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Mr James Gunn
Technical Director, IAASB
International Federation of Accountants
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Dear Sir:

Thank you for providing me an opportunity to examine and provide my comments on "Improving the Auditor's Report". I am a practicing chartered accountant in Mumbai, India, and have been in audit practice for the past 32 years.

GENERAL COMMENT:

Many different constituents of Society rely upon an auditor's report. Any change desired to be made to the auditor's report structure and content ought to consider the needs and expectations of all such stakeholders and not just those of the institutional investor community, which is admittedly the most organised, well-funded and vocal of them all.

The premise in making changes to the auditor's report should be to provide whatever additional information that can be provided to users without creating any confusion with regard to the respective roles of the management, those charged with governance (TCWG) and the auditor – in other words, any overlap in those roles must be strictly avoided. Besides, providing additional information should not make the auditor any more liable to the risk of litigation than he currently is.

Auditors should report on information before them in an objective manner, within the confines of the standards, and must neither become original providers of information nor have the liberty or be asked to offer subjective comments on that information. Otherwise it could give rise to confusion.

Importantly, auditor's reports must not shed away the virtues of consistency and comparability, because otherwise they may lose professional propriety and could degenerate into a kind of "free-for-all".

RESPONSES TO "QUESTIONS FOR RESPONDENTS":

<u>Topic – Overall Considerations</u>

Question 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?*

Response: A change should not be made to a tradition unless it is absolutely necessary. If absolutely necessary in keeping with changing times, a tradition may be changed to a minimum extent in stead of radically.

All of the changes brought forth in this ITC may not necessarily be "improvements", and I would therefore urge that instead of using the term "suggested improvements", in future deliberations on the subject the words "suggested changes" be used, so as to remove the implied bias.

There can be wide-ranging ramifications of changing an auditor's report in the manner suggested and they all need to be carefully weighed before this step is taken. Some of the ramifications could spring up as surprises after the changes are implemented and it may not even be possible to imagine them at this stage.

<u>Therefore, wherever an alternative means can be found to achieve the same objective, that alternative should be fully explored and given precedence in our thoughts over changing of the auditor's report.</u>

Of course, there is merit in some of the suggestions made and I do believe that an auditor's report will become a more enriched document in the hands of users as a result of those changes.

Question 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.*

Response: There are three alternatives that come to mind with reference to the matters recommended for inclusion in Auditor Commentary:

- <u>Alternative Solution A</u> - The accounting standards may be revised or a new "disclosure standard" may be introduced to require management to make the disclosures that are being contemplated to be included in the Auditor Commentary. For example, in IFRS 7 there are detailed disclosure requirements designed to provide supplementary information, such as sensitivity analyses, to users.

  Once such disclosures are made by management and included in the financial statements, the auditor would audit them and report in the normal course if any of them is materially misstated. This way the burden is rightly on the management to make proper disclosures to satisfy the increasing information needs of their investors. This, in my view, is by far <u>the best solution</u> to address the growing demand for more information from investors.

- <u>Alternative Solution B</u> – A new *Assurance Engagement* Standard could be developed to identify the specific matters on which Auditor Commentary is desired and that Standard could mandate that the auditor provides a separate assurance report on those specific matters within, say, 15 days[1] of issuing the auditor's report on the financial statements. It is important to spell out the specific areas scoped into this report in stead of leaving it to the auditor's discretion in order to prevent risk of disagreement between auditors and managements.

[1] The reason for delay between issuance of the auditor's report and this report is to give auditor the time to apply his mind to this assurance report shortly after the deadline for approving the financial statements is over. As mentioned elsewhere such deadlines can be very grueling for the engagement team.

- Alternative Solution C – If the above proposals do not find favour, the third alternative would be to evolve a new *Assurance Engagement* Standard on "Information in the Annexure to the Auditor's Report". This new Standard would require an auditor to include an "Annexure to the Auditor's Report" in which an auditor is required to provide answers to a specific set of questions designed to elicit the required information. This would require the auditor to respond to all the matters on which additional information is desired and the questions could pointedly require the auditor to make categorical assertions and/ or to provide his views on the matters.

  Some thoughts on Alternative Solution C (with particular focus on Auditor Commentary):

  - What should be in the body of the auditor's report should only be what leads to and relates to the auditor's opinion on the financial statements, Other Matter Paragraph, and any other legal or regulatory matters that local laws or regulations require to be included in an auditor's report. All other matters, including what is currently given in Emphasis of Matter Paragraph, should be moved into an Annexure to the Auditor's Report. The auditor's opinion therefore retains its importance in the main report and if there are any modifications to it under ISA 705, then those also retain their due importance.

  - In other words, the following elements of the existing report continue to stay in the main report: title, addressee, introductory paragraph, the responsibility paragraphs (to include an additional separate paragraph on responsibilities of TCWG), basis for opinion, opinion, other matters paragraph, and report on other legal and regulatory requirements. Where the report is modified, the basis and opinion paragraphs will reflect the modification.

  - The Annexure referred to above contains the Additional Information. Additional Information does not affect the auditor's opinion or the responsibilities of either management, TCWG or the auditor insofar as the financial statements and the audit are concerned. This is supplementary information as required to be annexed by an auditor in terms of a separate Assurance Engagement Reporting Standard to be developed for the purpose.

- The Standard on "Information in the Annexure to the Auditor's Report" (by whatever name called) shall list specific matters or questions on which the auditor has to respond. These questions can be framed from matters finally decided by the IAASB as those that meet the requirements of this ITC. The auditor then answers those questions in the same sequential order in which the questions are listed in the Standard. For illustration:

Question	Auditor's response
Going concern: Were there any material uncertainties related to events and conditions that may cast a significant doubt on the company's ability to continue as a going concern? If yes, provide details.	
Outstanding litigation: Is the company exposed to claims or litigation that you believe could have a significant impact on the company's future operations or existence if one or more of them is/ are decided against the company? If yes, provide brief details of such claims or litigation including quantification where possible.	
Goodwill: Has the company recognised goodwill as an asset? If yes, has the Company met the	

requirements of IAS 36, *Impairment*, with regard to such goodwill?	
Etc….	

- The use of such an Annexure with a defined questionnaire will have several advantages over the suggestion to include a "free-flowing" Auditor Commentary in the auditor's report:
    - To begin with, such additional information, though provided by the auditor, is not a part of his main report where his opinion is stated. To that extent there is a physical separation of such information from the opinion – which is highly desirable.
    - The questions can be so framed that while the auditor's agreement with the accounting treatment is implied (unless the matter is the subject of a modification in the main report), the responsibility for that treatment stays with the management – which is how it should be. Careful thought and effort needs to go into framing of this questionnaire so as to ensure that the auditor is asked to only supply information and not an opinion on individual matters.
    - When there are prescribed specific questions (perhaps with a final open-ended question where the auditor is required to provide details which he would otherwise have provided in the nature of an emphasis of matter paragraph) the auditor is guided in what he needs to respond to and is not left a choice on what he should report or leave out. Also, the auditor will restrict himself to matters that are there in the financial statements and what he has audited and not stray into other areas which may be the in the domain of management. This method of eliciting a report will therefore be a safeguard against "dueling information".

- A specified set of questions will also remove the impediment of lack of comparability between auditor's reports and will add value to institutional investors by allowing them to make industry-wide analyses and comparisons.
- The management is also aware that the auditor has a duty to comment on the listed specific issues and cannot therefore put pressure on the auditor for not reporting on something that may be contentious.
- While institutional investors may be highly knowledgeable, it must be realised that there are many other stakeholders who read auditor's reports and who may be laymen, some without even an accounting background. If the Auditor Commentary is a part of the auditor's main report, they could get confused and not understand the true implications of what they are reading. The report containing the opinion should therefore be written in simple understandable English, while the Auditor Commentary may get into technicalities, such as impairment methodology, valuation of financial instruments, etc., if need be.
- This being an additional report, the auditor can rightfully charge an additional audit fee based on the work involved in making this report in the Annexure. If it were to be included as Auditor Commentary in the main report, given the situation in many countries, clients may refuse to compensate the auditor for the additional cost. The report in the Annexure should form a separate reporting requirement in the engagement letter. The manner in which IAASB should make the Standard for this should identify this as a linked, but a separate and additional reporting requirement.

- The questions should be so framed that they do not elicit a subjective response from the auditor, nor require an auditor to provide his opinion or judgement on any individual matter. The principle that an auditor does not opine on individual account balances or assertions but on the financial statements taken as a whole, needs to be kept sacrosanct at all times.

Topic – Auditor Commentary

Question 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.)*

Response: Much is being made of auditor's reports being boilerplate and not "free-flowing" in language. An auditor has a professional role where he deals with sensitive matters of his client which if made public might adversely affect the economic interests of his client. He therefore has to be controlled in the use of language and say only as much as is necessary. While the Company may choose to be eloquent in writing its MD&A, it is not for an auditor to emulate that "free-flowing" style or to be the original source of providing information.

Those who advocate "free-flowing" Auditor Commentary may be warned that in course of time, with experience and legal advice, even Auditor Commentary as envisaged will become "boilerplate" and that will defeat the purpose of now asking for a "free-flowing" narrative.

The concept of Auditor Commentary in the manner proposed in the ITC may provide the information but has the following impediments:

- Currently managements, audit committees and auditors freely inter-act and exchange sensitive information. This is because the management and audit committee know that the auditor is going to take an overall view. But, if they fear that he will be giving a running commentary on individual sensitive matters to the world at large, the managements and audit committees may expectedly raise their guard against the auditor, become secretive and withhold the information that they may currently feel free to share with the auditor. This will harm the entire audit process in stead of improving it and the loss to everyone concerned will be far greater than the gain.

- An auditor's opinion is on the financial statements taken as a whole and not on individual transactions, account balances or elements of the financial statements. Auditor Commentary will be on individual transactions, account balances or elements of the financial statements. This will hold the threat of "piecemealing" the auditor's report and confusing the users into wondering about the implications of the disparate commentary that the auditor will provide on different matters. Such a result would be counter-productive.

  Moreover, the danger is that it may indeed lead to alarmist media reports on company performances quoting out-of-context matters from the Auditor's Commentary and creating situations where both managements and auditors may get sued.

  When such out-of-context matters are blown up by the media, even if they could later be proved to be incorrect, the media exposure could have disastrous consequences on stock prices, and may even be deliberately misused by some stock market players to manipulate prices.

  Auditor's responses should therefore be strictly factual, supportable with evidence and defendable.

Question 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.)*

Response: No. While it is not that an auditor would not be competent to judge what matters to include in the Commentary, it will not be prudent to leave him to do that. While some of the matters may be quite straight-forward, the investors are interested in knowing the auditor's views on management estimates and judgements where two views could be possible, or difficult or contentious issues. These are areas where management may not be fully supportive and there may be disagreements between management and/ or audit committees and the reporting auditor.

It is therefore very important that the matters to be addressed are clearly specified, with guidance provided in a Standard on how the auditor should address each such matter. A "questionnaire" format with notes elaborating what is broadly expected in response to each question including illustrative guidance would be the best method for the IAASB to provide support to the auditors.

Question 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.)*

Response: In response to the last of the four questions above, the argument given is that understanding how an audit was planned and performed would help users in understanding the risks that they are taking and in making the audit more transparent.

Audit is an exercise in applying professional judgement based on performance of certain procedures. What procedures to follow in a given circumstance are also matters of an auditor's professional judgement. While an auditor may document how he exercised his professional judgement in his working papers, he has no obligation to share this with anyone else, including the management or TCWG unless he voluntarily wants to. Besides, even where he may have certain findings on individual matters, he forms his opinion on the financial statements as a whole. Asking him to describe or justify bits and pieces of his audit procedures to users of auditor's reports is taking the guise of "transparency" much too far.

I feel this demand is unprofessional, preposterous, demeaning and should in no case be acceptable. Acceding to this suggested change is fraught with danger as it would expose the auditing profession to a huge risk of litigation.

Question 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.)*

Response: The objective of Auditor Commentary is, in some ways, similar to what is called an "LFAR" or "Long-Form Audit Report" in India which is mandated by the banking regulator, Reserve Bank of India. In India we also have to provide a report that we call a "CARO Report" where CARO stands for "Companies Auditors' Report Order" under the Companies Act. While LFAR is given as a separate report from the auditor's report, the CARO Report is given as an Annexure to the auditor's report.

From our experience of making these reports over several decades, it is easy to see that Auditor Commentary will load a significant additional cost on the auditor, most of it "partner or senior manager hours". Clients are typically unwilling to pay for anything that does not add value to them unless mandated, and clearly they would rather not have Auditor Commentary at all, with or without paying additional remuneration to the auditor. It will therefore be an uphill task for auditors, especially smaller audit firms with low bargaining ability (which abound in countries like India), to get compensated from their clients for the additional cost unless the IAASB helps them by making this into a mandatory, separately chargeable engagement. Thought needs to be applied so that this is achieved.

A suggestion is made sometimes that an auditor has already done the audit and formed an opinion so not much of time and effort would be required in writing the Auditor Commentary. This is not true. As stated above, there will certainly be a large additional cost involved in preparing Auditor Commentary, particularly where the commentary, as drafted by the auditor, is not acceptable to the management and TCWG. In such circumstances (which one fears will be commonplace) the auditor will need to hold discussions with management and TCWG to resolve the differences. This may also lead to considerable friction and unpleasantness in the client-auditor relationship.

As suggested above in Alternate Solution B, Auditor Commentary could be made into a separate assurance engagement under an IASE, in stead of an ISA: like in the case of the LFAR that is issued after the main auditor's report is issued. That will solve one more important impediment that is referred to in paragraph 62 of the ITC discussed below:

It may or may not be there in other countries, but it has become a fashion in India (driven by the institutional investors) for most very large corporations to hold board meetings to issue audited consolidated financial statements in the first week or ten days after year-end. Auditors barely have time and resources to complete audit and issue the report (under existing ISA 700) and it is not unusual for engagement teams to be continuously working for up to 72 hours non-stop without sleep until the dawn of the board meeting. Under such stress, if the same team has to also produce the Auditor Commentary for inclusion in the auditor's report, it will be unfair and risky. If the Auditor Commentary is made a separate reporting requirement that could be issued within a given short period of time after the auditor's report containing the opinion, as it is in case of LFAR, it would significantly ease the pressure on the engagement partner and his team and help prevent the risk of any unintended errors either in audit or reporting that could occur under stressful working conditions.

An auditor should never comment on matters that are not already reported by the management – in other words he must not be required at any time to be the primary provider of any information about the client being put out in the public domain. Should that happen, the auditor will invite grief upon himself: both in terms of conflicts with management and TCWG, loss of business and possibly getting himself embroiled in legal proceedings that may be filed against him by his own client. This is therefore extremely dangerous and completely out of bounds for an auditor to do.

Auditors should restrict themselves to information in the financial statements and be urged to refrain from commenting on information not provided by the management in the financial statements or on information provided by management elsewhere in the document containing the financial statements – as such information is not audited, and must therefore never be referred to in an auditor's report.

- To illustrate – on page 10 of this ITC, in the model auditor's report under "Goodwill" it is stated, "…Due to the current economic conditions as discussed on page X of Management Commentary, there is…" By making such a reference the auditor holds himself out as vouching the validity of the management assertion on current economic conditions in the Management Commentary that he may not have subjected to audit rigour. (My views on auditor's responsibility for other information are given elsewhere in this Comment Letter)

Question 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.)*

Response: A question was raised about the appropriateness of providing Auditor Commentary in the auditor's report (or in a separate assurance report or in an Annexure, as suggested above) only for listed companies or PIEs. To begin with, the term PIE would need to be legally defined – which it is not in many jurisdictions, and therefore defining or using it in an auditing standard for enforcing certain onerous auditor's report criteria would lead to a lot of confusion, subjectivity and inevitable disputes.

I am unaware of the situation elsewhere, but in India (which is one of the fastest growing economies in the world having as many as 6000 listed entities on various stock exchanges), there is there is a strong trend among large corporates of late to de-list from stock exchanges. This is mainly the case with promoter-driven enterprises which are rampant in the Indian corporate world, as it provides them considerable freedom from the regulatory environment. While these giant "private limited" corporations do not have public shareholding, they borrow heavily from lenders who have huge exposures to them. There are other equally important stakeholders too like the tax authorities and the tens of thousands of employees that such "private" companies employ. Such other stakeholders would also be interested in the information contained in Auditor Commentary.

In India all companies: private, public, semi-government and government need to be audited under the Companies Act. Therefore, all companies, including SMEs, should be covered by the new auditor's report rules because making exceptions for small entities would require making judgements about what is to be considered as "small" in which economy. By US standards, many of India's large enterprises may be termed as small, but by Indian standards they are large.

The idea of auditors providing Auditor Commentary voluntarily is completely unworkable in real life practice as the auditor would face stiff resistance from clients if he attempts to report anything other than what is mandatory. Standards should arm an auditor to perform his duty to Society's expectations and not disarm him.

In many western countries the focus of reporting is on the financial statements of the consolidated entity. In countries like India the whole focus is still on the stand-alone entity. Changes to auditor's report requirements made under this Project should therefore apply equally to auditor's reports on separate as well as consolidated financial statement audits.

While the standards are clear enough, there is a risk that Auditor Commentary may in practice sometimes be misused by a few auditors to park matters that should correctly lead to a qualified opinion. In some jurisdictions where regulatory oversight and law enforcement are not very efficient or prompt, this is seen to happen occasionally with emphasis of matter paragraphs being misused by some auditors to stand in for matters where they have reservations and a qualification might be more appropriate.

This is a strong reason for my suggestion to physically delink the main auditor's report from Auditor Commentary by making it a separate assurance report or at least putting it into a separate Annexure to the Auditor's Report, and including matters of emphasis there too, so that they are no longer a part of the auditor's report.

Topic – Going Concern/Other Information

Question 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.)*

Response: Auditor Commentary on going concern certainly has a lot of value, given that many failures have an inherent going concern issue that might not have been properly detected or reported on a timely basis. It has been suggested above that the going concern assertion may be a part of the

Auditor Commentary and could be the first question in the questionnaire in a separate report or an Annexure. However, if it is felt that the going concern assertion should ideally be in the main auditor's report, then that too would be appropriate because I believe that it is of significant importance to all stakeholders. Besides, if management's and TCWG's responsibility paragraphs in the auditor's report include specific responsibility for going concern, there is logic in the auditor too making make his assertion on going concern in the auditor's report itself, rather than in Commentary.

It is observed that managements of companies with a going concern issue are happy to navigate the reporting towards "uncertainty" so that they may give a disclosure in the Notes to Financial Statements and the auditor refers to that Note in his emphasis paragraph. I think that ISA 570 needs to be made more effective by requiring cases of material uncertainty with regard to going concern to be compulsorily made into a qualification. "Uncertainty" can be widely interpreted. In real life practice, auditors are often provided with evidence that could be sketchy, subjective and not easily auditable in order to reach a conclusion that there is some sort of "material uncertainty", when the real fact is that the company is in actually in dire straits.

Question 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.)*

Response: I support this suggestion because I find that in practice this will help portray a better picture about the critical health of the Company to justify regular accounting in stead of NRV accounting. Besides, having to make a categorical assertion will drive auditors to better apply their mind to the question of going concern.

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

Response: This is an important question. While ISA 720 casts responsibility on an auditor to read the other information in documents containing the auditor's statements and, as mentioned in the ITC, the investor community may want the auditors to take a greater responsibility in this regard, succumbing to that pressure, in my opinion, is fraught with immense danger because such other information is not audited and in some cases contains rosy, forward-looking material that the auditor may not have the ability or the inclination to respond to.

There is a cultural issue involved here with which those in European or American countries may not be completely familiar. In jurisdictions such as India, most of this other information is simply not available to the auditor at the time when the financial statements are approved. In such jurisdictions, typically, there may not be a legal/ regulatory requirement or practice to get the other information "approved" by TCWG along with the financial statements, and therefore such information is mostly not available at the relevant time for the consideration of auditors. Because of this, requirements of paragraphs 11-13 and A8-A9 of ISA 720 get triggered in most cases. Complying with ISA 720 in this fashion becomes indeed a difficult matter, needlessly increasing the auditor's risk.

To overcome this problem, I may suggest that a way be found by IAASB to delete ISA 720 from the "auditing" standards and include it (with appropriate enhancements/ modifications) in ISAEs and require the auditor to take this up as a separate assurance engagement either at the request of an entity's management (as may be sought for by their investors) or as may be required by a regulator. A separate report may then be issued by the auditor on his findings which may be inserted as one of the items in the document containing the financial statements. A requirement like this will ensure that managements are forced to provide the other information to the auditor along with the financial statements. Moreover, this will also enable auditors to get paid a fee for rendering this additional, time consuming service.

Such a separate assurance report would be similar to the requirement of a separate report on compliance with Corporate Governance requirements that auditors in India are required to annually provide as per Securities and Exchange Board of India (SEBI) regulations for listed companies. This signed report has to be mandatorily filed with SEBI and published in the Annual Report of listed companies immediately following the Directors' disclosure on corporate governance.

Based on the above, any reference to auditor's responsibilities for "other information" in the auditor's report would be extremely onerous for an auditor and must be avoided at all costs.

<u>Topic – Clarifications and Transparency</u>

Question 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.)*

Response: There are several points to be noted here –

- There should be three separate paragraphs, individually titled in bold font, for management's responsibility, responsibility of TCWG (or more appropriately, Audit Committee or "AC") and auditor's responsibility. They should not come under one omnibus umbrella because that increases the chance of users skipping over these very important assertions in the independent auditor's report. In particular, the ITC has bundled the responsibility paragraphs for management and TCWG/ AC into a single combined paragraph and excluded TCWG/ AC from any responsibility for going concern! This is not appropriate.

- The responsibilities of both these groups are **not** identical. The responsibilities of TCWG/ AC are for corporate governance and for exercising oversight over management in respect of internal controls and the appropriateness of accounting policies, estimates and judgements applied by the management in preparing the financial statements. TCWG/ AC are also responsible for approval of financial statements and other information provided by the company to the auditors. It is only after such approval of the financial statements by TCWG/ AC that an auditor theoretically issues his auditor's report. TCWG/ AC therefore have 'primary responsibility' for financial statements next only to that of management, and such responsibility must be clearly brought out.

- The addition of Management's Responsibility Relating to Going Concern is most welcome. However, in my opinion (supported by what I have said below), while this wording is appropriate for management, a separate paragraph needs to be included for TCWG / AC to assert that they are responsible for having reviewed the management's assessment on going concern and to be in agreement therewith.

- The term "Audit Committee" should be used in stead of or along with the term TCWG. The reason is that in many jurisdictions, the term TCWG is not clearly understood by the general public or users, whereas the term "audit committee" is. Besides, the insertion of such a paragraph in the auditor's report with the term "audit committee" will, hopefully, bring about an awareness to the independent directors and others who sit on ACs that they are indeed being held primarily responsible for overseeing the internal controls, policies, estimates and judgements and encourage them to actively challenge the management in order to get comfort that these are appropriate.

- This may help in some way to achieve the desired purpose of ensuring effective corporate governance. Currently what we see, in jurisdictions such as India, is that the AC is more concerned with reviewing business operations than performing its financial reporting oversight role – they mix up their board responsibilities with AC responsibilities, with the latter inevitably suffering.

- Another suggestion in this regard is that the IAASB recommend to key securities regulators around the world that just as most regulators now require a CEO/ CFO certification, a certification in similar vein may also be required from TCWG/ AC, or maybe the chairperson of the audit committee, that they have performed the tasks they were responsible for. The reason is that the world over when there is a fraud the only professionals who get directly in the firing line are auditors, and not TCWG/ AC. If a requirement is made to make them sign such a declaration which should form part of the published annual report or other document containing the financial statements such as an offering document, there will be a much greater responsibility on them, resulting in making them more vigilant in exercising their financial reporting oversight role.

In the event that this suggestion cannot be practically implemented in the short-run, the ISAs may be revised to require an auditor to obtain a representation letter (along the lines of a management representation letter) from the AC, signed on its behalf by its chairperson, committing to the AC's having performed its designated role.

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

Response: In India it has been a longstanding regulation that the signing partner signs, for and on behalf of the firm, his personal name and not the firm's name, mentions the firm's registration number and his own membership number. The primary liability in the event of disciplinary proceedings is on the signing partner and not the firm. There appears to be neither any impediment nor much value in this suggestion. In India many years ago auditors used to sign in the firm name but a regulatory requirement of the local CA Institute required and started this tradition of signing in personal name, and it has not really made any difference except that senior partners in audit firms like to sign reports of the firm's more prestigious clients.

Question 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.)*

Response: The sole responsibility principle in ISAs is not necessarily the best or the only alternative. I support the US move to divide responsibility for group audits with other auditors and make a reference to this divided responsibility in the auditor's report (Other Matters Paragraph) and not in Auditor Commentary. The PCAOB's proposal to make such a disclosure is welcome.

Each jurisdiction has its own peculiar problems and cultural issues. Whereas in many developed countries smaller firms do not engage in audit practice and the work is concentrated in the top eight or so large audit firms, in India it is the reverse. About 70% of listed company audits and most SME audits are done by small firms and only about 30% are done by the Big 4. This makes it necessary for firms to pool together their resources to undertake larger engagements and therefore joint audits are widely prevalent and, indeed are mandated by law in case of public sector.

The way in which joint audits work in India is that at the planning stage, work is divided between the joint auditors by mutual consent and rotation. Each auditor is responsible for performing the work falling to his share and to formalise his observations. Then at the joint meeting of all the auditors, these observations are discussed and decisions about them taken. Generally there is consensus and a common auditor's report signed by all joint auditors is issued. But in the rare event of a disagreement, each joint auditor has the freedom to issue a separate auditor's report, and all such reports are published with equal emphasis in the annual report of the entity.

A peculiar feature of this practice is that the legal responsibility for work done in a given area is that of the joint auditor who did that work and the responsibility is generally not collective. This is an arrangement with which everyone including the government is happy and no change in it is envisaged.

This may not be the way joint audits are done in other countries where they are done, but each country has to decide this for itself based on its cultural peculiarities and it would not be appropriate for the IAASB to prescribe collective responsibility in such situations as that would be strongly opposed and come in the way of allowing a large country like India to be fully compliant with ISAs.

It is the same for group audits (except where they are done by the larger international accounting firms): resources of several firms are pooled together. Due to difficulty in evaluating the competence of participating firms as also to ensure that they take/ share responsibility for the portion that they have audited, there is a disclosure in the auditor's report of the fact that the signing auditor has relied on work done by other auditors. The signing auditor, evaluates the work done by the participating firms and, where he deems it necessary, has the liberty to perform additional procedures for any subsidiary.

ISA 600's rigid stance on enforcing sole responsibility is the reason why India is unable to adopt ISA 600 as it stands today, and this is one of the only reasons preventing India from becoming fully ISA compliant, although it has adopted almost all other ISAs after the Clarity Project. There may be some weaknesses in following a multi-responsibility route, but then nothing is flawless and standard setters also need to be sensitive to cultural diversity. This system is so deeply entrenched in India over several decades that it will not be possible to win the support of the government or the profession in India to change this easily.

It is recommended that the IAASB make a standard on joint audits, taking inputs from the related Indian standard, and make it flexible enough to suit the different conditions prevailing in all countries where joint audits are permitted. Such a standard should not impose structures that will be unacceptable to member countries, as that would be a recipe for failure rather than success. In the same way ISA 600 also needs to be changed and made flexible to suit the varied practices in different jurisdictions.

Question 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.)*

Response: I strongly disagree. The entire purpose of including the responsibility paragraphs is to educate and warn the users about who is responsible for what. Bundling off the responsibility paragraphs to a remote website or appendix that no user is going to look at has the implied purpose of keeping them out of reach of the users and is as good as not having the responsibility paragraphs. I believe that this could have legal ramifications for auditors as users could claim to be confused about the auditor's role as they have not been warned.

<u>Topic – Form and Structure</u>

Question 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.)*

Response: Placement of opinion before anything else is just like putting the cart before the horse. It does not serve any useful purpose whatsoever. An audit opinion is given based on certain criteria of work performed, responsibility for that work, observations on going concern and other matters, exceptions observed, etc. If it comes at the beginning, there is a strong likelihood that users will not read beyond that paragraph and consequently, the importance of the other paragraphs in the report, which are central for a user's understanding, will inevitably get diminished. This will also make it more likely than not that users will not read the Auditor Commentary. Moreover there is a danger that some users may not even read the basis paragraphs or the other important additions sought to be made like going concern. This will defeat the very purpose of the changes suggested in this ITC.

It should be remembered that organised institutional investors have the technical expertise to read auditor's reports and will read them fully, irrespective of where its paragraphs are placed. An auditor's report should be so prepared as to be "friendly" to lay users who may not possess such expertise. The paragraph placement should therefore help such lay users by navigating them through the logical steps that lead to an auditor's opinion or conclusion, rather than reveal the opinion first and then give the steps leading to that opinion.

My suggestion would be to leave the positioning of the opinion paragraph to where it is but, if it needs to be highlighted, it could be presented in **bold font**.

Question 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.)*

Response: I am not in favour of giving too much leeway to NSSs in the way an auditor's report should be framed. If you leave it to different people to do as they please while prescribing minimum requirements, I can see it becoming a world-wide muddle. The standard auditor's report as prescribed by IAASB and adopted by NSSs has stood everyone in good stead for generations and there is no benefit in changing this principle now. The whole purpose of global standards is to standardise the way accounting and auditing are done all over the world in order to provide comfort and security to the stakeholders. Why is the suggestion to stray from that path called an "improvement"? To my mind, giving member countries leeway to prepare auditor's reports runs contrary to the overall purpose of IFAC.

Question 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.)*

Response: I am not enthusiastic about putting the opinion first as stated above. I believe the information flow in the existing SA 700 report is just fine, in fact excellent, and does not need to be tinkered with. The basis for opinion or modified opinion should also logically precede the opinion paragraph and not follow it. As for the Auditor Commentary, I have expressed my preference for putting it elsewhere for the stated reasons.

Question 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.)*

Response: I do not believe SMEs or public sector entities deserve any different treatment as far as reporting is concerned. Otherwise there will be undesirable inconsistencies in reporting even within the same jurisdiction.

CONCLUSION:

While I strongly support most of the suggestions made in the ITC, there are those with which I disagree because I do not see them fulfilling the aim of reducing the expectation gap between providers and users of auditor's reports or because, based on my experience in the profession, I anticipate that they might be impractical, counter-productive, culturally unacceptable or professionally hazardous.

I have also made some suggestions, such as with regard to alternatives for Auditor Commentary which I believe overcome many of the impediments of having Auditor Commentary in the manner suggested in this ITC. I am also a strong advocate of including a detailed responsibility paragraph for TCWG. I believe these suggestions need to be seriously considered as they will reduce the possible impediments.

Many consequential and major changes will need to be made simultaneously in the accounting standards (IFRSs) which are binding on companies, as well as in auditing standards (ISAs, ISAEs) that are binding on the auditors. Deep thought needs to be given before such changes are finalised.

I would like to reiterate that the objective of this exercise should not be a response only to the most influential group of stakeholders (institutional investors) but to the whole body of stakeholders, and that the hands of the auditing profession should be strengthened and not compromised.

Also, the roles and responsibilities of company managements, TCWG and auditors should be respected and auditors should not over-enthusiastically intrude into areas belonging to the others, because by doing so they will only hurt themselves. It would also be perilous for auditors to make 'subjective' assertions or insinuations in their report, as they would then invite legal battles upon themselves. The IAASB should carefully weigh and consider these matters.

I thank you once again for the opportunity and should you have any questions based on my comments above, you may reach me at the address or phone number given at the head of this letter.

Yours truly,

Khurshed Pastakia