



*European Federation of Accountants and Auditors for SMEs*

International Auditing and Assurance Standards Board (IAASB)  
545 Fifth Avenue, 14th Floor  
New York, New York  
10017 USA  
Attn. IAASB Technical Director  
Brussels, 16 September 2011

Dear Sir

**Comment on Consultation Paper: Enhancing the Value of Auditor Reporting: Exploring Options for Change**

The European Federation of Accountants and Auditors for SMEs (“EFAA”) represents accountants and auditors providing professional services primarily to small and medium-sized entities (“SMEs”) both within the European Union and Europe as a whole. Constituents are mainly small practitioners (“SMPs”), including a significant number of sole practitioners. EFAA’s members, therefore, are SMEs themselves, and provide a range of professional services (e.g. audit, accounting, bookkeeping, and tax and business advice) to SMEs.

EFAA appreciates the opportunity to comment on the IAASB Consultation Paper: Enhancing the Value of Auditor Reporting: Exploring Options for Change. Our comments are made in relation to the areas outlined below.

General comments

We welcome the IAASB’s approach with respect to this Consultation Paper (“CP”) and view the use of feedback as a tool towards the possible future standard setting projects as a positive move.

We welcome the inclusions and consideration of the differing user perspectives and are pleased to note that the “Perspectives for Smaller Entities” are laid out at the outset of the project. EFAA is happy to provide an SME / SMP perspective in this regard.

The issue of Auditor Reporting is just one facet of the over arching issue of audit quality. There are projects already being undertaken in this regard by the European Commission, to name just one, and we would suggest that the IAASB monitor this and other projects to ensure that a wide range of stakeholder views are obtained to enable the public good to be best served through the development of a consistent approach that properly serves the SME market.



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## **ISSUES IDENTIFIED**

### **1. Do respondents have any comments about the issues identified in Section II regarding the perceptions of auditor reporting today?**

The CP considers the issues in respect of auditor reporting in the context of the “expectations gap” and the “information gap”. The former being the misunderstandings by users about the nature of an audit, including its scope, objectives and inherent limitations and the latter being the concept that certain users believe that the audit report does not allow them to make informed investment or fiduciary decisions.

#### Expectations Gap

Whilst we agree that an expectations gap is in existence it is our belief that the gap will never be fully bridged. The audit of financial statements provides only reasonable assurance and can never provide absolute assurance.

There is a clear user demand for better explanation of the audit process and we believe that in general, it would do no harm to increase communication and information on what an auditor does. However, audit users are diverse and hence the first stage in any process that seeks to better communicate audit methodology and looks to improve auditor reporting must surely be to identify the various users and then to assess and appraise their demands.

*We note that one of our member bodies has taken action in this respect during the exposure period, and has organised a meeting with various stakeholders about, amongst other matters, user demands regarding auditor reporting.*

The audit methodology is clearly outlined in the public environment should any interested parties wish to read the ISAs. We question how the audit methodology could be summarised sufficiently to improve the explanation of the audit process and thus reduce the expectations gap. What amount of explanation would be adequate but not excessive? It is unlikely that ‘one size fits all’ here as SME users will have different views from the users of large listed company financial statements.

#### Information gap

The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. In the case of most general purpose frameworks, that opinion is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework. Hence the role of the auditor is to express an audit opinion on the financial statements.

The profession acknowledges its responsibility in doing this. Our belief is that it is not an auditor’s role to warn investors or shareholders of the risks that are inherent to a business.

An audit is an important function of the financial framework and it can greatly influence the stability of economic and financial markets but we should also note that any attempt to extend the auditor’s responsibility has the possibility to lead to the creation of a wider expectations gap that would require careful management.



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**2. If respondents believe changes in auditor reporting are needed, what are the most critical issues to be addressed to narrow the information gap perceived by users or to improve the communicative value of auditor reporting? Which classes of users are, in the view of respondents, most affected by these issues? Are there any classes of users that respondents believe are unaffected by these issues?**

In order to assess whether changes in auditor reporting are required we must first identify to whom the report is addressed and therefore the users of the audit report. It is well accepted that the users of audited financial statements differ in the context of small, medium, large, public interest entities (“PIEs”), and public sector entities.

Whilst our view is and remains that “an audit is an audit” one has to concede that consideration of the instances when the audit report should or could appropriately differ depending on its audience may well have merit. For example, the completeness of income may be an area where there are different expectations.

The response to this question would thus be better given if evidence had been collected on the needs of users of audited financial statements and we suggest that the IAASB consider further research and outreach into this area.

**3. Do respondents believe that changes are needed for audits of all types of entities, or only for audits of listed entities?**

Please refer to our answer above.

In general we believe that it would be a major burden on SMEs and the users of audited reports if those audit reports deemed suitable for PIEs were to be decided to be the standard for all entities.

**Exploring Options For Change**

**A. FORMAT AND STRUCTURE OF THE STANDARD AUDITOR’S REPORT**

**4. Respondents are asked for their reactions to the options for change regarding the format and structure of the standard auditor’s report described in Part A. Do respondents have comments about how the options might be reflected in the standard auditors report in the way outlined in Appendix 1 of this Consultation Paper?**

Section II of the paper established the current issues in terms of both the expectations gap and the information gap. Once identified it is then difficult to see how a change of format and structure to the audit report could possibly add any value in this context and thus address any of the aforementioned issues.

The introduction of the paragraphs that outline the management and auditor responsibilities was done to contextualise the audit. It would seem therefore logical that the removal of these paragraphs would not serve to reduce the expectations gap. One way to do this may be by outlining in very simple terms what the auditor has done to enable him to give an opinion on a set of financial standards. An example of this may be the use of the long-form audit report employed by the German auditing profession, which includes disclosure of the major audit methods employed and the scope of substantive audit testing.



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If we believe that the reader of the audit report is only interested in the opinion paragraph then it may add more weight to the report if this paragraph were to be placed first. One other idea put forward would be to use the emphasis of matter paragraphs to enable more specific comments on the entities to be given and thus recognise that every entity is unique.

**5. If the paragraphs in the current standard auditor's report dealing with management and the auditor's responsibilities were removed or re-positioned, might that have the unintended consequence of widening the expectations gap? Do respondents have a view regarding whether the content of these paragraphs should be expanded?**

Please refer to the response to question 4.

As a general rule we are in favour of the audit report for SMEs being presented in entirety. We do not believe that removing certain sections of the report or indeed repositioning these will add any value to the report but there is possibility of a widening of the expectations gap. Experienced users of audit reports will not be affected in this manner but those entering the SME audit market for the first time should have the opportunity to see all the information pertaining to the audit report in one place. This would also recognise the fact that SME financial statements are in general shorter and much less complex in terms of disclosures.

We do note, however, that the audit methodology is clearly outlined in the public environment should any interested parties wish to read the ISAs and we question how the audit methodology could be summarised sufficiently to improve the explanation of the audit process and thus reduce the expectations gap. There is a clear balance to be struck as to what amount of explanation would be adequate but not excessive?

It is our belief that identifying user demands would enable a more focussed approach to be taken in this regard.

## **B. OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS**

**6. Respondents are asked for their reactions to the possibility that the standard auditor's report could include a statement about the auditor's responsibilities regarding other information in documents containing audited financial statements. Do respondents believe that such a change would be of benefit to users?**

It would be useful for the auditor's responsibilities in relation to the information presented within audited financial statements to be explicitly stated in clear and concise wording.

However there should be no need for the report on the financial statements to mention such matters unless it also includes opinions on other information. These separate opinions should therefore indicate what the auditor has done in relation to any other matters.



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**7. If yes, what form should that statement take? Is it sufficient for the auditor to describe the auditor’s responsibilities for other information in documents containing audited financial statements? Should there be an explicit statement as to whether the auditor has anything to report with respect to the other information?**

Please refer to the response to questions 4 and 6.

### **C. AUDITOR COMMENTARY ON MATTERS SIGNIFICANT TO USERS’ UNDERSTANDING OF THE AUDITED FINANCIAL STATEMENTS, OR OF THE AUDIT**

**8. Respondents are asked for their views regarding the auditor providing additional information about the audit in the auditor’s report on the financial statements.**

Please refer to the response to questions 4, 5 and 6.

**9. Respondents are asked for their reactions to the example of use of “justification of assessments” in France, as a way to provide additional auditor commentary.**

The audit report should be capable of outlining the auditor’s responsibilities and his actions but not be so unwieldy that it will not be read. We have already noted the German long-form report as an example and we believe that the French use of “justification of assessments” may also be an alternative and may better explain the auditor’s responsibilities and the audit process. However in all these examples there is always a risk that such statements will themselves ultimately become generic.

**10. Respondents are asked for their reactions to the prospect of the auditor providing insights about the entity or the quality of its financial reporting in the auditor’s report.**

The role of the auditor is to express an audit opinion on the financial statements as a whole. If the auditor were to be asked to provide insights about the entity or the quality of its financial reporting in the auditor’s report then this is surely an extension of the scope of the audit report. Before we decide that the audit scope should be widened we need to be certain that there is merit in providing more information and consider whether stakeholders actually require more information and if they do, to what end.

It is clear that the auditor should not be asked to report to shareholders on matters that are under the remit of the management or those charged with governance.



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#### **D. AN ENHANCED CORPORATE GOVERNANCE MODEL: ROLE OF THOSE CHARGED WITH GOVERNANCE REGARDING FINANCIAL REPORTING AND THE EXTERNAL AUDIT**

##### **11. Respondents are asked for their reactions to the options for change relating to an enhanced model of corporate governance reporting, as described in Section III, Part D.**

We believe that the communication for auditors is adequately governed by ISA 260 (Communication with Those Charged with Governance) and ISA 265 (Communicating Deficiencies in Internal Control to Those Charged with Governance and Management). It is for those charged with governance to provide necessary information to investors and other interested stakeholders on matters that would seek to close the “information gap”. We are not convinced that the auditor would always be best placed to do this.

##### **12. To the extent that respondents support this model, what challenges may be faced in promoting its acceptance? Also, what actions may be necessary to influence acceptance or adoption of this model, for example, by those responsible for regulating the financial reporting process?**

Please refer to the response to question 11.

##### **13. Do respondents believe assurance by the auditor on a report issued by those charged with governance would be appropriate?**

Please refer to the response to question 11.

#### **E. OTHER ASSURANCE OR RELATED SERVICES ON INFORMATION NOT WITHIN THE CURRENT SCOPE OF THE FINANCIAL STATEMENT AUDIT**

##### **14. Respondents are asked for their reactions to the need for, or potential value of, assurance or related services on the type of information discussed in Section III, Part E.**

Whilst we are not averse to changes per se we believe that any changes should be in line with the demands of the users.

##### **15. What actions are necessary to influence further development of such assurance or related services?**

As a consequence of our answer to question 14 we do not answer this question.



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### **Implications of Change and Potential Implementation Challenges**

**16. Respondents are requested to identify benefits, costs and other implications of change, or potential challenges they believe are associated with the different options explored in Section III.**

There is clear merit in the IAASB being able to assess the costs and benefits (or indeed “effects analysis” as proposed by the current EFRAG and APB discussion paper “Considering the effects of accounting standards”) of the issuance of new standards or revisions to existing standards.

Any changes must surely flow from the demand of users and we would suggest that user views are sought in order to establish the demand for changes in either reporting or scope. Finally we would also note that auditor reporting is just one facet of audit quality and it would therefore be advisable to address the entire area of audit quality, not audit reporting in isolation.

**17. Do respondents believe the benefits, costs, potential challenges and other implications of change, are the same for all types of entity? If not, please explain how they may differ.**

Please refer to the response to question 16. We would stress that across the board changes fall more heavily on SMEs and costs and benefits are not the same for all types of entities.

**18. Which, if any, of the options explored in Section III, either individually or in combination, do respondents believe would be most effective in enhancing auditor reporting, keeping in mind benefits, costs, potential challenges, and other implications in each case? In this regard, do respondents believe there are opportunities for collaboration with others that the IAASB should explore, particularly with respect to the options described in Section III, Parts D and E, which envisage changes outside the scope of the existing auditor reporting model and scope of the financial statement audit?**

Please refer to the response to question 16.

**19. Are there other suggestions for change to auditor reporting to narrow the “information gap” perceived by users or to improve the communicative value of the auditor’s report?**

Please refer to the response to question 16.



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Other comments

We acknowledge that some of the research effort of the IAASB that we would wish to be undertaken is in fact the central theme of this consultation paper. However if the research effort is to be effective then we would suggest that the IAASB may wish to consider doing more targeted outreach which would then allow other respondents (and possibly many more SMEs) to give feedback and analysis and to share practical experience and insight in this matter. It may be that a specific SME initiative is needed and this could possibly be in the form of a series of regional events organised to consider and engage several thousand SMEs. EFAA would be happy to assist in this regard.

I trust that the above is comprehensive but should you have any questions on our comments, please do not hesitate to contact me.

Yours faithfully,

Federico Diomeda  
Chief Executive Officer