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Ref: DAH

8 October 2012

Mr James Gunn  
Technical Director  
International Auditing and Assurance Standards Board  
545 Fifth Avenue, 14th Floor  
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**Via website:** [www.ifac.org/publications-resources/improving-auditor-s-report](http://www.ifac.org/publications-resources/improving-auditor-s-report)

Dear Mr Gunn

## INVITATION TO COMMENT: IMPROVING THE AUDITOR'S REPORT

We appreciate the opportunity to provide our views on this paper. We recognise that the auditor's report is often the primary means of an auditor's communication with an entity's stakeholders and therefore its form and content is significant to those who rely on audited financial information.

Pitcher Partners is an association of independent firms operating from all major cities in Australia. Our clients come from a wide range of industries and include listed and non-listed disclosing entities, large private businesses, family groups, government entities, small to medium sized enterprises and not-for-profit entities. Consequently we provide audit and assurance services to a wide range of business structures and issue auditors' reports which are used by a broad range of identifiable stakeholders beyond the largely anonymous group of investors in capital markets.

We have responded to the specific requests for comments below, with the understanding that the status quo is not an option. However, we have the following overarching concerns which we consider require attention in order for the "improvements" to the auditor's report to be effective:-

### *Focus on the opinion paragraphs*

- In our experience, readers of the auditor's report have a primary focus on the opinion paragraphs and pay little attention to the standard text which explains the scope of the audit, management and auditor responsibilities. We do not believe that *more* information is necessarily *better* information, and particularly when that information is not presented in plain English.

### *Communications using technical audit language*

- Auditors' reports and International Standards on Auditing (ISAs) are written in a technical audit language. While the relevance of particular terms and phrases are well understood by standard setters and technical experts, they are often "translated" into plain English when firms develop their own methodologies and audit manuals. We have serious concerns that an "improved" auditor's report, written in technical audit language, is unlikely to provide an optimal solution. We concede that the language used in auditors' reports to explain responsibilities or to comment on subjective areas must be written in the language of the auditing and accounting standards to mitigate practice risk in the event that the auditor's report needs closer examination. Therefore, we consider the availability of plain English descriptions and explanations, albeit in a different location (such as the standard setters' web sites) are imperative to improving the effectiveness of communications with stakeholders.

### *Expectation gap issues and presentation of financial information*

- Even if it is assumed that extending the nature of information in the auditor's report will provide user benefits, these benefits can only be incremental at best. The expectation gap is exasperated by financial information being presented in a format that is not user-friendly. In the absence of improvements to the presentation of financial information, the proposed "improvements" to the auditor's report will simply add to the complexity that already exists in financial reports.
- Expectation gaps exist in respect of both the audit and in respect of the subject matter of the audit, being *economic performance* as reported in financial statements prepared in accordance with a specified accounting framework. In particular users have a lack of understanding that an audit provides reasonable not absolute assurance, and a lack of understanding that there are few "absolute measures" in a fair value accounting framework. Although annual reports contain a wealth of information that explains the subjectivity in determining the financial performance and position of a business, user understanding is inhibited by the complex presentation format in which lengthy financial information is provided to users in a sequential format.
- We consider that the *sequential presentation* of financial information in lengthy, complex financial reports, which essentially replicate a hard copy printed format, is **not** the most user-friendly presentation format. Those involved in *technical* financial reporting are familiar with the requirements and can quickly navigate through the pages of content. However, those who are not closely involved with technical accounting concepts are faced with information overload. We need to have a mechanism where users can drill down through summarised financial information to find detailed explanations quickly and easily. The technology is available now to use hyperlinks to drill down quickly through multiple disclosures for easier direct access by users.
- When entities began placing their financial information on company websites in the late 1990s, the audit profession was instrumental in making sure that the audited financial information was separately identifiable on a web site, often in "pdf" documents. Despite advances in technology, more than a decade later these same formats are still being used. We consider that solutions need to be researched to enable the identification and separation of audited and non-audited information on company web sites, which can then be presented in a user-friendly, searchable, electronic format.

Our responses to the specific questions for comment follow.

### Overall considerations

#### **Q1: Overall, do you believe that 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?**

Subject to the satisfactory resolution of the matters described in our overarching concerns, the enhancements may bring incremental improvements to user understanding. However, the proposals prompt the need for important consequential amendments to numerous ISAs. In particular:

##### *ISA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

- Paragraph 11 of ISA 200 refers to the auditor's objective in terms of expressing an opinion on the financial statements **as a whole**. The auditor's commentary explicitly gives emphasis to particular areas requiring user attention. This mode of reporting is inconsistent with the current objective of an audit as stated.

##### *ISA 315 Identifying and assessing the Risks of Material Misstatement through Understanding the Entity and its Environment*

- ISA 315 directs the auditor's consideration of risk at the financial report level and the assertion level. The auditor's commentary is intended to draw the users' attention to subjective areas of the financial report and audit. This action will therefore require the auditor's specific consideration of the disclosure of items that have a high level of "qualitative disclosure risk". There is minimal consideration of this aspect of audit risk in the current ISA 315.
- The extent of the auditor's responsibilities in respect of note disclosures is the subject of a separate IAASB project. However, in advance of the outcome of that project, auditors will need to apply professional judgment to determine which disclosures should be emphasised, based on individual understanding of the significance of those disclosures, and in the absence of appropriate authoritative guidance. While this is not an impossible task, in the absence of clear direction, there is likely to be significant divergence in practice.

##### *ISA 320 Materiality in Planning and Performing an Audit*

- "Qualitative disclosure risk" will impact the consideration of materiality and audit planning. However, a clear and consistent understanding of what "qualitative disclosure risk" might comprise is yet to be determined.

##### *ISA 450 Evaluation of Misstatement identified During the Audit*

- Although ISA 450 includes reference to qualitative considerations, more extensive guidance will be needed to ensure a consistent approach to evaluating qualitative concerns in respect of narratives in disclosures. Complex disclosure notes are frequently written by technical experts in the specific subject matter, using the language of the accounting standards. The understandability of these disclosures, even to sophisticated users of financial statements, will require closer audit attention, if the intention to provide useful information to users is to be achieved.

#### *ISA 705 Modifications to the Opinion in the Independent Auditor's Report*

- The impact of additional information in the auditor's report on a modification to the opinion needs careful consideration. For example, if there is concern regarding fair value measurement of a particular item, currently the basis for the qualified opinion can focus the reader's attention specifically on that item. However, with the introduction of the commentary, there may be additional matters that need to be identified (say) regarding the underlying assumptions described in other related note disclosures. There is a risk of cumbersome reporting which leaves the reader more confused than enlightened.

The status and relevance of current guidance in *ISA 706 Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report* and *ISA 720 The Auditor's Responsibilities Relating to Other Information in Documents Containing an Audited Financial Report* will also need significant revision.

If the improvements to the auditor's report were implemented as anticipated in the ITC, revisions are likely to be needed in other assurance reports issued by auditors, which follow the framework currently set out in ISA 700 for the requirements of an auditor's report.

#### **Q2: 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.**

We consider that there is an urgent need for a plain English guide to explain the auditor's responsibilities to directors and other users of financial reports. The current auditor's report attempts to capture the essence of the extensive requirements of the ISAs, which set out an auditor's responsibilities at every stage of the audit, in just a few lines. However, this short explanation contains lengthy sentences written in technical audit language and therefore provides little real meaning to those outside the audit profession. We question the benefit to users in extending explanations of audit inquiry using technical language.

We consider that a short form auditor report, supplemented by a long-form guide written in plain English, would significantly enhance stakeholder understanding of the auditor's objective and the meaning attributed to the opinion given.

#### **Auditor Commentary**

#### **Q3: 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?**

We do not consider the concept of Auditor Commentary is an appropriate response. International Financial Reporting Standards (IFRS) require extensive disclosures concerning the recognition and measurement of items presented in the financial report.

In particular IAS 1 *Presentation of Financial Statements* paragraph 125 states:

125. An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of:
- (a) Their nature; and
  - (b) Their carrying amount as at the end of the reporting period

For a financial report prepared in accordance with IFRS, these items are frequently "sign-posted" in a separate note under the heading "Critical Accounting Estimates and Judgments". If an entity has critical accounting estimates and judgments and does not

comply with this disclosure requirement, it is likely that the auditor would consider the financial report to contain a material omission. This would result in a qualification where appropriate disclosure is not made.

Similarly, even financial statements of SMEs compiled by a practitioner in accordance with ISRS 4410 *Engagements to Compile Financial Statements* require notes to the financial statements to disclose the applicable financial reporting framework and any known departures (refer ISRS 4410 paragraph 15).

Consequently, in practical terms, in the auditor's commentary the auditor can only draw attention to the information in the notes already provided by management. If the appropriate notes are not provided by management, or if they contain insufficient detail, the auditor will need to modify the opinion provided in respect of material omissions. In our view, repetition of information provided in the notes in the auditor's report only lengthens the financial report and adds to the complexity. It would be preferable for the auditor to make a simple statement that (for example) "Critical accounting estimates and judgments are described in note X to the financial statements."

However, a further issue arises in respect of the **reasonable assurance** provided on the critical accounting estimates and judgments. By definition, these items are based on assumptions the entity makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. We consider that auditing standards should direct the auditor to provide only **limited assurance** on these items which are based on "best estimates of the future". In reality there is more than one possible scenario for the future and frequently the auditor can only conclude that the assumptions used are **not unreasonable** estimates of future outcomes (i.e. nothing has come to the auditor's attention that suggests that the assumptions are inappropriate). However, whether or not the assumptions are actually "the best estimate" of the future outcomes depends entirely on future events and management's response to those events. We consider that users of financial reports would have a better understanding of the uncertainty underlying accounting estimates, if the auditor's report clearly differentiated these items.

**Q4: 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? [para 43-50]**

We consider that if matters to be addressed in Auditor Commentary are left to the judgment of the auditor, the Auditor Commentary has the potential to become an opportunity for marketing the audit firm's services. We have already seen a similar response where firms are required to provide transparency reports regarding the nature of their audit practices in accordance with regulatory requirements.

Matters of significance are likely to vary based on the perspective of the users of the financial statements. For example consider the differing priorities of financiers, investors (and subgroups such as "ethical investors"), unsecured suppliers, employees, environmentalists etc. Guidance is needed to facilitate the auditor's decision-making process in identifying the user groups to be considered in order to select the matters to include in Auditor Commentary.

We consider that auditor's reports should focus on matters relating to the presentation of reliable financial information prepared in accordance with the applicable financial reporting framework. If the Auditor Commentary is not restricted to matters relating to the financial report we are likely to see significant divergence in practice and an increase in user *mis*understanding of the objective of an audit.

Please refer to our comments under Q3 above. We consider the commentary should be restricted to a statement to reference the note on "Critical Accounting Estimates and Judgments" under IFRS or their equivalent under other accounting frameworks.

**Q5: Do the illustrative examples of the Auditor Commentary have 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?**

Please refer to comments made under Q3 and Q4 above. Also comments regarding going concern and solvency provided under Q8 below.

**Q6: 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?**

Any modifications to the auditor's report require consultation by the engagement partner with a quality review partner and technical experts. Therefore we anticipate a significant increase in audit costs to ensure that the issues identified for commentary are appropriate, the language used to describe issues identified is consistent with the financial report disclosures, and the language in the accounting and auditing standards. Further time and costs will be required in discussion and agreement of matters arising with management and those charged with governance. The impact of a modification to the auditor's opinion, on any additional disclosures (refer Q1 above) will also need consideration and consultation with all parties.

To the extent that these disclosures are likely to become "boiler-plate" with a direct copy from the note disclosure on "critical accounting estimates and judgments" costs may not be excessive except for the first year when the new reporting format is introduced.

**Q7: Do you agree that providing Auditor Commentary for certain audits (e.g. audits of public interest entities (PIEs)), and leaving its inclusion in 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 Audit Commentary should be provided?**

We do not support a differentiation in the nature and extent of information provided in the auditors' report of different types of entities. We consider that the proposed differentiation is inconsistent with the view that "an audit is an audit". Given that the auditor's report is the primary means of an auditor's communication with an entity's stakeholders, the significant difference that is likely to arise in the form and content of auditor's reports for different types of entities immediately raises questions about the nature and extent of work conducted by the auditor.

### Going concern/ Other information

**Q8: 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?**

Going concern, solvency and liquidity have very similar, but not identical meanings. In Australia the directors and auditors consideration of *solvency* is addressed through legislative requirements in the *Corporations Act 2001*. Directors are required to make an explicit declaration that they consider that the entity will be able to pay its debts as and when they fall due, and the auditor provides an opinion on the directors' declaration. In contrast, going concern is a fundamental underlying assumption for preparation of the financial report.

We question whether the global financial crisis and the corporate failures that followed arose through inappropriate consideration of the going concern assumption, solvency issues or a lack of understanding of volatility in fair value measurements. Would the proposals as suggested in the ITC have caused the auditors to think differently about application of the going concern basis? It is possible that the auditors would have made positive statements about going concern as put forward in the ITC, which would have been of no consequence to enabling users to understand the uncertainties that existed.

We consider that there is adequate disclosure in financial statements concerning going concern. We also consider that auditor reporting by exception on this issue will be more useful to readers of the financial report than "boiler-plate" statements about application of the going concern basis in all auditors' reports.

**Q9: What are your views on the value and impediments of including additional information in the auditor's report about the auditor's judgement and processes to support the auditor's statement that no material uncertainties have been identified?**

Please refer to Q8 above.

We have serious concerns that the use of disclaimers to state the obvious has little value to users.

In particular we question the value added to the auditor's report by the statement: "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." Auditors do not "guarantee" any aspect of the financial report and therefore use of this language in respect of a fundamental underlying assumption is potentially misleading to users.

**Q10: What are your views on the value and impediments of the suggested auditor statement in relation to other information?**

We recognise that the IAASB has a separate project in respect of other information included with the entity's financial report and consider that this whole area needs specific separate consideration. We consider that in the absence of regulatory control that requires entities to obtain audit examination of information presented to the public, it is not feasible for the auditor to have *any* responsibility for the consistency of other information presented with the financial report. Depending on the nature and extent of an entity's use of web sites and social media, there is the potential for the financial report to be distributed with other

information over which the auditor has no control, either at the time the financial report is first issued or at a later date.

We consider that the practice of clearly labelling audited information as “audited” is preferable. Also, users should be educated to understand that all other information which does not bear the “audited” label is not audited.

### **Clarifications and Transparency**

**Q11: 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?**

Please refer to our comments on page 2 regarding the limited usefulness of explanation written in technical audit language. Also refer to comments under Q2 as we consider that there is an urgent need for a plain English guide to explain the auditor’s responsibilities to directors and other users of financial reports.

Although the explicit responsibilities of management and TCWG in respect of the financial report may vary between different jurisdictions, the ISAs are written with the presumption that preparation and presentation of the financial report is always management’s responsibility. It would be useful to include this discussion alongside the discussion of the auditor’s responsibilities in a plain English guide to the audit.

**Q12: What are your views on the value and impediments of disclosing the name of the engagement partner?**

The name of the engagement partner is always disclosed in auditors’ reports in Australia and we have not observed any issues arising from this practice.

When there is a change of auditor or where Pitcher Partners are to be appointed as auditors for the first time, it is always useful to have the name of the previous engagement partner who was the signing auditor to facilitate communications to obtain ethical clearance and access to prior year working papers.

**Q13: 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 be included in the all relevant circumstances, or left to the auditor’s judgement as part of Auditor Commentary?**

We do not support disclosure regarding the involvement of other auditors. The proposed disclosure is inconsistent with the fact that the auditor of the consolidated group has responsibility for obtaining sufficient appropriate audit evidence for the consolidated financial statements. If this practice were to be adopted it then raises questions as to whether disclosures should be made where the work of experts or other external parties has been referenced. We consider that these disclosures will lead to a blurring of responsibilities and result in misunderstanding by users.

**Q14: 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 an appendix to the auditor’s report?**

We support the proposal to move standardized material out of the body of the auditor’s report so that users can focus on current information. In preference to limited information



provided in an appendix to the auditor's report, we would prefer to see a more comprehensive guide to auditor's responsibilities written in plain English and made available on the IAASB web site or the local standard setter's website.

Please also refer to our comments on Q2.

### **Form and structure**

**Q15: What are your views on whether the IAASB's suggested structure of the illustrative report, including the 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?**

We support the proposal to place the auditor's opinion at the beginning of the report together with any "true" modification, in contrast to the Auditor Commentary.

We have concerns that the placement of the Auditor's Commentary close to the opinion will confuse user understanding of significant issues that modify the opinion, or which need emphasis in the context of the opinion given.

**Q16: What are your views regarding the need for global consistency in auditors reports when ISA's, or national auditing standards that incorporate or are otherwise based on ISA's are used?**

We support the need for global consistency. We would prefer local reporting issues to be addressed in a separate section of the auditor's report.

Please refer to our response to Q17 below.

**Q17: What are your views as to whether the IAASB should mandate the ordering of items in a manner similar to the shown in the illustrative report, unless law or regulation require otherwise? Would this provide sufficient flexibility to accommodate national reporting requirements or practices?**

We do not support the ordering of items as presented in the illustrative report, although we do support the mandatory ordering of items to promote consistent presentation of auditor's reports.

We would recommend the following structure:

- (a) Auditor's opinion on the financial statements, with basis for qualification and emphasis of matter (in accordance with the current ISA 706) if any
- (b) Statement to reference auditor responsibilities to the plain English guide on IAASB or standard setters web site including an explanation that reasonable assurance does not provide any guarantees to users; ALTERNATIVE: reference to Appendix 1
- (c) Statement to reference "Critical accounting estimates and judgments" note to the financial statements; ALTERNATIVE: reference to Appendix 2
- (d) Statement regarding directors' consideration of going concern
- (e) Other local reporting responsibilities

Appendix 1 – auditor responsibilities and management responsibilities with reference to plain English guide on the IAASB web site

Appendix 2 – auditor commentary (if retained but preference is to delete this section and replace with disclosures under (b), (c) and (d))

**Q18: 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, medium-sized entities (SME's) and public sector entities should the IAASB further take into account in approaching its standard-setting proposals?**

We consider that the content described under Q17 items (a) to (e) is relevant for all entities of all sizes. On the basis that "an audit is an audit" we do not support differentiating the content of auditor's report based on the nature or size of the entity

Please do not hesitate to contact me if there are any matters arising that require further explanation or clarification.

Yours sincerely



S D AZOOR HUGHES  
Partner