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Financial Reporting Council

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12 October 2012

The International Auditing and Assurance Standards Board

Re: Invitation to Comment: Improving the Auditors Report

Dear Mr Gunn

I refer to the Invitation to Comment issued by the International Audit and Assurance Standards Board (IAASB) in June 2012 entitled 'Improving the Auditor's Report'.

I am pleased to attach a submission by the Financial Reporting Council (FRC). I would like to thank you for giving us an opportunity to comment on your proposals.

The FRC is currently conducting a number of audit quality projects as part of its strategic advice role, of which a review of the auditor commentary is one component. The FRC Audit Quality Committee has been specifically tasked with assisting the FRC in providing advice on audit quality to the Australian Government. The Committee commissioned an online survey of members of the Australian Shareholders Association on perceptions of the usefulness of the audit reports for retail shareholders in September 2012, to inform the FRC response to the IAASB ITC. A summary of the results of this survey are at [Attachment A](#).

Please feel free to contact me or the FRC Secretary (frcsecretary@treasury.gov.au) should you have any queries regarding the FRC submission.

Yours sincerely

A handwritten signature in cursive script that reads 'Lynn Wood'.

Lynn Wood
FRC Chair

SUBMISSION OF THE AUSTRALIAN FINANCIAL REPORTING COUNCIL ON THE IAASB INVITATION TO COMMENT ‘IMPROVEMENT TO THE AUDITOR’S REPORT’

Summary of Recommendations

The recommendations in this submission may be summarised as follows:

- The Australian Financial Reporting Council (FRC) supports the development of the auditor commentary and believes that the auditor commentary may be an important tool for communicating key information to users of financial reports. The challenge will be in providing meaningful information to users and avoiding boilerplate disclosure. A survey of retail shareholders conducted for the FRC identified that any material uncertainties in relation to going concern are of particular interest. A concern about major differences between book values and market values has also been suggested for review.
- The FRC believes it is important that the users of financial reports understand the role and responsibility of the audit.
- The FRC supports the industry’s attempt at self-regulation to better communicate the value of audit and believes that there is merit in relocating the auditor’s opinion to the beginning of the auditor’s report. The FRC notes that the ITC is one element of a broader push towards audit regulation internationally that the IAASB can address.

Specific reforms to the audit reporting framework must be considered in the context of improving market stability and accountability more broadly. As this is one of a number of mooted changes to the audit framework from various sources, we believe that it is important that the IAASB consider the systemic effects of these modifications on the whole financial reporting process. In particular, it is important that changes do not result in an over-regulated system or a system in which the parts are in conflict.

Overview

The FRC is pleased to make a submission to the IAASB public consultation process. The FRC is the peak body responsible for overseeing the effectiveness of the financial reporting framework in Australia. Its key functions include the oversight of the accounting and auditing standards setting processes for the public and private sectors, providing strategic advice in relation to the quality of audits conducted by Australian auditors, and advising the relevant Australian Government Ministers on these matters.

The FRC monitors the development of international accounting standards by the International Accounting Standards Board (IASB) and auditing standards by the IAASB, works to further the development of a single set of accounting and auditing standards for world-wide use and promotes the adoption of these standards.

The FRC has a wide range of stakeholders including a broad spectrum of preparers and users of financial reports, the Australian Government, State and Territory Governments, and other government bodies such as standard setters and regulators. Key stakeholder bodies are represented on the FRC as Members. In addition, the Australian and New Zealand Governments have established cross-appointment arrangements to promote closer economic relationships between the two countries. The FRC accordingly has a New Zealand representative as one of its members.

Australia was one of the early adopters of International Financial Reporting Standards (IFRS) in 2005 – and this is because we recognised early on, that with the current pace of globalisation, the movement to a global set of accounting standards is a logical transition. Australia’s auditing standards have been harmonised with International Standards on Auditing (ISAs) since the mid-1990s. More recently, since the clarity revision of ISAs in 2009, Australian Auditing Standards have been converged with ISAs. In addition, the Australian Accounting Professional and Ethical Standards Board (APESB) use the pronouncements of the International Ethics Standards Board for Accountants (IESBA) to develop Australian standards consistent with those issued by the international body.

The FRC has decided to provide a general response, with particular detailed comments to be provided by other Australian organisations, with specific interests in the requirements of particular stakeholders. These include stakeholders such as the Auditing and Assurance Standards Board (AUASB), professional accounting bodies and the Group of 100, which represents Australia’s senior finance executives.

As noted above, the FRC’s Audit Quality Committee (AQC) is specifically tasked with assisting the FRC to provide advice to the Australian Government on audit quality. To help inform the FRC response to the IAASB ITC, the AQC commissioned an online survey of members of the Australian Shareholders Association (ASA) a member group of retail shareholders. The survey sought to understand views about the usefulness of the auditor’s reports for retail shareholders in September 2012. A summary of the results of this survey are at [Attachment A](#).

Overall Consideration

The FRC supports the IAASB’s ongoing interest in improving audit quality at the international level through initiatives such as the proposed improvements to the auditor’s report. The FRC also supports changes to improve the usefulness and relevance of the auditor’s report.

However, the FRC believes that care must be taken to ensure that information included in the auditor’s report remains meaningful to users rather than simply increasing the quantum of information required to be disclosed by audited entities or the auditors. Accounting Standards currently require preparers of financial reports to provide further detail where required if the existing reporting requirements are “insufficient to enable users to understand the impact of a particular transaction, other events and conditions on the entity’s financial position and financial performance” (AASB 101 clause 17(c)). As such, additional audit reporting requirements may duplicate and increase the existing compliance burden on Australian businesses.

The FRC believes that improving audit quality requires a coordinated effort by both the international bodies in developing improved standards and guidance, as well as the national regulators to promote and support means by which auditors can effectively communicate meaningful information to users of financial reports of the audited entity.

Respondents to the FRC survey on the usefulness of the auditor's report noted that they were generally comfortable with the information currently included in the auditor's report; however some respondents support the inclusion of an explicit statement as to whether or not any material uncertainties in relation to going concern have been identified.

Auditor Commentary

The FRC believes that the auditor commentary may be an important tool for communicating key information to users of financial reports. Almost one third of respondents to our survey supported this position, revealing that the auditor's report was one of their most useful sources of information. In terms of further improving the auditor's report through enhanced auditor commentary, survey respondents especially supported the inclusion of references to significant or unusual transactions and contentious matters noted during the audit.

However, the FRC believes that care should be taken to ensure that the contents of the auditor commentary remain within scope of the auditor's existing role. The possible expansion of the audit role through the auditor commentary risks increasing the liability of auditors at a time when auditors are being held to account for decisions made by directors and management. In Australia, recent experience with various failed public companies ignited public debate about the role of audit in preventing corporate collapse, despite the contributing roles of the directors, management and poor business strategy more broadly. Audit reform may have the unintended consequence or the perception of increasing the role of audit by increasing the importance of the auditor commentary. This would not address problems associated with directors and management not meeting their existing statutory obligations in relation to financial statement preparation and entity management. The FRC supports the proposal to only require auditor commentary for public-interest audits. Tiered auditing requirements ensure that large and public interest entities have an appropriate level of oversight without increasing the compliance burden on smaller entities. In the Australian context, nearly 98% of companies are small proprietary companies, small companies limited by guarantee or not-for-profits that are subject to reduced or no reporting requirements. Care also needs to be taken in relation to whether public sector entities might be included in the proposals for various reasons and, if so, how. This is because auditors-general ordinarily prepare descriptive long-form reports to Parliament on the outcomes of their annual financial audits, which are separate to the auditor's reports that accompany the financial reports of public sector entities. Another consideration is whether all public sector entities should, as a matter of course, be considered to be public interest entities.

Going Concern/Other Information

The FRC believes that it is important that the IAASB carefully considers the purpose of expanding the auditor commentary, and to clearly distinguish between providing information otherwise not included, and highlighting significant information contained elsewhere in the financial report.

Improvements to the use of audit and accounting concepts such as ‘going concern’, ‘emphasis of matter’ and ‘areas of significant auditor effort’ need to be carefully considered in the context of the broad range of users of financial reports. The FRC believes that these concepts should be clearly defined in the auditor’s report, as different users of financial reports have widely divergent understandings of these concepts. Respondents to the FRC survey reflected this, demonstrating varied understandings of key audit concepts, with just over half claiming to understand the ‘going concern’ concept, whereas only 13 per cent claimed to understand the use of ‘emphasis of matter’. We understand that the IAASB has reached out to the IASB seeking better definition and guidance in relation to the accounting terms in the accounting standards. To this end, we believe that, ideally, those charged with governance should be required by IFRS to make an explicit statement in the notes to the financial statements, as distinct from the present implicit assumption, that the financial statements have been prepared on a going concern basis and that the entity is a going concern as at reporting date. It would also be helpful for the IASB to consider whether such a statement should highlight that the financial statements have been prepared on a “going concern” basis, or highlight solvency risks more broadly.

Clarifications and Transparency

The FRC believes that users of the financial reports should have a clear understanding of the role and responsibility of the auditor. This should not itself add to the complexity of reading such reports, and not be overly wordy, including perhaps tables or diagrams if useful.

The survey results reflect the degree to which clarity about the role of the auditor is needed. While a majority correctly identified the role of the auditor as forming an opinion as to whether the financial reports had been prepared according to the relevant accounting standards, approximately half of the survey respondents also noted that the role of the auditor was also to ensure that the entity was financially ‘healthy’, that the financial reports are ‘100% correct’ and to prevent serious mismanagement leading to corporate collapse. To the extent to which users believe that the auditor is responsible for ensuring the health of the audited entity, auditors can be seen to have assumed responsibility for management decisions in the preparation of the accounts.

The FRC believes that users should have easy access to descriptions of the respective roles of key actors in the audit, to better understand the scope and role of the auditor. Over the longer-term, a review of the auditor’s report is an opportunity to review the means by which the roles of those involved in the development of financial reports are communicated to users. As almost two thirds of the survey respondents stated that the auditor’s report does not provide sufficient information about what the auditor is

required to do, there is potential for the auditor's report to improve communication with users. Such communication could be improved through the provision of standardised material describing the respective roles of auditors, directors and management in an appendix to the annual report, a proposal that was overwhelmingly supported by survey respondents.

Form and Structure

The FRC believes that it is not necessary to overly regulate the order and structure of the auditor's report any more than currently. Additional auditor commentary is designed to reveal areas of significant audit interest in relation to the audited entity. As such the inclusion of additional commentary is expected to result in different auditor's reports between audited entities. This position is supported by over 80 per cent of survey respondents, who noted that they had no problems with auditor's reports becoming less standardised where additional auditor commentary is included.

Equally, however, we believe that too much latitude in this respect runs the risk that the objective of consistency and comparability across jurisdictions may not be attained. It is worth noting that in Australia, the relevant auditing standard ASA 700 directly follows the requirements and form of ISA 700, other than the additional insertion of local regulatory requirements to conform to the *Corporations Act*.

More broadly, rather than focus on the form of the information, it is important that auditor's reports effectively communicate key information to users. Survey respondents have expressed frustration at what they consider to be increasingly "bland", "useless" and "lengthy" auditor's reports when many are seeking a clear, plain language account of the position of the audited entity. The development of further auditor's report requirements risks increasing audit disclosures without improving the communication of key audit information to users. At its extreme, the volume of disclosures may make it increasingly difficult for non-sophisticated users to understand this information.

Nevertheless, the FRC supports the relocation of the auditor's opinion to the beginning of the auditor's report; with over three quarters of survey respondents also supporting this position. The auditor's opinion plays an important role in conveying the focus of the audit, and allows users to easily understand the key issues in the audited accounts and to identify highlighted areas in their subsequent consideration of the auditor's report.

ATTACHMENT A – AUSTRALIAN SHAREHOLDERS ASSOCIATION SURVEY ON PERCEPTIONS OF THE USEFULNESS OF AUDIT REPORTS, SEPTEMBER 2012










Usefulness of Audit Reports for Retail Shareholders



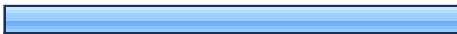
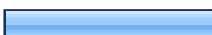




1. As an investor, on which of the following sources of information do you rely? (please select all that apply)

		Response Percent	Response Count
1.1 Investment advisors		29.4%	115
1.2 Financial planners		13.6%	53
1.3 Brokers		39.4%	154
1.4 Auditor's Report		25.6%	100
1.5 Annual Report to shareholders		69.6%	272
1.6 Accountants		14.8%	58
1.7 Newspapers		73.1%	286
1.8 In-house investment teams		10.7%	42
1.9 None of the above		1.8%	7
1.10 Other please specify		23.8%	93
	Other (please specify)		137
answered question			391
skipped question			1



2. You said that you rely on the Annual Report to Shareholders. As an investor, which of the following components of the Annual Report to Shareholders do you find most useful? (please select up to five options)

		Response Percent	Response Count
2.1 Chairman's letter		60.5%	46
2.2 CEO's letter		67.1%	51
2.3 Corporate Governance Statement		11.8%	9
2.4 Remuneration Report		40.8%	31
2.5 Director's Report		38.2%	29
2.6 Financial Statements		89.5%	68
2.7 Auditor's Report		27.6%	21
2.8 None of the above		1.3%	1
2.9 Other (please specify)		5.3%	4
	Other (please specify)		5
answered question			76
skipped question			316

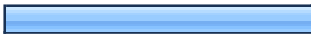






3. You said that you find the financial statements component of the annual report useful. Which of the following elements do you find most useful? (please select up to five options)

		Response Percent	Response Count
3.1 Statement of Income		73.3%	11
3.2 Statement of Comprehensive Income		33.3%	5
3.3 Balance Sheet		66.7%	10
3.4 Statement of Cash Flows		80.0%	12
3.5 Statement of Changes in Equity		40.0%	6
3.6 Notes to the Financial Statemetns		40.0%	6
3.7 None of the above		0.0%	0
answered question			15
skipped question			377


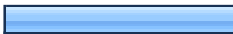



4. Does the auditor's report provide sufficient information to you about what the auditor is required to do?

		Response Percent	Response Count
Yes		35.2%	109
No		64.8%	201
answered question			310
skipped question			82










5. Which of the following do you regard as the responsibility of the auditor? (please select all that apply)

		Response Percent	Response Count
5.1 To ensure that the entity is financially 'healthy'		49.3%	176
5.2 To form an opinion about whether the financial statements provide a true and fair representation of the results and financial position of the company		88.8%	317
5.3 To ensure that the financial statements are 100% accurate		51.5%	184
5.4 To ensure that the financial statements are generally correct		37.5%	134
5.5 To form an opinion that financial statements are prepared according to the relevant accounting standards		75.6%	270
5.6 None of the above		0.3%	1
5.7 Other (please specify)		8.7%	31
	Other (please specify)		52
	answered question		357
	skipped question		35



6. As an investor, where would it be of value to you to find standardised material describing the auditor's, management's and director's responsibility? (please select all that apply)

		Response Percent	Response Count
6.1 In a appendix to the Annual Report to Shareholders		64.0%	226
6.2 On a website		36.8%	130
6.3 In the auditor's report		39.1%	138
6.4 In some other accessible location (please specify)		5.1%	18
6.5 None of the above		5.1%	18
	Other (please specify)		21
answered question			353
skipped question			39









7. As an investor, which of the following concepts used in relation to the auditor's report do you understand? (please select all that apply)

		Response Percent	Response Count
7.1 Reasonable assurance		42.3%	151
7.2 Materiality		37.3%	133
7.3 Audit Opinion		60.2%	215
7.4 Emphasis of matter		13.2%	47
7.5 Going concern		52.4%	187
7.6 Areas of significant audit effort		22.7%	81
7.7 Areas of significant auditor judgement		28.0%	100
7.8 Matters of audit significance		40.1%	143
7.9 None of the above		17.1%	61
answered question			357
skipped question			35



8. Would it be of value to relocate the audit opinion to the beginning of the auditor's report?

		Response Percent	Response Count
Yes		75.5%	259
No		24.5%	84
answered question			343
skipped question			49

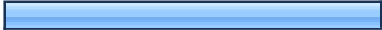


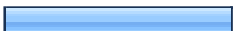

9. As an investor, if the auditor's report provided additional commentary, which of the following areas would be valuable to you? (please select all that apply)

		Response Percent	Response Count
9.1 Matters of audit significance, including areas of significant auditor judgement		73.9%	257
9.2 Areas of significant management judgement		56.0%	195
9.3 Significant or unusual transactions		86.8%	302
9.4 Difficult or contentious matters noted during the audit		84.8%	295
9.5 Other issues of significance related to the audit scope or strategy		52.6%	183
9.6 Matters disclosed in the Financial Accounts		52.6%	183
9.7 None of the above		1.7%	6
9.8 Other (please specify)		4.6%	16
	Other (please specify)		26
answered question			348
skipped question			44



10. If additional commentary were included, auditor's reports are likely to be less standardised. Would you see any difficulties with this?

		Response Percent	Response Count
Yes		17.0%	58
No		83.0%	284
answered question			342
skipped question			50

11. Annual reports include a lot of information that is not included in the financial statements, for example the Directors Report, Chairman’s letter and CEO’s letter, Sustainability reports etc. Which of the following should be included in the auditor’s report? (please select all that apply)

		Response Percent	Response Count
11.1 A conclusion about management’s use of the going concern assumption in the preparation of the financial statements		60.8%	206
11.2 An explicit statement as to whether any material uncertainties in relation to going concern have been identified		87.3%	296
11.3 A more detailed description of what the auditor has done		41.9%	142
11.4 Details of any other auditors in the audit process (eg firms in other countries)		36.6%	124
11.5 Commentary about work performed by the auditor on the other information that is included in the Annual Report that is not audited		50.7%	172
11.6 None of the above	<input type="checkbox"/>	4.4%	15
11.7 Other (please specify)	<input type="checkbox"/>	3.5%	12
	Other (please specify)		24
answered question			339
skipped question			53

12. Is there any additional information that you would like to see included in the auditor's report?

		Response Percent	Response Count
Yes		20.8%	67
No		79.2%	255
answered question			322
skipped question			70

13. Please use the space provided to tell us what additional information you would like to see included.

		Response Count
		71
answered question		71
skipped question		321

14. Please use the space provided for any other comments about the value of the auditor's report.

		Response Count
		103
answered question		103
skipped question		289









15. What is your age bracket?

		Response Percent	Response Count
15.1 Less than 20 years		0.0%	0
15.2 20-39 years		0.9%	3
15.3 40-54 years		8.5%	29
15.4 55 to 70 years		43.0%	147
15.5 more than 70 years		45.9%	157
15.6 Not disclosed		1.8%	6
answered question			342
skipped question			50







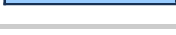



16. What is your gender?

		Response Percent	Response Count
Female		16.6%	57
Male		82.5%	283
Not disclosed		0.9%	3
answered question			343
skipped question			49





17. What is your current working status? (please select one)

		Response Percent	Response Count
17.1 Full-time employment		7.1%	24
17.2 Part-time employment		3.8%	13
17.3 Self-employed		10.0%	34
17.4 Unemployed		0.3%	1
17.5 Retired, but working part-time		14.1%	48
17.6 Fully retired		60.0%	204
17.7 Not disclosed		2.1%	7
17.8 Other (please specify)		2.6%	9
	Other (please specify)		18
answered question			340
skipped question			52

18. Where do you reside?

		Response Percent	Response Count
18.1 ACT		5.9%	20
18.2 NSW		31.2%	106
18.3 NT		0.6%	2
18.4 QLD		13.8%	47
18.5 SA		9.4%	32
18.6 TAS		2.1%	7
18.7 VIC		27.4%	93
18.8 WA		8.8%	30
18.9 Not disclosed		0.6%	2
18.10 Other (please specify)		0.3%	1
	Other (please specify)		4
		answered question	340
		skipped question	52

19. Investors are classed differently to ensure that those in need of regulatory protection are entitled to disclosure and other consumer protections. What type of investor do you consider yourself? (please select one)

		Response Percent	Response Count
18.1 Professional – Professional investors have extensive experience in using financial services or investing in financial products and include investors that have already satisfied certain licensing, registration or listing requirements, or having control of a substantial sum of money.		10.0%	34
18.2 Retail – Retail investors have less experience in using financial services or investing in financial products. Retail investors tend to be those who invest for their personal account rather than for any other company or organisation.		81.2%	276
18.3 Not disclosed		5.9%	20
18.4 Other (please specify)		2.9%	10
	Other (please specify)		18
answered question			340
skipped question			52