

20 August 2012

James Gunn
Technical Director, IAASB

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Dear Sir

IAASB Invitation to Comment: Improving the Auditor's Report

Westworth Kemp Consultants value the opportunity to provide feedback into the consultative process surrounding the proposed improvements to auditor reporting set out in the consultative document "*Improving the Auditor's Report*". We are a boutique consultancy specialising in financial reporting, assurance and compliance issues, particularly in the context of litigation and dispute resolution. (www.westworthkemp.com.au)

Whilst we welcome the fact that IAASB has sought to improve auditor reporting, in our view these proposals do not achieve that objective. In summary our reasons are:

- The proposed report is too long and prone to boilerplate commentary which is counter to the current thrust of reducing the clutter and simplifying financial reporting for example <http://www.frc.org.uk/getattachment/8eabd1e6-d892-4be5-b261-b30cece894cc/Cutting-Clutter-Combating-clutter-in-annual-reports.aspx>. Consideration should be given to the use of electronic links to websites that contain much of that information that is relevant, but does not change much from year to year, including the statements introduced to define the scope and purpose of an audit which in our experience have not achieved the objective of reducing the expectation gap;
- The inclusion of commentary on areas of sensitivity contributes to the excessive length and detracts from more clearly identifying those areas where the auditor disagrees with information in the financial statements. We have concerns with the proposed obligation to report on the applicability of the "going concern" basis because in our view this is a poorly understood concept and may even be no longer relevant as accounting standards include more obligations to assess probability of outcomes in asset and liability measurement which would include assessment of the probability of realization in the ordinary course of business. We note that in Australia directors are obliged to make a solvency statement (*Corporations Act 2001 s295(4)(c)*) as part of the financial report and auditors have to report whether that part of the financial report is in accordance with that Act.
- In our experience auditors are often ill placed to make assessments of either solvency or its related concept of "going concern". We will deal with this more fully in our detailed submission, attached, but in our view consideration of an auditor's role in opining on solvency/going concern should be accompanied by a discussion of the communications that auditors should obtain from client's bankers and the nature of solvency.

We are firmly of the view that IAASB should not address this topic alone but should work with IASB to arrive at a practical conclusion to the presentation of clear uncluttered information in a financial reporting framework that includes the positioning and content of the auditor's report and the determination of what information should be included in that report as opposed to the financial statements. We recommend that this joint working party should address not only format but how best to deal with the many judgments in financial statements in the financial report as a whole. These proposals are in danger of overlaying another layer of disclosure without making the financial report as a whole any more meaningful. In our view the "expectation gap" is not only an audit expectation gap and we refer to Hans Hoogvoorst's comments:

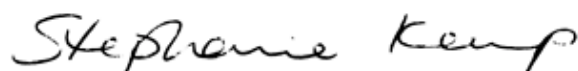
<http://www.ifrs.org/Alerts/Conference/HH+speech+Amsterdam+June+2012.htm>

We attach our more detailed commentary on the questions put in the request for comment and in conclusion also attach a form of auditor's report which we believe would best achieve the objectives of the paper. If you would like to discuss any of these issues further, please do not hesitate to contact us at chris@westworthkemp.com.au or +61414 459 083.

Yours faithfully



Chris Westworth, LLB, FCA, FAICD



Stephanie Kemp MA, FCA

Attachment 1

SUGGESTED FORM OF AUDITOR'S REPORT

“We have audited the financial information of [entity]for the period ended [balance date] in accordance with [auditing standards]. A description of the audit process and our approach to the quality control of our audits is set out at [website ref];

In our opinion the financial statements present fairly the entity’s financial position at [balance date] and its results and cash flows for the period then ended. In expressing this opinion we draw your attention to the following notes which describe areas of particular sensitivity in the preparation of the financial statements.

- Note 1 *name of note but no more*
- Note 12 *name of note but no more*
- Note 23 *name of note but no more*

We are satisfied that these statements fully describe the sensitivities except for note 42 and comment thereon as follows.....”

Attachment 2

DETAILED COMMENTARY AND RESPONSES TO SPECIFIC QUESTIONS

Overall Considerations

1 Overall, do you believe 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?

Our response to this question is that the above overall objective is not achieved. This is covered by our summary letter, but, in synthesis, in our view, to be valuable, the auditor's report should be clear and concise. It should be readily discernible whether the auditor accepts or disagrees with the information in the financial statements. We do not believe the proposals achieve that aim.

2 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 have provided an alternative form of report. In our view, the best way to ensure that investors get a clear and understandable set of financial information is for IASB and IAASB to work together to determine how best to ensure effective disclosure of complex, difficult and judgmental areas. The audit report should not have to make up for inadequacies in financial reporting and in our view investors should not have to get their information from two sources unless the auditor disagrees with the financial statements prepared by management. The proposals under consideration would result in unnecessary duplication of commentary, and confusion for the reader.

We also believe that the IAASB and IASB should work together on the consideration of the use of the term "going concern" and its relevance in the context of accounting standards and its relationship with the concept of solvency. Judicious application of evaluative judgement and the use of probabilities in the measurement requirements of accounting standards could achieve the same outcome as a consideration of going concern, so that the issue could be reduced to a contemplation of the need or otherwise to disclose impending insolvency. We refer to the final report of the Sharman Inquiry that was commissioned by the UK Financial Reporting Council.

Auditor Commentary

3 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 believe that an auditor's commentary is appropriate, subject significantly to our concerns about the illustrative example of that commentary. In particular we believe that commentary should only deal with exceptions from the manner in which the information is conveyed in the financial statements.

4 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?

We believe that the matters to be referred to in the auditor's commentary should be left to the discretion and judgement of the auditor guided by appropriate guidance and standards.

5 Do the illustrative examples of Auditor Commentary have the 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?

Our views on the illustrative example are given in our covering letter. Our primary concern is that it will encourage boilerplate report writing and detract from a clear representation of significant audit disagreements with the manner in which the information is included in the financial statements.

6 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?

The Auditor Commentary in the manner proposed in the illustrative example carries the risk that matters of significance are underreported in the financial statements and lost in the length of the audit report. It is our view that descriptive commentary on items in the financial statements should be contained within those statements, closely cross referred to the aspect of the financial report it relates to. In order to convey meaningful information, commentary must be well positioned and in context. To convey such material through an audit report (except in the important circumstances of auditor disagreement) removes those comments from their context and diminishes a reader's understanding of their implications. In our view it also may have the collateral consequence that preparers of financial statements may abrogate their responsibility for difficult disclosures to the auditors.

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

We see no reason to distinguish between different audits and believe our proposed form of report could be applied easily and simply to entities that are not PIEs. Because it is focused on clearly and concisely identifying exceptions to the information in the financial report, it will convey information of importance to all users of financial statements.

Going Concern/Other Information

8 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?

We have, in our introduction, referred to our concerns with the present lack of clarity in the meaning of the term going concern; our view is that much of the information going to the question of funding for a company can be conveyed through disclosure of, inter alia, the terms and duration of debt, commitments, and the cash flow statement and perhaps commentary on any fragility in ongoing business terms. Furthermore, in our view, accounting standards that are properly attuned to valuations that take into account the probability and timing of cash flows will adequately deal with the valuation issues which form the basis of the traditional difference between the going concern basis of accounting and other bases.

In our view, the question is whether financial statements should contain an assertion that a company continues to be solvent. If such a statement is to be made we believe it should be made by the company, and, pursuant to our request for simplification of the auditor's report the auditor should only have to comment if he or she disagrees.

We believe that before such statements are required, thought should be given as to the information needed to make such reports. Very often the key to whether a company can remain solvent lies outside the information readily available to auditors and possibly even to the board and management. The answer can lie in the halls of the providers of finance or arrangers of capital raisings. We propose that consideration should be given to requiring such financiers to provide, at least privately to the company and auditors, unequivocal statements of their intentions (at the time of making that expression of intent) in respect of funding and continuing to provide that funding to the company under consideration.

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

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

In response to the above two questions we note that we have, above, expressed our view that the auditor should be required to do no more than identify areas that have required the exercise of judgment, except where there is disagreement with management over either the judgements made or the expression thereof. To require otherwise detracts from serious messages of disagreement when they are required and encourages boilerplate reporting that will not be seen as of value to readers and in time will not be read (further detracting from the serious message).

As regards the auditor's own processes, we believe that this can be covered by a reference to the audit firm's website and documents thereon such as the transparency report. It is difficult for any person other than the auditor him or herself to understand the complexities and appropriateness of audit processes from abbreviated reporting statements. Detailed

reporting of process is only needed (if at all) to elaborate on areas of disagreement and then only to support the auditor's conclusions.

Clarifications and Transparency

11 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?

We do not believe that the inclusion of a description of the roles of auditors, management and TCWG has ever or will ever enhance the understanding of users of audit reports as to the relative roles of those parties. Put more clearly such requirements have existed in their present form since the pre-Clarity ISAs and in an abbreviated form for much longer. Nevertheless, the audit expectation gap continues. The place for such commentary (if any) is in the audit firm website as part of or close to the transparency statements.

12 What are your views on the value and impediments of disclosing the name of the engagement partner?

From our Australian experience in respect of the naming of the audit partner we note that:

- a. There is no empirical evidence that naming a partner raises that person's sense of responsibility beyond that felt by partners in jurisdictions where naming is not required;
- b. Whilst naming the audit partner can provide a simple mechanism for a regulator to identify the responsible partner in regulatory proceedings, in fact this information can be easily obtained by regulators anyway;

In Australia not only is the partner named under the Corporations Act but that partner has personal responsibility for the conduct of the audit in accordance with auditing (and accounting) standards.

13 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 should be included in all relevant circumstances, or left to the auditor's judgment as part of Auditor Commentary?

We do not believe that reference to other firms involved in the audit enhances the reader's understanding of the quality of the audit. In our view the responsibility for the conduct of the audit lies firmly in the hands of the firm signing the report and disclosure of the names of other firms involved in the audit detracts from that primary responsibility.

By the same token the use of other firms is an important facet of the audit selection process and at the time of appointment or reappointment of an auditor the extent of use of other auditors and the manner in which their work will be controlled and reviewed should be clear to those making the appointment.

14 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 to an appendix to the auditor's report?

We wholeheartedly agree that full use should be made of websites to convey standardized material. We do not endorse the use of an addendum to the auditor's report as that fails to achieve our preferred position of reducing the "clutter" in financial reports.

Form and Structure

15 What are your views on whether the IAASB's suggested structure of the illustrative report, including 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 have commented above and in our summary report on the form and structure of the proposed report. We support the initiative of placing the auditor's opinion near the beginning of the auditor's report so that it is easy to find.

16 What are your views regarding the need for global consistency in auditors' reports when ISAs, or national auditing standards that incorporate or are otherwise based on ISAs, are used?

We absolutely endorse the need for global consistency in auditors' reporting.

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

We agree that the IAASB should mandate the ordering of matters in the auditor's report unless local law or regulation requires otherwise. This approach provides appropriate flexibility to accommodate local requirements whilst encouraging uniformity.

18 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- and medium-sized entities (SMEs) and public sector entities should the IAASB further take into account in approaching its standard-setting proposals?

In our view, **in the form of our suggested auditor's report**, these proposals would be appropriate for all entities irrespective of size and including public sector entities.