

October 5, 2012

International Auditing and Assurance Standards Board  
Mr. James Gunn, Technical Director  
529 Fifth Avenue, 6<sup>th</sup> Floor  
New York, NY 10017

Via Electronic Submission

Re: Invitation to Comment – Improving the Auditor’s Report

Dear Ladies and Gentlemen:

Standard & Poor’s Ratings Services appreciates the opportunity to provide the International Auditing and Assurance Standards Board (IAASB) our comments on the “Invitation to Comment – Improving the Auditor’s Report” (Invitation to Comment).

The views expressed in this letter represent those of Standard & Poor’s Ratings Services and do not address, nor do we intend them to address, the views of any other subsidiary Hill Companies, Inc. We intend our comments to address the analytical needs and expectations of our credit analysts.<sup>1</sup>

Standard & Poor’s Ratings Services agrees there is a need to improve the auditor’s report. We believe the recommendations in the Invitation to Comment, especially requiring auditor commentaries, will enhance the auditor’s report and related financial statements, increasing their usefulness and transparency for credit analysts and other users of financial statements.

### **Overall Considerations**

The auditor’s work and report are clearly valuable to our analysts. We rely on the audit report, we expect it, and we are skeptical in its absence or qualification. As users of financial statements, we will benefit from information beyond the assurance currently provided by the pass-fail auditor’s opinion. While the auditor’s report should maintain its pass-fail element, we believe the expanded disclosures, especially the auditor commentaries proposed in the Invitation to Comment, will increase usefulness, minimize expectation gaps, and enhance audit discipline. Specifically, we believe the proposals in the Invitation to Comment will help users to better understand and provide:

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<sup>1</sup> The opinions stated herein are intended to represent Standard & Poor’s Ratings Services views. Our current ratings criteria are not affected by our comments on the Invitation to Comment.

- The basis of the auditor’s work, particularly on specific areas where management judgment is applied, financial statement risks exist, and emphasis is warranted.
- The overall results of the audit beyond the pass-fail opinion.
- The responsibilities that management and the auditor have for the financial statements.
- An improved format and structure of the overall report for more effective delivery of key messages.

### **Auditor Commentaries**

We support requiring auditor commentaries in the auditor’s report or as a supplement to it, and believe they will provide insight beyond the binary pass-fail opinion and the current boilerplate language. Financial statements are increasingly complex, so we believe users need additional insight to understand areas where preparers and auditors apply judgments and estimates, and how auditors were able to obtain sufficient, appropriate audit evidence. We believe auditor commentaries will create a better understanding of the financial statements and provide relevant information on issues identified in the audit that are meaningful to credit analysts and other financial statement users. The auditor commentaries will also provide an independent and objective perspective.

The global financial crisis demonstrated that relevant company information--including hidden financial risks and management judgments--was revealed too late. Perhaps auditor commentaries would have disclosed more information about areas such as where key estimates and assumptions were most subjective, vulnerable, or susceptible to change, or areas in which the accounting--while appropriate--did not fully meet the standard-setting intent or masked the economics (e.g., repo 105, synthetic leases, and other “unique” arrangements). We believe auditor commentaries that highlight areas of significant risk and judgment, especially where it is important to understand future prospects and cash flows, will be useful to analysis.

We believe auditor commentaries should be mandatory. In our view, it is not appropriate to leave their inclusion to the auditor’s discretion. Consistent, comparable auditor commentaries will better enable users to understand and compare the financial condition, results, and cash flows among peer companies. We believe financial-statement users of private- and public-sector entities will better understand financial statements and audit results when auditor commentaries are included. In our credit analysis, we seek the same level of information from all entities, whether large or small; public interest entities or private companies; not-for-profits or government and public finance entities. In this regard, we also recommend expanding the requirement for auditor commentaries to all entities, rather than limiting their use to public interest entities, as suggested in the Invitation to Comment.

We expect guidance for auditor commentaries will be needed to help auditors apply informed and comparable standards regarding topics to address. The minimum matters described in paragraph 45 of the Invitation to Comment are a good foundation and include those we believe will significantly improve the utility of the audit report, such as:

- Areas of significant management judgment in relation to accounting practices, accounting policies, estimates, and financial-statement disclosures.
- Significant or unusual transactions, including related party transactions or restatements.
- Matters of audit significance, including areas of auditor judgment, including difficult or contentious matters noted during the audit (e.g., close calls), and other audit matters that would typically be discussed with those charged with governance (TCWG); and other issues of significance related to the audit scope or strategy.

We believe auditor commentaries should include (if significant):

- Audit risks, including how the auditor addressed and concluded on those risks.
- Information on material accounting choices that might be in technical compliance with accounting standards, but in the auditor's view, need further disclosure or emphasis to increase user's understanding of their effects on the financial statements.
- Areas where the auditor believes management could have plausibly considered applying different accounting or disclosure.
- Control environment and control weaknesses.
- Information on the audit procedures performed and audit evidence obtained in response to matters included in the auditor commentaries.

We also believe auditors should disclose the factors they applied to determine which issues they viewed as “most important to users.”

The information in the auditor commentaries should be presented from the auditor's viewpoint.

### **Going Concern and Other Information**

The going concern assumption is inherent in every audit and justifies valuing assets and liabilities using historical cost; otherwise, a liquidation (or fair value) perspective should be considered. Following the financial crisis, the going concern issue has become a greater worry, and accordingly, addressing it explicitly in the report may add accountability and comfort over this aspect of the audit. However, we do not believe it adds to the informational value of the report (because it already is implicitly required).

## **Form and Structure**

The report format is particularly important to ensure that it communicates key messages effectively. We agree with the Invitation to Comment: The auditor's opinion should be most prominent in the auditor's report. Because of the informational and analytical value auditor commentaries will add, they should be next in order of importance. The auditor commentaries should be clear and concise using entity-specific information, which is where significant value for users will be provided. The auditor commentaries should not include "boilerplate" language. We understand that certain parts of the auditor's report, such as the section on responsibilities of management and auditor, will be more standardized, but entity-specific information should be more prominent. Clarity is also important: Disclaimers should not hide the single critical opinion sentence nor should the auditor's report bury unique information in standardized wording. We suggest the description of the auditor's responsibility and limitations be relegated to a last section of the report, an appendix, or potentially even using a link to an auditor's website. Because this section will be identical for all audits, it does not provide new information and users will not read it after the first time.

In summary, the proposed format should be:

- Core Audit Opinion, including the outcome of internal control audits. Financial-statement users will benefit from auditor review of management's discussion and analysis and XBRL; the results of these reviews should also be included in the core opinion section.
- Auditor Commentary (Auditor Discussion & Analysis), including information in an emphasis paragraph. This should represent incremental information, rather than a validation of existing assertions.
- Specific Nature Of The Audit, including audit procedures performed, use of other auditors, materiality considerations, and scope limitations.
- Disclaimers.

We believe the use of titles, headings, and subheadings, as demonstrated in the illustrated independent auditor's report in the Invitation to Comment, is an excellent technique to identify the purpose of each section and paragraph of the auditor report.

A well-defined format and structure will be helpful to users of the audit report and, unless required by law, should be mandated.

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We thank you for the opportunity to provide our comments, and will be pleased to discuss our views with Members of the IAASB or your staff. If you have any questions or require additional information, please contact the undersigned.

Very truly yours,

Neri Bukspan  
Executive Managing Director, Chief Quality Officer, and Chief Accountant  
Standard & Poor's  
neri\_bukspan@standardandpoors.com  
(212) 438-1792

Joyce Joseph  
Managing Director, Corporate & Government Ratings  
Standard & Poor's  
joyce\_joseph@standardandpoors.com  
(212) 438-1217

Sherman Myers  
Director, Corporate & Government Ratings  
Standard & Poor's  
sherman\_myers@standardandpoors.com  
(212) 438-4229