

IAASB

## Views on the Invitation to Comment on Auditor Reporting

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IAASB Meeting – Agenda Item 6

December 11–12, 2012

## Asia Pacific Roundtable – October 8, 2012

Co-hosted by Malaysian Institute of Accountants (MIA), Institute of Chartered Accountants in Australia (ICAA), and Malaysian Institute of Certified Public Accountants (MICPA)

Stakeholder Groups	> 50 attendees
Investors and Analysts	6
Preparers and Those Charged with Governance (TCWG)	4
Regulators and Audit Oversight Bodies	8
Auditors, including SMPs	12
IFAC Member Bodies and Standard Setters	21

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## Summary of Participation at the Roundtables

Stakeholder Groups	> 140 Participants
Investors and Analysts	19
Preparers and Those Charged with Governance (TCWG)	22
Regulators and Audit Oversight Bodies	24
Auditors, including SMPs	33
IFAC Member Bodies and Standard Setters	41

## Breakout of 164 Respondents to ITC by Category

Respondent Category	Number	Percentage
Investors and Analysts	13	8%
Those Charged with Governance (TCWG)	8	5%
Regulators and Audit Oversight Bodies	17	10%
National Standard Setters (NSS)	13	8%
Accounting Firms	24	15%
Public Sector Auditors	12	7%
Preparers	11	7%
Member Bodies and Other Professional Organizations	43	26%
Academics	10	6%
Individuals and Others	13	8%
<b>Total</b>	<b>164</b>	<b>100%</b>

## Broad Support, but Key Matters to Consider

- Broad support from stakeholders for various suggested improvements to auditor reporting, but divergent views as to how best to proceed
- Overarching matters to address
  - Ensure the auditor is not providing original information about the entity or the financial statements
  - Identify changes that best serve the public interest, with careful consideration of related benefits and costs
  - Ensure that the IAASB's auditor reporting standards are flexible enough to accommodate national financial reporting regimes
  - Explore complementary actions to help address the information and expectations gaps

## Key Themes Underlying Broad Support

- A fundamental review of auditor reporting is timely and in the public interest
- Not about having the auditor explain complex accounting, but about the value and relevance of the audit in enhancing the credibility of financial reporting
  - Asking the auditor to provide information on key areas of focus may enhance audit discipline and audit quality
- IAASB commended for responding to the calls for change and developing a high-quality ITC to advance the debate

## Other Pervasive Points of Interest

- Emphasis on the need for a more holistic approach to improve corporate reporting, i.e., changes to auditor's report alone not sufficient
  - Suggestions for enhanced reporting and accountability by TCWG
  - Attention to financial reporting standards to address concerns about the complexity of financial reporting and "disclosures overload"
  - Need to ensure the roles and responsibilities of all participants in the financial reporting supply chain are appropriate and adequate to meet the needs of users
- Care must be taken to ensure that additional information in the auditor's report is meaningful to users, rather than simply increasing the quantum of information required to be disclosed by entities or their auditors

## Suggestions for the IAASB to Consider

- A staged approach to introducing change may be appropriate in light of the challenges identified across different stakeholder groups, i.e., in relation to
  - The entities for which suggested improvements will apply (listed, PIEs, all)
  - How far the proposals would go, in particular in relation to auditor commentary (e.g., the level of detail that would be included)
- A post-implementation review could help to build on leading practices and also could inform broader applicability

## Suggestions for the IAASB to Consider

- While there was support for keeping the current scope of an audit, calls for change may actually represent a desire for change in the auditor's role
  - In the aftermath of fraud, bankruptcies, or other negative press about an entity, users often ask "where were the auditors" (i.e., could the auditors have done more)
  - Potential for mandatory or voluntary assurance on new areas (e.g., critical accounting estimates and the entire annual report; reports to regulators; preliminary announcements; key performance indicators; or forward-looking information)
  - Effect of integrated reporting should be considered, in particular in relation to the auditor's assurance role

## Some Did Not Support the Suggested Improvements

- The auditor's role is to provide independent, objective assurance on financial statements prepared in accordance with the applicable financial reporting framework
- Information applicable only to certain stakeholders could be provided through other means, as institutional investors typically have more access to management and could fill their information gap through direct interaction instead
- Cost implications to entities, in particular SMEs, are likely greater than the benefits

## Navigating the Way Forward

- Widely divergent views as to how change in auditor reporting would best be effected continue to exist and will be difficult to reconcile
- It will be important to find a balance between what investors and other users will consider valuable (and a meaningful step forward) and what reasonably can be provided in view of the costs and other challenges of implementation
- Continued coordination with the EC, PCAOB and others addressing the topic of auditor reporting will be important
- On balance, support for the IAASB continuing to move forward rapidly

## Questions to Bear in Mind

- What can be done to acknowledge respondents' significant emphasis on the need for a more holistic approach to change?
  - Should the IAASB encourage other relevant players in the financial reporting supply chain to consider whether they should undertake particular initiatives? If so, how?
- How should the IAASB be addressing calls for additional outreach and field testing?
  - If considered necessary, at which stage should this occur (e.g., before issuance of an exposure draft (ED), while ED is out for comment, at another time)?
  - What are the implications of such additional outreach on the planned timeline for the ED and final standards?

## Getting to the June 2013 Exposure Draft

- IAASB's views on auditor commentary, going concern, and certain elements of the "building blocks approach" needed at this meeting
- Discussion of other elements in the ITC planned for Feb 2013 (naming the engagement partner, disclosure of other auditors, statement of compliance with ethical requirements, auditor's responsibility)
- First read of standards in Feb 2013 (ISA 706) and April 2013 (ISA 700)
- Rather than one Task Force, two drafting teams will be used
  - ISA 706 – *Montgomery, Gélard, Grabowski, Pickeur, Sekiguchi*
  - ISA 700 – *Winter, Grant, Jui, Kelsall, Köhler, Montgomery, Murtagh*

## Auditor Commentary

## Overall Views about Auditor Commentary (AC)

- Broad support across stakeholder groups for the concept
  - But in general preparers did not support the concept
  - Less support noted from Canadian respondents, other than CPAB
- While initial demand came from institutional investors, other users such as regulators and oversight bodies, would find value in the auditor providing additional information in the auditor's report
  - Provides a unique opportunity to reinvigorate the public's trust and confidence in the independent auditor and increase the relevance of the audit
- Diversity of views about its nature and content

## Overall Views about Auditor Commentary (AC)

- Biggest concerns
  - The auditor providing original information about the entity or the financial statements, in particular if auditors are required to provide subjective views or impressions
  - AC being perceived by users as separate assurance, "piecemeal" opinions or hidden qualifications
- AC cannot solve all users' information needs on its own
  - Also is a need to explore a more "holistic" approach to change in financial reporting through enhancements to financial reporting frameworks and corporate governance regimes

## Matters for IAASB Consideration

1. Based on the responses and feedback received, does the IAASB agree the TF should continue to pursue the concept of AC in some form, by which the auditor would provide more information in the auditor's report?

## Views about the Objective of AC

- The objective and title of AC will likely need to be revised, bearing in mind the diversity of views about what AC is intended to achieve
- Some support a focus on highlighting key matters related to the financial statements, including areas of significant management judgments, using an expanded Emphasis of Matter approach
  - Similar approach discussed at recent PCAOB Standing Advisory Group meeting
  - But others do not believe it is the auditor's role to simply provide a roadmap

## Views about the Objective of AC

- More support was noted for a focus on key audit areas and significant auditor judgment, by having the auditor explain why such matters are important from an audit perspective
  - Some acknowledged an expanded EOM approach could be supplemented by a short description of why the auditor considered the matter to be important
  - Some suggested an alternative approach to describe significant audit matters, including the auditor's risk assessment and response
- Focusing AC on key audit matters, particularly significant risks, may achieve the objective of highlighting areas important to users' understanding of the financial statements

## Views about the Objective of AC

- A minority of respondents would like to know more about other "matters of audit significance", for example
  - Matters of audit scope and strategy, including materiality
  - Use of experts and other auditors
  - Key audit findings
- Many believe that AC should not describe these matters because
  - Users will not possess the appropriate context necessary to consider this information
  - Public reporting of these matters could negatively affect auditors' discussion with TCWG
- No support for a detailed description of audit procedures

## Matters for IAASB Consideration

2. Does the IAASB have views as to how the objective of AC could be further refined and whether a different title than AC would be appropriate?
  - a) Should the TF continue to explore how auditors could draw attention to key matters in the financial statements? If so, is there a need for auditors to provide additional context about the audit rather than simply referring to the relevant disclosure in the financial statements? If this could be done, might this also achieve the objective of providing more information about the audit?

## Matters for IAASB Consideration

- b) In light of the mixed support for including AC relating to matters of audit scope or strategy, what are the IAASB's suggestions about a way forward? For example, should the TF conduct further outreach to determine whether other illustrative examples may be useful to investors?
  - c) How and when should the TF obtain feedback and reaction from investors, in particular to a revised proposed objective of AC and any criteria that the IAASB may develop, as well as a revised illustrative auditor's report with new examples of AC?

## Possibility of Retaining EOM and OM Paragraphs

- Many respondents suggested the IAASB should consider retaining the concept of EOM and OM paragraphs, because their use sends an appropriately strong signal that may be lost if included under a broader umbrella of AC
  - Doing so would also address the concern that EOM and OM paragraphs might be needed for entities for which AC is not required
- If EOM and OM paragraphs are retained, the IAASB will need to
  - Develop guidance explaining the relationship between EOM / OM paragraphs and AC
  - Determine how to appropriately distinguish these paragraphs from AC in the auditor's report

## Matters for IAASB Consideration

3. What are the IAASB's views about possibly retaining the concepts of EOM and OM paragraphs separate from AC?

## Developing Requirements and Guidance for AC

- The majority of respondents across all stakeholder groups were of the view that matters to be addressed in AC should be left to the auditor's judgment
- But many respondents acknowledged the need for sufficient guidance to ensure that the auditor's decision-making process is robust and diversity in judgments is limited

## Criteria for AC

- Many respondents believed AC should be rooted in the concept of significant risks and other matters communicated to TCWG
- Support noted for areas described in the ITC
- Matters of significant management judgment, such as critical accounting estimates, are often also matters of significant auditor judgment / effort
- Criteria will depend on the IAASB's views about a revised objective for AC

## Other Guidance and Illustrative Examples

- In addition to criteria, respondents noted the need for guidance to
  - Explain how such matters should be addressed, including the level of detail that should be provided
  - Highlight the number of matters that would be addressed in AC
  - Address concerns that AC may be seen as piecemeal opinions or separate assurance
  - Ensure that AC is not used as a substitute for a qualified opinion
  - Assist auditors in determining the accuracy and completeness of AC
- Respondents agreed the IAASB should provide illustrative examples of AC, but generally did not support the illustrative examples in the ITC
- Some respondents proposed changes to the introductory language to AC

## Views on Applicability of AC

- Strong support for listed entities, but mixed views on whether AC should be required for PIEs
  - Concerns expressed were consistent with difficulties outlined in the ITC
  - Some thought legislators or NSS should determine whether to apply to PIEs
- Some thought the concept of AC is scalable and could apply to all entities consistent with “an audit is an audit”
- It was also suggested the IAASB could adopt a phased approach
  - Require AC for listed entities, and after a post-implementation review, decide whether to extend the requirements to other entities or allow jurisdictions to determine whether to do so

## Matters for IAASB Consideration

4. What are the IAASB's suggestions as to how the differing views might best be reconciled regarding the entities for which AC should be required? For example:
  - a) Does the IAASB believe the TF should seek to develop a global definition of PIEs on which to base requirements for AC?
  - b) Or does the IAASB believe the focus should be to require AC for listed entities, with the option for legislators or NSS to require it for the broader group of PIEs as defined in their jurisdiction?

## Matters for IAASB Consideration

5. What are the IAASB's views about whether the concept of a post-implementation review should be explored? Such an approach could, for example
  - a) Subject to the approach taken in response to Question 4, provide the IAASB with further input to determine whether wider application of requirements for AC would be appropriate (e.g., for PIEs, or all entities)
  - b) Enable the IAASB to ensure that the proposals relating to AC are achieving their intended objective

## Going Concern

## Overall Views about GC

- Continue to explore auditor reporting on GC, addressing both the use of the GC assumption and the identification of material uncertainties
- Continue to engage with the International Accounting Standards Board (IASB) and International Financial Reporting Interpretations Committee (IFRIC) on implications of changes to financial reporting standards
- Continue to monitor developments of the US Financial Accounting Standards Board (FASB)
- Encourage efforts towards a common global financial reporting solution in response to calls for a more “holistic” approach to GC

## Wording of Auditor Statements Related to GC

- A number of respondents identified the need for revisions to the wording in the ITC so as to not widen the expectations gap
  - Explaining what is meant by “the use of the going concern assumption”
  - Explaining that the auditor’s work on material uncertainties is triggered by identification of events or conditions that may cast doubt on an entity’s ability to continue as a GC
  - Explicitly noting management’s responsibility for assessing the use of the GC assumption and identifying and disclosing material uncertainties
- Also a need to provide flexibility for application due, in part, to differences in management’s responsibilities under different financial reporting frameworks

## Placement of Elements of GC Reporting

- A number of respondents suggested the IAASB should consider revisiting the placement of elements of GC reporting, including
  - Whether the description of management’s responsibilities would be better placed with auditor reporting on GC
  - Whether the “clear signal” of the required EOM paragraph required by extant ISA 570 may be lost if included together with the conclusion on the GC assumption
  - Whether the conclusion on the GC assumption is better placed in the Opinion or Basis for Opinion paragraphs, as it is the basis of accounting used to prepare the financial statements
  - Whether flexibility in the placement of the GC reporting elements should be allowed, to take into account the relative importance of GC reporting to the particular entity

## Matters for IAASB Consideration

1. Based on the feedback received (and notwithstanding suggestions for a more holistic approach), does the IAASB believe that the TF should continue to explore how best to propose auditor reporting on GC, addressing both the use of the GC assumption and the identification of material uncertainties?

## A More Holistic Approach to Addressing GC

- A range of holistic options was noted
  - Clarify and enhance definitions and concepts relating to GC such as “material uncertainties” and “significant doubt”
  - Enhance financial reporting frameworks, as a comprehensive re-assessment of accounting and disclosure requirements may provide more useful information for users
  - Further international convergence of financial reporting frameworks
- These options vary in terms of time horizon and level of difficulty, and are not necessarily within the remit of the IAASB

## Clarifying Definitions and Concepts Relating to GC

- Lack of clarity around the meaning of certain terminology
  - Not well understood by users
  - Can be subject to differing expectations by both preparers and auditors
  - Expectations gap between what users think auditors should warn of in respect of GC, and what auditors are required to do under ISA 570
- Requiring auditor statements on GC, without clarification in the accounting standards or disclosure by management, could result in misunderstanding or confusion by users
- IFRIC and IAASB to further consider issues in 2013

## Clarifying Definitions and Concepts Relating to GC

- Based on calls for clarification, TF proposes to develop limited amendments to ISA 570 to operationalize auditor reporting on GC
  - Clarification of terminology or additional application material for inclusion in the June 2013 exposure draft
- TF will consider the need for a longer-term revision of ISA 570 in light of potential changes to management's responsibilities for GC that may be promulgated by accounting standard setters
- TF also believes there is a need for further outreach to determine the implications of reporting on GC for banking and financial institutions

## Convergence of Financial Reporting Frameworks

- Not all financial reporting frameworks require management to disclose material uncertainties or address management's responsibilities relating to GC
- US FASB proposing changes to management's responsibilities, focused on disclosures at a lower threshold than currently required in IFRSs
  - Disclosures at a "more likely than not" threshold
  - Exposure draft planned in Q1 2013
- IAASB urged to collaborate with accounting standard setters

## Matters for IAASB Consideration

2. Does the IAASB believe that the recommendations by respondents to explore a more holistic approach to GC should impact the IAASB's work on GC as to providing clarity and transparency for the exposure draft planned for 2013? What is the IAASB's view as to how the timing of the IAASB's work should take into account IFRIC or IASB's deliberations and development of additional accounting guidance?

## Matters for IAASB Consideration

3. In relation to improving ISA 570 and IFRSs, should ISA 570 be considered for revision to provide more clarity, transparency and flexibility of application based on the relevant financial reporting framework? Should certain limited amendments be made to ISA 570 for purposes of the exposure draft planned for 2013? What is the IAASB's view as to whether a longer-term revision is appropriate?

## Matters for IAASB Consideration

4. Does the IAASB believe that further outreach is needed to determine the implications of reporting on GC for banking and financial institutions?

## Auditor's Processes and Judgments on GC

- Majority of respondents were of a view that it was not appropriate for the auditor to include additional information about the auditor's judgments in concluding that no material uncertainties have been identified
  - Doing so would go beyond what is currently required of management
  - Such a statement could widen the expectations gap
- Depending on the IAASB's views about the objective and focus of AC, the auditor's work on GC may be among those matters considered for inclusion in AC

## Matters for IAASB Consideration

5. Considering the lack of support, what are the IAASB's views as to whether the TF should pursue reporting by auditors on their judgments and processes when events or conditions have been identified that may cast significant doubt on an entity's ability to continue as a GC, but the conclusion is that no material uncertainties exist?

## Building Blocks

## Views about the Need for Consistency

- A majority of respondents indicated a strong steer towards exploring global consistency in auditor's reports
  - Continue to encourage consistency, but recognize that law or regulation may prescribe the form and content of the auditor's report
  - Specify requirements for all auditor's reports for audits conducted in accordance with ISAs to ensure the IAASB's suggested improvements in auditor reporting are promulgated globally
  - Continue to require minimum elements, and possibly expand them, when law or regulation prescribe the form and content of auditors' report that refer to ISAs

## The Approach under Extant ISA 700

- Paragraph 43 of ISA 700 specifies minimum elements for auditors' reports that refer to ISAs when law or regulation prescribes the form and content of the report
  - IAASB favored retaining this approach when discussing at its September 2012 meeting
  - Respondents acknowledged that this mechanism permits jurisdictions to accommodate differences in auditors' reports arising from local law or regulations and should be retained
  - But IAASB may need to consider expanding the minimum elements

## Format, Structure and Ordering of Required Elements in the Auditor's Report

- Mixed views about the degree of consistency that should be required
- On balance, the TF believes it may be preferable to encourage, but not mandate, a specified format, structure, and ordering for the required elements. This could be done through
  - Including application material in a revised ISA 700 explaining the rationale for the IAASB's preferred presentation, including the focus on presenting the most relevant information first
  - Illustrative reports in a revised ISA 700
  - Liaising with NSS

## Way Forward for the BB Approach

- Determine whether requirements are appropriate for auditor's reports of audits of SMEs and public sector entities
- Consider and take into account existing and evolving auditor reporting regimes in other jurisdictions
- Continue to strive for alignment with others currently addressing auditor reporting (e.g., PCAOB and EC), and consider existing requirements or practices in other jurisdictions to further inform discussions on alternative ways of providing information to users, including through a corporate governance reporting model similar to the UK FRC

## Matters for IAASB Consideration

1. When law or regulation does NOT prescribe the form and content of the auditor's report:
  - Does the IAASB agree that it is not appropriate to mandate the ordering of sections within the auditor's report?
  - Rather, would it be more appropriate for the IAASB to be more prescriptive about the use of particular titles, headings and subtitles, so that users can recognize key elements of an ISA auditor's report?

## Matters for IAASB Consideration

2. When law or regulation prescribes the form and content of the auditor's report (and minimum elements are required to be included in accordance with ISA 700):
  - Recognizing the minimum elements will need to be expanded to incorporate new areas (such as AC, GC, etc.), is it worthwhile to take a more prescriptive approach to these elements to help users recognize that ISAs have been applied?