



Meeting: IAASB Consultative Advisory Group

Meeting Location: Brussels

Meeting Date: March 6–7, 2012

Agenda Item

G

Auditor Reporting—IAASB Project Proposal and General Approach

Objectives of Agenda Item

1. The objectives of this Agenda Item are to:
 - (a) Brief the CAG on the overall approach being taken to the project, including plans for the approval of a consultation on auditor reporting at the June 2012 IAASB meeting.
 - (b) Provide context in which to consider additional agenda items on auditor reporting for discussion at the March 2012 CAG meeting.

Detailed comments on the project will be considered in the context of the detailed discussions of **Agenda Items H, K, L, and M.**

Papers to Be Referred to during Discussion

2. The discussion of this topic will follow the structure of this CAG Paper. **Agenda Item G.1** contains the project proposal on auditor reporting approved by the IAASB at its December 2011 meeting. The Task Force Chair intends to use a slide presentation to guide the discussion, which will be distributed to the Representatives separately as Appendix 3 to this paper prior to the meeting.

Project Status and Timeline

3. Appendix 2 to this paper provides a history of previous discussions with the CAG on this topic, including links to the relevant CAG documentation.

Background

4. At its May 2011 meeting, the IAASB approved the issuance of a Consultation Paper (CP), *Enhancing the Value of Auditor Reporting: Exploring Options for Change*.¹ The CP was issued with a 120-day comment period that ended on September 16, 2011, and 82 responses were received. At its September 2011 meeting, the CAG continue to provide strategic input to the IAASB on the

¹ The CP and all responses can be accessed at www.ifac.org/publications-resources/enhancing-value-auditor-reporting-exploring-options-change. These responses were analyzed by the Auditor Reporting Working Group and IAASB in approving the project proposal in **Agenda Item G.1** and are discussed in more detail in the December 2011 IAASB Issues Paper, available at [www.ifac.org/sites/default/files/meetings/files/20111205-IAASB-Agenda_Item_5-B-Auditor_Reporting_Issues_Paper-v1-03%20\(3\).pdf](http://www.ifac.org/sites/default/files/meetings/files/20111205-IAASB-Agenda_Item_5-B-Auditor_Reporting_Issues_Paper-v1-03%20(3).pdf).

topic of auditor reporting.² At its December 2011 meeting, the IAASB considered comments from the CAG's September 2011 meeting as well as the responses received on consultation to determine an appropriate way forward.

5. As a result of its discussions, at its December 2011 meeting the IAASB approved the commencement of a project on Auditor Reporting on a priority basis. While accepting of the plan to issue a comprehensive exposure draft (ED) by June 2013 as outlined in the project proposal (PP) (included as **Agenda Item G.1**), the Board advised that serious consideration should be given to ways to accelerate the project timetable or engage global stakeholders earlier than 2013 on key issues.
6. In response, and with input and direction from the IAASB Steering Committee, the Task Force has as its immediate priority the development of a meaningful consultation on key elements of the auditor's report by June 2012 (as an interim step to the June 2013 ED.) The intention is for this consultation to demonstrate substantial progress in IAASB thinking on critical issues, and present the most likely direction the IAASB would propose to take relative to the content of the auditor's report, including proposed illustrative examples to the extent appropriate. This interim consultation is important to IAASB's ability to formulate a quality and well-informed ED in 2013 and subsequently finalize new standards in a timely manner. (Hereafter the June 2012 consultation is referred to as Consultation Paper (CP), for convenience. It may be appropriate, however, to identify a different title when releasing the actual publication to avoid confusion with the May 2011 CP and reflect the progressive nature of the document.)

Prioritization of Issues

7. The TF's intent is not to address all possible issues for purposes of the June 2012 consultation; rather, it believes the consultation should focus on major issues where directional input, and reactions to proposed options, from stakeholders will be important. To facilitate the IAASB's March 2012 discussion and the development of the June 2012 CP, the TF determined a number of priority issues³ to be explored by four subcommittees (SCs). These are addressed in the relevant agenda material and were based on areas highlighted in the PP and relevant responses to the May 2011 CP. The SCs comprise:
 - Insights; (**Agenda Item H**)
 - Going Concern / Other Information; (**Agenda Item K**)
 - Building Blocks; and (**Agenda Item L**)
 - Clarifications and Transparency (**Agenda Item M**).
8. In addition, the TF considered the European Commission (EC) legislative proposals relating to auditor reporting, with a specific focus on Article 22. It is the TF's understanding that the EC proposals were not intended to change the current scope of the financial statement audit. On this

² See discussion of Item H in **Agenda Item A**. These points will be further considered as the IAASB's proposals develop.

³ Other relevant matters that were not deemed to be of the highest priority will be considered by the TF and SCs in advance of the June 2013 ED.

basis, Staff prepared a detailed analysis to consider the extent to which the extant ISAs already addressed the proposals. This analysis also identifies key areas to be addressed in developing the June 2012 CP, and highlights how the matters will be further considered by the SCs. It is included as a CAG Reference Paper. There are a number of other areas⁴ for further consideration where, before proceeding, further information as to the intent of the proposals may be helpful. Also, the TF is of the view that certain of these proposals may not be appropriate to mandate on an international basis, but may be more usefully addressed by the application of the “building blocks approach” in the context of other regulatory requirements for auditor reporting, which is discussed in **Agenda Item L**.

9. A similar analysis was undertaken for the EC’s proposals in Article 23 relating to reporting to audit committees / those charged with governance (TCWG), also included as a CAG Reference Paper. The TF was of the view that further consideration of Article 23 and the possible effects on ISA 260⁵ would be appropriate after the issuance of the June 2012 CP. This will allow the IAASB to leverage its thinking relating to the external audit report in determining whether more is needed to strengthen reporting to TCWG. This CAG Reference Paper also refers to the Article 24 proposals, which may need to be further considered by the IAASB in due course.

Consideration of Options by the SCs and TF, including their Value and Impediments

10. In considering options at the SC and TF level, the TF agreed that working principles were needed to substantially advance the discussions, namely that:
 - The current scope of audit is maintained, unless discussions indicate a pervasive need to reconsider this position.
 - Extant ISA 700 should be used as a starting point, supplemented by known proposals for change in auditor reporting (e.g., EC, US Public Company Accounting Oversight Board (PCAOB), UK Financial Reporting Council (FRC), etc.).
 - Detailed response from the May 2011 CP on auditor reporting will be leveraged as a basis for new proposals.
11. The TF also agreed to use a value and impediments model to evaluate options and thereby provide a basis for narrowing options to those that it believes should be pursued. This model is included in **Appendix 1**. In using this model, the SC and TF members were asked to raise the pros and cons of each proposed option and the rationale for their preference. Further information about their decisions and judgments are described in the related agenda material on each topic. The TF believes that the value and impediments model is a useful means for informing decision-making.

⁴ In addition, a number of the proposals are relevant to both the IAASB and the International Ethics Standards Board for Accountants (IESBA) and, to the extent the IAASB intends to require auditor reporting on matters relating to ethics, coordination with the IESBA will be necessary.

⁵ ISA 260, *Communication with Those Charged with Governance*

Coordination and Outreach

12. The PP explained that, due to the nature and potentially wide scope of the project, obtaining further stakeholder views will be fundamental to the IAASB's objectives in undertaking the project. For example, consultation with members of the user/investor community, as well as preparers, TCWG, regulators, and auditors of financial statements, will inform the IAASB's deliberations in exploring various proposals. The TF has considered the extent to which outreach should be undertaken in advance of the planned June 2012 CP and has concluded efforts should be directed towards:

- EC Representatives – To ensure a consistent understanding of the intent of the proposals to ensure they are adequately addressed.
- PCAOB – To identify areas of mutual interest and opportunities for collaboration.
- CAG – To seek feedback on the proposals from the investors, preparers, regulators, corporate governance and other organizations represented thereon.
- National Standard Setters (NSS) – To discuss relevant national reporting regimes that should be taken into account in developing the “building blocks approach.”
- Forum of Firms / Transnational Auditors Committee – To discuss implications of the various proposals, with a focus on how they could be operationalized on an international basis.
- Groups representing investor interests or analysts, through other ongoing liaison activities by IAASB leadership, as appropriate.

The CAG will receive a presentation from EC and PCAOB Staff on their recent proposals and current activities relating to auditor reporting as part of **Agenda Item F**.

13. The TF believes the June 2012 consultation will provide a further platform on which outreach with investors and analysts, regulators and oversight bodies, TCWG, and others can be conducted effectively. The TF intends to further consider the approach to such outreach in advance of the June 2012 meeting.

Matters for CAG Consideration

14. The TF recognizes that finalizing a CP on auditor reporting by June 2012 is an ambitious goal. In order for the TF to progress proposals on various options and develop illustrative reports for purposes of this consultation, it is important that the IAASB at its March 2012 meeting forms a view on the specific options presented for consideration in the agenda materials.

Matters for CAG Consideration

The CAG is asked to:

1. Consider the recommendations and questions posed in the context of the individual sub-committee agenda materials (**Agenda Items H, K, L and M**); and
2. Raise any other matters considered relevant to the project and the plans for a June 2012 CP.

Material Presented – IAASB CAG PAPER

Agenda Item G.1 Enhancing the Value of Auditor Reporting—IAASB Project Proposal to Revise Relevant ISAs
(Approved December 2011)

Material Presented – FOR IAASB CAG REFERENCE PURPOSES ONLY

Agenda Item 4-F of the March 2012 IAASB
Meeting – Preliminary Analysis of EC
Proposals in Article 22 – For Reference
Purposes Only

[http://www.ifac.org/sites/default/files/meetings/files/20120312-
IAASB-Agenda_Item_4F-
Auditor_Reporting_Analysis_of_EC_Article_22_Proposals-
for_reference_only.pdf](http://www.ifac.org/sites/default/files/meetings/files/20120312-IAASB-Agenda_Item_4F-Auditor_Reporting_Analysis_of_EC_Article_22_Proposals-for_reference_only.pdf)

Agenda Item 4-G of the March 2012 IAASB
Meeting – Preliminary Analysis of EC
Proposals in Article 23 – For Reference
Purposes Only

[http://www.ifac.org/sites/default/files/meetings/files/20120312-
IAASB-Agenda_Item_4G-
Auditor_Reporting_Analysis_of_EC_Article_23_Proposals-
for_reference_only.pdf](http://www.ifac.org/sites/default/files/meetings/files/20120312-IAASB-Agenda_Item_4G-Auditor_Reporting_Analysis_of_EC_Article_23_Proposals-for_reference_only.pdf)

Appendix 1

Decision Making Guidelines in Relation to Value and Impediments

1. The TF agreed it would be useful for the sub-committees, TF, and IAASB to consider options for change in terms of the relative value and possible impediments of the various proposals, for example:
 - (a) What is the value?
 - Does any proposed additional information to be included in the auditor's report enhance its communicative value (i.e., does it address the information gap⁶)?
 - For example, does the proposed change further enhance users' ability to navigate and understand significant matters in the financial statements?
 - Does it enhance transparency about the audit, by better explaining the nature and purpose of an audit, including explaining what an audit is intended to achieve and how it is executed i.e., does it narrow the expectations gap⁷)?
 - Does the option provide appropriately tailored, rather than additional technical and standardized (i.e., "boilerplate"), language to the extent practicable based on the topic?
 - (b) In relation to impediments, a subset of which is costs:
 - Does the proposed action go beyond the current scope of the audit?⁸ If so, at what cost and to what extent would changes to other ISAs be needed?
 - Can the option be operationalized by auditors?
 - Does the option raise questions about management's primary responsibility for the financial statements and the auditor's assurance role?
 - (c) Does the proposed "building blocks" approach allow for proportionality and scalability (for example, based on the size of the entity or jurisdictional needs)?
2. The goal is to focus on areas with high value and a low level of impediments, though it was recognized that user demand may warrant exploration of areas of high value even if impediments are considered to be high. To illustrate, the following matrix may be helpful:

⁶ The term "information gap" describes the divide between what users believe is necessary to make informed investment and fiduciary decisions, and what is available to them through the entity's audited financial statements, the auditor's report or other publicly available information.

⁷ The term "expectations gap" has been defined and described in a number of ways. In the broadest terms, the expectations gap is the difference between what users expect from the auditor and the financial statement audit, and the reality of what an audit is.

⁸ The project proposal assumed the current scope of audit is maintained, unless discussions indicate a pervasive need to reconsider this position. The TF confirmed that, in proposing options, consideration would be given as to whether each option would expand the scope of the audit and, if so, the cost of doing so.

Im pe di me nt	High	Options that Are Least Likely to Be Pursued	Other Options that May Be Pursued
	Low	Options that Are Less Likely to Be Pursued	Options that Are Most Likely to Be Pursued
Value (in terms of user needs)			
		Low	High

3. In considering value and impediments of particular options, the TF believes the IAASB will need to be mindful of the links to audit quality. Any proposals should not detract from audit quality or perceptions of audit quality. While it may be more difficult to evaluate how an option may favorably impact audit quality, it is likely that enabling auditors to provide additional commentary on matters of key audit judgment will lead to greater focus on these areas and related disclosures by management and TCWG, thereby strengthening the financial reporting process and audit quality in turn. The TF also discussed the need for the IAASB to remain as open as possible in considering the options presented for change and give thought as to what might be needed in relation to making options feasible to respond to user demands.

Appendix 2

Project History

Project: Auditor Reporting

Summary

	CAG Meeting	IAASB Meeting
Report of IAASB Working Group – key findings from academic research studies on user perceptions of the standard auditor's report	March 2010	December 2009
Issues Paper and IAASB Working Group Proposals	-	December 2010
Development of Proposed Consultation Paper	March 2011	March 2011 May 2011
Consultation – May 2011		
Further Discussion	September 2011	
Discussion of Project Proposal and Issues	March 2012	December 2011 March 2012

CAG Discussions: Detailed References

Report of IAASB Working Group – key findings from academic research studies on user perceptions of the standard auditor's report	<u>March 2010</u> See IAASB CAG meeting material: http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=5253 See CAG meeting minutes (in Agenda Item D of the following material): http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=5882 See report back on March 2010 CAG meeting (in paragraph 12 of the following material): http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=6095
Development of Proposed Consultation Paper	<u>March 2011</u> See IAASB CAG meeting material: http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=6095 http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=6096 See CAG meeting minutes (in Agenda Item M of the following):

	<p>http://www.ifac.org/sites/default/files/meetings/files/20110912-IAASBCAG-AgendaItemA-Final_March_2011_Public_Minutes_APPROVED-v1-03.pdf</p> <p>See report back on March 2011 CAG meeting (in paragraph 1 of the following):</p> <p>http://www.ifac.org/sites/default/files/meetings/files/20110912-IAASBCAG-AgendaItemH1-Auditor-Reporting-V1-02.pdf</p>
Further Discussion	<p><u>September 2011</u></p> <p>See IAASB CAG meeting material:</p> <p>http://www.ifac.org/sites/default/files/meetings/files/20110912-IAASBCAG-AgendaItemH-Auditor-Reporting-V1-02.pdf</p> <p>http://www.ifac.org/sites/default/files/meetings/files/20110912-IAASBCAG-AgendaItemH1-Auditor-Reporting-V1-02.pdf</p> <p>See CAG meeting minutes (in Agenda Item H of the following material):</p> <p>See draft September CAG meeting minutes at Agenda Item A.</p>