The Institute of Chartered Accountants in Australia

15 September 2011

James Gunn,
Technical Director
International Auditing and Assurance Standards Board,
545 Fifth Avenue, 14th Floor
New York, New York, 10017 USA

Email: www.iaasb.org

Dear James,

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

The Institute of Chartered Accountants in Australia (Institute) is pleased to have the opportunity to respond to the above Consultation Paper. The Institute is Australia's premier accounting body, which represents over 50,000 professional accountants. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

The Institute is a founding member of the international accounting coalition called the Global Accounting Alliance (GAA), which provides reciprocal arrangements with ten other leading accounting bodies in the world. The Institute is the only Australian accounting body within the alliance. The GAA represents more than 778,000 members world-wide and includes professional accounting organisations from America, Canada, Hong Kong, England/Wales, Ireland, Scotland, Japan, Germany, New Zealand and South Africa.

We welcome the IAASB's paper. In our view the role of auditors is vital to the functioning of a modern economy. And it is perhaps more important now than ever, particularly as the reporting of non historical financial information develops apace, with stakeholders seeking further information on which to base policy and other decisions.

We have not attempted to address all the issues raised in the Consultation Paper, but have limited our comments instead to those areas we view as being of the greatest importance and where we might be able to add most value to the Board.

Customer Service Centre
1300 137 322

NSW
33 Erskine Street
Sydney NSW 2000
GPO Box 9985
Sydney NSW 2001
Phone 61 2 9290 1344
Fax 61 2 9262 1512

ACT
L10, 60 Marcus Clarke Street
Canberra ACT 2601
GPO Box 9985
Canberra ACT 2601
Phone 61 2 6122 6100
Fax 61 2 6122 6122

Qld
L32, 345 Queen Street,
Brisbane Qld 4000
GPO Box 9985
Brisbane Qld 4001
Phone 61 7 3233 6500
Fax 61 7 3233 6555

SA / NT
L11, 1 King William Street
Adelaide SA 5000
GPO Box 9985
Adelaide SA 5001
Phone 61 8 8113 5500
Fax 61 8 8231 1982

Vic / Tas
L3, 600 Bourke Street
Melbourne Vic 3000
GPO Box 9985
Melbourne Vic 3001
Phone 61 3 9641 7400
Fax 61 3 9670 3143

WA
Ground, 28 The Esplanade
Perth WA 6000
GPO Box 9985
Perth WA 6848
Phone 61 8 9420 0400
Fax 61 8 9321 5141

Some particular themes we believe are important for us collectively to consider follow:

Expectation and Information Gaps

Consensus seems to be that the global events of recent years have shown that there is more work to be done by all stakeholders to contribute to identifying, analysing and responding to 'systemic risk', which stem from the size and complexity of institutions and their relationships with other parts of the financial system. A number of varied proposals about systemic risk have been brought forward. Current practice is for auditors to identify risk within the company. However we foresee much greater emphasis internationally, at country level as well as industry and company level on business risks. Auditors are well placed to be involved with reporting on risks to the business model and the potential for that model to fracture.

However, we need to make sure that we understand as clearly as possible what actually failed. Once we know that, appropriate policy and other responses become easier to determine. As a participant at an Institute-sponsored round table discussion on this topic put it "Unless we are very careful, we will be building great architecture for yesterday."

More detail in financial reports is not necessarily the solution. The Institute hears regularly from members and other stakeholders that financial reports are already far too voluminous, complicated and intelligible to only a few. One proposal to reduce clutter is for much of the detailed information that tends to be 'boiler plate' to be web-based only and not reproduced in the financial report itself. Stakeholders who require this information would thus continue to have access to it, albeit on the internet.

Further, the expectation gap is not necessarily confined only to external stakeholders. There are many in the director community who appear not to have a clear understanding of the auditor's role and how it relates to those charged with governance of the entity. Having more words in the auditor's report will not address this issue.

The Role of the Audit Committee

An independent audit committee is a fundamental component of a sound corporate governance structure. Importantly it brings together in one place non-executive directors, management, external audit, internal audit and advisors. The role of the audit committee has evolved significantly in the last decade and will continue to evolve. It has moved from being a fairly narrow function focused primarily on completion of the audited financial statements, involving limited interaction with the external auditors, to a much broader and integrated focus of responsibilities. Drivers of this evolution include regulatory expectations, market expectations and better practice initiatives the committee members and auditors gain in closer working relationships.

We believe that further enhancements can and should be made to the role of the audit committee. An essential element of the audit committee's role is to interact effectively with the external auditor towards obtaining a quality audit. In order for this to happen the audit committee needs to be equipped to understand what a quality audit entails and to engage with their auditor meaningfully. We are assisting with this goal and have a range of initiatives underway to assist the director and audit committee community. To support these initiatives we have used *The Benefit of Audit: A Guide to Audit Quality*.

We also believe further analysis needs to be undertaken about potential ‘barriers’ to effective audit committees and how those barriers may be overcome. This could include consideration of potential changes which could be made to relevant laws (if any) to allow auditors to provide more meaningful reports for the better performance of the audit committee.

The rigour and nature of director and audit committee questions of auditors and the willingness and capacity of auditors to deal with those questions should be considered. Factors inhibiting a free and frank exchange between auditor and audit committee (or directors) may be about business models, or also about individuals and other business stresses. Barriers to a better and more fluent discussion between auditors and audit committees include a fear of litigation, as well as the competencies of those involved.

One also needs to ask whether some aspects of independence requirements limit an auditor’s capacity to provide useful insights and engage in useful conversations with the audit committee or directors.

Communication between auditors and the audit committee is important, as is communication between the audit committee and the company’s stakeholders. In our view there is merit in exploring an enhanced role for the audit committee in external communication and contributing to an improved understanding of what auditors do.

The Role and Future of Audit

A great deal of work has been conducted over many years on the clarity of communication, but it is evident that many stakeholders continue not to understand the role of external auditors in general – even by groups who have regular on-going contact with their auditors. The ‘expectation gap’ is very much alive – and potentially growing wider. The statutory audit report – a primary output of an audit – is important to stakeholders in terms of the fundamental assurance it provides, enhancing the credibility of information reported on.

The current model of audit needs to change and expand. Part of this change lies in the general annoyance that audit is seen to be only focused on the past and the question asked as to ‘why didn’t the auditor see this beforehand?’

However, the primary obligation for reporting must remain with the company and its audit committee. It is first and foremost the responsibility of the company to report in accordance with a reporting framework. If there is information of value to stakeholders which is not currently being reported, the reporting and regulatory frameworks need to address this.

The role of the auditor has been, and continues to be, to provide an independent professional opinion on whether the financial report of the company present fairly its state of affairs and financial results for the period in accordance with the reporting framework. The financial position and operating results directly reflect the results of the decisions of management and the Board of Directors of the entity.

We believe that the role of the auditor should be expanded to focus on:

(i) the reporting of risks to the business model and
(ii) ‘closer to the event’ assurance.

Audit Quality

Shareholders, company directors, audit committee members, auditors and regulators all agree that quality external auditing is fundamental to capital market confidence.

In only a few years the concept of audit quality has evolved from the somewhat esoteric, loosely discussed and poorly acknowledged, to having 'real' substance and involving all stakeholders. The pace of evolution of Audit Quality is accelerating, as evidenced by the establishment of the International Auditing and Assurance Standards Board's task force on this topic. There are great opportunities for standard setters, audit firms and professional bodies to influence the ongoing enhancement for the benefit of all.

For example in recent years there has been significant work in clearly understanding the drivers of audit quality. That work is then being used by participants and stakeholders with the common goal of continuing to improve audit quality. We produced *The Benefit of Audit – A Guide to Audit Quality* based upon these drivers of audit quality to enhance communication (in plain English) between the audit committee and the external auditor – it has been well received. We attach a copy of our Guide.

We have also produced the *Framework for Managing Audit Quality Sustainability* to provide a structure for continuous improvement in audit quality and to stimulate further discussion on this important topic. We attach a copy of this Framework as well.

Continuous Assurance

Enabling technology now permits business to be conducted 24 hours a day, every day of the year. While this dramatic change has occurred in the business environment, the financial reporting and assurance model continues to focus on the past, reporting in accordance with a historical financial reporting framework.

In our view there is merit in exploring changes to this model to permit 'closer to the event' assurance in order to align the assurance model more closely to the business model. The term 'continuous assurance' is used to describe such a model. It may well be that this type of assurance is complementary to, but does not replace, the current historical financial reporting framework. We attach a copy of our recent thought leadership paper on continuous assurance, titled *Continuous Assurance for the Now Economy*.

The Institute is of the view that the above themes are of sufficient importance that we will continue to devote substantial resources in their further development.

We would welcome the opportunity to provide further evidence to the Board if required.

Lee White
Executive General Manager – Members
Institute of Chartered Accountants in Australia