光华管理学院
Guanghua School of Management

October 8, 2012

International Auditing and Assurance Standards Board
New York, New York, USA

By website submission

Dear Sir or Madam:

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

Thank your for including me in the IAASB Roundtable in Kuala Lumpur to discuss the proposals regarding improving the audit report. I have provided a record of my oral comments below:

Presentation by Professor Paul Gillis in Kuala Lumpur on October 8, 2012:

Thank you for giving me the opportunity to express my views on the IAASB's efforts to improve the audit report. The IAASB is to be commended for taking on this initiative. The expectation gap between auditors and users of financial statements is great in Asia, and efforts should be made to close it.

Before I go further I must tell you that the views I express today are my personal views and do not necessarily reflect the views of the Board or the staff of the PCAOB, or my university.

Financial markets have been shaken by a large number of frauds committed by Chinese companies listed on stock exchanges around the world. In many cases investors have asked, "Where were the auditors?" To be fair, auditors uncovered many of these frauds, and auditors cannot be expected to uncover well-constructed frauds. But these problems have highlighted the gap between the expectations of investors and the responsibilities of auditors.

That brings me to the first of two points I wish to make today. Any changes made to the audit report should help to close the expectations gap. Providing more information about the audit should help users to better understand how the audit process helps them to mitigate risk.

Although a rather simple change, positioning the opinion prominently at the beginning of the report will help to reinforce the purpose of the audit and emphasis the pass/fail nature of the opinion. The IAASB can help to encourage consistent application of this practice worldwide.

I also believe that specifically referencing the notes as an integral part of the financial statements is appropriate. Sophisticated users consider the financial statements as an index to the notes where the most meaningful financial information is found. Emphasizing this link is appropriate.

Modern financial reporting involves a document where the audited financial statements are only a part. Extensive financial disclosures are made in management discussion and analysis sections of these documents. Auditors typically review these disclosures to assure consistency with the financial statements that they are associated with. Auditors commonly issue comfort letters to underwriters on this information. The proposed changes would require auditors to note in their report any inconsistencies present in these disclosures. In effect, the proposed changes would result in the auditor providing a form of comfort letter to the public. I support this change, but it should be done in a manner that does not increase the liability of auditors related to this information.

Users of financial statements need more information about how the audit was conducted. The proposal to name the signing audit partner follows the current practice in many countries including China and the European Union. Intuitively, greater personal accountability of the partner should increase audit quality. However, two recent academic studies (Blay, et al., 2012; Lambert, Luippold and Stefaniak, 2012) suggest that there is no evidence to support this intuition. There is an argument that disclosure of the audit partner's name actually results in impaired independence, as the naming of the partner fuses the reputation of the client and the audit partner, improperly aligning the interest of the client with the interest of the audit partner.

The proposal to require disclosure regarding the involvement of other auditors in the audit of financial statements has significance in Asia. Increased use of shared services and outsourcing of financial processing activities has led to the shift of audit work to locations involved in these activities. The firms that audit this information are usually legally separate member firms. Users of financial statements should know who is actually performing significant parts of the audit. There was a recent situation in Hong Kong where a firm apparently outsourced the entire audit to another member firm, and then was unable to produce the relevant working papers when requested to do so by Hong Kong regulators. The PCAOB has sanctioned firms for similar activities in China. Disclosure of significant involvement of other auditors is appropriate.

My second point is that the audit report should not be the original source of disclosure about a company. The function of an auditor should be to assess whether the financial statements fairly present the position of a company. If more disclosure is necessary to provide a fair presentation, management should provide that additional disclosure in the financial statements.

I believe the proposals for additional auditor commentary risk making the auditor the original source of disclosure. While I agree with the need for additional disclosure of the matters that have been identified, I believe it is management's responsibility to make these disclosures and it is the auditor's responsibility to evaluate management's disclosure. What we need is a change in disclosure standards, not auditing standards.

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I am skeptical as to whether the proposed changes in audit commentary will have the desired effect. Fear of liability and client pressures are likely to lead to boilerplate disclosures that provide no useful information. We do not need more boilerplate.

The proposed changes related to auditor reporting on going concern also risk resulting in the auditor becoming the original source of disclosure about a company. I believe that companies should expand disclosures about the key assumptions and uncertainties underlying the going concern conclusion, and auditors must evaluate those disclosures. I do not see value in the auditors making explicit statements about selected key assumptions in the financial statements. Perhaps the going concern assumption is so critical to financial statements that it should be the subject of an explicit auditor conclusion. However, revision of this standard should not be a reaction to the latest auditing crisis. Perhaps the going concern issues should simply be added to the list of issues discussed in expanded audit commentary, and included when they are considered significant.

I appreciate the opportunity to be with you today at this important meeting, and to make my comments about the proposed changes. Properly designed and implemented, these changes should help to reduce the expectations gap and provide useful information to the users of financial statements.

Sincerely,

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## References


Blay, Allen D., Notbohm, Matthew, Schelleman, Caren and Valencia, Adrian, Audit Quality Effects of an Individual Audit Engagement Partner Signature Mandate (April 23, 2012). Available at SSRN: http://ssrn.com/abstract=2044817

Lambert, Tamara A., Luippold, Benjamin L. and Stefaniak, Chad M., Audit Partner Disclosure: Potential Implications for Investor Reaction and Auditor Independence (July 30, 2012). Available at SSRN: http://ssrn.com/abstract=1983482 or http://dx.doi.org/10.2139/ssrn.1983482