

ENHANCING THE VALUE OF AUDIT REPORTING: EXPLORING OPTIONS FOR CHANGE

A consultation paper issued for comment by the International Auditing and Assurance Standards Board

Comments from ACCA
September 2011

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Executive Summary

ACCA welcomes the opportunity to respond to the consultation paper *Enhancing the Value of Auditor Reporting: Exploring Options for Change* issued by the International Auditing and Assurance Standards Board. The paper seeks input on issues relevant to the usefulness of auditor reporting and possible options to enhance its quality, relevance and value.

We are particularly pleased to see this initiative as ACCA has carried out a body of work in this area in which we have called for a broadening of the scope of audit.¹

In this response we emphasise that the current consideration of the value of auditor reporting must form part of a wider holistic approach to disclosure, reporting and assurance, as efforts to enhance the value of corporate reporting must encompass much more than just revision of the existing auditor reporting standards.

We caution that changes driven primarily by the needs of users in a global business environment which is characterised by increasingly complex financial reporting requirements should not adversely impact the interests of users of the financial statements of other types of entity. Indeed, we stress the need for such changes to reflect developments in the reporting of non-audit engagements and the need to demonstrate value to those who commission voluntary audit engagements.

¹ ACCA's work on Audit and Society may be found at <http://www2.accaglobal.com/af/audit>

General Comments

ACCA welcomes the opportunity to respond to the consultation paper *Enhancing the Value of Auditor Reporting: Exploring Options for Change* (the consultation paper) issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants.

The consultation paper is thorough in its analysis and presentation of the issues. Naturally the IAASB focuses on the role of the auditor but we would caution that the response to user needs for disclosure is primarily a matter for preparers and those responsible for determining the applicable reporting frameworks. There are undoubtedly opportunities for the IAASB to collaborate with others, particularly with respect to changes outside the scope of the existing auditor reporting model and scope of the financial statement audit. We would support the IAASB devoting resources to such activities.

While the issues dealt with in the consultation paper are more obviously relevant to companies and auditors concerned with the voluminous annual reports now seen on major capital markets, they also impact, to some extent at least, on smaller entities. We suggest that the IAASB should ensure that any changes to auditor reporting are not to the detriment of smaller entities and also that those changes take into account the circumstances where audit is not a statutory or regulatory requirement, but is commissioned voluntarily.

ACCA has been arguing for the past two years that while the role of audit is not 'broken' and still adds real value by enhancing trust in financial statements, it could do much more. We believe it needs to evolve to take into account not just the historic financial statements but also to give an opinion on more forward-looking, qualitative and non-financial data. There needs to be less focus on out-of-date figures and more on risk information.

ACCA believes auditors should consider incorporating into the standard auditor report a clear statement of responsibilities for reviewing and/or reporting on companies' risk management and corporate governance arrangements. We also believe the auditor is well-placed to assess and report on the client's business model, or at least on the financial assumptions underlying that model. We accept that taking on such responsibilities – which would meet demands from users for more useful information from the audit – would require commensurate legal protection for auditors.

ACCA is committed to identifying ways of closing the expectations gap and we have recently carried out a considerable body of work in response to the challenges presented to the auditing profession by the business environment. As part of ACCA's *Accountancy Futures* programme, in the year to September 2010 we researched the views of audit committee chairmen and hosted an international series of ten round-table discussions on the value of audit. The report *Reshaping the audit for the new global economy*² presents our findings including those in relation to expanding the scope of the audit.

Within the above programme, during 2011 we would particularly draw attention to *The Value of Audit: Views from Retail (Private) Investors*³, a report prepared by ACCA for the Singapore regulator ACRA which examines the value of audit as perceived by private investors and *A Framework for Extended Audit Reporting*⁴ a report by Maastricht Accounting, Auditing and Information Management Research Center (MARC) of Maastricht University, Netherlands commissioned by ACCA to examine a possible framework for extended audit reports.

In the next section of this response, we answer the specific questions posed in the consultation paper.

Should the IAASB have any questions about our response, or require further information, please contact in the first instance:

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² http://www2.accaglobal.com/pubs/general/activities/library/audit/audit_pubs/pol-af-rtf2.pdf

³ http://www2.accaglobal.com/pubs/general/activities/library/audit/audit_pubs/views_from_retail.pdf

⁴ http://www2.accaglobal.com/pubs/general/activities/library/audit/audit_pubs/extended_audit_reporting.pdf

Matters on which Specific Questions are Asked

In this section of our response we answer the questions posed in the consultation paper.

Question 1

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

Section II correctly identifies the issues relevant to market participants' perceptions of auditor reporting today. There is indeed much evidence to show that non-specialist users of financial statements do not understand what the role of audit is. Many believe that the role of an auditor is to detect fraud and certify that the company will not fail in the foreseeable future. ACCA welcomes initiatives aimed at reducing the expectations gap, but recognises that the gap may never fully be bridged.

Explaining better the audit methodology employed may help change user perceptions of audit, but users have different needs and levels of understanding; necessitating different approaches to meet those needs. Audit methodology can be highly complex and clarity of communication to users will be difficult to achieve. Users can always refer to the International Standards on Auditing (ISAs) and related materials but these extend to many hundreds of pages. It is unlikely, therefore, that any audit report can itself go into sufficient detail on the audit methodology employed to properly inform users. It would be feasible, however, to use the report to explain why the auditor has arrived at a particular opinion.

There are essentially two ways to bridge the expectations gap: moving the audit closer to the public perception, or changing that perception. ACCA believes that it is now necessary to undertake an evolution of the auditor's role within the reporting process. The economic crisis has shown that there is still room for improvement within the audit and risk management functions and there is a legitimate debate that should take place about the role of audit, involving all stakeholders in the process. Policies need to be developed in respect of audits of larger entities that pay more heed to the deeper and wider needs of stakeholders and hence meet the demands of the market.

Question 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?

There are limits to the extent to which auditors can fill the information gap (as discussed in the consultation paper) as management, or those charged with governance, have the primary role for disclosing additional information that is currently not available to users. Auditors can, nevertheless, add credibility to such disclosures.

A financial reporting framework may accommodate new disclosures but information may also be provided outside the financial statements. As we first said in our January 2010 policy paper *Audit Policy: Lessons from the Crisis*, there is value in auditors fulfilling user expectations in relation to disclosures, but that need not take place wholly within their traditional audit mandate as significant aspects could also form the subject matter of related engagements:

'Audit needs to be broadened in scope – as well as reporting on historic financial statements, auditors can meet stakeholders' needs better by incorporating into the audit assurance on risk management and governance arrangements. They should also report on the assumptions underlying the business model as to whether these seem reasonable or optimistic. If the scope of audit is to be expanded, and if auditors are to be given significant new responsibilities, then it is reasonable for law-makers to address the issue of the exposure of auditors to liability.'

In terms of standard setting, it is important that the current consideration of the value of auditor reporting results in more than just revision of the existing form of reporting. An holistic approach is necessary encompassing:

- the suitability of the International Standards on Assurance Engagements series of pronouncements for assurance of non-financial information
- possible improvements to ISA 720 *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements*
- other enhancements to ISAs, perhaps through additional standards that expand on how the core ISAs⁵ are to be applied (as is done by ISA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*).

⁵ The 'core ISAs' are: ISA 300 *Planning an Audit of Financial Statements*, ISA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment*, ISA 320 *Materiality in Planning and Performing an Audit* and ISA 330 *The Auditor's Responses to Assessed Risks*.

Responses to the recent IAASB discussion paper *The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications* will assist in determining appropriate courses of action⁶. That paper correctly identifies significant trends: the ‘modernisation’ of disclosures in the financial statements and user interest in disclosures that are arguably not part of the financial statements (or at least which are not addressed by the financial reporting framework). The overarching question is whether such disclosures are understood by users without an expectations gap? Furthermore, is there an appropriate user understanding of the limits of assurance when the subject matter is narrative and unrelated to traditional financial disclosures?

Question 3

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

The consultation paper responds to concerns of market participants that auditor reporting is not meeting the information needs of financial statement users in a global business environment with increasingly complex financial reporting requirements. Such users are undoubtedly the most affected by these issues. We are concerned that solutions appropriate to the needs of such stakeholders (typically listed company investors) should not adversely impact the interests of users of the financial statements of other types of entity. Although the concept that ‘an audit is an audit’ may be applied to the standards for the audit process (as that defines the ‘shape’ of reasonable assurance⁷) standards for reporting must allow for suitable variation.

⁶ ACCA’s response may be viewed at:

http://www2.accaglobal.com/general/activities/technical/archive_v2/subject/auditing/cdr1021

⁷ More explanation concerning the ‘shape’ of reasonable assurance is provided in our recent response to the exposure draft of proposed International Standard on Assurance Engagements 3000 *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*, which may be viewed at:

http://www2.accaglobal.com/general/activities/technical/archive_v2/subject/auditing/cdr1039

We would also point out the need for changes to auditor reporting to reflect developments in reporting of non-audit engagements, in particular where statutory audit is no longer the norm; where audits are voluntary engagements, it is much more important that standards and reporting demonstrate their value to those who commission them. This, similarly, may be achieved by allowing for suitable variation in reporting.

A. FORMAT AND STRUCTURE OF THE STANDARD AUDITOR'S REPORT

Question 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 auditor's report in the way outlined in Appendix 1 of this Consultation Paper?

We consider each of the following options for change:

- (a) Considering the most useful presentation or positioning of generically-worded paragraphs explaining the respective responsibilities of management (or, where appropriate, those charged with governance) and of the auditor that appear in every auditor's report;*
- (b) Addressing the lack of common meaning of technical terms used in the auditor's report; and*
- (c) Changing the location of the auditor's opinion on the financial statements to give it greater emphasis.*

In general, we prefer brevity and simplicity in reporting as both encourage users to read auditor's reports and both facilitate comprehension. Thus, a primary test for the inclusion of material has to be whether it is sufficiently important to counterbalance the attendant lengthening and complication of the report.

We believe that the overall impact of the report has to be considered even though, for the purposes of this consultation paper, elements of it, such as genetically-worded paragraphs, are separately discussed.

Generically-worded paragraphs

The consultation paper reports the outcome of academic research on the usefulness of the generically-worded paragraphs. Such paragraphs also contain technical terms which themselves embody disadvantages as we set out below. Recitations of the respective responsibilities of the auditor and management can be regarded as communication of their respective roles, but some regard the material as risk management by the auditing profession. We believe that the report of the auditor can best add to user understanding by setting out clearly the scope of the auditor's work. This we feel is a better direction for development of generically-worded paragraphs than, for example, incorporating the whole of the matters referred to as comprising the premise on which the audit is conducted⁸.

Technical terms

We are sympathetic to the complaint that certain technical terms are not understood by report users. Indeed, in the absence of a proper theoretical underpinning for ISAs, we doubt whether auditors would always completely agree on their meaning.

It is not, however, further explanation of technical terms that is the root cause of a lack of understanding. It will be instructive to consider not only whether the report could be constructed without technical terms (although in many jurisdictions these are embodied in the law) but also whether the whole objective of the report is correct. The user is concerned to know whether the auditor believes that the financial statements, as presented, are fit for purpose. In the same way that the directors approve the financial statements for publication, the auditor approves the change of status from unaudited to audited. This is obviously a gross oversimplification, but over recent years there has been much tinkering with auditor reporting without solving many underlying problems and we believe fundamental reconsideration from a user perspective is now necessary to make real progress.

⁸ These are listed in paragraph A2 of ISA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With International Standards on Auditing*.

Location of the auditor's opinion

The consultation paper discusses giving the opinion more prominence, either through inclusion in an 'opinion only' report or repositioning it within the existing report. As extant ISA 700 *Forming an Opinion and Reporting on Financial Statements* does not actually prescribe the positioning of the opinion, the latter is currently permitted (albeit discouraged by such devices as describing the elements of the report in a particular order).

We are not in favour of an 'opinion only' report as it is important that users have access to material to put the opinion in context. Such material might be provided in an additional or separate report, or even through an internet link, but these mechanisms (without an alternative) may disadvantage certain classes of user, for example those not having Internet access.

If the concerns about prominence are judged to be sufficiently important, we see considerable merit in allowing the opinion to be the first element of the report (after its title) as further elements could then be structured as either relevant to it, or resulting from other reporting requirements as necessary.

Question 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?

While there may be some unintended detriment to the expectations gap if the responsibilities paragraphs were removed or repositioned, one would have to seek evidence before concluding that this was a necessary consequence. In several recent responses we have made the point that it is important to say what the auditor (or practitioner) has done rather than what they have not done. It is important to communicate the auditor's responsibilities precisely rather than make statements about who has assumed other related responsibilities.

B. OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS

Question 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?

We believe that it would be generally beneficial for auditors to indicate the precise scope of their responsibilities regarding 'other information'. This is particularly important where there are separate opinions on other matters in addition to the general responsibility imposed under ISA 720.

As we said earlier in this response, it is important that an holistic view is taken of reporting and responsibilities of auditors imposed by ISA 720 and other standards.

Question 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?

Until the current revision of ISA 720 is essentially complete, it would be premature to suggest the form of an appropriate statement. Because of the considerations of brevity, we are generally against boilerplate statements that the auditor has nothing to say in relation to a particular requirement. It is more important that users understand the difference between information that is within the financial statements and is audited and the auditor's responsibilities towards other information. Such responsibilities arise from the operation of ISA 720, but there may also be other standards, law or regulation dealing with assurance on certain matters.

C. AUDITOR COMMENTARY ON MATTERS SIGNIFICANT TO USERS' UNDERSTANDING OF THE AUDIT OR THE AUDITED FINANCIAL STATEMENTS

Question 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.

We are attracted to the model of reporting whereby the audited entity is free to report matters which the auditor has raised with those charged with governance. The mechanism to support this currently exists in the ISAs that drive auditor communication, but entities may consider that they need the equivalent of financial reporting standards to govern the way in which they communicate so that there is a degree of consistency and comparability between reporting entities. This is clearly an area where much consideration is necessary of alternatives and preferred solutions. Having said that, in the overall context of the financial statements and accompanying information, such disclosures are not of the same order of importance as the primary financial statements and there is a danger that too much attention will be paid to them if a project has too narrow a focus. We fully support the development of such reporting and indeed targeted assurance engagements designed to achieve appropriate objectives; as these are more likely to be directly responsive to user needs and the value placed on them (as such assurance may be relatively costly).

Question 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 consultation paper summarises related survey results and we generally concur with its identification of the areas of difficulty and challenge. While 'justification of assessments' may be worthwhile in theory, there is a danger that statements will become boilerplate in practice. Such statements raise concerns over the brevity of reporting and we see, therefore, more scope for informative reporting where the auditor positively wishes to comment. This should continue to be allowed under reporting standards rather than introduce a required separate section of the report.

Question 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.

As set out in an answer to question eight, it is the entity itself that should be providing these disclosures.

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

The enhanced model envisages those charged with governance reporting on their oversight of the financial reporting process and the audit. This would be informed by internal communications to them from the auditor concerning key aspects of the audit.

For external auditors, the clarified ISAs require communication of matters of governance interest, including: the auditor's views about significant qualitative aspects of the entity's accounting practices, significant difficulties, if any, encountered during the audit, and other matters that are significant to the oversight of the financial reporting process. The external auditor will also ordinarily discuss how the external and internal auditors can best work together in a constructive and complimentary manner.

ACCA is in favour of this form of enhanced reporting because it responds to user demands for more information about such matters. For the reasons discussed in our answer to question eight, this approach is preferable to direct reporting by the auditor.

Question 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?

As the consultation paper itself notes, differences in national corporate governance models may limit the use of enhanced corporate governance reporting. International standards may put pressure on jurisdictions to change, but ultimately it is a matter for legislators and regulators to decide whether enhancement is needed in the particular national circumstances.

Question 13

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

Yes: assurance enhances the credibility of disclosures and should be valued by users. Auditors already have responsibilities under ISA 720 and comment implicitly, therefore, even if they remain silent. Revision of that standard is in hand and that process, if it is sufficiently wide, can allow for consideration of several methods of conveying assurance.

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

Question 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.

Part E discusses information that is of value to management of the entity and may also be of interest to external users, such as information on the business model, including the sustainability thereof, and key performance indicators.

The need for disclosure of such information depends on user needs, which may be established by research and due process of standard setters, or on an entity by entity basis. Where such information is demanded there is a valid role for assurance, as indicated in our general comments (which reference relevant ACCA research) and our answer to question two.

Question 15

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

The prime movers must necessarily be the users, reporters, regulators and standard setters concerned with the provision of subject matter information that is suitable for assurance.

The IAASB needs to reach a satisfactory position on standards for auditing, assurance and related services (and related quality control) to support such developments and we note that, while several relevant standards are currently under revision or development, standards for related auditor reporting also need to be under active consideration.

In our general comments and in our answer to question two we mentioned the issue of auditor liability. This must necessarily be resolved in parallel with other actions to develop further assurance or related services.

Question 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.

Section III lists several types of subject matter that is deemed to be of value to management of the entity as well as external users. These include some on which auditors in some jurisdictions already report and others that present different challenges to disclosure and assurance (either direct or on the related processes).

While ACCA has identified significant demand for change, through the body of work referred to earlier in this response, it is important that sufficient detailed research is carried out to explore the views of preparers, users and auditors to determine the demand and the cost; as experience has shown that, when the latter is fully appreciated, the price to be paid may be considered too high. As the benefits are greater for larger listed entities, measures can better be justified for such entities than those that are smaller.

Question 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.

It is almost self-evident that change would affect types of entity differently. As well as demand and cost varying, particularly between large and small entities, the circumstances in individual jurisdictions can have significant effects in relation to individual disclosures; for example, the extent to which disclosures are already required, especially where such disclosures are included in the financial statements and the scope of the audit.

Question 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?

While ACCA has identified significant demand for change, we are not in a position to conclude on the relative priority of options, which we expect will vary from jurisdiction to jurisdiction. We nevertheless caution against focusing on matters close to the area of standard setting for auditors when more valuable progress may be made by working together with others in the financial reporting supply chain.

Question 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?

In our answers to questions two and three, we drew attention to the need for an holistic approach to standard setting that took fully into account the influences on, and of, financial reporting of smaller entities.

We are now firmly of the view that options in reporting are the only way to accommodate the different needs of users along the spectrum from global corporation to small company. We have said so in several responses, most recently that concerning *ISAE 3000 Assurance Engagements Other than Audits or Reviews of Historical Financial Information*, and before that *ISRE 2400 Engagements to Review Historical Financial Statements*, making the point that, for voluntary engagements, reporting standards have to allow practitioners to describe what they have done and present those qualities that allow users to draw comfort from their involvement.⁹

⁹ These responses may be viewed at:

http://www2.accaglobal.com/general/activities/technical/archive_v2/subject/auditing/

When, because of audit exemption or otherwise, audit is voluntary, similar considerations apply. As ISAs were originally designed to be applicable to statutory audits this makes it apparently very difficult for the IAASB to adopt anything other than a traditional large company audit mindset. Unless the needs of SMEs are fully accommodated, the IAASB runs a high risk of failing to maintain its mandate as the standard setter for that constituency. As a firm supporter of global standards, ACCA would regard such an outcome as extremely undesirable, and one which in our view IAASB should actively seek to pre-empt.

Taking the above into account, we suggest that the information gap could be narrowed if auditor reporting were to include suitable options to allow the auditor to present appropriate credentials. In several jurisdictions, large audit firms are required to adopt publicly visible governance arrangements, publish 'transparency reports' and are subject to regulatory review that is in the public domain. Nevertheless, a reader of an audit report from such a firm will ordinarily receive no more information about a firm than its name and address and, where required, status under legislation or regulation in the jurisdiction as an authorised or registered auditor.

There is considerable overlap between the concept of audit quality and the user perception of audit quality, which may in itself be influenced by reporting. When considering an holistic approach to standard setting, we believe it is important that the IAASB combines the thinking from its current projects, including that on audit quality, to meet user needs for information, not only about a particular engagement, but also about the auditor or practitioner concerned.

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