of the initiatives - there is also a need for well-functioning audit oversight bodies.

We have noted that in paragraph 3 a reference to the increasingly complex financial statements is made. The audit report should not be fixing flaws in the accounting framework. Therefore, we agree with the statement in paragraph 8 - the accounting standard setters have a critical role to play.

*Question 2. Are there other alternatives to improve the auditor's report, or auditor reporting more broadly, that should be further considered by the IAASB, either alone or in coordination with others? Please explain your answer.*

As explained above, we would suggest another structure. The focus should be on the work performed by the auditor including an identification of the most significant audit areas. We should retain the emphasis of matter (which is flexible) but the IAASB or the regulators should look into whether the auditors have used the section appropriately.





Further, BUSINESSEUROPE believes that the internal reporting between auditor and TCWG should be strengthened for instance by introducing an internal long-form audit report addressed only to TCWG.

### **Auditor Commentary**

*Question 3. Do you believe the concept of Auditor Commentary is an appropriate response to the call for auditors to provide more information to users through the auditor's report? Why or why not? (See paragraphs 35–64.)*

No, we do not find the Auditor Commentary to be the correct approach and refer to our comments above.

*Question 4. Do you agree that the matters to be addressed in Auditor Commentary should be left to the judgment of the auditor, with guidance in the standards to inform the auditor's judgment? Why or why not? If not, what do you believe should be done to further facilitate the auditor's decision-making process in selecting the matters to include in Auditor Commentary? (See paragraphs 43–50.)*

BUSINESSEUROPE strongly opposes the introduction of the proposed Auditor Commentary, as we have already stated in the beginning of the document.

If introduced, then the sections should be left to the auditor.

It is important to highlight paragraph 49

*“As a result, there will be a need for the IAASB in its future standard-setting proposals to explain the balance to be struck by auditors in providing Auditor Commentary – namely, **that it have relevance and be understandable, therefore providing value to users, and does not result in the auditor being the original provider of information about the entity.**”*

and paragraph 50

*“It also will be necessary in future standard-setting for the IAASB to clearly state its view that Auditor Commentary should not be used as a substitute for either (a) the auditor expressing a qualified opinion or an adverse opinion, or disclaiming an opinion, when required by the circumstances of a specific audit engagement; or (b) disclosures in the financial statements that the applicable financial reporting framework requires management to make. This is a key premise for the use of Emphasis of Matter paragraphs today, so retaining this premise will be necessary if the IAASB ultimately decides to subsume Emphasis of Matter and Other Matter paragraphs under a broader umbrella of Auditor Commentary as discussed in paragraph 42.”*

Again – if the Auditor Commentary is introduced – BUSINESSEUROPE supports paragraph 61. The standard should not specify a minimum number and we concur with



IAASB that 2-10 items would be appropriate if the Auditor Commentary section is introduced.

*Question 5. Do the illustrative examples of Auditor Commentary have the informational or decision-making value users seek? Why or why not? If not, what aspects are not valuable, or what is missing? Specifically, what are your views about including a description of audit procedures and related results in Auditor Commentary? (See paragraphs 58–61.)*

See earlier comments

*Question 6. What are the implications for the financial reporting process of including Auditor Commentary in the auditor's report, including implications for the roles of management and those charged with governance (TCWG), the timing of financial statements, and costs? (See paragraphs 38 and 62–64.)*

The inclusion will require the auditor to provide new information which can give rise to legal and ethical impediments. Thus we agree to the concerns raised in especially paragraph 63 and to the cost concerns in paragraph 62.

*Question 7. Do you agree that providing Auditor Commentary for certain audits (e.g., audits of public interest entities (PIEs)), and leaving its inclusion to the discretion of the auditor for other audits is appropriate? Why or why not? If not, what other criteria might be used for determining the audits for which Auditor Commentary should be provided? (See paragraphs 51–56.)*

If introduced, the building block approach should be used and sections should only be required when needed. It should be left for the jurisdictions to define for which – if any – audits the Auditor Commentary is required.

### **Going Concern/Other Information**

*Question 8. What are your views on the value and impediments of the suggested auditor statements related to going concern, which address the appropriateness of management's use of the going concern assumption and whether material uncertainties have been identified? Do you believe these statements provide useful information and are appropriate? Why or why not? (See paragraphs 24–34.)*

BUSINESSEUROPE agrees that going concern is always a very important issue for many entities, but we are concerned about the relation to emphasis of matter and potentially near qualification. If the area do not qualify for a moderated opinion or an Emphasis of Matter paragraph, then it is difficult to see what the auditor should or could write.

The proposed auditor conclusion on the appropriateness of management's use of the going concern assumption in preparing the financial statements and the explicit statement as to whether material uncertainties in relation to going concern have been





identified will present difficulties that in practice will not only lead to boiler-plate language but also to a list of material uncertainties that are likely to expand over time, because dropping certain items will only create further uncertainties and questions by users.

Given the fact that it is presently not required in all accounting frameworks to include specific information about “going concern”, we would suggest deleting the “Going Concern” section. If the regulatory environment were to require specifically company information about going concern (or the company were to voluntarily include information about going concern in the financial statements) we would - assuming a “clean” opinion in this area – suggest in these circumstances to simply include the following sentence in the opinion section: “*As part of our audit of the financial statements, we have concluded that management’s use of the going concern assumption in the preparation of the financial statements is appropriate.*” as we have indicated in Appendix 1.

BUSINESSEUROPE agrees that the work should be based on ISA 570

*Question 9. What are your views on the value and impediments of including additional information in the auditor’s report about the auditor’s judgments and processes to support the auditor’s statement that no material uncertainties have been identified? (See paragraphs 30–31.)*

The section regarding auditor’s judgements is not clear as the key message is hidden in irrelevant information. The conclusion from reading other reporting is that there are no material inconsistencies should follow from the conclusion that the use of the going concern premise is appropriate. If inconsistencies have been identified, they are either immaterial (and should thus not be mentioned) or will need further explanations.

*Question 10. What are your views on the value and impediments of the suggested auditor statement in relation to other information? (See paragraphs 65–71.)*

The section informs the reader about the amount of work that has been carried out on the non-audited sections. This is positive and helpful and we support the section as is.

### **Clarifications and Transparency**

*Question 11. Do you believe the enhanced descriptions of the responsibilities of management, TCWG, and the auditor in the illustrative auditor’s report are helpful to users’ understanding of the nature and scope of an audit? Why or why not? Do you have suggestions for other improvements to the description of the auditor’s responsibilities? (See paragraphs 81–86.)*

No. Management responsibilities are in many jurisdictions stated under a separate header “Management Report” and signed by the management / TCWG. In these cases there is no need to duplicate the description – a simple reference should be sufficient.



The section on "auditor responsibilities" should be able to explain the responsibilities of the auditor as well as the procedures without having to write a long section on others responsibilities. The present proposal would indicate a need for a section entitled "the responsibilities of the reader" requiring them to be familiar with the auditing and accounting standards?

BUSINESSEUROPE disagrees with paragraph 32. The audit report is not the place to write about management responsibilities. This is also recognized to some extent in paragraph 33, where a more holistic approach is considered.

Paragraph 81 suggests the need for more information on auditor's responsibilities and to clarify certain technical terms. We agree with this, but find that some of the suggested language does not meet this principle. BUSINESSEUROPE finds the audit section is in a too abstract language and is not related to the individual audit.

If the description of the audit procedures is to be tailored more towards the individual company it should be ensured that the reader does not have to for instance cross-reference to the risk-section of the annual report. The narrative section should explain what the auditor in the planning phase has identified to be the areas with the significant audit risk either due to this being a requirement in the auditing standards (for instance going concern, fraud and turnover) or because of the specific business risks already highlighted by management in the risk section. It should be specifically noted if the auditing standards require certain areas such as going concern and fraud to automatically be considered as areas with significant audit risk in order to inform the user of the background for the identification.

As we indicated above in relation to the guiding principles, we agree that the change in the audit report should not broaden the scope. A change in scope would first of all potentially reopen the ISAs (making this a long term project) and would in certain areas be beyond the role of IAASB. The above approach builds directly on methodology in the ISAs, but would give relevant information to the users without requiring the user to cross-reference with the risk section. Therefore this approach will narrow the information gap, and thereby also the overall expectations gap.

Regarding the work performed, BUSINESSEUROPE is aware of the fact that in 2003 a justification of opinion was introduced and implemented in France, as a mandatory development and was aimed to provide more interesting information in the audit report. As we understand, the result is rather disappointing, and it seems that during the general meeting, nobody shows any specific interest in that part of the report.

*Question 12. What are your views on the value and impediments of disclosing the name of the engagement partner? (See paragraphs 72–73.)*

BUSINESSEUROPE finds that the name of the partner has to be publicly available. If this is not the case, how will the user then be comfortable with for instance the independence requirements or be able to monitor internal partner rotation. Further, the



ISA require (and is based on the premise) that there is an engagement partner, who is responsible for the audit. The user should have this information.

*Question 13. What are your views on the value and impediments of the suggested disclosure regarding the involvement of other auditors? Do you believe that such a disclosure should be included in all relevant circumstances, or left to the auditor's judgment as part of Auditor Commentary? (See paragraphs 77–80.)*

If the involvement is material for the audit, then it should be disclosed. However, we should be very careful not to dilute the responsibilities of the lead auditor.

*Question 14. What are your views on explicitly allowing the standardized material describing the auditor's responsibilities to be relocated to a website of the appropriate authority, or to an appendix to the auditor's report? (See paragraphs 83–84.)*

We would support the possibility of having the more generic explanations on the internet.

### **Form and Structure**

*Question 15. What are your views on whether the IAASB's suggested structure of the illustrative report, including placement of the auditor's opinion and the Auditor Commentary section towards the beginning of the report, gives appropriate emphasis to matters of most importance to users? (See paragraphs 17–20.)*

We would support having the auditor's opinion in front. Please see our suggestion for the report for answers to the geography of the rest.

*Question 16. What are your views regarding the need for global consistency in auditors' reports when ISAs, or national auditing standards that incorporate or are otherwise based on ISAs, are used? (See paragraphs 21–23 and 87–90.)*

There should be global consistency to the structure and the building blocks. This would still allow NSS to tailor the report to cater for national legislation and needs. We agree with paragraph 21 that there has to be consistency. National requirements should be catered for by appropriate building blocks.

*Question 17. What are your views as to whether the IAASB should mandate the ordering of items in a manner similar to that shown in the illustrative report, unless law or regulation require otherwise? Would this provide sufficient flexibility to accommodate national reporting requirements or practices? (See paragraph 17 and Appendix 4.)*

We would support a mandatory ordering as this would enhance the transparency.

*Question 18. In your view, are the IAASB's suggested improvements appropriate for entities of all sizes and in both the public and private sectors? What considerations*



*specific to audits of small- and medium-sized entities (SMEs) and public sector entities should the IAASB further take into account in approaching its standard-setting proposals? (See paragraphs 91–95.)*

The structure is appropriate and can be tailored for SMEs as well. BUSINESSEUROPE disagrees with paragraph 93 as it should be possible to tailor audits to size and complexity. Every audit is different, even if conducted under the same standards. The latest trend indicates differences in the audits, and some SMEs may not have internal controls, for instance. An audit is a tailored audit and the auditor's report should reflect this.

## **APPENDIX 1 – SPECIFIC CHANGES TO THE ILLUSTRATIVE REPORT**

BUSINESSEUROPEs suggested changes to the illustrative example:

### **INDEPENDENT AUDITOR’S REPORT**

To the Shareholders of ABC Company [or Other Appropriate Addressee]

#### **Report on the Financial Statements**

##### **Opinion [See paragraph 18]**

We are responsible for the direction, supervision and performance of the audit and remain solely responsible for our audit opinion.

In our opinion, the accompanying financial statements present fairly, in all material respects, (or give a true and fair view of) the financial position of ABC Company (the Company) as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs). The financial statements comprise the statement of financial position as at December 31, 20X1, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

*[If the regulatory environment were to require specifically company information about going concern (or the company were to voluntarily include information about going concern in the financial statements), the following sentence could be added: As part of our audit of the financial statements, we have concluded that management’s use of the going concern assumption in the preparation of the financial statements is appropriate.]*

#### **Report on the Financial Statements**

The financial statements have been prepared by management in accordance with their responsibilities outlined on page xx [reference to the management report signed by management].

#### **Basis for Opinion [See paragraphs 19 and 74–76]**

~~We have audited the accompanying financial statements in accordance with International Standards on Auditing (ISAs) and have Our responsibilities under these standards are further described in the Auditor’s Responsibility section of our report. In performing our audit, we complied with the relevant ethical requirements as outlined in the Code of Ethics applicable to financial statement audits, including independence requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.~~

The objective of our audit is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit

conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

An audit in accordance with ISAs involves a number of requirements. The complete set of requirements in the auditing standards can be found here [insert link].

[INFORMATION to be included at the web-site where the link refers to could include the below bullets – rephrased from the ITC-proposal:

- The preparation of an audit plan is based on procedures that require the auditor to gain sufficient knowledge of the company and the business segments the company operates in. Based on this knowledge the auditor identifies and assesses the risks of material misstatement of the financial statements, whether due to fraud or error.
- Some risks are always deemed as significant audit risks in the standards, and these risks are:
  - Going concern
  - Fraud
  - Turnover (revenue recognition)
  - Financial reporting procedures
- When setting up the audit plan the auditor obtains an understanding of the internal controls relevant to the identified audit risks in order to evaluate the risk of material misstatements and to design audit procedures that are appropriate in the circumstances. This process does not allow the auditor to express an opinion on the effectiveness of the Company's internal control as such.
- The auditor designs and performs audit procedures responsive to those risks as well as other audit risks and have obtained enough audit evidence to reduce the audit risk to the planned level. It should be noted that the audit risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. It should also be noted that because not all future events or conditions can be predicted, the auditor's opinion on the Company's ability to continue as a going concern reflects the auditor's present knowledge.
- In accordance with the ISAs the auditor also evaluates the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures.
- Further, the auditor evaluates the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.]

In addition to the significant audit risks applicable in all audit engagements in accordance to the information on the website, we have identified the following significant audit risks in our audit plan:

- Goodwill impairment due to the uncertainty associated to the basis of the impairment tests
- Valuation of financial statements due to the measurement uncertainties



- Implementation of new it-system to record revenue, accounts receivable and cash receipts. These risks are also identified by management in management report.

We believe that the audit evidence we have obtained regarding the financial information and business activities of the Company is sufficient and appropriate to issue the unmodified opinion above.

During the audit we have reported to and discussed with TCWG the planned scope and timing of the audit, the identified audit risks and the significant audit findings. We have also reported to them all relationships and other matters that we believe may reasonably be thought to bear on our independence.

**Going Concern [See paragraphs 24–34]**

*Use of the Going Concern Assumption*

~~As part of our audit of the financial statements, we have concluded that management's use of the going concern assumption in the preparation of the financial statements is appropriate.~~

~~*Material Uncertainties Related to Events or Conditions that May Cast Significant Doubt on the Company's Ability to continue as a Going Concern*~~

~~Based on the work we have performed, we have not identified material uncertainties related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern that we believe would need to be disclosed in accordance with IFRSs. Because not all future events or conditions can be predicted, this statement is not a guarantee as to the Company's ability to continue as a going concern.~~

~~The responsibilities of management with respect to going concern are described in a separate section of our report.~~

**Auditor Commentary [See paragraphs 35–64]**

~~Without modifying our opinion, we highlight the following matters that are, in our judgment, likely to be most important to users' understanding of the audited financial statements or our audit. Our audit procedures relating to these matters were designed in the context of our audit of the financial statements as a whole, and not to express an opinion on individual accounts or disclosures.~~

~~*Outstanding Litigation*~~

~~The Company is exposed to various claims and contingencies in the normal course of business. We draw attention to Note 9, which describes the uncertainty related to an environmental claim regarding a business that was sold by the Company in 20X0.~~

~~*Goodwill*~~

~~As disclosed in Note 3, in 20X0, the Company acquired a significant operation in [location]. Goodwill attributable to this acquisition is XXX, which is material to the financial statements as a whole. The annual impairment test, as described in the Company's summary of significant accounting policies, is complex and highly judgmental. Due to the current economic conditions as discussed on page X of Management Commentary, there is significant uncertainty embedded in the future cash flow projections used in the impairment calculation. The Company~~

**Comment [kko1]:** The conclusion is moved to the opinion section and the uncertainties to the Basis for opinion section

~~performed this testing as at [date]. No impairment was recognized because the recoverable amount of the unit to which the goodwill was allocated marginally exceeded its carrying value at that date. The Company has disclosed that a decline of Y% in the fair value of this unit would, all other things being equal, give rise to an impairment of the goodwill in the future and such an impairment would have a material negative effect on the Company's statement of financial position and statement of comprehensive income, but would not impact its cash flow from operations.~~

*~~Valuation of Financial Instruments~~*

~~The Company's disclosure with respect to its structured financial instruments is included in Note 5. Due to the significant measurement uncertainty associated with these instruments, we determined that there was a high risk of material misstatement of the financial statements related to the valuation of them. As part of our response to this risk, our firm's valuation specialists developed an independent range for purposes of evaluating the reasonableness of management's fair value estimate, which was determined through its use of a model. Management's recorded amount fell within our range.~~

*~~Audit Strategy Relating to the Recording of Revenue, Accounts Receivable, and Cash Receipts~~*

~~During the year, the Company implemented a new system to record revenue, accounts receivable, and cash receipts, which involved the introduction of new accounting software. The new system centralizes processes and related internal control for five of the Company's seven operating segments. These processes and controls are significant to our audit of the financial statements because they affect a number of material financial statement accounts. We discussed the effect of the new system implementation on our audit strategy with those charged with governance, including our consideration of the work that had been performed on the new system by the Company's internal audit function. Our audit strategy included supporting our understanding of the design of the new system through discussion with relevant personnel; testing the effectiveness of key controls; and testing the transfer of balances to the new accounting ledgers.~~

*~~Involvement of Other Auditors [See paragraphs 77–80]~~*

~~At our request, other auditors performed procedures on the financial information of certain subsidiaries to obtain audit evidence in support of our audit opinion. The work of audit firms with which we are affiliated constituted approximately [percentage of audit measured by, for example, audit hours] of our audit and the work of other non-affiliated audit firms constituted approximately [percentage of audit measured by, for example, audit hours] of our audit. Our responsibilities for the audit are explained in the Auditor's Responsibility section of our report~~

**~~Other Information [See paragraphs 65–71]~~**

~~As part of our audit, we have read [clearly identify the specific other information read, e.g., the Chairman's Statement, the Business Review, etc.] contained in [specify the document containing the other information, e.g., the annual report], for the purpose of identifying whether there are material inconsistencies with the audited financial statements. Based upon reading it, we have not identified material inconsistencies between this information and the audited financial statements. However, we have not audited this information and accordingly do not express an opinion on it.~~

**~~Respective Responsibilities of Management, [Appropriate Title for Those Charged with Governance], and the Auditor~~**

*Responsibility of Management and [Those Charged with Governance] for the Financial Statements [See paragraphs 85–86]*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. [Those charged with governance] are responsible for overseeing the Company's financial reporting process.

*Management's Responsibilities Relating to Going Concern [See paragraph 32]*

Under IFRSs, management is responsible for making an assessment of the Company's ability to continue as a going concern when preparing the financial statements. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period. Under IFRSs, the Company's financial statements are prepared on a going concern basis, unless management either intends to liquidate the Company or to cease trading, or has no realistic alternative but to do so.

IFRSs also require that, when management is aware of material uncertainties related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern, management disclose those uncertainties in the financial statements.

*Auditor's Responsibility [See paragraphs 81–84]*

The objectives of our audit are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism through the planning and performing of the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Obtain sufficient appropriate audit evidence regarding the financial information of entities and business activities within the group to express an opinion on the group financial statements. We are responsible for the direction, supervision and performance of the group audit engagement and remain solely responsible for our audit opinion. [Bullet applicable for group audits only] [See paragraph 80]
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

Comment [kko2]: Reference is made in the beginning

- ~~Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.~~
- ~~Communicate with [those charged with governance] regarding, among other matters, the planned scope and timing of the audit, the significant audit findings, and any significant deficiencies in internal control that we identify during our audit. We also communicate with them regarding all relationships and other matters that we believe may reasonably be thought to bear on our independence. [Last sentence for listed entities only]~~

**Report on Other Legal and Regulatory Requirements [See Appendix 4]**

The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities prescribed by local law, regulation, or national auditing standards. Depending on the matters addressed by other law, regulation or national auditing standards, national auditing standard setters may choose to integrate reporting on these matters with reporting as required by the ISAs (shown in the Report on the Financial Statements section).

The engagement partner responsible for the audit resulting in this report is [name]. [See paragraphs 72–73]

[Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate for the particular jurisdiction]

[Address]

[Date]

## **APPENDIX 2 – SELECTED ANSWERS RELATING TO THE CONSULTATION ON THE GREEN PAPER - AUDIT POLICY: LESSONS FROM THE CRISIS**

### Part 2 Role of the Auditor

#### Part 2.1 Communication by auditors to stakeholders

Question 4 Do you believe that audits should provide comfort on the financial health of companies? Are audits fit for such a purpose?

No. Audits should not be considered to provide comfort on the financial health of companies. Audits give assurance on the financial statements. Based on the financial statements, the user will and should form their own opinion on the financial health of the company. They may be guided by rating agencies or other professionals in this assessment.

Regarding the focus of the audit, BUSINESSEUROPE would support a change in focus (stronger focus on substantive verification of the balance sheet) in relation to the audit of small entities, as a system-based approach does not make sense due to the limited number of employees in small entities. For medium-sized and larger entities that have systems in place, the risk based approach is more efficient and should be maintained. However, even with a risk based approach it might be useful to maintain the focus of the audit on the financial data, and not broaden the scope to auxiliary areas and reports.

Question 5 To bridge the expectation gap and in order to clarify the role of audits, should the audit methodology employed be better explained to users?

BUSINESSEUROPE would like to stress that before answering this question, one has to first identify the users and then clarify the expectations from the users and identify the reasonable expectations.

Regardless of whom the users are, BUSINESSEUROPE clearly finds that the audit methodology should be better explained to the public and the users. However, this explanation should not be included in the audit opinion. Instead the European commission and the auditors should focus on explaining the concept of an audit, for instance by providing explanations on the Commission website, or have more in debt explanations elsewhere on the internet. Local audit bodies should be more active in explaining what an audit actually implies, and what the user can expect, on the national websites. Similarly, IFAC could play a significant role in this matter. There could be a reference to the appropriate website in or in connection with the audit opinion.

#### Comments regarding the audit opinion

The language in the audit opinion should also be revisited, as the present phrasing is very defensive and difficult to understand. The opinion should clearly state the responsibility of the auditor and the work performed.

The paragraph relating to the responsibility of the management should be deleted from the audit opinion, as this information is already given by the management in the financial statements.

Regarding the work performed, BUSINESSEUROPE is aware of the fact that in 2003 a justification of opinion was introduced and implemented in France, as a mandatory development and was aimed to provide more interesting information in the audit report. As we understand, the result is rather disappointing, and it seems that during the general meeting, nobody shows any specific interest on that part of the report.

BUSINESSEUROPE could support further studies in this area, but would like to highlight that it is important that the general outline of the audit opinion is identical (same headings etc.) and that the descriptions focus on the auditors work and deliberations.

Concerning qualified audit opinions, BUSINESSEUROPE is generally of the opinion that the explanations given are satisfactory. However, it might be beneficial to look into whether further explanations are necessary in the audit opinion, especially related to the work performed, if there is a general concern relating to qualified audit opinions.

Question 7 Should the negative perception attached to qualifications in audit reports be reconsidered? If so, how?

BUSINESSEUROPE is in general satisfied with the present regime. BUSINESSEUROPE acknowledge that difficult discussions may arise, when it is not crystal clear whether the auditor should issue a qualified opinion or not. However, BUSINESSEUROPE would assume that there are procedures in place to ensure that the auditor maintains the independence. These procedures consist of both the audit regulators and audit inspection units as well as the risk of either law suits or disciplinary sanctions if the auditor fails to qualify an opinion that should have been qualified.

If the regime is changed, BUSINESSEUROPE could fear that the value of the audit opinion might decrease due to the fact, that the opinion expressed by the auditor would send mixed signals. For instance, if the auditor “nearly qualify” an audit opinion due to going concern, does the auditor then believe that the business is going concern or not?

Finally, BUSINESSEUROPE would like to note, that the “emphasis of matter”-paragraph is also a tool that the auditor can use when for instance the auditor is concerned about “going concern”, but agrees with management on their assessment, and these assessments are clearly described in the financial statements.

Question 8 What additional information should be provided to external stakeholders and how?

BUSINESSEUROPE would like to reiterate the overall remarks regarding the expectations gap. As stated in Q5, BUSINESSEUROPE finds the audit opinion to be very difficult to understand. In fact, we understand that most people does not read the audit opinion, but only focuses on “qualifications” or “emphasis of matter”-paragraphs.



However, BUSINESSEUROPE is not in favour of longer audit opinions describing for instance business risks etc. If business risks or risks related to intellectual property are material, then management will provide this information in the financial statements. If the auditor finds that information should have been included, then the auditor has to consider whether to qualify the opinion or include an “emphasis of matter” paragraph.

The only relevant information the auditor should provide relates to how the auditor has planned and conducted the audit.