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By email

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Dear James

**Response of the Audit and Assurance Committee of Chartered Accountants Ireland**

**Invitation to Comment: Improving the Auditor's Report**

The Audit and Assurance Committee (AAC) of Chartered Accountants Ireland ('the Institute') welcomes the opportunity to respond to the invitation to comment (ITC) on improving the auditor's report.

Improving the communicative value and information content of audit reports is an issue that has been receiving much attention in the aftermath of the financial crisis.

In January 2011, the Institute published its own contribution to the debate on the future of statutory audit. At that time, the Institute acknowledged, while not settling on a definitive model, that the nature and content of reporting by auditors was in need of reform. Audit reports had to evolve to better meet the needs and requirements of users. However, it was also recognised that in many respects, corresponding improvement would also be required to financial reporting requirements.

We support the overall direction of the proposals contained in the ITC, with the reservation that financial reporting improvements need to accompany changes in auditor reporting.

We also see the international dimension to this issue as being of prime importance to maximise the extent of commonality of approach to audit reporting. Differing requirements between jurisdictions will nonetheless continue to exist, at least for the shorter term, and hence we support the IAASB's approach of advancing a global solution to how auditors should report in future using the 'building blocks' model set out in the ITC. This allows for a reasoned approach to applying the proposed new reporting model in a way that can meet local requirements. We believe it is important to retain that flexibility whilst encouraging greater convergence.

AAC notes the five categories of improvements that the ITC identifies on page 6 and comments in respect of three of these below. Responses to the individual questions posed in the ITC are included in the appendix to this letter.

### ***Auditor commentary***

We are supportive of the concept of additional information being provided in the auditor's report which is of a more 'entity specific' nature.

We would be concerned, however, if such additional reporting became, in some way, a substitute to the provision of information which is the obligation of those charged with governance ('TCWG') and which properly belongs within the financial statements themselves or in accompanying information. Such an approach may also give rise to independence issues of a 'self-review' nature in subsequent years.

In this regard, we would have a concern if the auditor's report is used as a mechanism to draw attention to information contained in the financial reports which would otherwise be 'lost' in such reports due to the volume of disclosures now required by financial reporting frameworks. The audit report should not be used as a remedy for weaknesses in financial reporting.

We therefore consider that additional information provided should focus on providing information on significant risks considered by the auditors in the context of the audit itself and discussed with TCWG. The auditor should not be the 'originator' of financial information or disclosures. Any comment therefore on information of this nature should be restricted to highlighting that which is already contained in the financial statements.

The ITC has identified at paragraph 63 some real and significant difficulties which may exist in seeking to provide additional commentary. Further debate and discussion involving, in particular, regulators and legislators is needed to resolve these.

### ***Auditor conclusion on management's use of going concern assumption***

In principle, we are supportive of explicit reference by auditors to the going concern assumption used by TCWG. This presumes, of course, that appropriate disclosures on going concern are also made by TCWG themselves.

We do, however, have some reservations about the continuance of an expectation gap and the emergence of an 'understanding gap' around what is understood as the going concern assumption. Further guidance may be needed in this regard.

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For that reason, the expression of a 'negative assurance' opinion may be more appropriate than a strong positive opinion which may be construed as a 'certification' by the auditor that an entity will continue to operate.

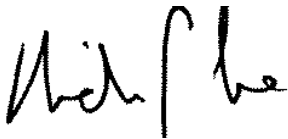
***Auditor statement regarding material inconsistencies between audited financial statements and the 'other information'***

This is an existing legal requirement in Ireland and we support its inclusion in a revised standard on auditor reporting.

Should you wish to discuss our response, or any other aspect of the proposals, please feel free to contact me.

Kind regards.

Yours sincerely,



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## OVERALL CONSIDERATIONS

**Q1: 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?**

We are generally supportive of the intention and direction of the proposals contained in the ITC and agree that the nature and detail of information imparted in auditor reports needs to evolve. We believe, however, that the impediments set out in paragraph 63 of the ITC are real and substantive and need to be resolved appropriately to allow the full potential of this initiative to emerge.

Undoubtedly, these proposals will impose additional cost on audited entities. However, we believe investors and other users will accept that such costs are merited in the interests of additional explanation and transparency around the conduct of the statutory audit.

**Q2: 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.**

We understand that the example audit report included in the ITC is but one approach envisaged by the 'building blocks' model referenced in the consultation. We do have a general concern that this particular example risks the auditor being identified as the originator (as acknowledged in the consultation) of information that should more properly be provided by TCWG.

As we have stated above, improvements to auditor reporting must, in the first place, be accompanied by corresponding improvements to reporting by TCWG. The auditors' report should not be used as a substitute for the provision of information that is the responsibility of others.

We encourage the IAASB to continue its work with relevant accounting standard setters and regulators to address perceived weaknesses in financial reporting and related disclosures by TCWG.

## AUDITOR COMMENTARY

**Q3: 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.)**

The introduction of an *Auditor Commentary* section to the auditor's report is an appropriate response to the call for auditors to provide more information to users.

However the primary focus of this should be on those matters that pertain to the conduct of the audit, including significant audit risks identified and other significant issues addressed by auditors during their audit and discussed with TCWG.

This does not preclude, of course, the auditor drawing attention to particular disclosures that have been made elsewhere in financial statements by TCWG. In particular this might refer to the provision of a 'roadmap' to navigating the financial statements referred to in paragraph 36 which should be the responsibility of TCWG. Restricting the extent of such references will support more effective communication of a matter judged to be sufficiently important to warrant an 'emphasis of matter'.

As we have highlighted above, we are concerned that the *Auditor Commentary* could become a mechanism to overcome deficiencies in financial reporting frameworks which increasingly have sought to require more and more detailed disclosures, not all of which may necessarily be significant or relevant to readers, but nevertheless must be provided.

**Q4: 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.)**

The decision as to the issues to be addressed in the *Auditor Commentary* should be based on the auditor's judgement in light of the specific circumstances of the reporting entity. Any future standard needs to be principles based and allow sufficient flexibility to the auditor. While it may be appropriate for the auditor to comment on the specific matters identified in paragraph 45, in the first place, it should be the responsibility of TCWG, for example, through the audit committee, to produce this information.

The auditor, in turn, is then in a position to comment on whether such disclosures are appropriate and to address deficiencies /omissions.

Otherwise, there is a risk of a self- review threat arising for the auditor, particularly in subsequent years.

**Q5: 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.)**

We agree that some of the examples contained in the illustrative *Auditor Commentary* will be of value to users. However, as discussed above, the focus of the *Auditor Commentary* should be on issues relevant to the audit process and to the conduct of the audit itself. Information relating to the financial statements should be via cross reference to where such information has been disclosed in the first place by TCWG.

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**Q6: 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.)**

We believe there are a number of potentially significant issues arising from the *Auditor Commentary* approach as proposed in the current example. Such issues have largely been captured in paragraphs 62 – 64.

Some of the disclosures in the current illustrative example may blur the line of responsibility between TCWG and the auditor. For that reason, as well as improvements to financial reporting requirements, it is vital that appropriate 'safe harbours' are available. Otherwise it is likely that significant costs will arise due to fears about litigation.

The IAASB should therefore continue its engagement with all relevant bodies and authorities in this regard.

**Q7: 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.)**

We agree with the proposal that the *Auditor Commentary* for PIEs is appropriate. One issue that arises, of course, is that there does not appear to be a single shared understanding of the meaning of a PIE between jurisdictions, standard setters, and regulators. In the first instance, therefore, it may be appropriate to mandate the *Auditor Commentary*, for example, to entities having a primary listing on the main stock exchange of a jurisdiction.

Adopting the *Auditor Commentary* for non-PIEs, in particular privately owned entities, may become more problematic from a cost/benefit perspective, particularly when potential users may actually be quite few in number and, as in the case of owner-managed businesses, more informed as to the circumstances underlying the financial statements.

A further risk will be that the *Auditor Commentary* for such non-PIE entities becomes very much boiler plate in nature.

## GOING CONCERN/OTHER INFORMATION

**Q8: 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.)**

We support the concept of having the auditor make an explicit comment about management's use of the going concern assumption.

It will be important to ensure the alignment of financial reporting requirements with regard to going concern disclosures and that a common understanding exists of what is meant by 'going concern' and the definition of 'material uncertainty leading to significant doubt'.

**Q9: 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.)**

We agree that there may be some difficulty with the auditor disclosing information that is commercially sensitive.

However, we do not believe that any such information should be disclosed in the first place by the auditor. This is more properly the responsibility of TCWG.

Retaining the ability of the auditor to draw attention to such circumstances via an Emphasis of Matter would enable events or conditions to be highlighted that give rise to significant doubt relating to going concern.

**Q10: What are your views on the value and impediments of the suggested auditor statement in relation to other information? (See paragraphs 65–71.)**

We have no particular comment to make on this issue and are supportive of the suggested approach.

## CLARIFICATION AND TRANSPARENCY

**Q11: 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.)**

We consider that in the interests of shortening a report that could already be viewed as becoming overly long, respective responsibilities should be permitted to be dealt with elsewhere (such as on a website) with appropriate reference in the audit report.

**Q12: What are your views on the value and impediments of disclosing the name of the engagement partner? (See paragraphs 72–73.)**

This is now required by law in Ireland and the UK.

**Q13: 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.)**

We query whether such disclosure is particularly useful when the lead auditor already has full responsibility for the conduct of the audit, regardless of the involvement of others. Disclosure of any such information should be left to the judgement of the lead auditor.

**Q14: 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.)**

See our answer to Question 11.

## **FORM AND STRUCTURE**

**Q15: 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 are broadly supportive of the proposed structure, although we do consider that matters on which the auditor is obliged to report under national legislation should be given more prominence by being ‘promoted’ in the illustrative report to follow the audit opinion itself.

**Q16: 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.)**

We are supportive of the need for global consistency in reporting by auditors. The IAASB will recognise, however, that different jurisdictions will have differing legal frameworks and auditor reporting models. So while global consistency is desirable, IAASB will need to ensure that any revised approach to reporting by auditors provides sufficient flexibility to accommodate such differences.



**Q17: 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.)**

Subject to national requirements, we are supportive of this proposal.

**Q18: 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.)**

See our answer to Question 7. While we would be supportive of the ability of non-PIEs to adopt such improvements, we do have a concern from a cost/benefit perspective, particularly where the ownership of such entities is highly concentrated.