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Stockholm 9th October 2012

Invitation to Comment document: Improving the Auditor's report

FAR, the Institute for the Accountancy Profession in Sweden is responding to the Invitation to Comment document: Improving the Auditor's report.

FARs general comments

FAR welcomes the IAASB's project to explore how the auditor's report could be developed to provide more transparency about the audit and be more user-friendly. FAR agrees with the IAASB that the financial crisis and the development of business into more global and complex organizations clearly point out that there is a need for change in how the auditor communicates in the auditor's report. FAR has therefore with great interest studied the IAASB's Invitation to Comment document (ITC) and especially the suggestions made in the ITC of introducing a paragraph regarding Going Concern and an Auditor Commentary (AC). FAR has the following overall comments:

Going Concern:

The ITC suggests that the auditor shall make his or her conclusions regarding Going Concern public in the auditor's report. The auditor already makes these conclusions in accordance with ISA 570, and including these conclusions in the auditor's report would not change the scope of the audit. Generally, FAR believes that the auditor should give more information about the going concern considerations in the auditor's report, since a demand for that seems to have developed. It is absolutely crucial, however, that the auditor's conclusions over going concern are based on clear and explicit assertions from the management in the financial statements, and accounting standard setters as the IASB therefore need to be approached. FAR realizes that it will take some time until accounting standard setters have considered this matter and made relevant changes. Meanwhile, FAR recommends that the IAASB requires the auditor to refer to the management's assertion by stating for example: Management has concluded that the entity is a going concern and as a part of our audit we have assessed management's assertion and concluded that the going concern assumption is appropriate. However, FAR is not convinced that including a standard text about going concern should enhance the value of the auditor's report if going concern is not an issue in the audited entity. Should going concern be an issue in the audited entity it would be more appropriate to discuss the matter under the heading Auditor Commentary. If the IAASB should decide to require compulsory conclusions over going concern, FAR believes that all conclusions in an auditor's report should be included in the opinion paragraph, and not in a separate going concern paragraph.

FAR is, in addition, concerned that the expectation gap from including a going concern conclusion may be increased. FAR foresees a great risk that users will not understand the context wherein these conclusions were made and will put too much reliance in their degree of certainty. FAR recommends that the IAASB carefully considers how this risk should be addressed.

Auditor Commentary:

The ITC suggests that the auditor in an AC section should highlight matters that are "likely to be most important to users' understanding of the audited financial statements or our audit". FAR does not believe that it is the auditor's role to identify matters that are likely to be most important to users' understanding of the financial statements. It must be the role of accounting standard setters to define which information is most important to the users and it is management's role to interpret the accounting standards and to prepare financial statements which are transparent and user-friendly. The auditor's role is to carry out an audit of the financial statements and in that respect it appears more appropriate that the auditor in the AC provides important information about the audit. Consequently, FAR believes that the AC should provide information of the significant risks (as defined in ISA 315) identified by the auditor. FAR believes it is an advantage to connect the additional information on risks to a well-defined term in ISA, since it will increase the consistency in how various auditors choose to provide the information. FAR believes that information on significant risks will be useful to users that are analysts and investors, and that a requirement to provide this information therefore should be limited to audits in listed entities, and in large entities operating in the financial market.

Auditor's reports in SME-entities:

Users of auditor's reports in small- and medium-sized entities, have other needs of information than users of auditor's reports in public interest entities, especially listed entities. It is important that the IAASB carefully listens to SME-users to understand what type of information they look for in an auditor's report. A sensitivity for demands from SME-users is extremely important, otherwise a perception may be developed that ISA cannot be applied proportionally in SME-audits. FAR believes that SME-users generally demand more simple auditor's report than the current report in ISA.

Please see the attached appendix for FAR's detailed response to the specific questions in the ITC.

FAR



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Appendix

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?

FAR believes that many of the improvements suggested in the ITC will enhance the auditor's report, but has some overall concerns regarding the suggestions regarding going concern and the AC as explained in the cover letter. FAR's considerations regarding the remaining suggestions in the ITC are explained in relation to the response to the detailed questions below.

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.

FAR's concern in this respect is that the IAASB, the European Commission and the PCAOB are simultaneously looking at changes in the auditor's report, and that there is a risk that these organizations will decide on different solutions. It is therefore of the utmost importance that the IAASB works closely with the European Commission and with the PCAOB to avoid different auditor's reports in the market.

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.)

FAR believes that the auditor's report can and shall contribute more to the users' understanding of how the audit was conducted. The possible risks related to an AC section as listed in paragraph 63 in the ITC document, such as decreased comparability, increased expectations gap and boiler plate language all need to be carefully considered.

However, FAR does not agree with the description in paragraph 39 of the ITC that "The overarching objective of such a new Auditor Commentary Section in the auditor's report is to provide transparency about matters that are, in the auditor's judgment, likely to be most important to users' understanding of the audited financial statements or the audit". FAR's opinion is that the auditor's report should not be a tool to guide the users in their reading of the financial statements. The objective of the new information in the AC should in FAR's opinion only add transparency to the audit process. FAR believes that the appropriate way to enhance transparency is to include in the auditor's report a description of the risks that by the auditor have been identified and assessed as significant risks as defined in ISA 315.

As discussed in the ITC, the concept of the AC is based on the existing concepts of Emphasis of Matter (EoM) and Other Matter (OM) paragraphs. FAR believes that the information in the AC should not replace the EoM and OM paragraphs but to add additional information about the audit as discussed above.

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.)

FAR agrees that the AC shall depend on the auditor's judgment, there is no other alternative since the critical success factor for this section is that the information is customized for each audit. In the response to question 3, FAR has expressed that new information in the auditor's report should only be the significant risks identified by the auditor. There may be a need for further guidance on how to select and present significant risks. For instance, significant risks due to management overriding internal control and to sensitive business issues needs to be carefully considered whether it is appropriate to include such risks in the AC.

FAR believes that the IAASB, as discussed in paragraph 60 in the ITC, should require the auditor to make an explicit statement in the auditor's report if his or her conclusion should be that there is nothing to report in the AC. FAR agrees with the IAASB that it would be very rare that the auditor has nothing to report, especially that no significant risks have been identified.

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.)

The illustrative example includes three categories of information: 1) the paragraphs highlighting information available in the audited financial statements, 2) the paragraph discussing audit strategy but with no references to the financial statements and 3) the paragraph over involvement of other auditors. FAR's comments to each category are the following:

1) With references to the financial statements

As described in the responses to questions 3 and 4, FAR believes that the auditor's report should not be a tool for the user's understanding of the financial statements. A proper understanding of the financial statements is a matter for the financial reporting framework and the management applying it. FAR's opinion is that an auditor should only make reference to information in the financial statements when it is fundamental to the users' understanding of the financial statements, as currently with EoM. The illustrated auditor's report in the ITC includes information in the AC regarding litigation, goodwill and valuation of financial instruments, referring to the financial statements for further description. These areas may represent significant risks but it is not clearly stated in the example if that is the case.

2) Audit strategy

FAR believes as expressed above, that the auditor should enhance transparency to the audit strategy by describing the significant risks identified in accordance with ISA 315. These

risks should be briefly described. The auditor shall not include any conclusions made related to individual risks.

3) Other auditors

FAR has no evidence that information in the AC over how other auditors were involved in the audit, always would be of value to the users. If the IAASB should decide that such information shall be disclosed, it is important to consider the discussion in paragraphs 77-80 in the ITC, that information over involvement of other auditors must not give the impression that the audit firm/auditor does not have the sole responsibility. If the IAASB should decide to require this information, FAR believes that it must be accompanied by a statement from the auditor that even though other auditors have been considerably involved, the audit firm/auditor has the sole responsibility.

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.)

Adding more information to the auditor's report will obviously also add work and cost to the audit. However, if the additional information is limited to brief descriptions of significant risks, FAR believes that the implications for the financial reporting process will not be significant. FAR believes that the value users will obtain from this information could exceed the costs of providing it.

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.)

FAR believes that information in the AC primarily will only be relevant for users in public interest entities (PIE), and especially for users of auditor's reports in listed entities, i.e. investors and analysts, and in large entities operating in the financial market. FAR is not aware that users of auditor's reports in SMEs, public sector entities and other PIE-entities have expressed any demand for such information.

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

FAR believes that the auditor should provide more transparency about the conclusions made regarding going concern if there is a demand for that in the market. The auditor is already required to make these conclusions in accordance with ISA 570, and providing them to the users would not change the scope of the audit. However, FAR is not convinced that a standard text, as in the IAASBs example, would enhance the value for the users. In situations where there are no going concern issues, it could be more appropriate to include

the information in the description of the auditor's responsibilities and, as discussed in question 14, be better placed in an appendix or on a website. On the other hand, when there are going concern issues, the auditor would be expected to have identified these issues as significant risks which should be dealt with in the AC and/or be disclosed as EoM. Regardless of how and where the auditor's going concern conclusions are placed, the auditor's conclusions should always be based on the management's explicit assertions over going concern in the financial statements. It is therefore necessary to start the dialogue with accounting standard setters, especially the IASB, to ensure that management is required to provide such assertions in a clear manner. Since it may be necessary for the IAASB to introduce the going concern conclusions in the auditor's report before the accounting frameworks, if ever, require such assertions from management in the financial statements. In that case, FAR believes that the auditor should refer to the management's assertion differently than in the example in the ITC. One suggestion for how this could be phrased is: Management has concluded that the entity is going concern and as a part of our audit we have assessed management's assertion and concluded that the going concern assumption is appropriate. Moreover, FAR believes that all opinions, statements and conclusions an auditor express in the auditor's report shall be placed in the Opinion paragraph. Therefore, FAR does not agree with the example in the ITC where the going concern conclusions are placed in the separate going concern paragraph.

FAR is, in addition, concerned that the expectation gap from including a going concern conclusion may be increased. FAR foresees a great risk that users will not understand the context wherein these conclusions were made and will put too much reliance in their degree of certainty. FAR recommends that the IAASB carefully considers how this risk should be addressed.

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.)

As stated in FAR's response to question 8, FAR believes that in situations when there are no going concern issues it could be preferable that going concern information is placed with the standard information over the auditor's responsibilities and possibly in an appendix or on a website as discussed in question 14. In such non-issue situations, FAR does not believe that the auditor shall describe the judgments and processes. However, as stated in the response to question 8, going concern issues are expected to be identified as significant risks, and dealt with in the AC including how these risks were dealt with in the audit.

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

FAR believes that it might be of value to all user categories of the auditor's report, that the auditor explains his or her involvement with unaudited "Other information". FAR also believes that all opinions, conclusions and statements required by ISA should be presented in an expanded opinion paragraph. Even a sentence such as "We have not identified material inconsistencies...." is in FAR's opinion a conclusion that should be placed in the opinion paragraph.

In the EU, it is already required that the auditor's report presents an opinion concerning the consistency or otherwise of the annual accounts (management commentary) and, for listed entities, significant parts of the Corporate Governance Statement with the financial statements. In an auditor's report for Swedish entities, "opinions" over consistency are already presented in the opinion paragraph.

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.)

FAR generally believes that standardized descriptions in the auditor's report over the responsibilities for management, TCWG and the auditor fill an important purpose and must be easily available to the users. FAR is, however, not convinced that the users are best served by providing this information in the auditor's report. Since a majority of users probably will not read this information in every auditor's report, FAR's preliminary opinion is that users may be best served by having this information available elsewhere, with only a reference in the auditor's report to where it is available. See further FAR's response to question 14.

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

FAR has noticed the impediments described in paragraphs 72-73 such as that disclosing the name would create an impression that the responsibility of the firm might be perceived lowered and increasing the partner's personal legal liability. FAR does not believe that including the name of the engagement partner would have any negative consequences on how the audit firm's responsibility is perceived. Whether the inclusion of the partner's name would have negative consequences on the partner's legal liability in some jurisdictions is not possible for FAR to comment. Generally, FAR believes that it is of value to the users that both the name of the audit firm and the engagement partner is disclosed in the auditor's report. In Sweden, it is a legal requirement that the name of the engagement partner is disclosed. The engagement partner must also personally sign the auditor's report.

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.)

As discussed in the response to question 5, FAR has no evidence that information in the AC over how other auditors were involved in the audit, may be of any value to the users. However, when an auditor decides that such information is important to users' understanding of the audit, the auditor shall be free to give such information. If the IAASB should decide that such information always shall be disclosed, it is important to consider the discussion in paragraphs 77-80 in the ITC, that information over involvement of other auditors must not give the impression that the audit firm/auditor does not have the sole responsibility. If the IAASB should decide to require this information, FAR believes that it

must be accompanied by a statement from the auditor that, even though other auditors have been considerably involved, the audit firm/auditor has the sole responsibility.

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.)

As discussed in the response to question 11, FAR believes that standardized information over the auditor's responsibility must be available to the users of the auditor's report, but preferably elsewhere than in the auditor's report. A reference in the auditor's report to where the information is available would be sufficient. FAR sees no better alternative than placing this information on a web site, but realizes that there may be objections to that. For example, users of the auditor's report from the same jurisdiction as the audited entity would probably be comfortable with that the information is placed on the web site of the national standard setter, or at the web site of the national supervisory board or both. However, FAR is concerned whether users from other jurisdictions (foreign investors and analysts) may have the same trust in these web sites, and recommend the IAASB to consider alternative web sites.

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.)

FAR appreciates that the opinion paragraph is placed as the first paragraph in the auditor's report, since that may be of high value to many users. According to present ISA 705, the basis for the modified opinion in the auditor's report would be placed before the opinion paragraph, and in FAR's opinion it would appear odd to start the auditor's report with a basis for modification paragraph. Hence, FAR supports the IAASB's suggestion that the paragraph "Basis for opinion" is placed after the opinion paragraph. FAR assumes that it is the IAASB's intention that this paragraph is placed after the opinion paragraph also when it presents the basis for modification.

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.)

FAR believes that users are valuing globally consistent auditor's report. However, users can deal with the fact that some sections in the auditor's report must be customized to appropriately reflect jurisdictional differences. National legal requirements on the auditor's report will probably in many jurisdictions differ more or less from ISA. FAR believes that what is most important to global users is a consistent structure of the auditor's report. Even though auditor's reports in listed entities are not completely consistent today, FAR is not aware that this inconsistency has been any major problem for investors and analysts. FAR does not believe that including customized information such as AC will cause any problems due to increased inconsistency.

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.)

As discussed in the response to question 16, FAR believes that a common structure in the auditor's report is important to the users. Hence, the ordering of the various items should be prescribed in the standard. FAR's preliminary analysis is that the present legislation in Sweden will not create any obstacles to present the auditor's report in the order suggested in the illustrative example.

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.)

As discussed in the response to question 7, FAR is of the opinion that introducing an AC in the auditor's report for other than listed entities and large entities operating in the financial market, is unlikely to add value to the users. FAR is not aware of any demand for an AC from users of auditor's reports in SMEs, public sector entities and other PIEs. It is especially important that auditor's report for SME-entities only contains information that the users ask for. If an auditor's report contains compulsory information that is not relevant to either the entity or the users, such entities may perceive that an audit is not an appropriate service for them.