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Our ref SS/288

Contact Sylvia Smith

8 October 2012

Dear Sirs

IAASB Invitation to Comment, *Improving the Auditor's Report*

We are pleased to have the opportunity to respond to the Invitation to Comment (ITC) on *Improving the Auditor's Report* issued by the International Auditing and Assurance Standards Board (IAASB). We have consulted with, and this letter represents the views of, the KPMG network.

Overarching comments

As previously stated in our response to the IAASB's May 2011 Consultation paper, we strongly support the IAASB's initiative to explore options to enhance the quality, relevance and value of auditor reporting. We agree that change is required to respond to the needs of investors and other users. We believe for such change to be effective it would be best achieved through a more holistic approach involving parties in addition to the IAASB such as the IASB, the PCAOB, securities regulators, and analysts in order to reconcile the expectations and needs of users with current financial reporting and auditing standards. In the meantime, the ITC proposals provide a practical basis for developing a response to user needs without changing the scope of today's ISA audit. However, we believe changes and additions are required to the proposals if they are to be effective and to ensure they do not perpetuate or widen the current expectations gap.

We also look forward to the opportunity in the near future to exploring changes to the current scope of the audit and the role of the auditor with regulators and stakeholders to more fully address the needs of investors and other users and to help close the expectations gap by, for example, providing assurance on information presented outside the financial statements on elements such as management discussion and analysis, management commentary, the annual report, information and reports provided to regulators or on preliminary earnings announcements and periodic company disclosures of key performance indicators.

Enhancing users’ understanding of financial information

As noted in the ITC, requests for auditor insight often relate to the fact that users have difficulty in locating and identifying pertinent matters from the extensive disclosures provided in today’s financial statements. Therefore users may be looking for auditors to highlight certain matters to help them navigate their way through such financial statement disclosures.

We believe the IAASB’s objective of addressing the issue within the scope of current standards is appropriate provided:

- Management and those charged with governance (“TCWG”) remain the primary source of information in the context of their presentation to investors of the financial statements as a whole; and
- Users are not expected to have to sort through various sources of information provided separately by management, TCWG and independent auditors in order to form a complete understanding of the financial reporting.

However, as noted above, we believe that effective change also requires engagement with the IASB, regulators, and analysts to address these issues on a holistic basis to consider:

- Improvements to the relevance and informational value of financial statement disclosures;
- The nature and quality of other information that may be provided by management or TCWG including, for example, information on business risks and how they are managed or the nature of the interaction between TCWG, management and the auditors; and
- How the expectations and needs of users can be reconciled with current professional requirements for an audit and whether, for example, there is a role for auditors in providing assurance on information presented outside the financial statements on elements such as management discussion and analysis, management commentary, the annual report, information and reports provided to regulators, or on preliminary earnings announcements and periodic company disclosures of key performance indicators.

Auditor Commentary

We believe that there may be value in Auditor Commentary provided it is objective and fact-based and intended to draw users’ attention to matters disclosed in the financial statements that the auditor believes to be most important. It is also conceivable that a requirement to include commentary on matters disclosed in the financial statements will result in increased communication between the auditor and TCWG around the issues considered to be “most important to users’ understanding” and may also result in improved disclosures. The Auditor Commentary must not, however, undermine the overall opinion on the financial statements taken as a whole. Any requirement for auditors to provide such commentary should be supported by agreed criteria in order to achieve some degree of consistency between issuers. As suggested in the ITC we also believe that any requirements should be sufficiently flexible given

that, depending upon the jurisdiction, disclosures may be made in different parts of the financial report and simple duplication of information should be avoided.

We question, however, the value of requiring auditors to provide commentary in the auditor’s report on specific procedures relating to parts of the audit itself. We are concerned that users may not be able to place the procedures and the results of these into context as regards the auditor’s opinion on the financial statements as a whole or to properly understand the interaction of procedures performed on related audit areas.

Mandatory Auditor Commentary will inevitably result in additional time and cost to both the auditor and the entity. We expect management and TCWG to take significant interest in the Auditor Commentary resulting in increased time for engagement teams, in particular partners and engagement quality control reviewers. The value of such additional time and costs will depend on the amount of benefit that users derive from the additional information provided.

Going Concern

In our view many stakeholders do not understand that the use of the going concern basis of accounting simply means that management does not intend to liquidate the entity or cease trading, or has no realistic alternative but to do so. In itself it says nothing more about the entity’s ongoing viability. We are therefore very supportive of initiatives aimed at clarifying this misconception.

We are concerned however that simply requiring the auditor to make an explicit statement that management’s use of the going concern assumption is appropriate is unlikely to address this issue; indeed we believe that there is a danger that it will increase the potential for misunderstanding.

A second major area of confusion is exactly what constitutes “material uncertainties” related to events or conditions that may cast “significant doubt” on an entity’s ability to continue as a going concern. Again, simply requiring the auditor to make an explicit statement as to the existence or otherwise of such uncertainties is not in our view sufficient to address the expectations gap.

We recognize that the proposals in the ITC are intended to be responsive to user needs in the context of existing standards. Our responses to questions 8 and 9 in the Appendix suggest changes to the expanded descriptions in the ITC of the responsibilities of management and the auditor to avoid increasing the potential misunderstanding that exists today. However, we believe that additional guidance in this area is essential. We therefore encourage the IAASB to work with the IASB, PCAOB and other regulators to establish a common international understanding/approach to the following issues:

- Purpose of the going concern assessment performed by management to support use of the going concern basis in the financial statements;

It would be of benefit to all stakeholders if preparers had a requirement to perform a going concern assessment in all circumstances and to make an explicit statement on the results of their assessment (including identified uncertainties – material or otherwise) in the context of

the preparation of financial statements. This would provide a far sounder basis for the auditor's going concern assessment.

- Disclosures that should be provided in the financial statements relating to the assessment;

It also would be of benefit to all stakeholders if preparers had a requirement to disclose identified uncertainties to support their explicit statement.

- Disclosures that should be provided outside the financial statements relating to business and operational risks faced by the entity and how these matters may affect going concern;

While we agree with the principles underlying the going concern basis for purposes of preparing the financial statements, we also believe that preparers should be required to disclose their consideration of operational and business risks and their potential impact on going concern. As such information is forward looking and beyond the scope of the financial statements, we recommend that it be disclosed in information accompanying the financial statements.

- How the above should be applied to financial institutions, in particular banks;

Banks are clearly different from other entities in that confidence in a bank's solvency and liquidity is what sustains the business model – any fear about the future viability and solvency of a bank can give rise to a run on the bank and immediate liquidity concerns. Any expanded requirement to disclose going concern uncertainties therefore needs to be carefully considered in conjunction with banking regulators given the wider systemic contagion risks that can ensue.

- The expanded role that auditors should play in adding credibility to information on business and operational risks provided outside of the financial statements.

The Appendix to this letter includes our response to the questions posed in the ITC. It also elaborates on the issues discussed above.

Please contact Sylvia Smith at +44 (0)20 7694 8871 if you wish to discuss any of the issues raised in this letter.

Yours faithfully

KPMG IFRG Limited

KPMG IFRG Limited

cc: Jean Blascos, KPMG

Appendix – Responses to specific questions posed in the ITC

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?**
- 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.**

In considering whether overall the improvements suggested by the IAASB “sufficiently enhance the relevance and informational value of the auditor’s report”, we evaluated the proposals against the following key principles we referred to in responding to the IAASB’s May 2011 Consultation Paper:

- Audit quality is enhanced, or at least maintained;
- Whether the expectations gap is narrowed or at least not expanded;
- Whether users’ understanding of financial information is enhanced;
- Whether management and TCWG are the primary source of information about the entity; and
- Users are not expected to sort through information provided by management, TCWG and auditors to form a complete understanding of a matter or to understand similarities and differences in view.

These principles are consistent with factors considered by the IAASB in applying its value and impediments approach in assessing changes to the auditor’s report.

Overall, we believe that the proposals in the ITC provide a practical basis for developing a response to user needs without changing the scope of today’s ISA audit. However, we believe changes to the proposals in the ITC are required if they are to be effective and to adhere to the above principles, in particular, those relating to narrowing the expectations gap and enhancing users’ understanding of financial information. We elaborate on these two points below.

We also believe that, in the longer term, it is important that IAASB work with the IASB, regulators and the PCAOB to consider changes to financial reporting and auditing standards to more effectively respond to the needs of investors and other users of the financial statements and the auditor’s report.

Addressing the expectations gap

In relation to the expectations gap, the IAASB considered whether proposed improvements “enhance transparency about the audit, by better explaining the nature and purpose of an audit, including explaining what an audit is intended to achieve and how it is executed”.

In addition to explaining what an audit is intended to achieve, we believe there is a need to clarify what information is not covered by an audit since most users believe an audit is more encompassing than is actually the case under existing professional standards. More transparency about what is not covered in the current audit scope will help increase users’ understanding of an audit and will provide a strong foundation for discussion as to how the audit and the role of the auditor can be expanded to be more responsive to user needs. We therefore are very supportive of initiatives involving IAASB, regulators and users of financial information aimed at exploring how the scope of the audit and the role of the auditor may be changed.

With respect to the specific proposals in the ITC, we do not believe that proposed revisions aimed at providing more insights about procedures performed by the auditor in Auditor Commentary and the auditor’s conclusion about the going concern assumption will move us closer to this objective. Our responses to the questions relating to Auditor Commentary (questions 3 and 4) and going concern/other information (questions 8 and 9) set out our specific recommendations.

We also do not believe that improvements to the auditor’s report alone will be sufficient to effectively narrow the expectations gap. The auditor’s report on its own is not sufficient for user education relating to the purpose, scope and limitations of an ISA audit, especially in areas such as going concern, fraud and operational risks. We doubt whether users who currently do not have an understanding of these matters will be more enlightened by reading the proposed going concern section of the report or the sections that describe the responsibilities of management and the auditor.

Enhancing users’ understanding of financial information

In assessing the options for change, one of the factors considered by IAASB is whether any proposed additional information to be included in the report will enhance its communicative value. We are supportive of this provided auditors have robust guidance on the types of matters to be communicated (refer to our responses to questions 3 and 4 on Auditor Commentary for additional discussion of this issue).

Requests for auditor insight often relate to the fact that users have difficulty locating and distinguishing pertinent matters from the information available to them, including the extensive disclosures provided in today’s financial statements. Therefore, users may be looking for auditors to highlight certain matters to help them navigate their way through such financial statement disclosures.

We believe that providing such information may be helpful to users, so long as:

- Management and TCWG remain the primary source of information in the context of their presentation to investors of the financial statements as a whole; and

- Users are not be expected to have to sort through various sources of information provided separately by management, TCWG and independent auditors in order to form a complete understanding of the financial reporting.

However, while we agree that changes can be made to the auditor’s report today to improve its relevance and informational value, these changes will not, in our view, be sufficient to significantly narrow the expectations and information gaps. As we noted in our response to the May 2011 Consultation Paper, the types of changes that are necessary to make significant progress in these areas cannot be achieved by the IAASB on its own, working within the scope of an existing ISA audit. It therefore is important that the IAASB’s strategy and future work program include consideration of additional changes that need to be made going forward and the parties that need to be engaged to more robustly address the needs of users. For example, we believe the IAASB needs to engage the IASB, the PCAOB, securities regulators, and analysts to address these issues on a holistic basis in order to try and reconcile the expectations and needs of users with the current professional requirements for an audit and consider:

- Improvements to the relevance and informational value of financial statement disclosures;
- The nature and quality of other information that may be provided by management or TCWG including, for example, information on business risks and how they are managed or the nature of the interaction between TCWG, management and the auditors; and
- How the expectations and needs of users can be reconciled with current professional requirements for an audit and whether, for example, there is a role for auditors in providing assurance on information presented outside the financial statements on elements such as management discussion and analysis, management commentary, the annual report, information and reports provided to regulators or on preliminary earnings announcements and periodic company disclosures of key performance indicators.

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.)**
- 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.)**

The ITC indicates that Auditor Commentary is focused on enhancing the informational value of the auditor’s report to assist users in investment decision-making. The ITC also indicates that users have differing views about what information may have the most value and why such information should be coming from the auditor. Some users are looking for help in sorting through complex financial information, others are looking for additional context or insights. The range of reasons suggests that the issues the IAASB is trying to address through Auditor Commentary are broader than the informational value of the auditor’s report. They highlight the fact that there is a gap between the information users believe is needed to make informed

investment decisions and what is available to them through the audited financial statements (referred to as the information gap).

While Auditor Commentary may help give users some additional information, we question whether changes to the auditor's report alone will be sufficient to significantly narrow the information gap. As we noted in our response to the IAASB's May 2011 Consultation Paper, the types of changes needed to make significant progress in this area cannot be achieved by the IAASB on its own, working within the scope of today's ISA audit. In our view, in order to make significant progress, the IAASB will need to work with other key stakeholders such as the IASB, the PCAOB, securities regulators and analysts to address these issues on a holistic basis.

We recognize that involving other stakeholders will take time and that Auditor Commentary may appear to provide a practical means of being immediately responsive to user needs, because it is within the IAASB's remit and can be implemented relatively quickly within the scope of an existing ISA audit. While likely to be somewhat helpful, we believe that the proposed changes will not be sufficient in isolation. As we discuss in our responses to questions 1 and 2 of the ITC, it is important that the IAASB's strategy and future work program include consideration of additional changes in financial reporting that need to be made going forward and the parties that need to be involved.

In terms of what is actually proposed to be included in Auditor Commentary, the ITC is suggesting expanding the Emphasis of Matter and Other Matter concepts in the ISAs to facilitate Auditor Commentary in two areas:

- Matters likely to be most important to users' understanding of the audited financial statements; and
- Matters likely to be most important to users' understanding of the audit.

The ITC also indicates that the specific matters to be communicated should be based upon the auditor's judgement to help ensure that the information provided is tailored to the facts and circumstances of each entity subject to audit.

Matters likely to be most important to users' understanding of the audited financial statements

We are supportive of Auditor Commentary on matters that are likely to be most important to users' understanding of the audited financial statements provided what is communicated is consistent with the overriding principles we discussed in our responses to questions 1 and 2.

In particular, we believe it is important that what is communicated by auditors is objective, fact-based and relates to information disclosed in the financial statements. This will inform users of the matters the auditor believes are likely to be most important but also help ensure that management and TCWG continue to be the primary source of information about the entity and does not undermine the overall opinion on the financial statements taken as a whole, as doing so would lead to confusion as to the purpose of the audit and thus expand the expectations gap. It is also conceivable that a requirement to include commentary around matters disclosed in the financial statements will result in increased communication between the auditor and TCWG

around the issues considered to be “most important” to users’ understanding and may also result in improved disclosures.

These objectives can be best achieved if requirements for Auditor Commentary include:

- Criteria auditors should use in determining whether matters warrant inclusion in Auditor Commentary; and
- The information to be reported about these matters.

In terms of the criteria for Auditor Commentary, we agree that the key driver should be matters that, in the auditor’s judgement would be most important to users’ understanding of the financial statements. We also recommend that IAASB develop criteria that cover the following:

- Factors auditors should consider in exercising judgement about matters that may be most important to users;

For the reasons noted above, we believe the criteria should emphasize that the matters should be restricted to significant matters including areas involving significant management judgement (e.g. critical accounting policies, accounting estimates involving significant estimation uncertainty) or significant or unusual transactions.

In assessing whether these matters may be “most important to users’ understanding”, the criteria developed by IAASB should emphasize the importance of considering:

- The complexity and pervasiveness of the matters;
 - Whether the matters were communicated to TCWG; and
 - The level of audit effort related to the matter, including the extent to which the matter required the involvement of the engagement quality reviewer and others within the firm.
- To avoid having auditors dilute the effectiveness of Auditor Commentary by reporting too many or too few matters, it would be helpful if the criteria also emphasize that Auditor Commentary would not necessarily include all matters discussed with TCWG.

Matters likely to be most important to users’ understanding of the audit

We recognize that the concept of Auditor Commentary on matters likely to be most important to users’ understanding of the audit is based on an expansion of the concept underlying the Other Matters paragraph in ISA 706.

The original purpose of the Other Matters paragraph in the auditor’s report is to give auditors a means of communicating very significant matters affecting the audit but not the audited financial statements. We are not in favor of broadening this concept to matters likely to be most important to users’ understanding of the audit. We are concerned that auditors will find it difficult to succinctly and understandably describe the procedures performed on complex estimates or significant risks. It is also not clear how information about procedures performed

will affect users’ perceptions about the reliability of the information to which the procedures relate and the reliability of the financial statements as a whole. There is a risk that users will derive a different level of assurance from information about procedures than is intended, especially if auditors report differences in the types of procedures performed for what on the surface may appear to be similar matters.

For example, the illustration of a possible improved auditor’s report on page 10 of the ITC includes Auditor Commentary on the specific audit procedures relating to the recording of revenue, accounts receivable and cash receipts. It is not clear how this information will be used in understanding the financial statements or as part of a user’s “investment decision-making”. Will a user conclude that this information is supportive of the auditor’s opinion on the financial statements as a whole, that it enhances their overall confidence in the auditor’s opinion and the financial statements or will they treat it as a warning in the event they draw a conclusion that the auditor has some residual concerns or that the auditor may not have performed enough work on these matters?

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.)

We recognize that, in preparing the illustrative examples, the IAASB presented a number of alternatives in order to elicit feedback on the most appropriate. We believe that the following considerations are important in considering these alternatives:

- The purpose of the commentary and whether it is reasonable to assume that the matters addressed are likely to be “most important” to users’ understanding of the audited financial statements;
- The type of information provided by the auditor, in particular whether the information:
 - Is objective, fact-based and highlights matters disclosed in the financial statements;
 - Continues to have management and TCWG as the primary source of information and therefore does not result in the auditor being the primary source of the information. IAASB believes this is inappropriate and we share this view; and
 - Could possibly lead users to question the auditor’s opinion on the financial statements as a whole and thus undermine the auditor’s report.

We have included below specific comments on each of the illustrative disclosures provided in the ITC.

Outstanding litigation

In this example, the auditor draws attention to a note in the financial statements which describes outstanding litigation. No other information is provided.

The significance of the outstanding litigation and its potential effect on the entity will determine whether it is likely to be “most important” to users’ understanding of the audited financial statements. To give users a better understanding of why the matter has been included in Auditor Commentary, we believe it would be helpful if the commentary included some additional factual and objective details regarding the litigation and its potential effect on the entity, assuming this information is required to be disclosed in the notes to the financial statements.

Goodwill

In this example, the Auditor Commentary includes information about the matter that is factual and objective. It also cross-referenced to the financial statements. This information helps users understand why the matter can be considered to be “most important” to their understanding of the audited financial statements.

However, the auditor is referring to disclosures made in management commentary as well as in the notes to the financial statements. We do not believe it is appropriate for Auditor Commentary to make reference to information presented outside the audited financial statements as it will blur the line between the information that is and is not covered by the auditor’s report under today’s standards.

Audit Strategy Relating to the Recording of Revenue, Accounts Receivable and Cash Receipts

In this example, the auditor is highlighting the fact that the company implemented a new accounting system which involved the introduction of new software. The auditor is also highlighting the implications of the new system on specific audit procedures undertaken. In this case, the auditor is the primary source of information about the new system since a cross-reference to a note to the financial statements is not being provided. It is not clear why information about a new accounting system is relevant to users and how it will be used to better understand the financial statements. As discussed in our response to questions 3 and 4, there is a risk that inclusion of such information in the auditor’s report may lead users to question whether the auditor’s opinion on the financial statements taken as a whole is in some way affected by the commentary and thus potentially this could undermine the auditor’s unqualified report.

Valuation of Financial Instruments

In this example, the Auditor Commentary includes:

- Information about the matter that is factual and objective to help users understand why it can be considered to be “most important” to their understanding of the audited financial statements – i.e. disclosure of structured financial instruments subject to significant measurement uncertainty and a high risk of material misstatement of the financial statements related to the valuation of the instruments; and
- Information about where the matter is disclosed in the financial statements – i.e. Note 5 to the financial statements.

However, the Auditor Commentary in this example also includes information about the auditor’s response and findings. We are not in favour of providing this type of information as we are

concerned that this may be viewed by users as providing a separate opinion on an individual line item and may undermine the overall opinion on the financial statements taken as a whole.

Involvement of Other Auditors

We have provided comments on this example in our response to question 13.

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.)

We expect management and TCWG to have significant interest in the matters that auditors plan to include in their Auditor Commentary given that it is intended to cover matters likely to be most important to users’ understanding of the financial statements. We therefore expect that it will be necessary for engagement teams, in particular partners and engagement quality control reviewers, to increase the amount of time they spend on audits that involve Auditor Commentary in order to discuss the matters planned to be included in Auditor Commentary with TCWG and management, and to prepare the auditor’s report. Such additional time could potentially have an effect on the release date of the audited financial statements.

The potential increase in time and costs will vary depending on the size and complexity of the entity being audited. Therefore, it is difficult to determine the likely increase, but we believe for most audits it would not be insignificant. Whether such additional costs are justified will depend on the amount of benefit that users derive from the additional information.

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 agree that Auditor Commentary should be required for certain entities. For example, we believe that Auditor Commentary should be required for audits of listed entities. However, we do not believe it is necessary for audits of private entities since users of their financial statements often have the ability to obtain additional information when it is required. The value of Auditor Commentary for all PIEs, other than listed entities, in our view needs to be explored. We therefore recommend that IAASB work with interested parties to determine whether the benefits from Auditor Commentary that may be derived by users of financial statements issued by PIEs, other than listed entities, would outweigh the costs of providing such information.

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.)

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.)

We recognize that the enhanced reporting requirements being proposed by IAASB are intended to be responsive to users who have asked for clarification of the roles/responsibilities of management and the auditor within existing requirements. Given this objective, we are supportive of enhancing current reporting requirements around going concern. Our comments on the proposals in the ITC are set out below. However, it is important that IAASB not stop here. We believe that users’ needs around going concern cannot be fully addressed without changes to existing financial reporting and auditing requirements. Our reasoning for this is set out below.

- **Material uncertainties and significant doubt**

The proposal that the auditor’s report explicitly states that the auditor has not identified “material uncertainties” related to events or conditions that may cast “significant doubt” on the entity’s ability to continue as a going concern raises concerns linked to the fact that although these terms are referred to in accounting and auditing literature they are not well defined and application guidance is lacking.

We recognize that changes to accounting standards is not within the IAASB’s mandate, we therefore recommend that the IAASB work with the IASB to update requirements and guidance relating to the assessment of the going concern assumption applicable to both preparers of the financial statements and to auditors. We also recommend that this guidance include definitions of key terms.

Further, the introduction of an explicit statement in the auditor’s report that the auditor has not identified material uncertainties goes beyond that which is required of management. Management is only required to make a disclosure around material uncertainties when such uncertainties have been identified.

As we have noted previously, we believe that management and TCWG should be the primary source of information about the entity and therefore the statement that ‘no material uncertainties have been identified’ should be delivered from the perspective of management with the auditor commenting on this statement based on the results of the audit. Refer to the section on ‘proposed changes to going concern wording’ below for the proposed wording.

- **Matters relating to management’s use of the going concern basis**

ISA 570 today requires the auditor to evaluate management’s assessment of the entity’s ability to continue as a going concern. When events or conditions have been identified which may cast significant doubt on an entity’s ability to continue as a going concern, the standard requires the auditor to consider whether they affect the auditor’s assessment of the risks of material misstatement and to:

- Review management’s plans for future actions based on its going concern assessment;

- Gather audit evidence to confirm or dispel whether or not a material uncertainty exists, including the effect of any plans of management and any other mitigating factors; and
- Seek written representations from management regarding its plans for future action.

It is critically important to note that, in the first consideration above, management's going concern assessment under today's standard is simply premised on the basis that management does not intend to liquidate the entity or cease trading, or has no realistic alternative but to do so. This in itself says nothing more about the entity's ongoing viability. We are therefore very supportive of initiatives aimed at clarifying this misconception.

An additional important point to note is that both IAS 1 and ISA 570 acknowledge that entities with a history of profitable operations and ready access to financial resources may not need a detailed analysis to support the going concern assumption. Recent and continued difficult economic and market conditions have shown that a good track record is no protection from rapidly changing market conditions for credit, liquidity and profitability, particularly for financial institutions.

We believe it would be of benefit to all stakeholders if preparers had a requirement to perform a going concern assessment under all circumstances and a requirement to make an explicit statement on the results of their assessment and to disclose identified going concern uncertainties. Further, while we agree with the current basis for when financial statements are prepared on a going concern basis, (i.e. management does not intend to liquidate the entity or cease trading, or has no realistic alternative but to do so), we also believe preparers should be required to disclose their consideration of operational and business risks and their impact on going concern. As such information is forward looking and beyond the scope of financial statements, we recommend that it be disclosed in information accompanying the financial statements. The auditor could then, if stakeholders require this, provide assurance on such disclosures. We therefore also recommend that regulators, users and the IAASB assess the benefits and costs of having auditors add credibility to all or part of this information.

- Specific considerations relating to financial institutions, in particular banks

Explicit statements on going concern are particularly relevant to financial institutions in today's economic environment where the financial health of a financial institution can change in a very short time.

Banks are clearly different from other entities in that confidence in a bank's solvency (or indeed even its national currency) is what sustains the business model – any fear about the future viability and solvency of a bank can give rise to a run on the bank and immediate liquidity concerns. Any requirement to disclose going concern uncertainties needs therefore to be carefully considered in conjunction with banking regulators given the wider systemic contagion risks that can ensue.

Given the above, we encourage the IAASB to work with the IASB, PCAOB and regulators to establish a common international understanding/approach to the following issues:

- Purpose of the going concern assessment performed by management to support use of the going concern basis in the financial statements;
- Disclosures that should be provided in the financial statements relating to the assessment;
- Disclosures that should be provided outside the financial statements relating to business and operational risks faced by the entity and how these matters may affect going concern;
- How the above should be applied to financial institutions, in particular, banks; and
- The role that auditors should play in adding credibility to information on business and operational risks outside the financial statements.

With respect to the current proposals we have the following comments:

- All information on going concern should be included in a single section to help minimize the risk that users will misunderstand what is intended;
- Explicit statement on use of going concern basis – such a statement is of limited value given that it will apply in most circumstances. Given the expectations gap around going concern, we are concerned that users may infer more assurance from such a statement than is warranted; and
- Explicit statement on no material uncertainties – to help ensure that management and TCWG continue to be the primary source of information about the entity, a statement that no material uncertainties have been identified should be presented from the perspective of management with the auditor commenting on this statement based on the results of the audit.

To address the comments above we propose that the following change may be made to the Going Concern section on the first page of the illustrated auditor's report on page 9 of the ITC:

Going Concern

~~Use of the Going Concern Assumption~~

~~As part of our audit of the financial statements, we have concluded that management's use of the going concern assumption in the preparation of the financial statements is appropriate.~~

~~Material Uncertainties Related to Events or Conditions that May Cast Significant Doubt on the Company's Ability to Continue as a Going Concern~~

Under IFRSs, management is responsible for making an assessment of the Company's ability to continue as a going concern when preparing the financial statements. In assessing whether the going concern basis is appropriate, management takes into

account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period. Under IFRSs, the Company's financial statements are prepared on a going concern basis, unless management either intends to liquidate the Company or to cease trading, or has no realistic alternative but to do so.

IFRSs also require that, when management is aware of material uncertainties related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern, management disclose those uncertainties in the financial statements. Management have not identified any such material uncertainties and as such have not disclosed material uncertainties in the financial statements. Based on the work we have performed, we concur with management's conclusion that disclosures are not necessary ~~we have not identified material uncertainties related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern that we believe would need to be disclosed~~ in accordance with IFRSs. Because not all future events or conditions can be predicted, this statement is not a guarantee as to the Company's ability to continue as a going concern.

~~The responsibilities of management with respect to going concern are described in a separate section of our report.~~

Lastly, in our view, changes to the auditor's report alone may not be sufficient for user education relating to the purpose, scope and limitations of an ISA audit, especially in areas such as going concern. We doubt whether users who currently do not have an understanding of these matters will be more enlightened by reading the proposed going concern section of the report or the sections that describe the responsibilities of management and the auditor.

In order to provide an effective means of narrowing the expectations gap with respect to going concern we are of the opinion that other additional actions are required to improve user understanding. These actions are likely to involve education, training and informational publications to users of financial information and we encourage the IAASB to work with relevant regulatory bodies, national standards setters, the International Federation of Accountants and business schools, to undertake such actions.

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 recognize that the suggested auditor statement in relation to other information is making what is currently implicit explicit. While we have a responsibility to read the information, such information is not audited. Accordingly, we are concerned that users may derive more assurance from the statement than is warranted and that this will increase the expectations gap. We are therefore supportive of including the following information in the auditor's report with respect to "other information":

- A reference to the auditor's responsibility to read the other information and to communicate material inconsistencies between this information and the audited financial statements that the auditor may be aware of;
- The names of the documents containing the other information; and

- The fact that the auditor has no responsibility for and has not audited the information and accordingly does not express any opinion on this information.

We believe that inclusion of this information in the auditor's report will clarify the auditor's responsibilities regarding other information.

Further, if users are in fact concerned about the credibility of other information, then we recommend that auditors be asked to specifically provide assurance on some or all of this information.

Clarifications and Transparency

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.)

Significant events such as the financial crisis have highlighted that some users do not have a clear understanding of the auditor's responsibilities – e.g. that the auditor's opinion does not extend to concluding on matters such as the appropriateness of an entity's business decisions or risk management controls. Therefore, we are supportive of initiatives aimed at enhancing users' understanding of the roles and responsibilities of management, TCWG and the auditor, including what an audit is and is not.

It is important that any description of the auditor's responsibilities address significant matters not covered by an audit of the financial statements (e.g. appropriateness of an entity's business decisions or risk management controls) as well as the matters that are covered and that it provide a brief explanation to why this is the case.

Having said this, we are concerned that lengthy standardized descriptions in the report of responsibilities could reduce the impact of the auditor's opinion and other commentary. We therefore agree with the IAASB's proposal to re-locate these descriptions to the end of the auditor's report following the opinion, basis for opinion and any Auditor Commentary.

Further, as noted in our response to questions 1 and 2, we do not believe that the auditor's report is an effective vehicle for user education. We therefore recommend additional actions aimed at narrowing the expectations gap such as education, training and informational publications and we encourage the IAASB to work with relevant regulatory bodies, national standard setters, the International Federation of Accountants and business schools to undertake such actions.

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

We recognize that disclosing the name of the engagement partner in the auditor's report is already required by law in some jurisdictions and that it is not required in others.

In considering the value of such disclosures, we have concluded that disclosing the engagement partner's name in the audit report will not enhance an engagement partner's sense of personal

accountability. Engagement partners already possess a deep understanding of their accountability to capital market stakeholders, audit committees, regulators, their firms and partners. They understand the potentially significant consequences to them personally (and their families) as well as to their partners and firms of failing to perform audits with integrity and in accordance with professional standards. In addition, they are also subject to internal inspection reviews and inspection by audit oversight regulators. Each of these factors creates significant accountability for engagement partners to the users of the auditor's report.

We are also concerned that in some jurisdictions disclosing the name of the engagement partner may lead to an increase in engagement partner liability and a misunderstanding of the role and responsibility of the firm and network affiliates in the performance of an audit.

Given these jurisdictional differences, we strongly recommend that this requirement be left to the discretion of local law or regulation.

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.)

Information on involvement of other auditors may be of interest to some users as it provides transparency regarding the involvement of other auditors in an audit. However, it is not clear how users will use the quantitative information described in the illustrative report (page 10) relating to the work performed by other firms in the group auditor's network and by other networks.

Also, it is important to highlight that such disclosure is not consistent with the key principle underlying ISA 600 that the group auditor has sole responsibility for the audit of an entity's financial statements.

Lastly, we do not believe that matters such as the involvement of other auditors should be within the scope of Auditor Commentary because, as previously stated, we believe Auditor Commentary should relate to information disclosed in the financial statements.

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.)

For the reasons noted in our response to question 11, we are supportive of IAASB's proposal to re-locate these descriptions to the end of the auditor's report following the opinion, basis for opinion and any Auditor Commentary.

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.)

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.)

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 are supportive of re-organizing the auditor’s report in the order set out in the illustrative report. In particular, we support moving the auditor’s opinion, basis of opinion and related Auditor Commentary to the beginning of the report in order to give appropriate prominence to matters that are company specific and most important to users.

Global consistency in the content and order of the auditor’s report is our preference as it enables users to quickly identify issues in reports across multiple jurisdictions. However, we recognize that in many jurisdictions the format of the report is required by legislation and that there are practical difficulties to getting changes to such legislation. Accordingly, we support the IAASB mandating the ordering of items and allowing flexibility to accommodate requirements in law provided the report includes the key elements set out in Appendix 4 of the ITC.

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.)

For the reasons outlined in our response to question 7, we believe that the Auditor Commentary proposals should be required for audits of listed entities. We also recommend that IAASB work with interested parties to determine whether Auditor Commentary should be required for PIEs, other than listed entities. However, we believe all other changes proposed (subject to the improvements suggested in this letter) are relevant to all ISA audits.

Observations on other issues

Conforming amendments

Should the IAASB decide to proceed with a project to revise ISA 700, we encourage it to consider the effect of any changes to auditor reporting to the following as part of conforming amendments:

- Interim reporting by auditors under ISAE 2410. To help ensure that auditors provide relevant and timely information during interim reviews; and
- Comparative information whether reporting on corresponding figures or comparative financial statements. We believe that auditors may need guidance in addressing issues relating to comparative information when, for example, Auditor Commentary was relevant in a prior year and is no longer relevant in the current year.