

## School of Accountancy

---

University of the Witwatersrand, Johannesburg  
Private Bag 3, Wits 2050 • Tel: +27 11 717 8049 • Fax: +27 11 717 8223  
• Email: [school.accountancy@wits.ac.za](mailto:school.accountancy@wits.ac.za) • [www.wits.ac.za/dm/accountancy](http://www.wits.ac.za/dm/accountancy)



To whom it may concern

Please find below the comments on the IAASB's *Invitation to Comment* on auditor reporting, from the Auditing class of the Masters of Commerce (Accounting) degree at the University of the Witwatersrand.

The Auditing module of our Masters degree involved reading recent literature in the field of auditing, including many of the publications issued by the IAASB such as the *Invitation to Comment*. One of the debates that took place in this class was surrounding auditor reporting and how it can be improved, and we decided to use this debate as the basis for a comment letter sharing our views on the issue.

Kind regards

Craig Wallington

Student in MComm (Accounting) class at the University of the Witwatersrand

## Overall considerations

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?

We do believe that the suggested improvements will enhance the relevance and informational value of the auditor's report. Specifically, we believe that the following improvements add value:

- The specific reference in the proposed audit report to going concern - this will potentially improve the information content of the audit report as users will receive clarity as to exactly what the auditor is attesting to in the area of going concern. Previous research suggests that users are unsure as to what level of comfort regarding the financial strength of a company is given in the auditor's report, and the proposed amendments should serve to clarify this to some degree.
- Auditor's commentary - given the large amount of work performed by auditors in the process of an audit, they are uniquely placed to give their insight to users as to highlights of the financial statements and the audit. Accordingly, we believe that this proposal will improve the relevance and informational value of the auditor's report.
- The specific reference to other information - again, this provides clarity to users as to what the auditor has done in respect of this information, enabling these users to place the appropriate degree of reliance on this information. This reference in the auditor's report may also serve to highlight the importance of this information to users resulting in more users actually making use of the other information sections of company's annual reports.

Please refer to our specific answers to other questions in this comment letter for further discussion of the above improvements.

We wish to note at this point, however, that while we believe that the improvements proposed will benefit users of financial statements, they do not go far enough in reducing the information gap which standard-setters such as the IAASB have attempted to address. The IAASB needs to undergo a wider project on the scope of the audit, to ascertain whether areas such as non-financial information belong within the scope. Auditor reporting would be a necessary component of this project, but focusing on it at the expense of these broader issues may not lead to the best result.

**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.**

See the answer to Question 1, regarding the scope of the audit.

While the proposed audit report is supported, we believe that this is merely the first step in improving auditor reporting. Once a full review of the scope of an audit is performed by the IAASB, the resulting impact on the auditor's report should contribute further to improving auditor reporting and truly addressing the information gap currently present in annual reports.

We also support the concept discussed in the IAASB's 2011 Consultation Paper on auditor reporting, of reporting to shareholders by those charged with governance. This would provide insight into the financial statements by an oversight body within the company, enabling that body (such as the audit committee) to fulfill its responsibilities and also providing a different viewpoint to users of financial statements so that the proposed Auditor Commentary does not represent a one-sided view of the financial statements (see question 3 below). We believe that this report by those charged with governance should also form part of the subject matter of the audit. Accordingly, we feel that the IAASB needs to work with other standard-setters (such as the IASB, which has issued a non-binding framework on management commentary which may serve as a starting point) to address this need.

### **Auditor commentary**

**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).**

We believe that there is merit in including audit commentary in the annual financial statements, since research indicates that such commentary would provide useful information to users. Furthermore, research shows that commentary in financial statements (such as management discussion and analysis) is more widely read than, for example, the notes to the financial statements or even some items in the core financial statements themselves. If auditors do not adapt their reporting model to address the information gap, the relevance of audit reports will decline and they will eventually be rendered obsolete by information provided by others which more successfully addresses that gap.

The value of the binary audit opinion should not, however, be lost in the process of reforming the auditor's report. Despite criticisms of the traditional audit opinion structure, research suggests that it

is valued by investors and lenders and provides a simple classification of a company's financial statements to assist in their interpretation. For this reason, we believe that the Auditor's Commentary section should form a separate part of the annual report, and should not be included in the traditional auditor's report containing the audit opinion. This will ensure that users do not lose sight of the opinion expressed by the auditor, and also it will not confuse users into believing that the auditor is providing a higher or lower level of assurance on the matters discussed in the Auditor Commentary than areas not discussed.

Furthermore, if the audit commentary is to provide real value and be used as a platform to provide relevant information, auditors should be able to limit or exclude liability related to such commentary. Without such limitations, auditors would be reluctant to provide useful information to users as liability would be the auditor's foremost concern. Again, we believe that the IAASB needs to work with other professional and regulatory bodies to reform the area of auditor's liability so that auditors are able to disseminate the useful information they possess without the specter of liability inhibiting their actions.

We also feel that Auditor Commentary should be introduced with a view to the introduction of "TCWG Commentary", to ensure that the governing bodies of the auditee are able to respond to the issues raised by the auditor and provide further context and insight to provide useful information to users.

**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).**

We agree with this point. Guidance provided in the standards (specifically based on factors such as those identified in paragraph 45) will ensure that auditors are directed in their interpretation of what to include in Auditor Commentary and will also ensure that the concept of "Auditor Commentary" has a consistent meaning across jurisdictions and audit firms. However, this guidance should not become excessively detailed, because this detail will stifle professional judgement on the part of auditors when deciding what to include in the Commentary. If detailed guidelines are provided, auditors may begin seeing this as a "checklist" of items to include in the commentary, resulting in boilerplate disclosure which will lose its relevance to users.



**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).**

In our view, the first three examples given (outstanding litigation, goodwill and valuation of financial instruments) are good examples of what belongs in an Auditor Commentary. These examples demonstrate the auditor's ability to bridge the gap between the financial statements and the users thereof, by providing context with which users can interpret the information provided. One shortcoming of the modern corporate reporting model is that it implies a degree of certainty in measurement that does not exist, and such disclosures in the Auditor Commentary can show users the degree to which reliance can be placed on such measurements (and will also improve the understanding by users of the "reasonable assurance" provided by auditors).

However, the fourth example (relating to audit strategy) is unlikely to provide useful information to users. Research suggests that users do not obtain informational value from an understanding of the procedures performed by auditors in an audit (they are more interested in the outputs rather than the processes). Furthermore, an explanation of procedures performed may be interpreted by users as an attempt by auditors to limit their responsibility for the opinion expressed in the auditor report.

We feel that a general statement regarding component auditors should always be made in the audit report (that is, it should not form part of the Auditor Commentary and should not be subject to the auditor's discretion). We would like to see more examples of what items belong in Auditor Commentary, and would request that the illustrative examples in the finalized ISA show the varieties of disclosure that can appear in Auditor Commentary. See the answer to question 13 for further information on our view of disclosures surrounding component auditors.

Furthermore, Auditor Commentary serves an opportunity for auditors to give insight to users as to the *quality* of a company's reporting practices, in a way that the binary audit opinion cannot. The examples given are inadequate in the sense that those that do focus on the company's reporting practices do not give insight into whether management's estimates were conservative or aggressive and what those estimates tell about financial reporting quality.

**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).**

One criticism of the proposed Auditor Commentary model is that the auditor becomes an originator of information, rather than an evaluator of information originated from management and TCWG. This may blur the lines between preparation of financial statements and attestation thereof. However, as the corporate report evolves beyond financial statements into areas such as integrated reporting, the role of the auditor is likely to change fundamentally; Auditor Commentary simply represents the first step in that change.

A second criticism of the Auditor Commentary is that it may result in a breakdown in communication between auditors and management and TCWG. Management and TCWG may be inclined to hide information from auditors for fear that it will be openly disclosed to users, possibly out of context (which is why TCWG reporting is also needed) or may modify the way in which they deliver information so that the Auditor Commentary begins to reflect the biases of management and TCWG. This could have implications for the quality of the audit process itself and the reliability of the audit opinion reached.

The proposed Auditor Commentary should not have any impact on timing or costs involved in the audit because the scope of the audit has not expanded; the auditor will simply be reporting on matters already identified within the course of a normal audit.

**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).**

We agree with the IAASB's decision in this respect; while Auditor Commentary has the potential to improve usefulness of auditor reports of PIEs (where institutional investors analyse financial statements) it is not necessarily the case that this commentary will be useful in non-PIEs. However, if an auditor feels that such commentary will be useful in non-PIEs, it is appropriate that the auditor is able to elect to provide such disclosure.

We believe that all listed entities, irrespective of size, should be regarded as PIEs (as is the case in the current IESBA definition). However, we disagree with the IESBA definition in that it appears to rely on national regulations to identify non-listed PIEs; we would prefer a definition that is based on a consistent principle and is as comparable as possible across jurisdictions. For example, the IFRS for SMEs scope identifies that entities with "public accountability" cannot apply these simplified standards. While we do believe that public accountability as defined in that set of standards is

possibly too broad a criterion for the provision of Auditor Commentary, it may provide a useful starting point for the IAASB in identifying which entities constitute PIEs.

### Going concern/other information

**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 that these statements provide useful information and are appropriate? Why or why not? (See paragraphs 24-34).**

We believe that these statements do provide useful information and are appropriate, because they provide clarity on what the auditor has done in respect of going concern. This should serve to resolve the uncertainty currently experienced by users of audit reports, as research suggests that many such users are not aware of the exact work performed by an auditor on the going concern assumption.

However, we believe that this proposed disclosure again highlights that improving the auditor's report is insufficient. We feel that the auditor's current assessment of going concern prescribed in ISA 570 is not suitable for the volatility of the modern business environment, because the phrase "significant doubt" creates too high a threshold; that is, a significant doubt criterion means that information surrounding doubts over the going concern assumption will not be provided in a number of cases where it would assist users. Instead, a "more likely than not" test should be applied by the auditor. We also disagree with the statement made in paragraph 34 that reform of ISA 570 will require coordination with the IASB; ISA 570 (and a number of other standards such as ISA 550) have been designed to be usable irrespective of the financial reporting framework applied, so we feel that improvements to ISA 570 must be made as soon as possible, and not only when the IASB is able to amend its Conceptual Framework and IAS 1.

**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).**

We have identified the following advantages (i.e. this information would add value in the following ways):

- Users of the auditor's report would be able to assess for themselves whether the judgements and processes performed were appropriate to conclude that no material uncertainty exists.



- Increased clarity about what the auditor is required to do would incentivize the auditor to ensure that he or she performs these duties appropriately.

We also believe that the following impediments would be present if the additional information were provided:

- There is a risk that the costs of the audit will increase, as auditors may feel it necessary to increase the work performed on the going concern assertion to justify the disclosure made. However, as we have identified above (see question 6) we feel that if an auditor is performing the audit appropriately in terms of ISAs, the proposed disclosures in the new audit report will not increase costs because they relate to work that is already being performed.
- Auditors may be exposed to increase liability claims because of their explicit statements on going concern and the work that they performed. However, this simply serves to highlight once again the need for liability reform around the world, an area which the IAASB can contribute towards but one in which the IAASB does not have authority.

On the whole, we feel that the value provided by these disclosures is sufficient to overcome the impediments.

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

Given the aforementioned value that investors appear to place on narrative information in the annual report (see question 3), we support the suggested auditor statement in relation to other information. It will serve to clarify the auditor's work performed in respect of these pieces of information so that users are fully aware of how much reliance they can place on this information. Furthermore, we support the inclusion of a disclaimer sentence specifying that no opinion is expressed on this other information, to avoid confusion that may arise if users believe that the auditor is giving reasonable assurance on this other information. However, we feel that the chosen disclosure is close to the "low impediments but low value" end of the spectrum discussed in paragraph 67, and that the time has come to consider including other information in the scope of a financial statement audit (see question 1).

**Clarifications and transparency**

**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).**

Research suggests that the responsibility paragraphs in the audit report are largely ignored by users of financial statements, and that the expectation gap (which the responsibility paragraphs were designed to address) has actually widened in some countries since the introduction of these paragraphs. The changes to the responsibility paragraphs appear to be helpful (in that they are now to be provided in bullet point form for ease of reading, and they more explicitly identify areas such as fraud), however, they will only prove helpful to users if they are made in conjunction with the other changes discussed in the *Invitation to Comment*; changes that only clarify the report without improving its content will make it appear that there is no commitment to real progress in auditor reporting.

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

In our view, the value of disclosing the name of the engagement partner is based on the notion that people always act with greater care and diligence when their reputations are at stake and personal identification of those accountable will ensure such care and diligence is applied. This is supported by research that suggests that audit quality is higher in jurisdictions where audit partners are required to disclose their name in audit reports.

We believe that a counterargument against the above is that auditing firms have built globally recognised brand names and are not recognised by individual auditors. Furthermore, audit firms generally have globally accepted audit methodologies and thus the audit partner applying these methodologies is not acting in his/her own capacity but rather on behalf of his/her firm; accordingly, it would not be appropriate for the partner to sign in his/her name.

Nevertheless, on balance we believe that disclosure of the name of the audit partner will be beneficial to users of financial statements. Disclosure of the audit partner's name is already required by law in South Africa.

**13. What are your views on the value and impediments of the suggested disclosure regarding the involvement of other auditor? 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 believe that in all cases involving other auditors, disclosure should be made in the auditor's report (i.e. we do not believe that this should be part of Auditor Commentary and accordingly subject to the auditor's discretion). Given the complexity of audits involving components, particularly in multinational clients, we believe the disclosure outlined in the illustrative example provided surrounding component auditors should always be part of the audit report. However, we believe this should be carefully worded so that it does not appear that the group auditor is disclaiming or reducing responsibility for any of the components.

**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 support the IAASB explicitly permitting the standardized responsibility paragraphs to be relocated to a website. As discussed above (see question 11), these responsibility paragraphs do not appear to have an impact on many users. Furthermore, the proposed changes to the audit report in the *Invitation to Comment* will significantly lengthen the report relative to the current version. Including the responsibility paragraphs in this longer report may create an excessively cluttered report which obscures the important information. By placing these paragraphs on a website, interested users will still be able to obtain the information (while users who do not wish to read the information will not have to navigate past it) and this information can be expanded into a more thorough and informative description of an auditor's responsibilities.

We also feel that, given the research performed into the expectation gap, it is clear that the auditor's report is *not* the appropriate vehicle by which to educate users about the nature, scope and purpose of a financial statement audit. The IAASB and other bodies should consider developing educational material specifically designed to improve users' understanding of auditor reports, rather than attempting to merge the educational and reporting aims together in the auditor report.

#### **Form and structure**

**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).**

As noted above (see question 3) we believe that the current audit opinion is of high value to users; furthermore, many users see the opinion as the core purpose of the audit report. Accordingly, we

agree with the placement of the audit opinion at the start of the audit report. Given the benefit that the entity-specific Auditor Commentary is likely to bring to users, we also support the placement of the Auditor Commentary near the beginning of the report. However, we believe that, ideally, the Auditor Commentary section should form part of a separate report, possibly in conjunction with commentary by TCWG (see question 3).

**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).**

Despite the criticisms of standardized and boilerplate disclosures, they serve a clear purpose in that they promote consistency and comparability across auditor reports. Accordingly, we firmly support global consistency in this regard.

**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 support the mandating of the order of items in the auditor report, particularly given the benefits of placing the auditor opinion at the beginning of the report (see question 15) and the lower importance of the auditor responsibility paragraphs (see questions 11 and 14).

**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).**

See the discussion in question 6 for our views on Auditor Commentary.

We believe that any new disclosures made in this proposed auditor report (such as disclosure surrounding going concern and other information) should be made irrespective of the type of entity. In situations where the ISAs specify different considerations for smaller entities or public sector entities, it would be reasonable for these different considerations when performing the audit to manifest themselves in different considerations when presenting the auditor report; however, in all other cases we believe the auditor report should be standardized across all entities.