

12 October 2012

Mr James Gunn  
Technical Director  
International Auditing and Assurance Standards Board  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, 10017  
USA

Dear James,

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

Thank you for the opportunity to comment. We submit the feedback from the New Zealand Auditing and Assurance Standards Board (NZAuASB) in the attachment.

The NZAuASB is supportive of the IAASB's initiative to consider a fundamental review of auditor reporting at this time. Exploring options that may improve reporting to better meet users' information needs is timely and is in the public interest.

In formulating this response, the NZAuASB sought input from New Zealand constituents in several ways. The first was an invitation to comment placed on the NZAuASB website with an accompanying notification sent to subscribers. The NZAuASB also hosted a number of "roundtable" discussions on the subject of auditor reporting with key stakeholders representing preparers, and users in both the public (including local and central government), private and not for profit sectors and regulators. In addition, the NZAuASB issued an online survey questionnaire.

In developing our submission we have briefly outlined the range of views expressed by stakeholders that the NZAuASB consulted with as well as the NZAuASB's responses to the specific questions raised in the Invitation to Comment. We trust that this assists the IAASB to understand both the NZAuASB's position as the national standard setter and the position and views of stakeholders on matters of audit quality and the relevance and value of audit within a New Zealand context.

Should you have any queries concerning our submission please contact either myself at the address details provided below or Sylvia van Dyk ([sylvia.vandyk@xrb.govt.nz](mailto:sylvia.vandyk@xrb.govt.nz)).

Yours sincerely,



**Neil Cherry**  
**Chairman – New Zealand Auditing and Assurance standards Board**  
Email: [neil.cherry@xrb.govt.nz](mailto:neil.cherry@xrb.govt.nz)

# **Submission of the New Zealand Auditing and Assurance Standard Board**

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

### **Executive Summary**

The NZAuASB supports the IAASB's efforts to review and consider auditor reporting within the broader context of audit quality and with a view to enhancing the relevance and value of audit. The NZAuASB commends the work that has gone into the preparation of the Invitation to Comment (ITC) and to the IAASB's extensive engagement around these auditor reporting proposals.

Our discussions and outreach with key stakeholders indicate that audit and the audit process is valued in New Zealand.

We did not identify any major areas of concern around audit quality or of any widespread systemic failure in the audit process or the underlying auditing standards. We received a high level of interest from stakeholders in wishing to better understanding how the IAASB proposals could enhance the value and relevance that they attach to the independent audit or to the auditor's report.

At the outset of our discussions and engagement we noted that reaction to some of the proposals was mixed, and that initial observations as to how far the auditor commentary proposals could extend varied - with stronger negative reaction to proposals for the auditor to providing insights into the entity and financial statements that were not otherwise already disclosed in the financial statements.

We noted that:

- stakeholders generally agreed that the proposals set out in the ITC would enhance the information value of the audit report and of the findings and conclusions that arise out of the audit process;
- concerns centred on whether the proposals would change the role and purpose of audit or whether there was an increased risk that the proposals, if introduced, would result in blurring the separation of responsibilities of management, or those charged with governance, for the preparation of the entity's financial statements and the role of the auditor to express an independent opinion on these financial statements; and
- a general concern that proposals such as the introduction of an auditor commentary section could result in a number of unintended consequences, such as the auditor and management presenting different views on matters of significance.

The NZAuASB accepts that in New Zealand the public interest encompasses the views of a broad range of stakeholders and users, some of which may have competing views and positions. Depending on the perspective of individual stakeholders the proposals set out in the ITC could be considered either "revolutionary" or "evolutionary". The position taken in each jurisdiction is also likely to be significantly affected by other "contextual" factors that influence or are connected to audit quality – for example, the legal position regarding auditor liability. To this end, the NZAuASB strongly recommends that the IAASB gives equal consideration to how the proposals are introduced, explained and supported as the underlying proposals themselves.

In broad terms, the NZAuASB noted that users generally supported improvements in the information value of the audit report as long as the proposed changes did not change the role and purpose of an audit or blur the lines of accountability between those charged with governance (TCWG) for the preparation and

disclosure of financial information in the entity's financial statements and the role of an auditor to express an independent opinion on this information.

The NZAuASB believe it is appropriate to consider the IAASB proposals through the lens of whether they will enhance or strengthen the public interest. In this respect, the NZAuASB notes that it received clear feedback and comment that enhancements to the information set out in the audit report should not be introduced as a means of addressing underlying concerns around the financial reporting framework within a particular jurisdiction, the nature and extent of disclosures made by TCWG in the financial statements or to address broader concerns around corporate governance. The NZAuASB believes that the proposals need to be very carefully positioned as being "part of the solution" and not the "solution in itself".

If the status quo is no longer acceptable and that some form of change is considered necessary, then the NZAuASB accepts that within the context set out by the IAASB some form of commentary would be important to address areas of concern, in particular:

- concerns over the current and future relevance of audit and auditors;
- the information value derived from audit process and the resulting audit report; and
- improving the understanding and clarity of, or between, the respective roles and responsibilities of TCWG and the auditor.

The NZAuASB supports the approach adopted by the IAASB to identify as broad a range of options as possible. The challenge is in finding the right balance – assessing the benefits of the improvements in the eyes of the user compared with the cost and implications of the proposals. .

In this respect, the NZAuASB considers that it is essential that the IAASB can evaluate and clearly demonstrate whether the proposals achieve the objectives or outcomes being sought. We believe that the appetite and acceptability of change in each jurisdiction will be influenced by perceptions and analysis as to whether the changes proposed will enhance or improve audit quality without changing the role of audit or increasing the cost of compliance or audit liability. The NZAuASB considers it important that:

- the IAASB is clear in outlining its position on the role and purpose of an audit. To the extent that the proposals are not intended to change the role of audit then clear statements to this effect are important, and the IAASB must evaluate whether the proposals achieve this objective;
- the respective roles and responsibilities of auditors and TCWG are not blurred either in terms of each discharging their respective legislative responsibilities or in the communication of information to users and within the audit or capital market;
- the proposals should carefully consider and evaluate the benefits (to relevance or information value) against the costs or implications (including risk of unintended consequences, support that would be required from the accounting / auditing profession to enable the auditors to discharge their obligations). The results of this evaluation should be transparent;
- due consideration is given to fundamental contextual matters including:
  - the role and importance of the financial reporting framework (the NZAuASB accepts that, in part, the demand for the auditor to add commentary within the audit report is a response to the increased complexity of financial reporting),
  - the legislative position in respect of auditor liability in each jurisdiction (in that it is much easier to roll out some proposals if there is an environment where liability is more clearly defined or limited);
- The NZAuASB accepts that the ITC outlines a broad range of options in respect of some proposals (in particular, a range of options for the inclusion of auditor commentary) and that the IAASB intends to carefully consider how far the audit report should extend into the area of audit commentary. In this respect, the NZAuASB considers that the further "advanced" the proposals

the more important it is that the IAASB carefully consider the risks associated with the proposal and the unintended consequences that could arise (risk of confusion as to what the auditor is saying, risk of misinterpretation, the risk that there may be different disclosures from management and auditors, questions as to how auditors could address any confusion as they have no future platform from which to do this, the risk to the amount of work that may be required if auditors see the disclosure as increasing their liability etc.)

The NZAuASB encourages the IAASB to think as broadly and as far into the future as is reasonably practical in order to understand and / or contemplate the impact that changes may have on the public interest or the role and risk to the auditor. It is the contemplation of what impact these proposals may have on the audit market that will influence the quality and appropriateness of the changes proposed.

To the extent that the IAASB is not in a position to appropriately analyse or weigh up the risks and unintended consequences then we would support the IAASB making incremental changes and leaving open the opportunity or option for further change. The NZAuASB supports the IAASB including on their work programme further evolution of the audit report as and when is appropriate.

We strongly support the IAASB mapping out a broad and ongoing programme of evolution that continue to address matters of audit quality that advance the relevance of audit and auditors, and pursuing opportunities that address issues and concerns around the information value of the audit report or expectation gap issues.

The responses from key stakeholders to the specific questions in the ITC are set out below, followed by the NZAuASB's response.

## **Schedule of Responses to the IAASB's Specific Questions**

### **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?**

#### ***Response from key stakeholders the NZAuASB consulted with***

Stakeholders generally consider that there is not a great need for major change to the audit report. There may be some benefit in simplifying the language used in the audit report and placing the audit opinion in the beginning of the audit report.

There is general consensus that there is a need to educate users about the purpose of the audit report, and the limitations of an audit. The clarification of the respective responsibilities of management and the auditor are seen as enhancements in this regard.

Those charged with governance, preparers and auditors are concerned that the proposals on auditor commentary and statements on going concern seek to overlay the existing statutory obligations of management, those charged with governance, and the auditors, and go beyond the objective of the audit. They also consider that inclusion of auditor commentary in the audit report will cause a delay in the finalisation of the audit and an increase in the audit fees, as more time will be spent in agreeing the wording in the audit report. They are also concerned about unintentional consequences of the audit commentary.

Financial analysts we consulted with considered that the accounting standards are the problem and that disclosures in the financial statements are complex, and do not provide investors and analysts with sufficient information. They further consider that there is value in clearly explaining the audit process in more detail.

Investors, funders and regulators indicated that they obtain further information they need from other sources, or by requesting auditors to perform additional assurance engagements over information they require outside the scope of the audit.

#### ***NZAuASB response***

The audit report is valued because of the independent certification provided by auditors. Our discussions indicate that the audit report is not fundamentally "broken" but that users of financial statements are clearly looking to the auditor and / or those charged with governance to provide relevant information in either the financial statements or audit report.

In summary, the NZAuASB's views are as follows:

The NZAuASB is supportive of the IAASB's initiative to consider a fundamental review of auditor reporting at this time. Exploring options to improve the reference of the audit and reporting to better meet users' information needs is timely and is in the public interest.

We believe that some of the identified improvements in the auditor's report will provide value by meeting the user's expectations for greater transparency, and will contribute to the overall objective of the IAASB to ensure credible, high quality financial reporting in all sectors of the world economy.

The NZAuASB supports the proposal to move the opinion to the beginning of the auditor's report, and clarifying the respective roles of the auditor and those charged with governance. However, the NZAuASB considers there is a risk that adding auditor commentary (even if relevant) to the auditor's report could further increase the expectation and information gap, and may have other unintentional consequences and associated risks.

The NZAuASB is also concerned that the proposals on auditor commentary and statements on going concern seek to overlay the existing statutory obligations of management, those charged with governance, and the auditors, and go beyond the role and objective of the audit. Changes to the scope and content of the audit report by way of auditing standards requirements should not seek to override existing statutory obligations.

We also believe that the proposal on auditor commentary is likely to create much more practical tension between the auditors and those charged with governance as regards what the auditor is stating about the entity. This is likely to result in significant pressure which we are not sure will be helpful to achieving a quality audit. It may also change the dynamic of the informal discussions between the auditor, management and those charged with governance.

It is acknowledged that the audit report on its own does not provide sufficient information to users. However, this needs to be further considered in the context of other available information sources. Different users have different needs and those charged with governance, investors, funders and regulators can (and do) obtain further information they need from other sources.

There is no need for audit reports of different size entities to be different – an audit is an audit, and the principle to be applied should be scalable across all entities.

In our view more careful thought needs to be given to ensure that there is an appropriate balance between the informational value added by the proposals on auditor commentary and statements on going concern, and the implications of those proposals on the role of the audit, auditor liabilities and other associated risks.

**2) Are there other alternatives to improve the auditor's report, or auditor reporting more broadly, that should be further considered by the IAASB, either alone or in coordination with others? Please explain your answer.**

***Response from key stakeholders the NZAuASB consulted with***

The audit report is not fundamentally "broken" – it is more about education of users as to what an audit is, and the level of reliance provided by an audit report.

Whilst the principles forming the basis of the auditor commentary proposals have merit, there first needs to be a review and realignment of the statutory recognition of the responsibility and recognition of obligations of all the players in financial reporting.

As a step towards assisting users to have a better understanding about the nature and benefit of an audit opinion a best practice recommendation could be considered for an explanatory report from the auditor to shareholders referred to in the annual report and published on the web site of the reporting entity. References to the audit process to provide transparency about the audit performed and to clarify the respective responsibilities of the auditor, management, and those charged with governance could be the domain of the auditor. References to the entity specific materials that are, in the auditor's judgment, likely to be most important to users' understanding of the audited financial statements should be required to be approved by the directors of the reporting entity.

We also received a clear message from a number of stakeholders we consulted with, including those charged with governance, financial analysts, the Office of the Auditor-General and regulators, that disclosure on independence needs to be more explicit.

### ***NZAuASB response***

It is acknowledged that the audit report on its own does not provide sufficient information to users. However, this needs to be further considered in the context of other available information sources.

We acknowledge that the IAASBs has recognised (in this ITC and in the draft IAASB paper *Audit Quality: An International Framework*, August 2012) that changes to the auditor's report alone cannot appropriately respond to the information needs of users and narrow the expectation gap. We encourage the IAASB to continue to consider a more holistic approach, one that is synchronised with improvements to corporate governance and financial reporting more broadly. Reporting information in the auditor commentary section, information on going concern and other information should also be further considered in conjunction with the accounting standard setters and regulators.

For example, management or TCWG should be required under IFRSs to be responsible for explicit statements in the financial statements that the financial statements have been prepared on a going concern basis, and that the entity is a going concern as at balance date.

The NZAuASB therefore urge the IAASB to give more thought to identify who requires what information, why it is required, and then to identify whose statutory responsibility it is to report that information. The need for additional information in the audit report should be considered within that broader context, and must also be consistent with the audit objective. The NZAuASB also encourages the IAASB to work with the IASB to respond to the apparent user expectation gap that exists in relation to going concern.

The NZAuASB also believe that the audit report should require the auditor to assert their independence.

### **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.)?**

#### ***Response from key stakeholders we consulted with***

The majority of stakeholders questioned the reason and need to include audit commentary. Some of the information may be of relevance to analysts, but general readers only want to know if the auditors agree that the financial statements are in line with the financial reporting standards.

Whilst the principles forming the basis of the auditor commentary proposals have merit, there first needs to be a review and realignment of the statutory recognition of the responsibility and recognition of obligations of all the players in financial reporting.

The general view of preparers, TCWG, and auditors is that what is reported in the audit report should relate to the financial statements as prepared by the entity, and should not originate from the auditor. It is the statutory responsibility of management and TCWG to prepare financial statements in a manner that achieves fair presentation. The auditor's statutory obligation is to obtain appropriate evidence and express

an opinion as to whether or not the financial statements are 'fairly stated' or 'present a true and fair view'. The proposals on auditor commentary appear to seek to change this traditional approach. Changes to the scope and content of the audit report by way of auditing standard requirements should not seek to overlay existing statutory obligations.

Another comment from TCWG is that auditor comment issues will add time and unavoidable cost to the already expensive process, and will not assist in removing 'excess baggage' from annual reports. For example, the ICAS-NZICA report commissioned by the IASB, "*Losing the excess baggage: reducing disclosures in financial statements to what's important*" issued in July 2011 identified a reducing utility of annual reports by reason of information overload. That report recommended closer attention to materiality in disclosures. These proposals run counter to recommendations in that report. If the auditor disclosure proposals are to proceed there should be an explicit requirement to follow paragraph 31 of IAS 1 which states that "an entity need not provide a specific disclosure required by an IFRS if the information is not material". This should also apply to disclosures required by the auditing standards.

Those charged with governance also questioned whether the auditors always have a sufficient understanding of business matters, and that there is a risk that commentary could be inappropriate and alarming when it is not intended to be.

Some users considered that the communication value of the auditor's report could be improved by linkage to the "must read" sections of the financial statements, but that it should not provide any further detail.

### **NZAuASB response**

The NZAuASB supports the work of the IAASB in its efforts to address issues of relevance. Depending on your perspective, the proposals could be seen as evolutionary or revolutionary. The NZAuASB further agrees that adding additional commentary could enhance the information value of the audit report or audit process. It is reasonable to conclude that given the demands from users for additional information (such as investors or regulators - who are part of the community of public interest served by financial reporting framework and audit process) could enhance the public interest.

The NZAuASB is supportive of amending the audit report with the objective of providing transparency about the nature and purpose of the audit and consider that the description of responsibilities of the auditor's responsibilities assists users in their understanding.

However, the NZAuASB does not believe that the public interest would be best served if the proposals result in a change to the role and function of the audit, confuses the role and responsibility of auditors vs TCWG or if incremental change in financial reporting is not advanced. The acceptability of the proposals is also likely to be significantly influenced by broader contextual matters (regulatory environment, matters concerning auditor liability etc.)

The NZAuASB acknowledges the work of the IAASB to identify a broad continuum of options to improve the information value of audit report through a section on auditor commentary. We believe that there is a tension that arises across the options and proposals. For example, the inclusion of a broader range of information and commentary may result in a continual increase in the information value of the audit report to a broader range of users. However, as the information value increases, so does the risk and cost implications associated with those proposals. In addition, the further advanced the proposals the higher the risk that:

- responsibilities of auditors and TCWG are confused,
- that auditors risk introducing information that is new; and
- the proposals will influence the nature and extent of the relationship between the auditor and entity.

We believe that the IAASB needs to carefully consider the benefits to audit quality, relevance and information value with costs and implications that arise across the broad spectrum of proposals. The challenge is to position the changes as evolutionary and not revolutionary while at the same time mapping out a programme of ongoing change and evolution.

We suggest that certain proposals raise the potential risk that the auditor may introduce information that is new or becoming the source of new information about the entity. To the extent that there is an underlying issue with the disclosures required under the financial reporting framework then we believe that this needs to be addressed through changes or clarity of financial reporting requirements. What is important is that we need a change in the approach taken by management in the disclosures that they make in the financial statements.

We believe that as we move across the broad spectrum of options the risk of unintended consequences potentially increases. For example, we are concerned about the following:

- what impact would insight commentary have on users or the capital market?
- is there a risk that the information or commentary provided would be misunderstood, misinterpreted or misused?
- what are the risks of unintended consequences on the capital market or on the entity itself (is there a risk of investor or capital flight, what impact on value of entity)?
- to the extent that confusion or misunderstanding arises then we need to accept that the auditor does not have a platform to address those on a going forward basis;
- what impression or impact is created if the disclosures by management and those from the auditor are different?
- will users rely only on the auditor's report rather than reading the full financial report and drawing their own conclusions and views? There is an increased risk that users may only read the auditor's report and over rely on what the auditor is and is not saying;
- is there a risk that the proposals will be used for competitive advantage?
- what impact would the proposals have on the relationship between the auditor and the entity? Is there a risk that the commentary section may become a negotiation between TCWG and the auditors (accepting that the incentives on directors to show an entity in a favourable light may influence the discussions and relationship with the auditor)? This is likely to result in significant pressure which we are not sure will be helpful to achieving a quality audit. It may also change the dynamic of the informal discussions between the auditor, management and those charged with governance.

We believe that as the IAASB step through its consideration of the proposals it is also important that it takes into account:

- that the audit profession comprises a broad range of audit entities, not all of which have the capacity and resources available to the big 4 to manage its way through the audit commentary proposals;
- the risk to the audit expectation gap and therefore the way that these proposals are introduced, explained or supported needs to be carefully considered. We consider that despite the demand from various sections of the broad stakeholder community that it is important that the final proposals are clearly communicated and explained.

Fundamentally, the NZAuASB takes the view that it is the entity's responsibility to make sufficient appropriate disclosures about the financial statements. It is the auditor's responsibility to consider this information and determine if it meets the expectations of the financial reporting framework which it is required to meet. We question the appropriateness of the audit report being the source of information about the financial statements or the entity which haven't been outlined by TCWG in the financial statements.

In our view more careful thought needs to be given to ensure that there is an appropriate balance between the informational value added by the proposals on auditor commentary and statements on going concern, and the implications of those proposals on the role of the audit, auditor liabilities and other associated risks.

The NZAuASB is supportive of auditor commentary replacing the existing emphasis of matter paragraphs and other matter paragraphs to highlight important matters in the financial statements. In addition to clarifying the roles of the auditor in the auditor's report, users should be educated about the role and function of an audit through other means, for example, by including educational material on the websites of national standard setters, regulators and professional accounting bodies, and appropriate education programmes.

- 4) **Do you agree that the matters to be addressed in Auditor Commentary should be left to the judgment of the auditor, with guidance in the standards to inform the auditor's judgment? Why or why not? If not, what do you believe should be done to further facilitate the auditor's decision-making process in selecting the matters to include in Auditor Commentary? (See paragraphs 43–50.)?**

***Response from key stakeholders the NZAuASB consulted with***

Those charged with governance commented that auditors will be obligated to identify and comment on issues the auditor considers are the most important even though the auditor is satisfied the issues have been appropriately dealt with in the preparation of the financial statements. There may be a natural tendency for auditors to “over comment” out of an abundance of caution. Users generally are only interested in exceptions.

It is also not clear what happens if management and/or TCWG disagrees with the auditor that the matters chosen by the auditor to include in auditor commentary are “likely to be the most important to users understanding of the audited financial statements”, or consider the auditor's explanations do not properly explain the matter. The roles between management, TCWG and the auditors should be kept clear.

There should be clear guidance about what commentary to include and how much to include, and if there is a difference in view between TCWG and the auditor this should be reflected.

***NZAuASB response***

If auditor commentary is included, the NZAuASB is supportive for the IAASB to specify considerations and criteria to be addressed to allow for commonality while allowing for the application of professional judgement. However, the NZAuASB stresses that the auditor commentary should be consistent with the objective of an audit, and should not blur the statutory responsibilities of the auditor, management and TCWG. Requiring the auditor to provide subjective views is not desirable and auditors will need more criteria to be able to be objective on the matters to include. We stress that being objective is fundamental to the audit adding value.

Insufficient guidance in the standards around auditor commentary will have an additional audit cost, and may cause inconsistencies which will make it more difficult to compare entities. Consistency will be important to avoid two different audit reports for entities that are similar. Adding auditor commentary will involve additional cost, irrespective of how good the standard is.

Guidance in the auditing standards should address at least the following matters:

- How to avoid blurring the lines of management, TCWG and the auditor's statutory reporting responsibilities
- To consider the potential for misinterpretations
- To consider the risk of unintended consequences on the capital market or the entity
- How to determine consistency of auditor commentary with other information provided by management
- How to resolve and disclose differences of opinion about the audit commentary with management;
- How to deal with legal considerations
- How to determine what information should be included.

**5) Do the illustrative examples of Auditor Commentary have the informational or decision-making value users seek? Why or why not? If not, what aspects are not valuable, or what is missing? Specifically, what are your views about including a description of audit procedures and related results in Auditor Commentary? (See paragraphs 58–61.)**

***Response from key stakeholders the NZAuASB consulted with***

The majority of stakeholders questioned the reason and need to include audit commentary, and consider that the additional costs attached to this compliance exercise does not equate to better/more valuable information to the end user. Some of the information may be of relevance to analysts, but general readers only want to know if the auditors agree that the financial statements are in line with the financial reporting standards. Adding more detail could create more questions and confusion for users.

Some users considered that the communication value of the auditor's report could be improved by linkage to the "must read" sections of the financial statements, but that it should not provide any further detail. If there is a risk to an assumption, or a particular matter that is necessary for the understanding of the financial statements, management and those charged with governance should outline it, not the auditor. It should only be raised by the auditor if the matter assists with fair presentation of the financial statements, and it had not been disclosed adequately by management.

Some questions raised by stakeholders when considering the illustrative examples are:

What criteria does the auditor apply when deciding what to include? For instance, if the particular user group is 'investors and analysts' is the auditor only focusing on the downside risk? A good example is the goodwill paragraph, especially with the reference to 'marginally'. There are also shortcomings with the 'financial instruments', 'audit strategy' and 'other auditors' commentary.

***NZAuASB response***

The NZAuASB considers that the illustrative examples in the ITC are not specific enough and could confuse users by creating more questions.

The NZAuASB also considers that a description of the audit procedures in audit commentary will not be useful. We emphasise that it will be time consuming and therefore costly and challenging for the auditors to

summarise procedures to reflect the extent of work performed and the judgement involved and query what benefit such information adds. In many cases the explanation may be too technical for many users to understand. Non-standard audit reports may also cause greater confusion for users, and make it more difficult to compare entities.

Also, listing audit procedures could misrepresent the audit process and increase misunderstandings about the nature of the audit of financial statements. For example, identifying only certain procedures, in the absence of sufficient context about the audit approach and methodology may increase the expectations gap, and raise more queries. There is also considerable risk that the descriptions of audit procedures could become either too technical or 'boilerplate'.

As noted above, given the information overload presently in annual reports, the NZAuASB question whether lay users and even some technically experienced users will read the expanded auditor commentary. In our view the cost of producing the commentary will far outweigh the value. From our consultations with key stakeholders it was noted that most of the users look at the audit report only to see if it is 'clean' or modified, and if modified, to understand the reasons for the modification.

Investors, funders and regulators should obtain further information they need from other sources.

**6) What are the implications for the financial reporting process of including Auditor Commentary in the auditor's report, including implications for the roles of management and those charged with governance (TCWG), the timing of financial statements, and costs? (See paragraphs 38 and 62–64.)**

***Response from key stakeholders the NZAuASB consulted with***

Preparers/management will look to legal obligations including the obligations flowing from financial reporting standards. They will argue that if the financial disclosures meet all those obligations there will be no need for the auditor to comment and that the auditor's comments are unnecessary and superfluous.

Entities will want to negotiate audit commentary out of auditor's reports, as they will see this as criticisms of the entity. There will be a preference for required disclosures to be made in the financial statements rather than in the audit report. Entities may even change their financial statements to remove audit commentary from the audit report, and the goodwill paragraph in the illustrative audit report is a good example. This introduces bias in financial reporting where the focus is on downside risks only.

Auditors will be obligated to identify and comment on issues the auditor considers are the most important even though the auditor is satisfied the issues have been appropriately dealt with in the preparation of the financial statements. There may be a natural tendency for auditors to "over comment" out of an abundance of caution.

It is not clear what happens if management and/or TCWG disagrees with the auditor that the matters chosen by the auditor to include in auditor commentary are "likely to be the most important to users understanding of the audited financial statements", or consider the auditor's explanations do not properly explain the matter.

Other matters raised by TCWG include the following:

- What will management and/or those charged with governance's recourse be if they consider the auditor's commentary contains statements that are wrong? If the auditor comments on management and/or TCWG's financial statements should management and/or those charged with governance have the right to comment on the auditor's statement? And if so, where?

- Auditors predominantly interface with management to obtain evidence in support of their attest function, with those charged with governance giving buy in by way of letters of representation. What is the nature of representations that will be required of those charged with governance with extended audit commentaries?
- How will auditors and their legal advisers perceive the auditor's new responsibilities and obligations?

### ***NZAuASB response***

The NZAuASB share the concern of auditors and TCWG that the proposals on auditor commentary and statements on going concern seek to overlay the existing statutory obligations of management, TCWG, and the auditors.

As outlined above, and in our response to the IAASB's May 2011 consultation, we are strongly of the view that auditors should not be the providers of original information about an entity, and that this is the statutory role of management and TCWG. We are of the view that this would change the objective and role of the audit and therefore would have significant cost implications.

There is a risk that adding more information could further increase the expectation and information gap, and may have other unintentional consequences. Including auditor commentary in the audit report will cause a delay in the finalisation of the audit and an increase in the audit fees, as more time will be spent in agreeing the wording in the audit report. Non-standard audit reports may also cause greater confusion for users, and make it more difficult to compare entities.

Other potential unintended consequences that we are concerned about are listed in our response to question 3 above.

- 7) **Do you agree that providing Auditor Commentary for certain audits (e.g., audits of public interest entities (PIEs)), and leaving its inclusion to the discretion of the auditor for other audits is appropriate? Why or why not? If not, what other criteria might be used for determining the audits for which Auditor Commentary should be provided? (See paragraphs 51–56.)?**

### ***Response from key stakeholders the NZAuASB consulted with***

Auditors and TCWG we consulted with are of the view that the fundamentals underlying all assurance engagements should apply to all types of entities. The application of those fundamentals may vary depending on the size, nature or significance of a particular entity.

The general consensus among stakeholders is that it is the quality of the audit work that matters. If the quality of the audit work is of a high standard, competent auditors will make the correct disclosures in the audit report, irrespective of the size of the entity.

The Office of the Auditor-General considers that the audit report structure should be more flexible to allow auditors to report in a way that best meets the need of users.

Some shareholders consider that for listed entities there could be a second audit report on specific matters for those investors that need more information.

### ***NZAuASB response***

There is no need for audit reports of different size entities to be different – an audit is an audit, and the principle to be applied should be scalable across all entities.

We recommend that the criteria under the existing model of emphasis of matter paragraphs and other matter paragraphs should be extended and additional guidance given, but that auditor judgement would need to be applied in each instance to determine the appropriate information to be disclosed. One factor for the auditor to consider in exercising that judgement is whether this additional information about the audit would be understood by the readers or users of the financial statements. It may be that for smaller entities that are not PIEs, in many instances additional information of this nature may actually be unhelpful.

Another option for the IAASB to consider is to require audit commentary only for higher risk entities, for example those entities that are required to be subject to an engagement quality control review as per ISA 220 (that is listed entities and those other audit engagements for which the firm has determined an engagement quality control review is required).

### **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.).**

### ***Responses from key stakeholders the NZAuASB consulted with***

Auditors are concerned that the inclusion of such a statement will create a perceived viability certification, and do not see why this is different from any other accounting or risk management issue. They also consider that the existing tools are there to report on going concern, by using emphasis of matter paragraphs. What is reported in the audit report should relate to the financial statements as prepared by the entity, and should not originate from the auditor.

Those charged with governance, preparers and auditors are concerned that the proposals on auditor commentary and statements on going concern seek to overlay the existing statutory obligations of management, those charged with governance, and the auditors, and go beyond the scope of the audit.

A number of stakeholders consider that highlighting going concern issues could be self fulfilling, and could have flow on effects. However, other users (funders and shareholders) want the auditor (as an independent party) to highlight the risks.

### ***NZAuASB response***

The NZAuASB agrees there is value in providing enhanced information on the concept of going concern. However, the NZAuASB believes that improvements in information about going concern should be achieved through improved disclosures made by management/TCWG in the financial statements. The NZAuASB share the concern of auditors and TCWG that the proposals on auditor commentary and statements on going concern seek to overlay the existing statutory obligations of management, those

charged with governance, and the auditors. The NZAuASB is of the view that existing tools are there to report on going concern, by using emphasis of matter paragraphs.

The auditor should not be required to make a positive statement on going concern, as it could further increase the expectation gap, and confuse users. However, the auditor should highlight issues/risks about management's going concern assertion if management fails to do so in the financial statements. This would only relate to non-disclosure of a material matter that would require the entity to make the necessary disclosure or otherwise receiving a modified audit report.

**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.)**

***Responses from key stakeholders the NZAuASB consulted with***

Those charged with governance questioned whether the auditors always have a sufficient understanding of business matters, and that there is a risk that such additional information could be inappropriate and alarming when it is not intended to be. The purpose of providing this information was also questioned, and whether it is so that users can understand the rationale for the auditor's conclusion in order to form their own view.

***NZAuASB response***

There is a risk that users may misinterpret commentary of this nature made by the auditor, and that this will have unintended consequences/ influences on users. What is reported in the audit report should relate to the financial statements as prepared by the entity, and should not originate from the auditor.

If there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, under the existing ISAs the auditor either reports an emphasis of matter or modifies the opinion dependent on what is disclosed in the financial statements. If this proposal is adopted, we can envisage that it will become a 'boiler plate' disclosure in a short space of time. The NZAuASB is strongly of the view that it is the responsibility of TCWG to highlight such matters in the financial statements. If this is not done, the auditor may modify the opinion.

The NZAuASB supports the proposal to clarify the responsibility of TCWG with regards to going concern in the audit report.

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

***Responses from key stakeholders the NZAuASB consulted with***

Stakeholders generally feel that this would not add any value to the user. It is not clear why the comments on other information are needed, as long as it is clear what information has been audited.

***NZAuASB response***

Auditors should not provide commentary in the audit report on the work performed on other information in documents containing audited financial statements. It is clear from the audit report what information the audit report covers and adding this statement would not add any value to the user.

However, the distinction between audited and unaudited information is becoming increasingly important with the use of corporate websites as a principal means of distributing financial statements. The environment is dynamic and subject to the risk of unauthorised changes to data, and inappropriate omissions of information (including the audit report), and inappropriate associations between audited and non-audited information. Where the audited financial statements and audit report are published electronically, it should be made clear that the auditor does not provide an opinion on the information which may be hyperlinked to or from the website, and that the integrity of information on the entity's website is management's responsibility (This is currently covered by AGS 1003 *Audit Issues Relating to the Electronic Presentation of Financial Statements and Related Auditor's Reports* in New Zealand).

### **Clarification 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.)**

#### ***Responses from key stakeholders the NZAuASB consulted with***

Stakeholders are generally in agreement with clarifying the roles of management, those charged with governance and the auditor.

#### ***NZAuASB response***

The NZAuASB consider that the enhancements to the paragraphs on auditor and management responsibility are important as one method to address the expectation gap and provide context for the audit.

Even though the paragraphs are more detailed and will continue to be "boilerplate" and may not even be read by many readers of the audit report we are still of the view that such context is essential, and that the value of clarifying these responsibilities outweighs the costs of providing the material in the auditor's report.

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

#### ***Responses from key stakeholders the NZAuASB consulted with***

The regulators and funders we consulted were in favour of disclosing the name of individual auditors, as they were of the view that this may assist with assessing whether a quality audit had been done and therefore would contribute to audit quality. However, users generally mostly value the brand name of the firm, rather than the name of an individual partner.

Auditors we consulted with were concerned about personal liability. If things go wrong, the engagement partner could be unfairly tarnished. In addition, from a practical point of view there are often many partners involved on an engagement, a tax partner, any number of audit partners, and the quality review engagement partner. All of these partners collectively form the audit opinion on the financial statements and therefore it is questionable whether one individual partner can be named as in many instances it is a firm's position, not one individual partner.

#### ***NZAuASB response***

The perceived benefit of this proposal is not clear. There are some jurisdictions where the partner's name is included in the audit report because there is a statutory requirement to do so. The NZAuASB considers that this should be a flexible requirement to be determined by national standard setters.

- 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.)**

***Responses from key stakeholders the NZAuASB consulted with***

Stakeholders generally considered that this would provide transparency, especially where there are significant quantities of work performed by other auditors.

***NZAuASB response***

The NZAuASB considers that there may be instances where providing disclosure regarding the role of other auditors would be considered significant and would increase the transparency of the audit process. However, the NZAuASB recommends not to mandate this as there may be instances where such involvement were not significant and would not add any value.

- 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.)**

***Responses from key stakeholders the NZAuASB consulted with***

As a step towards assisting users to have a better understanding about the nature and benefit of an audit opinion a best practice recommendation could be considered for an explanatory report from the auditor to shareholders referred to in the annual report and published on the web site of the reporting entity. References to the audit process to provide transparency about the audit performed and clarify the respective responsibilities of the auditor, management, and TCWG could be the domain of the auditor, but references to the entity specific materials that are, in the auditor's judgment, likely to be most important to users' understanding of the audited financial statements should be required to be approved by the directors of the reporting entity.

***NZAuASB response***

The NZAuASB is supportive of amending ISA 700 to more explicitly permit this material to be positioned on a website or as an appendix to the auditor's report.

**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.)**

***Responses from key stakeholders the NZAuASB consulted with***

There is support from stakeholders for moving the opinion up front, as is done in the Office of the Auditor-General standard audit report. However, stakeholders are generally not concerned about where the opinion is in the audit report, as long as it is clear and understandable.

### **NZAuASB response**

The NZAuASB supports the proposal to move the opinion to the beginning of the auditor's report.

- 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.)**

### **Responses from key stakeholders the NZAuASB consulted with**

A number of users have indicated that consistency and comparability are important features in auditor reporting.

### **NZAuASB response**

Although consistency is desirable, the NZAuASB is of the view that it is important to allow for national tailoring of the audit report to enable local legislative requirements to be met, when preparing the audit report. If not, although the national standards may conform with the International Standards on Auditing in all other respects, due to local legislative requirements the local auditing standards may not be able to conform, to international standards.

- 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.)**

### **Responses from key stakeholders the NZAuASB consulted with**

Stakeholders generally consider that the ordering of items in the audit report is not important, as long as the important information is included in a clear and transparent manner.

### **NZAuASB response**

The IAASB should mandate what should be in the audit report but the auditor should decide the order, based on user needs, and what law and regulation may require. The IAASB should only provide guidance on the ordering of audit reports.

- 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.)**

### **Responses from key stakeholders the NZAuASB consulted with**

Auditors and TCWG we consulted with are of the view that the fundamentals underlying all assurance engagements should apply to all types of entities. The application of those fundamentals may vary depending on the size, nature or significance of a particular entity.

### **NZAuASB response**

There is no need for audit reports of different size entities to be different – an audit is an audit. The NZAuASB considers that improvements to audit reports should be applied to all audit reports, and that the underlying work effort in the ISAs supporting the possible reporting requirements can be applied proportionally to SMEs. Separate reports can be provided that cover other matters where necessary. For example, in the public sector in New Zealand the Auditor-General reports on financial statements in a traditional manner, but also provides separate reports to Parliament and Select Committees.