

Comments on the IAASB ITC on Improving the Auditor's Report

I. "Going Concern" Section in the Auditor's Report

I.1 The trigger point for apprehensions over the going concern status of an entity from the perspective of users of financial statements (Users) *vis a vis* auditors will vary considerably. The Users' trigger point/ threshold is likely to be far lower than that of the auditor. This is primarily because the auditor's assessment of appropriateness of going concern would be centered around the financial statements and within the parameters of ISA 570, *Going Concern*. This may not strictly meet the needs of the Users who, it is felt, are looking for more comfort in the form of pass/fail model on Going Concern. Besides, Users cannot reasonably be expected to distinguish between "*material uncertainty*" and "*significant doubt*", terms that are used in ISA 570.

I.2 In cases where the auditor includes an observation to the effect that a material uncertainty exists, the Users might not also be able to appreciate how the auditor has expressed an unmodified opinion on the financial statements. It is, therefore, felt that the proposed "Going Concern" section, as it is proposed in ITC will only lead to more confusion among the Users.

I.3 Subsequent events have a very important role to play *vis a vis* going concern. Invariably, in situations of subsequent discovery of the problems in going concern assumption, the Users tend to judge the auditors in "the hindsight". This kind of explicit reporting on going concern is bound to create more expectation gap as also more litigation for auditors.

I.4 Going concern is a very sensitive issue, particularly, with the listed entities whose securities prices and market credibility can be greatly and immediately impacted by any explicit observation of the auditor in respect of going concern in the audit report, even if the audit opinion is unmodified.

I.5 It needs to be seen whether the ISA 570 itself needs revision to empower the auditor further on the issue of going concern.

II. "Auditor's Commentary" Section in the Auditor's Report

Our comments on this section are also primarily in the same nature as on the Going Concern section. However, some specific comments are as follows.

II.1 *Prima facie*, this seems to be a very subjective area of judgment for auditors and is likely to give rise to deadlocks with managements.

II.2 Contents and effectiveness of this section would be marred by the issues of client confidentiality.

II.3 Including in the auditor’s report those significant audit issues which were required to be discussed with the Engagement Quality Control Reviewer or Those Charged With Governance, if the same have been resolved to the auditor’s satisfaction, would give rise to more confusion among the various Users. It will further promote auditors being judged in hindsight by the users and will bring into question the appropriateness of the audit opinion itself.

II.3 In practice, it is more likely to widen the expectation gap.

III. Auditor’s Statement on Other Information

III.1 While it is important that the “other information” is consistent vis a vis the audited financial statements and vice versa, it is important to consider the Users’ perception of the explicit statement on absence of any material inconsistency in other information vis a vis the financial statements. It is felt that it may not per se be appropriate to include a statement based on procedures that are not audit procedures in a document which is generally identified as being a result of an audit (in this case the Audit Report). It is therefore suggested that since the auditor only “reads” and does not “audit” the other information, it may be better that it takes form of an exception reporting by the auditor.

IV. Information relating to Involvement of Other Auditors

In this context, we enclose our observations on the implementation difficulties relating to ISA 600.

V. Auditor’ Responsibility

V.1 In so far as the proposal to include a description of risk-based audit is concerned, it is felt that the proposal:

- Adds tremendously to the length of the Auditor’s Report.
- Uses too much technical jargon relating to audit in the Auditor’s Report. For example, a lay User would, normally, not have an understanding of the core audit concepts such as “reasonable assurance”, “professional skepticism”, “sufficient appropriate audit evidence”.

V.2 A lay investor/ User would probably be more interested in knowing the materiality threshold ie the amounts below which the auditor has per se not subjected a class of transaction or an account balance or a disclosure to audit.

VI. Ordering of the Elements of the Auditor’s Report

A comparison of the ordering of the elements of the auditor’s report, existing vis a vis proposed in ITC, is as follows:

Sl.	Existing ISA 700	Proposed in ITC
01.	Title	Title
02.	Addressee	Opinion
03.	Introductory paragraph	Basis for Opinion
04.	Management's responsibility for financial statements	Going Concern
05.	Auditor's responsibility	Auditor Commentary
06.	Opinion	Other Information
07.	Report on other legal and regulatory requirements	Respective Responsibilities of Management, Those Charged with Governance and the Auditor
08.	Auditor's signatures	Report on Other Legal and Regulatory Requirements
09.		Auditor's signatures

The text in yellow highlight indicates a new element suggested by ITC.

V.1 In the above context, it is felt that while “opinion” was the most important element of the audit report, the sections relating to introductory paragraph (identifying the financial statements), followed by management’s and auditor’s responsibilities were also important, particularly, in providing the logical context to the auditor’s opinion.

The importance of these three sections is all the more enhanced and they have in fact become critical on account of the fact that as per the ITC, the Auditor’s Report would not only include the auditor’s opinion but also auditor’s statements on other sensitive/ critical matters like Going Concern, matters to be included in auditor’s commentary, which is as important as “auditor’s opinion” and most likely to be misinterpreted vis a vis auditor’s responsibilities. Accordingly, the auditor’s *vis a vis* management’s responsibilities should be clarified upfront in the auditor’s report as is being done in existing ISA 700.

V.2 The proposal of the basis of opinion (to be given even in the clean audit opinions) is acceptable. However, the placement of the “opinion” and the “basis of opinion” should be same as in the existing ISA 700.

Overall.....

BENEFITS	DRAWBACKS/ GENERAL OBSERVATIONS
<ol style="list-style-type: none"> 1. Will enhance more responsible preparation of financial statements, particularly. 2. Will demystify the management's Black Box of accounting estimates from the Users' perspective. 3. Will act as a deterrent on "creative accounting" by preparers of financial statements. 4. Will promote value of audit in the eyes of preparers of financial statements. <ol style="list-style-type: none"> a. Audit will no longer be construed as being a mere statutory formality to be dispensed with. 5. Will give more voice and power to the auditors. 	<ol style="list-style-type: none"> 1. May lead to significant change in the nature, timing and extent of audit procedures, even if the scope of audit <i>per se</i> doesn't undergo a change. 2. Is likely to enhance the litigation against the auditors. 3. Increases the length of the auditor's report. <ul style="list-style-type: none"> o Information overload in the auditor's report. o Lost focus. 4. With the proposals given in ITC, It is all the more necessary that the auditor's report now includes some words on the inherent limitations of an audit. 5. Is such reporting within the boundaries of the auditors' duties as defined under the company law? 6. With such a kind of audit report, we may be trying to address information needs of far too many stakeholders. It should be seen whether then the financial statements would really be able to retain the character of being "general purpose financial statements". 7. Who actually are the biggest target Users of the audited financial statements and the Audit Report? The Users of the audited financial statements and the Auditor's Report would include the common man. In the process of making the Auditor's Report more informative, it should not be forgotten that the common man does not understand much of the technical jargon that the ITC is proposing to include in the Auditor's Report, particularly, the Auditor's Responsibility paragraph. 8. Auditor cannot do the job of reading and interpreting the financial statements properly and in totality for the Users through his audit report. 9. The fundamental problem is that the Users are not

aware about the scope of an audit and the basic duties and responsibilities of the auditor. So long as this gap remains, no amount of extra information in the auditor's report would solve the matter. On the contrary, it may even backfire on the audit Profession.

10. The problems that the Users are facing on account of growing complexity in the financial statements cannot be resolved through auditor's report. This issue needs to be looked into by the International Accounting Standards Board as also the various regulators which prescribe the information requirements for the financial statements and annual reports.
11. Extra information can be provided by the auditors in separate long form audit reports as is being done in India under the Companies Act, 1956 by way of a separate Companies (Auditor's Report) Order 2003 and by the banking regulator for public sector banks.
12. The audit Profession should not be expected to step into the shoes of the Regulators. Audit is anyways a *post facto* event, whereas the Regulators have greater power to seek financial/ non financial information and take timely corrective action.
13. Will enhance the cost and time required for audit.
14. Likely to push the auditors from "*professional skepticism*" to "*persistent suspicion*" approach to audit.
15. Will pave way for more rule based rather than principle based auditing standards.