

Response to IFAC Exposure Draft on The Value of Auditor Reporting

1. Para 16 Non-disclosure of information about the audit procedures performed and the extensive judgments made by the auditor in forming an opinion.

Commentary

Agreed. The standard audit report does not give sufficient information due to non disclosure of the above, hence may impact on the quality of audit reporting. More details regarding the audit procedures carried out and areas of extensive judgment may render the audit report more helpful to the readers of the financial statements. These details need not be in the audit report but can be disclosed and referred to in the audit report.

2. Para 22 Perception regarding transparency of the audit in respect of the entity and its financial statements, particularly key financial risks and the audit work performed including key areas of audit risk.

Commentary

Agreed more disclosures regarding these would enhance the value of audit reporting.

3. Para 23 & 24 Disclosure of information not currently available to users to narrow the “information gap”. This can be given by management or those charged with governance or the external auditor. There is perceived risk of dueling information (para 24) from the entity and from the auditor.

Commentary

Agreed there may be need for more information to be made available to meet user needs. Whereas information given by the auditor may enhance the degree of credibility to the information availed to the users, management and those charged with governance have a responsibility over the running of the organization and hence also reporting and maintenance of the accounting records, record of business transactions etc as per the national laws.

Therefore the external auditor should not be seen to be taking this responsibility which is for the management and those charged with governance. The external auditor could report on the additional info in para 23 as appropriate depending on the information needs of particular users and most of these are already been captured in the current financial statements on which the auditor gives an opinion. Others not captured like key audit issues which the auditor reports to

management and those charged with governance and the quality and effectiveness of governance structure, significant unusual transactions and risk management in other separate reports can be included, taking into consideration the responsibility of management and those charged with governance.

The report of directors and those charged with governance could be expanded to capture most of this info, then the auditor in his report provides a commentary regarding the information disclosed in this report as opposed to having the auditor reporting and deemed to be originating entity information which is the responsibility of the management and those charged with governance.

5. Para 28 Consistency in auditor reporting for all types of entities

Commentary

Agreed. The standard audit report should be the same for all entities, large or small for consistency but the level and volume/detail of disclosure will vary depending on complexity and risks for individual entities as the auditor exercised professional judgment and guided by the requirements of the specific ISAs and IFRS. Thus the additional information and disclosures will vary for different entities and industry sectors.

- For all entities the auditor exercises professional judgment in determining what other form of reports to give in addition to the standard audit report.*
- The auditor in forming an opinion on the financial statements takes into consideration whether **sufficient appropriate audit evidence has been obtained (ISA 330)** and whether **uncorrected misstatements are material (ISA 450)** individually or in aggregate, and these will influence the form of reporting and additional information the auditor may deem appropriate to disclose in the financial statements..*

6. Para 32 Audit reporting for public sector. Agreed with this. The info needs of users of financial statements in public sector are different and they need to satisfy the **Efficiency, Economy** and **Effectiveness** requirement, hence have much more details than those of other entities.. This demonstrates the info needs as discussed in the previous paragraphs will vary for different entities.

The standard audit report for public sector entities is the same yet the other detailed info in the notes and annexes to the financial statements gives the reader the other info they need to understand the entity and its performance. Whilst these additional info is being considered, the objective of an audit as per **ISA 200** must be maintained.

7. Questions - questions 1 and 2 already answered in the paras above. With regard to the classes of users most affected by the changes in the audit reports are:

- Regulators, investors, analysts, Government (Tax authorities etc)
- Changes would be needed for audits of all entities and not just the listed entities.

Integrated reporting may also need to be considered as these changes are considered because the non financial information not disclosed would also enhance the value and quality of financial reporting.

ISA 200 para 9 states that the auditors may have certain other communication and reporting responsibility to users, management or those charged with governance or parties outside the entity, in relation to matters arising from the audit. This may be spelt out by the ISA or applicable laws, for instance Banking Act, Insurance Act, Companies Act etc.

ISA 800 if the users of financial statements have specific info requirements which the auditor can provide this can be presented by the auditor separately as per their info needs. My view is that the audit report should not be clouded with too much details.

With regard to specific audit areas like Fraud, Going Concern and others IFAC could consider developing some specific standards similar to the PCAOB Standards and reference made to them in the audit report..

8. Paras 38-45 Explanations of Management and Auditor Responsibilities.

Commentary

- Generically worded paras in the audit report are seen by some research respondents to have little information value. I agree some changes can be made to this so that they are more informative, but taking into consideration the objective of an audit (paras 38-39).
- Para 40 - the management responsibilities can be expanded to cover the additional specific areas of their responsibility like fraud, going concern, risk, non financial disclosures and auditor independence.
- With regard to auditor responsibility regarding fraud according to ISA 240 the auditor is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement whether caused by error or fraud. An audit conducted in accordance with ISA and according to Ethical requirements enables the auditor to form an opinion as to whether the financial statements are prepared in all material respects in accordance with the applicable financial reporting framework and presented fairly to give a True and Fair view. Hence the responsibility for fraud detection is **not for the auditor but management**, who are responsible of the internal controls of the entity, but the auditor is expected to

plan the audit and carry out the audit procedures in a manner that would enable him detect frauds that may have taken place.

There may be need to consider adding a statement regarding the **auditor's independence** and the **process** to ensure this is maintained in the audit report.

ISA 580 an auditor is expected to obtain Management Representation to confirm they have fulfilled their responsibilities for the preparation of the financial statements in accordance with applicable financial reporting framework.

- Para 41 relocating the paras to another document out of the financial statements may not be appropriate, as the reader in understanding the financial statements would need to refer or read them as part of the financial statements.
- Para 42 I do not think it is advisable to remove these paras
- Para 43-44 Retain these paras and expand their contents and if need be have additional disclosures like in the notes or appendices.
- Para 45 Developing of material to explain the meaning of an audit and role of an independent auditor may be a good idea but such material is already available but auditors can have them as reference which they can share with clients as and when necessary. These could be in their audit manuals.
- Para 46-48 Technical language – technical terms used could be retained but as in para 45 the definitions can be in the technical material like in audit manuals or other reference material.
- Paras 49-50 Structure of the audit report. The opinion para could be given more prominence as per illustration 2. Although the current structure as per illustration 1 seems to be more logical where we bring out management responsibility before the audit opinion as the auditor relies on management in forming their opinion.

Questions

4. As per illustration 2

5. Retain the paras on auditor's responsibilities and managements' responsibilities but expand them.

Paras 51 -52 Other information in documents containing audited financial statements

- Para 51 I agree with this
- Para 52 Auditors' responsibility with regard to other information – the auditor in forming his opinion will have taken into consideration all other information/evidence that

he needs to form an opinion hence any other information that may not influence his opinion may not be referred in the audit report and the auditor may not be held responsible by users of the financial statements, hence there may be no need for a statement in the audit report in respect of this.

The audit report also mentions that we believe that the audit evidence we obtained is sufficient and appropriate to provide a basis for our audit opinion.

Inclusion of **Management Discussion and Analysis** and a **Report for those Charged with Governance** with sufficient details may be adequate to close the information gap. The auditor in forming his opinion looks at these reports and would confirm their consistency with the rest of the financial statements or otherwise, where the opinion may need to be modified (**ISA 706**), then this is done.

- Paras 54-58 Agreed such a commentary will enhance the value and quality of audit reporting. Emphasis of Matter and Other Matter para in my view are okay as the matters referred to in these paras would influence a user to form an opinion on the financial statements, hence his decision as he uses the audited financial statements.
- Para 61 Increased use of Emphasis of Matter as appropriate is recommended
- Para 62 Additional paras could be considered in the audit report but avoid too much details in the audit report, disclosure in form of a note and reference made in the audit report could be considered.
- Para 63 Materiality thresholds need not be mentioned in the audit report. This could be detrimental to the auditors and its omission does not render the audit reporting inadequate.
This concept may also not be well understood by the users and this may cause ambiguity to such readers of the financial statements, or misunderstanding.
- Para 64 The auditor should ensure any information contained in the management report about the entity is consistent with other info contained in the financial statements.
- Para 65 Auditor Reporting Model – this gives good guidance on the audit reporting
- Para 70 The auditor should not provide info about the entity which has not been disclosed by the entity itself, again guided by the objective of an audit. If there is info the auditor feels should be disclosed by management or those charged with governance in their report then he can discuss this with them and agree with them to include this in their

report, again guided by the responsibility of management and those charged with governance as ISA and National Laws.

- Para 71 Justification of assessments as per French reporting seems to be a very good idea.

Questions

8. Auditor providing additional information about the audit in the auditors report on the financial statements. I agree but care to be taken to avoid too much details and inconsistency with other info reported in the financial statements.

9. Justification of assessment as auditor commentary – a very good idea

10. Auditor providing insights about the entity or the quality of its financial reporting in the auditors report. This may be done elsewhere in the financial statement but reference made in the audit report.

- **Paras 75-86** Enhanced Corporate Governance reporting model

I agree inclusion of a report of those charged with governance and audit committee would add value to financial reporting and the auditor in his report would mention that he has assessed their effectiveness. In case of any dissatisfaction with their evaluation this may require a modification of the auditors report.

Challenges may include the lack of or inadequate technical skills of some audit committees but this form of reporting may necessitate getting the people with appropriate technical skills as members of audit committee. Thus improving governance of the audited entities.

- **Paras 87-88** Other Assurance or Related Services on information Not within the current scope of financial statement audit.

Auditor providing assurance on other such matters is beyond the scope of the audit and may pose a high risk for the auditor as insufficient or no work may have been done in the course of the financial audit for the auditor to give an assurance on such areas.

Such areas would need to be evaluated separately and discussed with the client as this may be subject of a separate assignment where the auditor gives a separate opinion outside the audit opinion on the financial statements.

Some of these areas would be covered in an integrated reporting assignment where an auditor gives an assurance report. There is a risk that the auditor may not have the skills to evaluate and give an assurance on these areas, hence the risk in covering this in the audit report.

- **Paras 92-99** Roles of those charged with governance and auditors and enhanced quality of audit reporting.

The changes proposed to the audit reporting will clarify roles of these parties and enhance the quality of reporting and improve the efficiency in performing these roles by these parties. It will also improve governance and enhance credibility of financial reporting.

Questions

16. **Benefits of changes:** better risk management, improved quality of financial reporting, (auditors and management and those charged with governance will be more careful as there is more scrutiny), more transparency hence increased confidence of audits by the users of financial statements and enhanced governance.

Costs: Additional work for auditors but this can translate to additional fees for the work done once the scope is well determined and agreed with the client, need for educating and training those charged with governance of their roles and the impact on financial reporting and the reports they need to prepare, potential conflict initially between these parties in terms of their financial reporting but this can be managed through training and ensuring appropriate skills mix especially for those charged with governance (Board and Audit Committee), alignment with applicable laws like Banking Act, Insurance act and others, Public Audit Act for Public Sector entities.

17. The benefits, costs and potential challenges and other implications will vary for different entities. Additional work and exposure discussed in the previous para differ from entity to entity and for some like the regulated industries more will be required hence more costs but again dependent on their current state.

- 18 A combination borrowing from each to enrich the audit reporting. IAASB could look at the reporting for several jurisdictions like they have done for France and also consider others like UK, ICAEW and see what can be borrowed.
- 19. Other suggestions for change of auditor reporting
Consider additional Mandatory Disclosures on areas like going concern corporate governance, internal controls and financial reporting processes.

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N.B These are personal views and not the views of Ernst & Young