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Mr. James Gunn
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USA

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Re: IAASB CP on Enhancing the Value of Auditor reporting: Exploring Options For Change

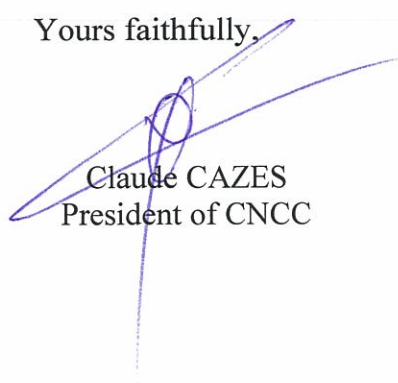
Dear Mr. Gunn,

The Compagnie Nationale des Commissaires aux Comptes (CNCC) and the Conseil Supérieur de l'Ordre des Experts-Comptables (CSOEC) are pleased to provide you with their comments on the IAASB Consultation Paper on Enhancing the Value of Auditor reporting: Exploring Options For Change.

Responses to the specific questions raised in the Consultation Paper are set out below.

If you have any further questions about our views on these matters, please do not hesitate to contact us.

Yours faithfully,


Claude CAZES
President of CNCC


Agnès BRICARD
President of CSOEC

Envoyer obligatoirement toute correspondance aux deux adresses ci-dessous :

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

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?

Designing a global solution:

The French Institutes welcome the consultation launched by the IAASB “Enhancing the value of Auditor Reporting: Exploring Options for Change”. The consultation is particularly relevant at this time when many are questioning the role of the audit and the auditor.

The French Institutes consider that now is the time to rethink the auditor’s communication in its entirety in a modern financial reporting system where each party plays its part in fulfilling its respective responsibilities.

For this reason the French Institutes consider that a mere modification of the auditor’s report will not be sufficient to build a coherent system that will fully respond, in the public interest, to the information needs of the different stakeholders mentioned below.

In the context of the Green Paper issued by the European Commission, the French Institutes have provided the Commission with their views on the possible future role of the audit, exploring the possible interaction and communication of the auditor with the different parties and stakeholders in the audit, namely:

- The management of the entity
- Those charged with the governance of the entity (audit committees in particular)
- The shareholders
- The regulators

The French Institutes’ proposals are presented in the attached notes 1 to 4 and in the diagram: Overview of the audit that are included as an appendix to this letter.

In essence, the proposal calls for:

- a detailed communication by the auditor to those charged with governance (audit committee) that sets out the key issues and findings of the audit
- reporting by management to the audit committee on going concern, internal control, risk management.

The audit committee would then issue a report to the shareholders explaining how it discharged its responsibilities and would respond to the information needs of the market on:

- The main risks identified by the entity’s management and how these risks are managed;
- The internal control system that management has put in place;
- The appropriateness of applying going concern principles when preparing financial statements.

It should be noted that this approach is very similar to that envisaged by the APB, with the exception that the APB proposes that the auditor reports systematically to the audit committee, and not on an exception basis.

Two other proposals are provided which we believe would help fill the information gap:

The generalisation of the French “justification of assessments” in the auditor’s report and the establishment in every Member State of a « Macro-economic Risk Observatory » grouping auditors, prudential and market regulators and professional associations to share information on emerging types of risks and transactions that could give rise to large scale systemic-type risks. The analyses and observations made by each national Observatory would be monitored at a European level so as to create a basis for actions to be led by the European regulator. The auditing profession would thereby play an « early warning » role, while leaving the responsibility for action to the regulators or the legislator.

We recognize that the IAASB, which is the international standard setter for auditing, does not have the power to change corporate laws or security rules, but we believe it can influence the debate and elevate it to the right level via the PIOB and the Monitoring Group where various regulators and oversight bodies are represented to ensure the public interest is best served.

The French Institutes therefore strongly encourage the IAASB to participate in the global debate on the role of the audit and expand this to include consideration of the role of other key parties to the financial reporting process, including, Audit Committees.

Focus on the auditor’s report:

Having described the French Institutes overall approach to proposals for responding to the information needs of the various users of audited financial information, the following paragraphs focus on the auditor’s report to shareholders.

The French Institutes respond to this consultation from the vantage point of having already introduced measures in 2003 to change the auditor’s report in order to address the information gap.

As a matter of principle, we are in favour of the auditor providing additional information about the audit in the auditor’s report, but only to the extent that the responsibility for providing information about the entity remains with the entity and not the auditor.

The French model, whereby the auditor “justifies his assessments” in the auditor’s report, has been under scrutiny since the current debate on the auditor’s communication/ reporting started with the IOSCO consultation paper. It is referred to in the European Commission’s Green Paper, in the IAASB Consultation Paper and, more recently, in the Concept Release of the PCAOB.

In order to contribute to the current international debate on auditor’s communication/ reporting and also to understand users’ perception of the justification of assessments, the CNCC mandated a study by an independent consultant. The results of the study have been translated in English and are referred to in the Consultation Paper of the IAASB.

Interestingly the study shows that the users want more from the auditor’s report than the traditional binary “pass or fail” model. In this respect, the “justification of assessment” is an improvement to the traditional binary model.

Various respondents representing the Banking and Insurance regulator, the Stock Exchange regulator, the auditing profession’s supervisory authority and also the not for profit charities, have described the “justification of assessment” as “*a step in the right direction*”, “*a good positive thing*”, “*a very interesting development*”, “*an essential component of financial information and financial transparency*”, “*very useful and positive*”.

The key question is therefore what type of information do users require and should they receive this from the auditor or from others such as, for example, the audit committee. Do the needs vary from one category of user to another? Is it the role of the auditor to provide such information through the auditors' report?

The information needs range from information on:

- the entity: key business and operational risks
- the financial statements: key assumptions underlying the judgements that materially affect the financial statements¹
- the audit: key audit issues and their resolution

We therefore consider that section II of the Consultation paper appropriately sets the scene for the current debate on the auditor's report.

In our opinion there is a clear need/demand for a change at the international level to the auditor's report. For many years the profession has been trying to narrow the expectation gap by changes to the wording of the standard audit report. The profession is now facing a so-called "information gap" and we believe that changes should focus on giving information on the key judgements made both in preparing the financial statements and in auditing them in order to demonstrate the real value of audit.

Simply changing the wording of the standard report or reordering the paragraphs will probably not be sufficient to provide the users with the entity specific information they are seeking on the key areas of the financial statements and their audit.

We believe that the response should consist of a range of measures including:

- Changes to the "boiler plate" language of the report, drawing perhaps on the UK example of cross referencing the description of what an audit is and what the respective responsibilities of the auditor and management
- Reordering of paragraphs, with the opinion first, is probably worth exploring.
- Providing the users with entity specific information as it is presently in the justification of assessments. The justification of the assessments could provide:
 - an indication of the key items that have been considered (specific risks or sensitivities, audit issues, key events in the financial year, ...);
 - explanations on the procedures that have been carried out to comply with auditing standards, without however using too much technical jargon or using boilerplate language, as the aim is above all to inform stakeholders;
 - Conclusive comments on each item, aimed in particular at improving stakeholders' understanding of the basis for the conclusions that were reached.

Users of the auditor's report

With respect to which categories of users would be most interested in which type of information, it is interesting to note from the French study that the users most interested in the "justification of assessments" are primarily (without ranking):

¹ Interestingly the results of the French study on the "justification of assessments", also reveal that users, especially minority shareholders, value the justification of assessment" insofar as it helps them read the Financial Statements and focus on the areas of greater sensitivity. The auditor's report could therefore indirectly be valued as a means to reading increasingly complex financial statements

- The regulators (prudential authorities, stock exchange regulator), because they say it gives them an insight on the quality of the audit
- The minority shareholders, because they say it helps them read through the financial statements, they stated that the justification of the assessment “is useful and makes a valuable contribution by drawing attention to sections of the financial statements that might otherwise be overlooked”

Surprisingly, financial journalists, financial analysts, and above all institutional investors were less enthusiastic about the “justification of assessments”. This is a serious concern as they stated that they did not use the auditor’s report for their investment decision making, since it was too late and decisions were made on the basis of the preliminary announcements. This raises a more fundamental question of the role of the auditor’s report in investment decision making, the timing of the auditor’s report and whether the auditor should be required to “clear” the preliminary announcements. This is a question that the auditor cannot resolve alone without the involvement of the market regulators.

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

We firmly believe that the auditor’s report should be the same in terms of structure, wording and content, irrespective of the size of the entity. The French Institutes consider that the ISAs are capable of proportionate application and so should ISA 700 and the auditor’s report.

Of course, depending of the governance structure of the entity, the existence or not of an audit committee, the presence or not of a regulator in the sector or in the market, some of the reports proposed in the notes from the CNCC to the European Commission may not be applicable.

Questions 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?

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?

As mentioned above, we do not believe that by simply changing the format, structure and wording of the auditor’s report will be enough to close the “information gap”.

Nevertheless, as mentioned above, we consider that by changing the “boiler plate” wording of the description of an audit and the respective responsibilities of management and the auditor to make them more understandable to users may be worth exploring, as is the idea of positioning the opinion first in the report.

We do not think that such changes may have the unintended consequences of widening the expectation gap

Questions 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?

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?

The French Institutes are not against the addition of a statement about the auditors' responsibilities regarding other information in documents containing audited financial statements. Nevertheless they consider that potentially this could widen the expectation gap, since users may derive from the additional statement implicit assurance that everything in the other documents containing audited financial statements has been verified when in fact it has simply been read.

It would be clearer if the auditor were to provide explicit assurance on the other information containing or accompanying the financial statements, but this would require an extension of the scope of the audit. The report could make an explicit reference to the documents covered so as to reduce the risk of misunderstanding.

In France, the auditor explicitly reports in the third section of its auditor's report on the consistency of the information in the management report with the financial statements and on the fairness of the information presented.

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.

As already mentioned, we consider that the proposed structure by which the auditor and management report to the audit committee and subsequently the audit committee reports to the shareholders on :

- the main risks identified by the entity's management and how these risks are managed,
- the internal control system that management has put in place;
- the relevance of applying going concern principles when preparing financial statements.

complies with the key principle that the auditor should not be the primary source of information that is for the entity to disclose.

As mentioned in response to questions 1 and 2, we are in favour of the auditor providing additional information about **the audit** in the auditor's report on the financial statements.

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.

We are in favour of this.

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.

See above, our response to question 8.

On this question, it should be noted that one of the subtleties of the French "justification of assessments" is that the auditor's justification is always anchored to a note to the financial

statements that describes the issue. The auditor therefore does not disclose information that the entity has not already disclosed but it does give the reader an insight into the procedures performed relating to the issue for the purpose of the audit. We consider that this is the appropriate way of serving the public interest while preserving business confidentiality as well as maintaining the fundamental principle that the entity and those charged with governance are responsible for presenting the financial information.

Furthermore, experience has shown that by anchoring the justification of the assessments to the notes to the financial statements has had, at least in the first years of implementation, the positive effect of improving disclosure and therefore the transparency of the financial statements.

On the other hand, one of the drawbacks of the justification of assessments is that over the years it tends to turn into boiler plate wording, at least for the same entity, as the audit risk focus tends to be similar in successive years.

In case of unusual events like the financial crisis, however, the justification of assessments becomes more tailored to the circumstances.

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.

See above our response to questions 1, 2 and 8. We consider that it is a very interesting idea. We consider the audit committees and more generally those charged with governance, to be a crucial component of the process for achieving reliability and transparency of the financial statements. They monitor the independence of the auditor and they provide a critical forum for discussion and debate with auditor.

For these reasons we favour a report by those charged with governance on the way in which they have discharged their responsibility for the oversight of the financial reporting process and the preparation of the financial statements.

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?

This would require significant changes to company law and an in-depth dialogue between the government, the regulators, the representatives of the industries, the auditors, and the users of the financial statements and more generally all the stakeholders.

We believe that the information gap cannot be resolved by simply changing the auditor's report.

The current debate at the European level launched by the European Commission provides a good forum to discuss these issues with all the stakeholders.

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

We are in favour of the auditor providing assurance on a report issued by those charged with governance. The auditor's report could be issued either systematically on each report prepared by those charged with governance or on an exception basis if the auditor has comments on the audit committee report.

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.

All the topics mentioned in paragraph 88 of the Consultation Paper are of interest and the profession stands ready to play its part, in the public interest, by studying the possibility of

providing assurance in these areas. We consider that the audit of financial statements is but one element of the decision making process of investors and that the need for assurance extends much further. However, The French Institutes consider that a preliminary step before requiring additional assurance to be provided is to understand the real needs of users and develop an appropriate reporting framework in order to respond to this need. As soon as there is a reporting framework the auditor will be in a position to design procedures to provide assurance and report on that information. The progress made by the IAASB in the revision of ISAE 3000 will provide a useful resource for such engagements.

Investigating the needs of users may even highlight topics which may have not been identified in paragraph 88 of the Consultation Paper. Topics such as the financial strength of the entity which are mentioned in the E.C. Green Paper, for example, may arise.

Question15. What actions are necessary to influence further development of such assurance or related services?

See our response to question 12 above. Actions necessary to influence further developments of such assurance or related services will vary between countries. At present in Europe, the debate launched by the European Commission with its Green Paper may be a good platform to influence such developments.

Questions16: 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.

The response to this question on the costs/benefits of each option very much depends on what is already in place in each country, in terms of governance structure, auditor's reporting , etc...

Change format auditors report (option A)

We believe that the potential benefits of changes to the wording and structure of the auditor's report may result in improved understandability of the report and reduce the impression that the report is worded to explain what an audit is not and what the auditor is not responsible for. However, as mentioned in our response we do not believe that such changes will be of much help in reducing the information gap. The cost of such a change should be relatively low.

Assurance on ISA 720 work (Option B)

We believe that providing assurance on the information covered by ISA 720 could be of great benefit to users, even more so if such assurance is explicitly given in a report or in a section of the auditor's report. Incremental costs may be relatively high, depending on what the country already has or has not in place with respect to auditor's involvement with other information accompanying the financial statements.

Additional information (French model-Option C)

We believe that the benefits to users of introducing additional information in the auditors report on a model similar to the French model is high in comparison to the extant auditor's report. Costs may also be relatively high in terms of training the auditors, internal quality review for the firms, discussions with the audit clients and their lawyers, but we believe that the benefits outweigh the costs.

Report/Audit com. report (UK model-Option D)

We believe that this model is probably the one that bears the highest potential benefits since it strikes the right balance between those who provide information and those who give assurance on it. The information given to the shareholders by the audit committee may be potentially richer, given its role in overseeing the financial reporting process, than that provided by the auditor which will necessarily be more constrained and more focused on the audit itself. Information provided by the audit committee may therefore be potentially more useful to the users in understanding the risks of the entity. Its cost may be high since it requires a new report by the audit committee and a new report by the auditor on this report.

Additional assurance on new topics(option E)

This will depend on which additional topics are required to be covered.

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.

See our response to question 3, we favour having the same auditor's report for all entities irrespective of their size. Nevertheless some proposals will clearly not be appropriate for all entities: the auditor's report on an audit committee report for example would not be relevant to SMEs.

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?

See our notes that were provided to European Commission: A model combining Option B (reporting on ISA 720) and option C (the French model) for the auditor's report to the shareholders on the financial statements and the accompanying documents, and Option D (the UK model) for the audit committee report would probably be the most effective.

As already mentioned, we believe that the IAASB has a role to play to engage with the regulators to promote these options through constructive dialogue that would best serve the public interest.

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?

One of the key difficulties in today's world of financial reporting is the profusion of information.

The financial statements together with the other information given to the market has become so extensive and dispersed that it cannot possibly be read by the average user. This is why we believe that users are really asking for information that is digestible, understandable and concise; not necessarily more.

Another important challenge is the timing and the usefulness of the auditor's report with respect to the investment decision of the investors. As shown by some responses to the study on the "justification of assessments", the auditor's report arrives often too late for investment decisions which have already been made on the basis of a preliminary announcement.