

15 September 2011

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

Dear Mr Gunn

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

Attached is the Australasian Council of Auditors-General (ACAG) response to the Consultation Paper referred to above.

The views expressed in this submission represent those of all Australian members of ACAG.

While ACAG consider that changes to the structure and wording of the auditor's report to clarify the role of the auditor are worthy of further investigation, ACAG does not support a number of the other possible options for change set out in the Consultation Paper including:

- the proposal to provide additional commentary in the auditor's report in regard to the auditor's judgements and procedures
- the proposal to provide insights about the entity and the quality of its financial reporting
- the model for enhanced corporate reporting set out at paragraph 84.

ACAG's views on these matters are outlined further in relation to each of the specific questions.

The opportunity to comment is appreciated and I trust you will find the attached comments useful.

Yours sincerely



Simon O'Neill  
**Chairman**  
**ACAG Financial Reporting and Auditing Committee**

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

ACAG provides the following comments in response to specific questions raised by the IAASB.

### **II BACKGROUND**

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

Paragraph 7 identifies that the quality of information available to users depends on the decisions of management and those charged with governance “with input from ... the independent auditor”. The paper should be amended to reflect that, while the auditor reviews the disclosures made within a financial report, the extent to which audit provides input on particular information within a financial report will vary depending on the circumstances of each audit.

Paragraph 12 (a) states that “other than communicating the auditor’s overall conclusion, the content of the auditor’s report is not viewed as being as useful or informative as it could be”. This comment suggests users may not be aware that the objective of the audit is to express a conclusion and is consistent with comments in paragraph 13 regarding “misunderstanding by users about the nature of an audit”. The comments in paragraphs 12 (a) and 13 suggest there is a fundamental lack of understanding of the role of the auditor. ACAG recommend that the Board consider other means to address this lack of understanding, in addition to considering changes to the audit report.

Paragraph 12 (b) identifies issues which would be dealt with more appropriately within an examination of the financial reporting framework and the responsibilities of those charged with governance i.e.:

- users wish to obtain information to assist them in assessing the financial condition and performance of the entity. ACAG feel it is important that the paper clarify whether the information sought is historical financial information that may be periodically reported through financial reports or more up to date information that focuses on the future prospects of an entity
- “users wish to obtain this richer information directly from the entity and/or through communications about the auditor’s insight into such matters”. This statement is at odds with the nature of an attestation audit in which auditors should report only on information already reported by those charged with governance. Given the lengthy disclosures already required in financial reports, ACAG feel it is important that the paper clarify whether the problem lies in the complexity of information presented in the current financial reports and perhaps, given the broad range of users of financial reports, whether some users lack the understanding to interpret the information in the financial reports.

The same paragraph also identifies that additional information in the auditor’s report would assist users to assess the quality of the audit. ACAG does not believe that such information would facilitate a valid assessment of audit quality. Furthermore, given that mechanisms are already in place to promote audit quality (i.e. reporting on auditor independence, regulatory oversight) ACAG recommend that the Board consider other means to promote users’ awareness of these mechanisms, as an alternative to adding further information to the auditor’s report.

Paragraph 15 refers to the use of generic language to describe the audit. ACAG does not support a move away from this practice as the approaches taken by most auditors are unlikely to vary significantly.

The same paragraph states that the auditor's report "does not provide a complete picture about the extent of the auditor's procedures". ACAG consider that the level of detail that would be needed to fully explain the audit process would be counterproductive to improving the usefulness of auditor's reports. It could also lead to misconceptions including when drawing comparisons between auditor's reports. A longer list of procedures or details of the audit process could be misconstrued as providing a greater level of assurance. Those without knowledge may not understand that procedures are responsive to risks and therefore while they may differ, they should still provide the same level of assurance.

Similarly, it would be difficult to adequately articulate the application of professional judgment in the audit process, particularly in view of the broad user base for auditor's reports.

Also, the inclusion of greater detail on the audit process would give rise to additional costs.

Paragraph 20 refers to the complexity of and weaknesses in current financial reporting. ACAG believe that the onus should be on those who establish the financial reporting framework to address concerns over the framework.

Paragraph 22 deals with perceptions around the need for more information on areas of risk, including audit risk. While auditors currently consider risk during the conduct of an audit, it is not done with a view to the public reporting of such information. ACAG consider that the public disclosure of such information would lead to additional processes and costs and the information would still be at risk of being misunderstood by users.

Paragraph 23 provides a list of additional information that could be provided by auditors, including further explanation of items in the financial report. ACAG consider that explaining the financial report to users is not the role of the auditor and support the comments in paragraph 24 that it is wrong for auditors to originate information about clients. The additional information also includes audit assessments made during the conduct of an audit which are not made with a view to the public reporting of such information. ACAG consider that the public disclosure of such information would lead to additional processes and costs and the information would still be at risk of being misunderstood by less sophisticated users.

- 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?**

ACAG consider that changes to the structure and wording of the auditor's report to clarify the role of the auditor (i.e. explaining what an auditor does and what the opinion means) are worthy of further investigation in order to reduce users' misunderstanding about the nature of an audit. Users of public sector audit reports include a broad range of taxpayers, ratepayers, members of parliament, media and academia who may benefit from greater clarity in auditor reporting. Those users who may be unaffected by these issues are likely to be those who can obtain the information they need through other means, such as governments and regulators.

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

ACAG consider that the limited changes that are supported, as described under question 2 above, should be consistently applied for all types of entities in the interests of comparability. Any lack of understanding of the auditor's role may be exacerbated if different types of auditor reporting were used for different entities. Also, due to the legal status of Australian audit pronouncements, the wording of auditor's reports for all entities will be similar.

### III 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 standards auditor's report described in Part A. Do respondents have comments about how the options might be reflected in the standard auditor's report in the way outlined in Appendix 1 of this Consultation Paper?**

The provision of an "opinion only" report, discussed in paragraph 42, is not supported, as this option is predicated on users having a sound understanding of the audit process.

As the Preface to the paper points out, the management and auditors responsibilities paragraphs were added only in recent years with the aim of addressing the expectation gap. ACAG is concerned that not providing users with information about responsibilities in the auditor's report, as suggested in paragraph 41 and 42, may exacerbate misunderstanding of the nature of an audit.

ACAG support presenting the opinion in the first paragraph and the responsibilities paragraphs at the end of the auditor's report as discussed in paragraphs 43 and 50.

Reducing the level of technical language in the auditor's report, as suggested in paragraph 47, is supported; however the elimination of all technical jargon in the auditor's report may prove difficult. The provision of a glossary of terms explaining key audit terminology contained in the auditor's report (e.g. materiality, risk assessments, presents fairly, audit) is worth further consideration. It could be provided as an attachment to the auditor's report to avoid increasing the length of the auditor's report.

**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?**

As stated above, ACAG does not support removal of the responsibilities paragraphs but are supportive of presenting the opinion in the first paragraph and the responsibilities paragraphs at the end of the auditor's report.

ACAG supports including certain further information about the conduct of an audit e.g.:

- the auditor checks only a sample of transactions
- the auditor does not always test controls
- the audit may not detect all material fraud
- the auditor focuses on detecting material misstatements only.

#### 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?**

The introductory paragraph in the auditor's report names the statements subject to audit. Accordingly ACAG does not support the inclusion of an additional statement in the auditor's report about "other information". This additional statement would add to the length of the report for minimal benefit.

- 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 other information?**

Refer response to question 6 above.

**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.**

ACAG does not support changing the auditor’s report to provide a rationale for the opinion by setting out in the report the auditor’s judgements and procedures. Such a step could introduce levels of detail and complexity into the auditor’s report that will be counterproductive to improving auditor communication. Also, the inclusion of greater detail on the audit process would give rise to additional costs.

ACAG does not support the increased use of “Emphasis of Matter” paragraphs for the reasons set out in paragraphs 58 and 59 i.e. excessive other reporting might cause the auditor’s report to be ambiguous, or confuse readers as to the meaning of the auditor’s opinion on the financial statements.

Paragraph 60 suggests that “the auditor can play a greater role in helping users navigate increasingly complex corporate financial reports by drawing attention to information within the financial statements, such as important disclosures”. ACAG does not support such changes as they could lead users to consider that auditors are responsible for the financial report and would require auditors to second guess which disclosures were important across a diverse range of users. These issues would be dealt with more appropriately within an examination of the financial reporting framework and the responsibilities of those charged with governance, rather than through changing the role of auditor reporting.

Paragraph 62 lists additional information about the audit that could be disclosed in the auditor’s report. ACAG does not support the inclusion of this type of information as:

- most of this information pertains to the application of professional judgement which would be difficult to adequately articulate in the auditor’s report
- the additional information requires a certain level of financial knowledge by users
- it is not certain that the inclusion of this information would assist users to make more informed decisions
- care has to be taken to avoid increased reporting on individual components rather than reporting on the financial report as a whole
- while auditors currently consider these areas during the conduct of an audit, it is not done with a view to the public reporting of such information. ACAG consider that the public disclosure of such information would lead to additional processes and costs due to the need to manage information disclosure with client relationships.

**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.**

ACAG has reviewed the example French justification of assessments linked to in footnote 9 on page 18 on the Consultation Paper (i.e. the example located at <http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=6046>). ACAG consider that the information provided in the example “justification of assessments” in relation to accounting estimates (i.e. in the first dot point on page 3) would be more appropriately provided by those charged with governance in the notes to the financial statements.

In our view the descriptions of the audit approach provided in the subsequent dot points are summarised to such an extent that they provide little value to users.

**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.**

ACAG does not support changes in auditor reporting that involve the disclosure by the auditor of financial and related information currently not available to users. This proposal is at odds with the nature of an attestation audit in which auditors should report only on information already reported by those charged with governance. If users require more information for their decision making than is currently provided by the entity, these issues would be dealt with more appropriately within an examination of the financial reporting framework and the responsibilities of those charged with governance.

Other concerns with the proposal include:

- the difficulty of commenting on the items listed in paragraph 72 in a consistent and objective way in the absence of an agreed framework
- cost implications for clients
- risk/liability implications for auditors
- different user groups have differing information needs.

The provision of additional commentary which raises concerns with the quality of the financial reporting process, for example, may cast doubt over the auditor’s opinion.

**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.**

Paragraph 81 envisages reporting by those charged with governance to the entity’s shareholders or external stakeholders in conjunction with expanded reporting by the independent auditor on the report provided by those charged with governance. Changes in reporting of this type would require changes to the various public financial reporting legislation and potentially changes to some audit legislation. While various sectors have established governance guidelines (i.e. stock exchange listing rules, government financial management guidelines) there is no agreed governance framework appropriate to all reporting entities. Establishment of a generally accepted framework with information disclosure requirements and clear accountabilities will need to underpin any extension of the reporting framework.

The options set out in paragraph 83 regarding additional communication by the auditor are:

- the auditor's report to include an additional element addressing the audit committee's report or
- a separate assurance report to be issued by the auditor.

In our view it would be more appropriate for assurance over a "corporate governance report" to be provided separately to the auditor's report on the financial report due to the differing objectives of the two auditor's reports.

The model set out in paragraph 84 is predicated on the audit committee receiving a report from the auditor that enables the committee to "understand fully the factors the auditor has relied upon in exercising professional judgment in the course of the audit and in reaching the audit opinion". ACAG does not consider that an auditor's report should be a pre-requisite for the formulation of a report by a governing body. While ISA 260 currently requires the auditor to communicate with those charged with governance on the significant findings from the audit, ACAG consider that the auditor reporting envisaged in paragraph 84 would be a significant extension of the existing requirements.

**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?**

ACAG does not support the model outlined in paragraph 84, although a broader model of corporate governance reporting is worthy of further consideration provided an agreed framework can be established.

There is a need to consider whether extending the responsibilities of those charged with governance will affect the readiness of appropriately qualified and experienced people to join governing bodies. The public sector in particular already faces difficulties in attracting and retaining suitably qualified candidates to fill such positions. Imposition of more onerous reporting may be impractical for very small organisations.

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

As stated above ACAG does not support the model outlined in paragraph 84. ACAG consider that it would be appropriate for the auditor to provide assurance on a corporate governance report, provided such assurance was separate to the financial statements audit. Many public sector auditors already provide assurance on a range of governance and operational issues, for example, audits of key performance indicators.

To allow the auditor to provide assurance, the framework governing the report would need to provide:

- suitable criteria on which to assess entities to promote consistency in assessment
- the level of assurance to be provided (limited or reasonable)
- the content of the auditor's report
- the respective responsibilities of those charged with governance and the auditor.

**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.**

The examples listed at paragraph 88 include topics which are often the subject of audits within the public sector, both as attestation audits (including key performance indicators) and as direct reporting performance audits (including risk management). These audits form an important part in the broader accountability framework within many public sector jurisdictions.

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

While generic standards on assurance engagements are in place, supported by Australian standards on compliance and performance engagements, guidance on commonly audited topics (e.g. key performance indicators) would assist the development of a consistent approach to these audits. Further research on what other types of subject matter are of value to users should be undertaken before further development of assurance or related services.

#### **IV 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.**

ACAG consider that changes to the structure and wording of the auditor's report to clarify the role of the auditor are worthy of further investigation. While this would involve some administrative costs and additional effort to communicate changes to clients, ACAG believe these costs would be worthwhile. As previously stated, ACAG support further consideration of:

- reducing the level of technical language in the auditor's report and the provision of a glossary of terms explaining key audit terminology contained in the auditor's report
- including certain further information in the auditor's report about the conduct of an audit e.g.:
  - the auditor checks only a sample of transactions
  - the auditor does not always test controls
  - the audit may not detect all material fraud
  - the auditor focuses on detecting material misstatements only.

ACAG consider that providing a rationale for the audit opinion is likely to introduce levels of detail and complexity into the auditor's report that will be counterproductive to improving auditor communication. ACAG consider that the public disclosure of such information would lead to additional processes and costs due to the need to manage information disclosure with client relationships. Also, auditors are unlikely to move away from using generic language in their reports and so it is likely that the additional information will become 'boilerplate' over time.

ACAG does not support changes in auditor reporting that involve the disclosure by the auditor of financial information currently not available to users, as these changes will alter the role of the financial report auditor. These issues would be dealt with more appropriately within an examination of the financial reporting framework and the responsibilities of those charged with governance.



The options of establishing an enhanced corporate governance reporting model and other assurance services rely on legislative changes to establish reporting requirements and would need provision of clear frameworks to audit against. The implications of these changes would be far reaching and difficult to quantify but may include cost implications for clients and risk/liability implications for auditors.

**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 differ.**

The effect of changes to the structure and wording of the auditor's report would be similar for most entities.

Including in the auditor's report the auditor's judgements and procedures and additional financial information currently not available to users may be felt more by smaller clients with lower audit fees due to the additional costs of preparing the audit report and managing the information disclosure with clients.

The effects of establishing an enhanced corporate governance reporting model or other assurance services may be onerous for very small organisations.

**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?**

ACAG consider that changes to the structure and wording of the auditor's report to clarify the role of the auditor are worthy of further investigation.

Given that ACAG believe that a number of the issues highlighted in the consultation paper would be dealt more appropriately within an examination of the financial reporting framework (e.g. at questions 1, 10 and 16) ACAG recommends collaboration with the IASB on these issues.

**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?**

ACAG have no further suggestions.