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James Gunn
IAASB Technical Director
IAASB
By website transmission

Our Ref: SJG

Dear Mr Gunn

Improving the Auditor's report

We are pleased to provide our submission to the above Invitation to Comment. Our detailed response to the individual questions raised is attached.

Yours sincerely

Steve Gale.

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Questions for Respondents

Comments are linked to the 18 questions included in the IAASB Invitation to Comment; they are answered using the sub-headings given in the document.

Overall Considerations

1. We accept that users would like to receive greater information concerning the audit process and some of the issues discussed and we consider that it is important for this demand to be met if the audit is to remain relevant into the future. We support the principles behind the IAASB's Invitation to Comment but believe that national standard setters are best placed to consider how they should be implemented at a local level. We do not believe that a 'one size fits all' approach to the audit report is appropriate given the wide range of business and governance cultures, legal and regulatory systems and auditor liability laws existing around the world.

2. The IAASB should not consider auditor reporting in isolation. Both management and those charged with governance (TCWG) have obligations in respect of the preparation of financial statements, making accounting judgements, setting estimates and overseeing the audit process and we would like to see the IAASB consider these disclosures, as well as the audit report, in a more holistic approach to improved reporting. Without this wider consideration, we are concerned that different bodies will mandate contents of different reports included within financial statements and the overall result will be repetitive disclosure which serves to confuse respective responsibilities and users.

Auditor Commentary

3. An Auditor Commentary is an appropriate response to the needs of users of the financial statements but we would urge the IAASB to be clear regarding its contents.

   Whilst we think it appropriate for auditors to provide insight into their procedures and their assessment of risk, we do not think it is the job of the auditor to initiate disclosure on the financial and risk management processes of the audited entity. The provision of this information, including where relevant the content or subject of matters discussed with the auditors, should be the responsibility of TCWG.

   We believe it important, however, that the auditor retains the right to include additional information in the Auditor Commentary if, in the auditor's opinion, the disclosure provided elsewhere by TCWG is either misleading or omits material facts concerning the audit process.

   The IAASB must be clear about who any commentary is addressed to. An audit report is addressed to the members of the company yet this question and the Invitation to Comment consistently make reference to 'users', a much wider group than just the members and consequently a group likely to have a wider range of concerns. Clarification of this point is essential if the contents of the commentary are to be left to an auditor's judgement.

4. We agree that the contents should be a matter of auditor judgement though the IAASB, and national standard setters, should provide the principles which the auditor should apply when considering the content. We would not support a detailed list of disclosure requirements that will result in boiler-plate wording that is of little value to users.

5. To be useful, any disclosure in the Auditor Commentary should provide an insight into the auditor's procedures and not merely cross references to notes to the financial statements. For this reason, we do not believe that the disclosure given on Outstanding Litigation and

Goodwill provides additional information as it replicates information normally expected to be disclosed in the financial statements. Additionally, as outlined earlier, it is not appropriate for the auditor to initiate disclosure on the company's circumstances unless the company's own disclosure is misleading or omits material facts. Accordingly, we believe the proposed disclosure on Revenue is inappropriate. In contrast, the example disclosure on Financial Instruments gives the user an insight into the audit process and this would be appropriate for inclusion in the commentary.

We are concerned with the wording concerning 'Other Auditors'. Firstly, such disclosure may be seen as a way for the group auditor to disclaim part of their opinion, or be seen as such by users of the financial statements. Secondly, we believe that such disclosure should be made by TCWG, explaining to shareholders their choice not only of group auditors but also the auditors of significant components. TCWG should also explain how they assess and monitor audit quality for both the group auditors and those of significant components.

6. There will be both time and cost implications in the preparation of the Auditor Commentary. The commentary is likely to contain sensitive disclosures and will need to be discussed with both Management and TCWG. This will need to be factored into the audit timetable and will have additional cost implications. How much is impossible to quantify and will depend on the issues raised and their complexity.

7. We note that there is no definition of public interest entity, other than being a listed company. We question whether all listed companies are automatically public interest (many small and mid-cap companies may not have widely held shares and would not pose a systemic risk) and consider that other organisations whose shares are not listed may well meet the definition of being public interest. We are also concerned that there is a risk that there will emerge multiple definitions of public interest entities (the EU is looking at a size based definition, the Financial Reporting Council in the UK has a wider definition) which could cause confusion amongst users.

   We acknowledge that the proposals will be of benefit to users but, particularly for small and mid-cap companies, the costs may outweigh those benefits. Consequently, we believe that the proposals should be mandatory for large listed companies (with this definition to be determined in conjunction with other regulatory bodies) but should be on a 'comply or explain' basis for other listed companies. For these other listed companies, it would then be left to the discretion of TCWG, where appropriate in discussion with users of the financial statements, to decide whether to adopt the proposals, i.e. to request the auditors to provide the additional commentary in their report. Where TCWG determined not to ask the auditors to provide the additional commentary, they should explain that decision.

   We do not believe that the inclusion of an Auditor Commentary is appropriate for non-public interest entities. In these circumstances, companies, or other stakeholders, could perceive the inclusion of a commentary to be akin to a modified report. In many private companies there is likely to be less of a division between those charged with governance and the shareholders hence the costs of the additional reporting may well outweigh the benefits.

Going Concern/Other Information

8. Whilst these disclosures would seem to address a need highlighted by users we are concerned that an expectation gap will remain over an auditor's responsibility in this area. Whilst the example disclosure makes it clear that the statement is "not a guarantee as to the Company's ability to continue as a going concern" we note the result of the academic studies which suggest that such caveats do not help close the expectation gap and may even widen it (see in particular the study "Financial Statement Users' Perceptions of the IAASB's ISA 700 Unqualified Auditor's Report in Germany and the Netherlands"). Indeed,

including this as a separate area in the audit report gives the impression than the auditor has provided an explicit and direct signed off on the company's ability to continue as a going concern. Given the danger of this expectation gap we do not believe that these disclosures are appropriate to be provided by the auditor but suggest that the IAASB considers whether Management should provide greater disclosure in this area.

If additional comment is considered necessary on going concern we believe that the IAASB should consider whether the opinion paragraph could be modified so as to include reference to the use of the going concern assumption. We support the positioning of the statement in the audit report on going concern being immediately after the opinion paragraph.

9. The disclosure envisaged is likely to be highly commercially sensitive and could well have a detrimental impact on the company by providing, for example, significant suppliers, customers or even employees with enhanced bargaining power if a reliance on them was identified or inferred. Consequently we consider the impediments too great to justify the additional requirement. As noted above we would continue to encourage more disclosure by Management on the basis on which they consider it appropriate to adopt the going concern assumption, the IAASB should consider the work of the UK's Financial Reporting Council in this area.

10. The suggested statement merely makes more explicit the existing responsibility of the auditor. We note again the risk of increasing the expectation gap but given the existing wording in the audit report consider this to be less significant than in respect of going concern. We would recommend that the IAASB and national standard setters consult further as to whether users would value a more explicit statement being provided by the auditors on the other information presented in an annual report.

    Overall we would recommend that all comment relating to the audit opinion (going concern and responsibilities regarding "other information") are given adjacent to the opinion.

Clarifications and Transparency

11. As noted above we question, based on the academic studies, whether lengthening the report in this respect will close the expectation gap and result in greater clarity on the relative responsibilities in the minds of users. This boilerplate narrative could be removed from the report and replaced by a clear cross reference to where such information can be found.

12. This is the practice in many countries, including the UK, and, in our experience, no serious impediments have been identified in doing so.

13. We do not agree that this disclosure is required and it should not automatically be included in the Auditor Commentary. By including the disclosure, the impression is given that, contrary to ISA 600, an auditor is seeking to give some responsibility for the opinion to another auditor.

    As discussed in our response to question 5, we do acknowledge that this might be an area of interest to users but would suggest that this should be disclosed by TCWG as part of their report on the assessment of the group's auditor and their oversight of the audit process.

14. Consistent with our answer to question 11 we would encourage the relocation of such material to a website and a suitable cross reference being provided.

Form and Structure

15. The relocation of the opinion paragraph to the beginning of the report has been a consistent demand of users from the evidence presented. Given this we support the suggested structure.

16. Whilst a single global audit report is a laudable aim it is unlikely to be practical given national variations in company law and business practice. We believe national standard setters should retain the flexibility to decide how best to implement to principals set forth by the IAASB. In the UK context this may well mean greater disclosure in Audit Committee Reports as opposed to an Auditor Commentary as envisaged by the IAASB. As part of this process, we encourage improved governance reporting globally, with the mandatory inclusion of a comprehensive and informative Audit Committee Report by public interest entities within the annual report.

17. To encourage consistency, it should be a requirement for audit reports to be ordered in a similar manner subject to specific provisions in local law or regulation. As noted in 15 above, however, we strongly recommend that the opinion paragraph followed by any auditor comment on going concern and other information are given prominence at the start of the audit report in all circumstances.

18. As noted in our answer to question 7 we question whether the additional benefits of the Auditor Commentary are outweighed by the costs for private entities and the same concern would apply to the additional disclosure on going concern and other information. Other areas of the report should be as consistent as possible with the report provided by public interest entities and hence the other suggestions made by the IAASB, such as moving the positioning of the opinion paragraph, should apply to all companies.