



September 26, 2011

Mr. James Gunn  
Technical Director, International Auditing and Assurance Standards Board  
International Federation of Accountants  
545 Fifth Avenue, 14th Floor  
New York, NY 10017

Dear Mr. Gunn:

We appreciate this opportunity to comment on the consultation paper, *Enhancing the Value of Auditor Reporting: Exploring Options for Change* (the “consultation paper”), which has been developed by the International Auditing and Assurance Standards Board (“IAASB” or “the Board”).

We have separated our comments into four sections:

- *Overall Comments* – this section includes principles which we believe should be followed as changes to auditor reporting are considered.
- *Responses to Request for Specific Comment* – this provides answers to the specific questions posed by the IAASB in the explanatory memo.
- *Recommendation for Holistic Approach to Changes in Financial Reporting*
- *Recommendation for Actions Going Forward*

## **OVERALL COMMENTS**

We strongly commend the IAASB for undertaking this vital project to solicit views regarding the perceived value of auditor reporting in connection with the audit of financial statements. It is inevitable that, as the information needs of users and the amount of information available to such users evolve, reporting (by auditors, management and those charged with governance) would also need to evolve to meet those needs.

We unquestionably encourage and support an evolution of auditor reporting that would achieve high quality financial reporting. As part of this process, we believe it is important to clearly link any proposed changes with the objectives of the project. We believe the objectives are to (1) meet the needs of users and (2) enhance audit quality. As the IAASB weighs the merits of any proposed changes, we request that the Board assess the ability of each proposal to achieve these objectives.

From the information gathered through various research projects, and as noted in the consultation paper, it appears that users have two different types of needs: (1) minimize the expectation gap (make it clear to users what an audit is); and (2) minimize the information gap (provide useful information and focus users on the most important areas of the financial statements). As part of addressing these needs and collecting feedback through this consultation process, the IAASB will need to consider whether any changes are needed to the scope of the audit, in addition to the content of the auditor's report.

**Principles:**

As noted above, we believe there are fundamental principles that the IAASB should keep in mind when considering changes to the auditor's report, as follows:

1. Any proposal that would increase the information gap or expectation gap or detract in any way from audit quality should not be considered.
2. The roles and responsibilities of the auditor, management and those charged with governance should remain unchanged. Auditors should not be the original source of disclosure about the entity; the responsibilities of management and those charged with governance should be preserved in this regard.
3. Any changes to the auditor's report should not create user confusion. Specifically, any revisions should not require users to sort through "dueling information" provided by the auditor, management and those charged with governance.
4. Auditor reporting should focus on the "objective" rather than the "subjective."

## **RESPONSE TO REQUESTS FOR SPECIFIC COMMENTS**

1. Do respondents have any comments about the issues identified in Section II regarding the perceptions of auditor reporting today?

We agree that an “expectation gap” exists, and we believe that the auditing profession, together with management and those charged with governance, can and should play an important role in addressing this expectation gap through a level of enhanced auditor reporting and enhanced corporate governance reporting.

We further agree that, due to the evolving information needs of a wide range of users that an “information gap” exists. Whilst we acknowledge that the auditor may have a role to play in narrowing this gap, we are of the firm belief that management and those charged with governance should be the major role players in addressing this information gap and that regulators should be considering revisions to the content of financial statements, related notes and disclosures if it is to be effective. We believe that auditors can assist in enhancing the perceived reliability and credibility of additional information provided by management and those charged with governance by performing additional procedures as part of the audit or separate assurance or related services type engagements on such information.

2. If respondents believe changes in auditor reporting are needed, what are the most critical issues to be addressed to narrow the information gap perceived by users or to improve the communicative value of auditor reporting? Which classes of users are, in the view of respondents, most affected by these issues? Are there any classes of users that respondents believe are unaffected by these issues?

We believe that it would be most beneficial to direct users to the matters that are the most important to understanding the specific entity’s financial statement presentation, which include significant management judgments and estimates, and areas with significant measurement uncertainty. To achieve this aim, we support including a reference in the auditor’s report to the footnotes of the financial statements where the entity has identified and discussed its significant management judgments and estimates, and areas with significant measurement uncertainty. We believe that such a reference would not blur the lines of responsibility between the auditor and management (management is still the provider of information); however, it will focus users on the most important aspects of the entity’s financial statements. We also believe that an increase in focus on these specific footnotes will improve management’s disclosures in these areas.

3. Do respondents believe that changes are needed for audits of all types of entities, or only for audits of listed entities?

We acknowledge that there are currently differences in auditing requirements for listed entities, which are generally jurisdictional regulatory differences. However, any changes to the standard auditor’s report on financial statements should apply to all

sizes and types of entities in order for the report to be consistently understandable. If changes to the auditor's report were to be made only for the audits of certain types of entities, this might have the effect of further widening the expectation gap and/or information gap of the users of financial statements. Thus, it is important to maintain uniformity in auditor reporting.

#### **A. Format and Structure of the Standard Auditor's Report**

4. Respondents are asked for their reactions to the options for change regarding the format and structure of the standard auditor's report described in Part A. Do respondents have comments about how the options might be reflected in the standard auditor's report in the way outlined in Appendix 1 of this Consultation Paper?

We are not opposed to re-positioning the opinion paragraph to be placed first in the auditor's report; however, we are not convinced that this would enhance the value of auditor reporting.

5. If the paragraphs in the current standard auditor's report dealing with management and the auditor's responsibilities were removed or re-positioned, might that have the unintended consequence of widening the expectations gap? Do respondents have a view regarding whether the content of these paragraphs should be expanded?

We are not supportive of removing or re-locating to another document the paragraphs on auditor and management responsibility. To the contrary, we believe it is critical for these paragraphs to remain within the auditor's report, and to be expanded (for the auditor, management and those charged with governance) to minimize the expectation gap. For example, we support adding descriptions of the auditor's responsibilities with respect to the following:

- Other information in documents containing audited financial statements (reporting on audit procedures required by ISA 720)
- To be independent under all relevant standards
- To use professional judgment in making risk assessments and selecting audit procedures

## **B. Other Information in Documents Containing Audited Financial Statements**

6. Respondents are asked for their reactions to the possibility that the standard auditor's report could include a statement about the auditor's responsibilities regarding other information in documents containing audited financial statements. Do respondents believe that such a change would be of benefit to users?

Yes, we believe it would be beneficial to include within the auditor's report a statement about the auditor's responsibilities regarding other information in documents containing audited financial statements. We believe that some users of financial statements place undue reliance on other information in documents containing the audited financial statements because they are of the belief that, because such information is included with the audited financial statements, it has been "audited". See also answer to question 5.

7. If yes, what form should that statement take? Is it sufficient for the auditor to describe the auditor's responsibilities for other information in documents containing audited financial statements? Should there be an explicit statement as to whether the auditor has anything to report with respect to the other information?

We believe there should be a statement within the auditor's report about the responsibilities under ISA 720 (i.e., the auditor's responsibility is to read the other information to identify material inconsistencies, if any, with the audited financial statements, and to follow up on any material inconsistencies and material misstatements of fact of which the auditor becomes aware with management and those charged with governance).

## **C. Auditor Commentary on Matters Significant to Users' Understanding of the Audited Financial Statements, or of the Audit**

8. Respondents are asked for their views regarding the auditor providing additional information about the audit in the auditor's report on the financial statements.

On a broad level, we support and are open to providing standardized information on what an audit is and how it is performed, as long as there is strong support for this expressed by users during this consultation process. We are concerned that lengthening the auditor's report in this way may not increase the value of the report or sufficiently address the expectation gap. However, if users indicate strong support for this standardized information to be included in the report and it would be helpful to them, we would not be opposed to it.

We do not believe that providing information specific to the entity regarding audit risks, audit judgments and materiality will be helpful to users. Rather, we believe such information will be confusing to users (due to the lack of consistency and comparability from one audit report to another), may compete with, and potentially contradict,

management's disclosures, will be at either too high a level to provide sufficient information for users to understand the issues or overly long and subject to varying interpretations, and may, in fact, increase the expectation gap. Confidentiality issues may also arise when the auditor reports matters not disclosed by management.

Additionally, we believe that identifying information which points out the most difficult areas of the audit and how such areas were addressed would undermine the meaning and value of the audit opinion, and may also leave the user with the belief that it contradicts the overall opinion on the financial statements. When an audit opinion is issued, it represents (and states explicitly) that the audit was performed in accordance with the ISAs and that the auditor is independent. We also believe that providing details regarding audit procedures performed would remove elements of "uncertainty and surprise" that audit procedures currently possess.

We are also concerned with the significant practical challenges that exist related to reporting specifics of each audit. These challenges mainly relate to the time, effort and resources required to develop such a narrative, and completing such a process within tight filing deadlines. The cost and process of arriving at the content of this additional information would not increase audit quality or the quality of the financial reporting.

9. Respondents are asked for their reactions to the example of use of "justification of assessments" in France, as a way to provide additional auditor commentary.

We understand that the "justification of assessments" in France has been seen as beneficial to some users. As included as part of the "justification of assessments," we support including a reference in the auditor's report to the footnotes of the financial statements where the entity has identified and discussed its significant management judgments and estimates, and areas with significant measurement uncertainty. We believe that such a reference would not blur the lines of responsibility between the auditor and management (management is still the provider of information); however, it will focus users on the most important aspects of the entity's financial statements. We also believe that an increase in focus on these specific footnotes will improve management's disclosures in these areas.

We do not believe that providing information about the auditors procedures in those areas will be beneficial – please see our response to Question 8 for further information.

10. Respondents are asked for their reactions to the prospect of the auditor providing insights about the entity or the quality of its financial reporting in the auditor's report.

We are strongly opposed to the auditor providing "insights" about the entity or the quality of its financial reporting in the auditor's report. Requiring the auditor to provide a discussion of his or her "views" on these matters would blur the distinction of the roles of the auditor and management. We strongly believe that management is the provider of information, and that the auditor is the provider of assurance on that information.

#### **D. An Enhanced Corporate Governance Model: Role of Those Charged with Governance regarding Financial Reporting and the External Audit**

11. Respondents are asked for their reactions to the options for change relating to an enhanced model of corporate governance reporting, as described in Section III, Part D.

We believe that the enhanced model of corporate governance reporting described in the consultation paper has a number of merits. Please see our comments on a holistic approach to improving financial reporting in the third section of this letter.

12. To the extent that respondents support this model, what challenges may be faced in promoting its acceptance? Also, what actions may be necessary to influence acceptance or adoption of this model, for example, by those responsible for regulating the financial reporting process?

The main barrier to this model would be that the IAASB does not have the mandate to require or change corporate governance reporting. Please see our comments on a holistic approach to improving financial reporting.

13. Do respondents believe assurance by the auditor on a report issued by those charged with governance would be appropriate?

We are of the opinion that auditor assurance on information improves the value of that information. After receiving input from this consultation, if users are interested in this type of assurance, we suggest that the IAASB create assurance standards (modeled on ISAE 3000) related to a separate engagement of this type, to create consistency and comparability.

#### **E. Other Assurance or Related Services on Information Not Within the Current Scope of the Financial Statement Audit**

14. Respondents are asked for their reactions to the need for, or potential value of, assurance or related services on the type of information discussed in Section III, Part E.

We are of the opinion that there is certain other financial and non-financial information about an entity which may be of value to users of financial statements. The financial information included in the audited financial statements is historic by nature and does not generally provide an insight into the future profitability and sustainability of an entity. It is becoming increasingly apparent that non-financial issues can have a significant impact on the future prospects and sustainability of an entity and therefore users are placing increasing value on information which provides insight into an entity's future prospects and sustainability. We believe that auditors or other assurance providers can assist in improving the reliability and credibility of such information by

providing other assurance and related services with regards to this information. However, in providing assurance on this type of information, the auditor would need to guard against shifting the primary focus away from financial statement audits. Additionally, the IAASB should monitor the number and types of these engagements being performed and reports being issued and consider whether specific assurance standards are needed.

15. What actions are necessary to influence further development of such assurance or related services?

We believe the following actions are necessary to influence further development of such assurance or related services:

- Regulators and/or exchanges would have to assess the level of assurance required for the type of information discussed in Section III, Part E.
- Regulators and/or exchanges would need to assess, in consultation with the IAASB, if the required level of assurance can be provided through the existing Assurance Engagement or Related Services framework.
- Regulators and/or exchanges would need to define exactly what information will be subject to such assurance engagement or related service.
- The responsibilities of management and the auditor with regards to the information would need to be defined.
- Criteria and guidance for the evaluation of the information would need to be developed.
- Concerns around the provision of assurance over forward looking information would need to be understood and addressed.

16. Respondents are requested to identify benefits, costs and other implications of change, or potential challenges they believe are associated with the different options explored in Section III.

Although we have been supportive of some of the different options explored in this consultation paper, they do not come without an associated cost. However, some options are more costly than others (for example, descriptions of audit risks and procedures), and some may only have an additional cost in the first year of implementation (for example, including standardized wording on the responsibilities of the auditor and management). Other options (providing additional assurance on corporate governance reporting) would require the auditor to perform a separate engagement in addition to the audit, which would lead to an increase in costs.

17. Do respondents believe the benefits, costs, potential challenges and other implications of change, are the same for all types of entity? If not, please explain how they may differ.

The costs would differ by entity and depend on the type of information to be reported, and the additional time, effort and resources necessary to provide and report on additional information. The more complicated an entity, the more costly the changes may be.



18. Which, if any, of the options explored in Section III, either individually or in combination, do respondents believe would be most effective in enhancing auditor reporting, keeping in mind benefits, costs, potential challenges, and other implications in each case? In this regard, do respondents believe there are opportunities for collaboration with others that the IAASB should explore, particularly with respect to the options described in Section III, Parts D and E, which envisage changes outside the scope of the existing auditor reporting model and scope of the financial statement audit?

As noted in our response to Question 9, we support including a reference in the auditor's report to the footnotes of the financial statements where the entity has identified and discussed the significant management judgments and estimates, and areas with significant measurement uncertainty. We believe that such a reference would not blur the lines of responsibility between the auditor and management (management is still the provider of information); however, it will focus users on the areas that are the most important aspects of the entity's financial statements. We also believe that an increase in focus on these specific footnotes will improve management's disclosures in these very important areas.

19. Are there other suggestions for change to auditor reporting to narrow the information gap perceived by users or to improve the communicative value of the auditor's report?

As is the case in some jurisdictions, we believe it would be beneficial to address the audit report to both the shareholders of the entity and those charged with governance (this provides clarification that the auditor's responsibility is to report to shareholders and those charged with governance).

## **RECOMMENDATION FOR HOLISTIC APPROACH TO CHANGES IN FINANCIAL REPORTING**

While we strongly support the IAASB's project to consider revisions to the auditor's report, we also believe a holistic approach to improving financial reporting is warranted. The audit is only one piece of the financial reporting process. We believe that reporting by management, those charged with governance and auditors should all be considered together in order to create the best outcome for users.

For example, we believe that users would benefit from expanded, refined or improved disclosures, particularly in the area of critical accounting estimates. Additionally, as included in the consultation paper, expanded reporting by those charged with governance may provide users with more information regarding oversight activities.

We understand however, that all of these changes would not be within the mandate of the IAASB. We encourage communication with other standard setters (both accounting and auditing), and regulators around the world to improve the quality of financial reporting.


## **RECOMMENDATION FOR ACTIONS GOING FORWARD**

As part of the process to receive input and develop proposals for changing the auditor's report and considering the scope of the audit, we recommend that the IAASB:

- Specifically assess whether the proposed changes would (1) decrease the expectation and/or information gap, or (2) enhance the quality of the audit
- Hold roundtables with experienced users of the auditor's report (i.e., institutional investors, analysts, and banks), or seek direct input from them in some way, to confirm whether the proposed changes would meet their needs
- Consider how any changes would be managed to educate investors and other users.

We would be pleased to discuss our letter with you or your staff at your convenience. If you have any questions, please contact Jens Simonsen, Managing Director of Global Audit Services at + 1 212 492 3689.

Very truly yours,



Jens Simonsen