

Mr James Gunn
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5 October 2012

Re: IAASB Invitation to Comment (ITC): Improving the Auditor's Report

Dear James

PKF International Limited administers the PKF network of legally independent member firms. There are around 300 member firms and correspondents in 440 locations in around 125 countries providing accounting and business advisory services. PKF International member firms have \$2.6 billion aggregate fee income (year end June 2011) and the network is a member of the Forum of Firms – an organisation dedicated to consistent and high quality standards of financial reporting and auditing practices worldwide. This letter represents the observations of PKF International Limited, but not necessarily the views of any specific Member Firm or individual.

We welcome this opportunity for dialogue and we are supportive of exploring changes to the auditor's reporting model. We further encourage the IAASB to consider and promote the need for additional auditor services, beyond the financial statement and internal control over financial reporting audits, where such services may increase investor confidence in the capital markets, as a means to address some of the apparent concerns raised by users of financial statements and the auditor's report thereon.

There are several matters which we would like to draw your attention to before we respond to the questions posed in the IAASB Invitation to Comment.

- a. First and foremost it is the auditor's role to provide assurance on information provided by management and governance bodies. If this was to change, wholesale changes would be required to the "system" which currently comprises reporting by entities in accordance with set standards and requirements and assurance on that reporting. Focusing on the assurance aspect only, and auditor reporting specifically, is starting in the wrong place, and potentially creates unintended consequences. Reporting by entities needs to be improved – assurance over that reporting is only one way of achieving compliance and protecting the public interest. In particular, corporate governance standards need to be enhanced and become more consistent across jurisdictions. As auditing standard setters generally do not have jurisdiction over entities themselves, more focus should be placed on promoting regulatory consistency around the world. The type of change necessary to appropriately respond to the information needs of users and narrow the expectations and information gap needs to go further and can not be achieved by changes to the auditor's report alone. We consider that the role of Those Charged with Governance (TCWG) is paramount to further meaningful change and therefore it is important that efforts to improve auditor reporting are synchronized with improvements to corporate governance and financial reporting more broadly.

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PKF International Limited is a company limited by guarantee incorporated in England registered number 3816253 and has its registered office at Farringdon Place, 20 Farringdon Road, London EC1M 3AP.

PKF International Limited administers a network of legally independent member firms which carry on separate businesses under the PKF Name. PKF International Limited is not responsible for the acts or omissions of individual member firms of the network.

- b. Changes to auditor reporting (and the potential consequences of changing the role of the auditor, even if just by implication) should not be explored without acknowledging the impacts on auditor liability. While increased risk should not inhibit the exploration of means to improve auditor reporting, it should serve to inform the types of changes that realistically can be expected within the current financial reporting supply chain.
- c. Auditors should not be responsible for the provision of original information because this could blur the different roles of management and the auditor in the eyes of investors. Whilst paragraph 9 of the ITC states that “there is a need to preserve the separate responsibilities of management and TCWG, as providers of original information, and the auditor, respectively”, we do not believe this is evident in some of the proposals made later in the same paper.
- d. Assurance over additional information provided by the entity should be more fully explored before simply concluding that auditors should provide more information.
- e. Currently, auditors’ reports on general purpose financial statements are addressed to the members who are therefore regarded as the primary users of the financial statements. The introduction to the ITC implies a much wider set of users; for example including lenders and other creditors. The remainder of the document then uses the term “users” and we presume this is the wider group of users. While financial reporting principles generally and some auditing standards (e.g. materiality) typically acknowledge a broader range of users, the focus in the proposals in the ITC may at times be too heavily weighted to specific groups of users. This is a significant step which suggests a much wider group of interests to be considered.

Overall Considerations

1. Overall, do you believe the IAASB’s suggested improvements sufficiently enhance the relevance and informational value of the auditor’s report, in view of possible impediments (including costs)? Why or why not?

We are supportive of exploring changes to the auditor’s reporting model, particularly with a view to narrowing the expectation gap, but as noted in our introductory comments we consider that changes to the auditor’s report and implied changes to the auditor’s role must not be seen in isolation. Any improvements must be synchronized with improvements to corporate governance and financial reporting more broadly, while acknowledging the increased risks of litigation in providing information which may well be very subjective.

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.

There must be a coordinated approach that encompasses all relevant parties such as regulatory bodies, standard setters, management, TCWG and securities exchanges. Securities exchanges typically govern additional reporting and governance requirements not covered by financial reporting standards. More should be done to enhance requirements set by the very exchanges on which investors rely to provide access to trading. Expanding the auditor’s responsibilities may be the only route available to the IAASB, but should not be explored in isolation simply because the profession is well governed and easier to control (i.e. an “easy target”).

In addition, the IAASB should consider alternative solutions in areas directly within its control. Specifically, consider whether current IAASB projects or enhancements to existing standards (other than just auditor reporting) could address some of the concerns of users, and encourage (through outreach and education) the use of tools already available to auditors and users. Examples include:

- i. The recently approved IAASB project on disclosures may result in more guidance to auditors on materiality, reducing the tolerance for boilerplate or inadequate disclosures. This could encourage management and TCWG to provide more meaningful disclosures, while guiding auditors to more readily modify their opinions and make more widespread use of emphasis of matter paragraphs.

- ii. Proposed revisions to ISA 720 on other information will amend the auditor's responsibilities. Explaining these responsibilities in the auditor's report will provide users with improved information and help narrow some of the expectation gap in this regard.
- iii. As stated in the introduction, assurance over additional information provided by the entity should be more fully explored before simply concluding that auditors should provide more information.
- iv. Minor amendments to ISA 570 and/or better disclosure of the auditor's responsibilities under the standard, could provide users with some of the information they need regarding going concern. Also see our more detailed comments under question 8 below.

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)

Auditor Commentary is not an appropriate response as it could lead to auditors providing original information and potential duplication of information. Use of emphasis of matter paragraphs may be more appropriate. These should be objective, factual discussions with specific references to where the information appears in the financial statements. What is needed is more guidance to auditors as to when to conclude that management disclosures are not adequate (e.g. lower tolerance levels or "materiality" for misleading disclosures). Given the judgement and principles frameworks under which entities typically report this is extremely difficult. Also see our comments under 2 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.)

See above – we do not consider Auditor Commentary to be appropriate. However, the principles in this question do apply to our view that emphasis of matter paragraphs should be used. These should be left to the judgment of the auditor, with expanded guidance in the standards to inform that judgment.

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.)

See above – we do not consider Auditor Commentary to be appropriate. Regarding description of audit procedures and related results, the level of detail required to adequately describe the work would be considerable and therefore would add to disclosure overload without providing significant value. Including results of procedures increases the risk of creating confusion regarding the auditor's conclusion on fair presentation (i.e. "the financial statements fairly present, but...")

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.)

Auditor Commentary would lead to increased costs and longer lead times. It will blur the responsibilities between auditors, management and TCWG and is likely to lead to a significant amount of "boilerplate" type reporting which does not meet anyone's needs.

7. Do you agree that providing Auditor Commentary for certain audits (e.g., audits of public interest entities (PIEs)), and leaving its inclusion to the discretion of the auditor for other audits is

appropriate? Why or why not? If not, what other criteria might be used for determining the audits for which Auditor Commentary should be provided? (See paragraphs 51–56.)

We are opposed to Auditor Commentary, but if it were to be required we do not consider it appropriate to have different requirements for different entities. Reporting requirements should be the same for all entities, with additional guidance on scalability. Also see our comments under question 18.

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.)

A more holistic approach is needed to address the information needs of users about going concern. Specifically, the financial reporting framework should ideally specify requirements in this area. There is a risk that such an audit requirement, without consideration of the specific financial reporting framework, will lead to original information being supplied by the auditor.

Certain frameworks may contain implicit rather than explicit requirements about preparers' responsibilities (e.g. under US GAAP there is no explicit requirement for management to perform an assessment of going concern, although this may be implied through the use of the going concern concept). In addition, the criteria for assessing going concern under different reporting frameworks are different. This should be explained in the financial statements if the information is considered to be of such importance to users. The auditor's report should not be used as a tool to compromise for inadequate financial reporting standards. Further, many frameworks require disclosure of material uncertainties and estimates and the fact if an entity is not a going concern, and auditor reporting is already required where the use of going concern is inappropriate. An auditor statement regarding the appropriateness of management's use of the going concern assumption therefore adds absolutely no information of value.

An alternative may be to:

- i. Explain in the auditor's report the requirements under the applicable reporting framework (e.g. implicit or explicit requirement for management to make an assessment of going concern).
 - ii. Describe in the auditor's report the auditor's responsibilities more clearly. ISA 570 provides very useful guidance to auditors addressing going concern under different reporting frameworks, including the auditor's responsibility to obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption irrespective of the financial reporting framework requirements. Failure to obtain the required evidence (e.g. this may be the case if management refuses to make or extend an assessment when requested by the auditor) will impact on the audit report. Explaining this to users may go a long way in providing some of the "comfort" which seems to be required.
 - iii. In situations where management's unwillingness to make the requested assessment does not impact on the auditor's opinion, emphasise in the auditor's report that management was unwilling to make or extend its assessment, even though the auditor concluded that it did not impact in the opinion. This results in factual information being stated, rather than subjective auditor views.
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.)

Management should make the necessary disclosures and auditors should then audit this information. As stated before, the auditor's report should not be used as a tool to compromise for inadequate financial reporting standards. In addition, discussion of subjective auditor judgments could result in unintended consequences (e.g. disagreement with management or the provision of original information) and introduces unacceptable risks of litigation. Also see 8 above.

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

We are supportive of auditors being more specific about the work they have done in this area. Providing users with better information will help improve their understanding and manage their expectations.

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.)

We are supportive of the enhanced description of relevant responsibilities in order to clarify how responsibilities are allocated and to narrow the expectation gap.

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

Whilst we are aware that some jurisdictions already have such requirements in place, we do not see any value in disclosing the name of the engagement partner. An audit is a team rather than an individual product so identification of a single name seems inappropriate. Indicating a single partner's name may also lead to the perception that different partners represent a different quality offering.

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.)

We are opposed to reporting on the involvement of other auditors. Under ISA 600 it has been clarified that the group auditor takes sole responsibility for the group audit opinion. Referring to other auditors could be misleading and potentially dilutes the value created by an enhanced ISA 600. It may also be seen as a weakness within a particular audit. In particular there may be the perception that the responsibility of the group auditor is diminished.

The IAASB should further consider where the request for this information originated from. As explained in the preceding paragraph, we believe it would have limited value for the users of the financial statements. If audit or securities regulators are requesting this information, we do not believe that the auditor's report is an appropriate vehicle for its disclosure.

14. What are your views on explicitly allowing the standardized material describing the auditor's responsibilities to be relocated to a website of the appropriate authority, or to an appendix to the auditor's report? (See paragraphs 83–84.)

We consider this description of the auditor's responsibilities so crucial that it should always remain within the audit report. Generic information regarding what an audit is and information on the audit process could be contained elsewhere, such as a website location.

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.)

Views from our Member Firms on this topic were split.

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.)

Global consistency in auditors' reports is very important, but it is also important to allow for some flexibility and additional information (rather than jurisdictional changes to the core report content). The proposed approach in this ITC seems appropriate.

17. What are your views as to whether the IAASB should mandate the ordering of items in a manner similar to that shown in the illustrative report, unless law or regulation require otherwise? Would this provide sufficient flexibility to accommodate national reporting requirements or practices? (See paragraph 17 and Appendix 4.)

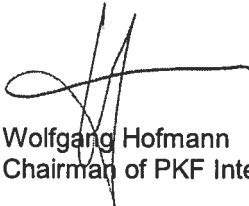
We consider that the IAASB should mandate the ordering of items and we are not aware of specific jurisdictions where there would be significant issues with this approach.

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.)

We consider that the reporting for all entities should be the same (with no additional requirements for PIEs). It is the process itself which should be scalable to entities of all sizes. We note that as one of the guiding principles the ITC stated "A revised auditor reporting standard must be capable of being applied on a proportionate basis to all entities." Whilst we agree with this principle, we consider the IAASB must provide guidance on how this should be done.

PKF International Limited appreciate the opportunity to comment on the ITC and we welcome the dialogue on the auditor's report. If you have any questions please do not hesitate to contact me.

Sincerely



Wolfgang Hofmann
Chairman of PKF International Limited