



15 October 2012

The Chairman
International Auditing and Assurance Standards Board
529 5th Avenue, 6th Floor
New York, New York 10017

Submission via IAASB website

Dear Professor Schilder

Invitation to Comment *Improving the Auditor's Report*

The Institute of Chartered Accountants Australia is pleased to respond to the Invitation to Comment (ITC) *Improving the Auditor's Report*.

The Institute is the professional body for Chartered Accountants in Australia and members operating throughout the world.

Representing more than 70,000 professionals and business leaders, the Institute has a pivotal role in upholding financial integrity in society. Members strive to uphold the profession's commitment to ethics and quality in everything they do, alongside an unwavering dedication to act in the public interest.

Chartered Accountants hold diverse positions across the business community, as well as in professional services, government, not-for-profit, education and academia. The leadership and business acumen of members underpins the Institute's deep knowledge base in a broad range of policy areas impacting the Australian economy and domestic and international capital markets.

The Institute of Chartered Accountants in Australia was established by Royal Charter in 1928 and today represents more than 58,000 members and around 12,500 talented graduates working and undertaking the Chartered Accountants Program.

The Institute is a founding member of the Global Accounting Alliance (GAA), which is an international coalition of accounting bodies and an 800,000-strong network of professionals and leaders worldwide. charteredaccountants.com.au

We recognise the need for the auditor's report to continue to evolve to better meet the needs of users and support the principles behind the amendments proposed in the ITC. Our response to the specific questions raised is included in the attached Appendix.

If you require further information on any of our views, please contact Andrew Stringer, Head of Audit via email at andrew.stringer@charteredaccountants.com.au

Yours sincerely

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APPENDIX

Introductory comments

In formulating our response to the ITC we have consulted widely with our members and other stakeholders and have considered the question of what issues the proposed changes to auditor reporting are attempting to address. Is it a response to corporate failures? Are users overwhelmed by financial report complexity? Is there a lack of understanding of the auditor's function? The core problem being attended to is not entirely clear.

The draft audit report included in the ITC deals with financial information. It does not appear to contemplate matters such as compliance, appropriateness of business activities and the like. Could it be that this is the information analysts are seeking?

We strongly support enhanced auditor reporting which needs to be clear, succinct and without clutter. We note that over the years the standard form of audit report has evolved significantly and uses a stylised form of words that is meaningful to auditors, but not to users of financial information. If what is important to users is not being readily understood by these users one must question if the audit report remains 'fit for purpose'. Consequently in our view there is a real need for a concerted effort to use plain language to provide a clear and succinct audit report. If necessary, the auditing standards should be updated.

We see interactions between audit committees and auditors as key to enhancing the quality of financial reporting. Analysts and other stakeholders are aware of these interactions and may well be seeking disclosures in the public arena of the information typically discussed at these meetings. There is a great deal of merit in the model being adopted in the United Kingdom, whereby the Audit Committee is required to make a report as part of the annual financial report.

Auditors play a fundamental role in preserving financial integrity and driving strong and reliable corporate reporting, underpinning capital markets. However, regardless of the amount of regulation and oversight in place, there will always be corporate failures. In market economies users have to accept that there is a degree of risk in investing which will, at times, result in financial losses. We believe the best protection for users, beyond appropriate levels of regulation and independent assurance, is for users to be educated in financial matters; for financial reports to present clear, simple and accurate information that is useful to the users in making their economic decisions; and for users to understand that while auditors via the conduct of the audit offer a level of assurance to users, the risk of corporate failure remains. While auditors are vital to the functioning of capital markets they cannot, and should not, be expected to underwrite corporate failure.

The proposals appear to be attempting to address both the "information gap" issue (ie that users do not feel that current financial reports are meeting their informational needs) and the expectation gap issue (ie that users do not understand what an auditor does and what an audit opinion means). We believe that the audit report should attempt to address the expectation gap. But decreasing the information gap is better served by improving the nature and understandability of financial report disclosures, which must be addressed by accounting standard setters, not by auditors. A fundamental principle to be particularly mindful of is that the auditor should not be the originator of information to be disclosed in the financial statements or audit report.

This information gap rests with the financial reporting framework and should be addressed at this level after appropriate consultation with stakeholders such as the International Accounting Standards Board (IASB), the UK Financial Reporting Council and others.

If changes to the auditor's report proceed as envisaged in the ITC, the current standard dealing with emphasis of matter paragraphs could be seen to be reduced in importance. Auditors already have modifications, emphasis of matter and other matter paragraphs to highlight issues that are key to a user's understanding of the financial report. These have strong signalling value. Adding commentary to all reports potentially dilutes the impact of those issues that really require highlighting.

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?

Overall we support improving the auditor's report to increase its relevance and informational value to users. However, we have concerns that there are impediments of some of the proposed changes.

We believe that the inclusion of Auditor Commentary, beyond highlighting of significant notes, risks blurring the distinction of the roles of management and those charged with governance (TCWG) and the auditor, and also extends the traditional scope of the auditor to areas that should be the responsibility of management and TCWG.

In our view it also has the potential to make it more difficult to distil information from the financial statements and is counter to present moves to reduce clutter. Our preference is for the financial statements to include all the information readers need. In such circumstances auditor commentary would only be in areas of deficiency in the financial statements. This in our view enhances the signalling which is a key part of audit reporting.

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 co-ordination with others? Please explain your answer.

As stated above, addressing the issue of users not being able to understand the financial report or feeling that the financial report does not address all their informational needs and therefore desiring more information or explanations from auditors requires changes to the content of financial reports. This information gap rests with the financial reporting framework and should be addressed at this level after appropriate consultation with stakeholders such as preparers, users, audit practitioners and accounting standard setters.

If users desire more detailed commentary on the entity's risks and business model we believe that it is management and TCWG who should make such commentary either in the financial report or in other reports to their stakeholders. Currently Public Interest Entities (PIEs) tend to make extensive disclosures around their risks and business models in their initial offering documents but in most jurisdictions are not required to continue to update this information on the public record. A model such as that recently adopted in the United Kingdom whereby the Audit Committee makes a report as part of the financial report has much to commend it. The auditor could comment by exception or, alternatively, provide assurance on the Audit Committee commentary.

Another aspect which needs to be considered is interim reporting. As interim financial reports and assurance on those reports are mandatory for PIEs in many jurisdictions, we do not believe that it is appropriate for the reporting format for annual audits and interim reviews to be inconsistent in form and content. If the auditor's report is restructured and new mandatory content added, the equivalent changes will need to be made to the ISRE 2410 reports.

It may be useful for the Board to conduct further research into the envisaged changes by:

- a) holding discussions with bodies such as the International Accounting Standards Board (IASB) and UK Financial Reporting Council on the best way to tackle the information gap in the financial statements. We acknowledge that the proposed draft is responsive to the requests of investors or their agents for more information. We are also aware that the IASB has had similar requests. We believe a process of considering and responding to these investor requests collectively is the best way to facilitate useful and readable financial statements and audit report with the minimum of clutter
- b) 'road testing' the approach with the assistance of stakeholders in various jurisdictions. This could provide valuable feedback.

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?

We understand the need for more information but question whether this is an appropriate response. Users of financial reports must accept that there is a risk involved in investing that cannot be fully mitigated by the performance of an audit and that they need to inform themselves and understand the entity they are investing in. Auditors play a significant role in the functioning of capital markets but cannot, and should not, be expected to underwrite corporate failure.

If users are unable to understand the entities they invest in due to the complexity of the financial reports presented to them or, if those financial reports do not present appropriate information to understand the true nature of the risks and business model of the entity, additional disclosures need to be made, or existing disclosures improved. Additions and improvements to disclosures need to be made by management and TCWG. Auditors can then provide assurance over those disclosures.

The traditional role of the auditor is to provide assurance over the disclosures made by management and TCWG and to 'shine a light' on areas of concern. We believe that this is the most appropriate model to preserve the independence of the audit function and that any changes to the audit report should not move the scope of the audit beyond this role. Therefore, if commentary is to be included, it should be only to draw attention to particular disclosures made by management as areas of significant judgement or sensitivity that the user should be aware of, not to provide additional commentary. Alternatively, as per our response to question 2, alternative mechanisms for making disclosures desired by users should be explored so that auditors can provide assurance rather than commentary.

Other types of commentary could be subjective and open to misinterpretation. If audit practitioners take a risk averse approach to commentary the statements may well add little value to users.

We have concerns that a longer form auditor's report will risk diluting the impact of Emphasis of Matter and Other Matter Paragraphs.

4. Do you agree that the matters to be addressed in Auditor Commentary should be left to the judgement of the auditor, with guidance in the standards to inform the auditor's judgement? 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.

Some guidance for auditors deciding what matters to include in commentary would assist in the interests of consistency. This may require new auditing standards. The level of detail required in a framework would depend on the nature of Auditor Commentary to be provided. For example, if the Auditor Commentary is to be purely a "roadmap" whereby the auditor highlights particular disclosures in the financial report, less guidance would be required than where the Auditor Commentary moved beyond this role.

If Auditor Commentary is to be included, we also believe that the report wording should provide some explanation to users as to how items were selected for inclusion.

Further, in our view consideration should be given to placing standard wording such as that regarding the respective duties of management, TCWG and the auditor on the web site of the company, the audit firm or perhaps the national standard setter.

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?

We support commentary which draws attention to particular notes and we believe that the place for the disclosures about those items should be in the notes themselves. As mentioned before if users require more information and disclosures, this information should be provided by management and TCWG. Attempting to condense complex matters could result in descriptions that do not provide useful information to the users.

We believe there is merit in the auditor providing more information about the overall approach to the audit and procedures adopted, in the interests of transparency. The danger is that auditors could revert to using boilerplate language to describe procedures performed, reducing any value to users. The descriptions would need to be made in plain language.

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?

We believe that the inclusion of auditor commentary risks blurring the line between the responsibilities of management/TCWG and the auditor. It is the responsibility of management and TCWG to provide the user with the information they need to understand the financial report. It is the auditor's responsibility to provide assurance on the information presented by management.

In our view this is the proper independent purpose of audit. The obligation for the auditor to report exceptions in a framework of financial reporting that requires more qualitative disclosures would be the best way to ensure fulsome reporting.

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?

While we do not support the inclusion of auditor commentary, if it is included we believe that it is appropriate to limit the mandatory inclusion of commentary to PIEs and provide auditor discretion for other entities.

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?

We believe there is value to the users in making what was previously implicit into an explicit statement. There would need to be guidance on what needs to be done where there are material uncertainties i.e. would there be a move away from the current emphasis of matter approach to include statements on material uncertainties in the Auditor Commentary? We believe that the treatment of going concern issues that currently result in modifications to the auditor's opinion should not change.

In our consultations, concerns were expressed that including a positive statement on going concern in every auditor's report may pose a risk that users will become used to going concern being boilerplate in the auditor's report and thus will no longer read the statements and potentially fail to notice when there is an issue with going concern.

9. What are your views on the value and impediments of the suggested auditor statement that no material uncertainties have been identified?

We believe there are the same benefits and risks in relation to explicit statements on material uncertainties as expressed above for question 8 in relation to going concern.

10. What are your views on the value and impediments of the suggested auditor statement in relation to other information?

As per our comments in relation to question 8, we believe there is informational value to the users in making what was previously an implicit statement into an explicit statement. We do not believe this information will affect users' decision making greatly as the auditor already has specific responsibilities under ISA 720 to read other information and take specific action if there are material inconsistencies with the financial report. Therefore inconsistencies will either be adjusted or the auditor's report would be modified to highlight the inconsistency.

If such a statement is to be included, there would need to be a definition of other information made in the statement so that the user understood the scope of the statement. A statement should also be made in relation to management's responsibility for the other information.

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?

We believe that management's responsibilities should be set out before the auditor's responsibilities. There should be no separation between the description of general responsibilities and any responsibilities that may be included in relation to going concern. We believe there could be further explanation of management's responsibilities.

Any description of auditor's responsibilities is likely to become boilerplate language used by all firms so it is important that the language used is succinct and clear and accurately reflects what an auditor is responsible for and does during the audit. As mentioned above this material could conveniently be located on an appropriate web site.

12. What are your views on the value and impediments of disclosing the name of the engagement partner?

The disclosure of the engagement partner's name has been required in Australia for audits of companies performed under the requirements of the Corporations Act 2001 and a number of other regulators. The Australian experience is that this has not caused any impediments for auditors.

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 disclosure should be included in all relevant circumstances, or left to the auditor's judgement as part of Auditor Commentary?

We do not support the disclosure of the involvement of other auditors. Under ISA 600, the group auditor is responsible for the audit and therefore naming other auditors may be confusing to the user. Further disclosures about the involvement of other auditors such as total fees or hours are also potentially confusing to the user. For example a company may have a subsidiary in a less developed country which may require a fully substantive audit and may therefore have a very high number of audit hours or large audit fee compared to other subsidiaries and which could create a flawed perception of where audit effort was expended.

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?

We believe that it is important that users understand the respective responsibilities of managements and TCWG and the auditor. We understand that if the auditor's responsibilities are removed from the auditor's report and relocated, there is a risk that users will not read them.

We have no objections to the responsibilities being relocated but suggest that they could either be included as an appendix to the auditor's report or published on the entity's website in the same location as the auditor's report. If necessary, the auditor's responsibilities could also be located on national standards setters' and auditors' websites but they should be available with the auditor's report in the first instance.

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 the users?

Overall we support the placement of the auditor's opinion at the beginning of the report, though in our consultations with members, a number expressed support for maintaining the current format on the basis that it builds information for the users so that when they read the opinion, they are more informed.

We believe that the responsibilities of management and TCWG should be the second item in the report, after the auditor's opinion and any basis for the opinion as it is key for users to understand that management and TCWG are responsible for the financial report. The auditor's responsibility section should follow management's responsibilities.

The narrative around the relative responsibilities could be reduced. An example of the form of words could be *"It is management's responsibility to prepare the financial statements in accordance with the reporting framework. It is our responsibility to audit what management has prepared and report matters that are in our view deficient."* [link to web site]

While we question the inclusion of auditor's commentary, if it is to be included we believe it is vital that it be clearly segregated as commentary and that items such as emphasis of matter and other matter paragraphs are placed such that they cannot be confused with commentary and so can have sufficient prominence in the report.

16. What are your views regarding the need for global consistency in auditor's report when ISAs, or national auditing standards that incorporate or are other based on ISAs, are used.

While we are supportive of global consistency for ISA based auditing standards, there needs to be a mechanism for national standards setters to add additional requirements where local laws or regulation require.

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?

We support mandatory ordering to support consistency.

18. In your view, are the IAASB's suggested improvements appropriate for entities of all sizes and in both 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?

We support the suggested improvements for large private sector entities. We do not think there is added value for public sector entities as Auditors General already have mechanisms to make commentary style reports in addition to their assurance reports.

In relation to SMEs, as there is generally a lesser degree of separation between the owners and management/TCWG of the entities, we do not feel that including auditor commentary is necessary for these entities and may impose an unreasonable burden to SMEs.