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Dear Mr Gunn

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

Thank you for the opportunity to comment on the consultation paper on auditor reporting.

Our responses to the specific questions raised by the IAASB in the consultation paper are included in the Appendix. Our main comments are summarised below:

- Auditors should not be the original source of disclosure about the entity. While the auditor is responsible for forming and expressing an opinion on the financial statements, the responsibility for preparing and presenting the financial statements in accordance with the applicable financial reporting framework is that of the management of the entity, with oversight from those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.
- In our opinion, the current objective pass/fail audit report model is not broken and there is a risk that the IAASB proposals in this area will undermine the strength and clarity of the auditor's opinion. Whilst we acknowledge there is a need for greater transparency in the reporting of key financial reporting risks and how these are being addressed we do not agree that it is the responsibility of the auditors to provide such original information to fill the IAASB's perceived "information gap". Instead, we encourage the IAASB to put more pressure on companies to meet their existing financial reporting responsibilities with regard to this enhanced disclosure
- Many of the issues raised by the IAASB in this paper are relevant only to listed and larger entities. We do not believe that such an information gap exists for smaller unlisted entities and, in our opinion, it is important for the IAASB, as a matter of principle, to retain consistency in auditor reporting for all types of



entities, regardless of their size and not undermine the quality of the audit report given on smaller unlisted entities by adopting a two-tier audit reporting model.

- We do not believe that the justification of assessments approach used in France is an appropriate model for the IAASB to use in the development of audit reports internationally. In our opinion, the French approach is flawed and will inevitably lead to boiler-plate statements that are of little use to anyone. Furthermore, we believe that such “justification of assessments” will be interpreted by users as qualifying the auditor’s opinion and this will add considerable cost and delay to the agreement of auditor’s reports.
- We question whether there is a demand from users for additional assurance reporting or services in these areas. The IAASB needs to provide evidence that there is such a demand that warrants the level of time and cost involved in developing appropriate reporting frameworks and guidance in each of the areas concerned.

Please contact me should you wish to discuss any of the points raised in this response.

Yours faithfully

A handwritten signature in blue ink, appearing to read "Hugh Morgan".

Hugh Morgan  
Technical Director  
Baker Tilly UK Audit LLP



## Appendix

### Response to specific questions asked by the IAASB

#### Issues identified

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

Our main concern in relation to the issues identified in Section II of the consultation paper is the identification of the “information gap” issue and the view that this gap can be filled through enhanced auditor reporting. The consultation paper indicates that users of corporate financial information point to the existence of a gap between the information they believe is needed to make informed investment and fiduciary decisions, and what is available to them through the entity’s audited financial statements or other publicly available information.

We strongly disagree with the view that it is the responsibility of the auditors to fill this information gap through inclusion within the auditor’s report of additional information, for example about key areas of audit risk. We agree that there should be more transparency in the reporting of key financial reporting risks and how they are being addressed but believe that this is the responsibility of management and those charged with governance not the auditors and caution against expansion of the audit report to include such information. Unless the auditor is modifying the audit opinion and is required to include omitted disclosures we do not believe that original information about the company should be produced by the auditor.

We accept that there is a need to address deficiencies in the application of financial reporting requirements but in our view this should be done by better application by companies of the disclosure requirements that already exist and not by enhanced auditor reporting requirements. Companies should be encouraged to provide adequate information about the key financial reporting risks and we believe that investors will be disappointed if they expect auditors to remedy such deficiencies by requiring them to report on significant areas of audit risk. Auditors cannot disclose what they have no knowledge of and management will not furnish auditors with information that they are not prepared to disclose themselves.

In conclusion, we do not believe that the current pass/fail audit report model is broken or that it is the responsibility of the auditors to provide original information to fill the IAASB’s perceived “information gap”. We acknowledge there is a need for greater transparency in the reporting of key financial reporting risks and how these are being addressed but encourage the IAASB to put more pressure on companies to meet their existing financial reporting responsibilities with regard to this enhanced disclosure.



**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?**

As stated above, we do not believe that changes in auditor reporting are needed to address the IAASB's perceived "information gap" in financial reporting. If the IAASB attempts to narrow this perceived information gap through enhanced auditor reporting we believe that the following principles should be followed:

- Auditors should not be the original source of disclosure about the entity – the preparation of the financial statements is the responsibility of management and those charged with governance not the auditors;
- Any changes to the auditor reporting model need to enhance, or at least maintain, audit quality.
- Any changes to the auditor reporting model should narrow, or at least not expand, the expectations gap. In our opinion, disclosure by the auditors about their approach to risk and the significant risks faced during the audit will only serve to widen the expectation gap.
- Any changes to the auditor reporting model should not create investor confusion by requiring them to consider conflicting information about risks provided by management, those charged with governance and the auditors.
- Auditor reporting should continue to focus on the objective rather than the subjective – the strength of the existing audit report is the objective pass/fail opinion and disclosure about subjective areas such as audit and financial reporting risks will potentially confuse and may alarm users of the financial statements.

We agree with the view that the perceived "information gap" could be narrowed by disclosure of additional information that is currently available but do not believe that this gap should be filled by the auditor. As stated above, the auditor should not be the original source of disclosure about the entity because this would undermine the division of responsibility between the entity and the independent auditor. The responsibility of management and those charged with governance for the preparation and content of the financial statements and the independence of the auditor in conducting their audit should be maintained.

We can understand the attraction from some users for additional information, such as that provided by the auditor to the audit committee under the communication requirements of ISA 260, to be delivered directly from the auditor to the users of the financial statements. However, we believe that there is a fundamental difference between the information that an auditor provides to an audit committee or those charged with governance and the sort of information that an auditor can include in an auditor's report. A fundamental concept of ISA 260 is "two way" communication between the auditor and those charged with governance. It is important to understand that the information that the auditor





provides to those charged with governance is formulated with the expectation that there is a two way, often face to face, discussion between the auditor and the audit committee with each party able to ask questions and add additional information and explanations. There is an assumption that those charged with governance are “informed management” and will have a level of knowledge about the issues being discussed as a result of their financial reporting oversight responsibilities which will help put the auditor’s communication into context. In our view, if the same information is shared with relatively uninformed users of the financial statements it would potentially create confusion and undermine the credibility of the financial statements because users will not have been party to the earlier two-way communication that will have taken place between the auditor and those charged with governance.

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

Many of the issues raised by the IAASB in this paper are relevant only to listed and larger entities and we do not believe that there is such an information gap for smaller entities. It is important, as a matter of principle, for the IAASB to retain consistency in auditor reporting for all types of entities, regardless of their size. In the UK, we have a mandatory audit requirement that extends to all but the smallest companies and have fought for a long time to retain the notion that “an audit is an audit” and require that consistent ISA 700 compliant auditor’s reports are used on all UK audits. In our opinion, the IAASB should not undermine the quality of the audit report given on smaller unlisted entities by adopting a two-tier audit reporting model and, equally, we do not believe that it is wise to burden smaller companies or their auditors with unnecessary additional reporting requirements.

## **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 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?**

Whilst we support improvement in both the format and structure of the standard auditor’s report we do not believe that the options for change described in Part A and included in Appendix 1 of the consultation paper would have any significant impact in reducing the perceived information or expectation gaps. As discussed elsewhere in this response, we do not agree with the inclusion of an auditor’s commentary on the financial statements and believe that any change in this area potentially risks increasing the expectation gap.



- 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?**

We do not believe that the IAASB proposals for removing or re-positioning the auditor report paragraphs dealing with management and the auditor's responsibilities will lead to a widening of the expectation gap. In our opinion, IAASB should follow the approach adopted by the UK Auditing Practices Board (APB) and allow either the inclusion of a shorter form audit scope paragraph detailing the auditor's responsibilities or include a cross-reference in the auditor's report to a more detailed explanation of the auditor's responsibilities held on the IAASB's website. This approach has been successfully adopted in the UK and is the preferred approach of a number of UK audit firms.

***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 existing UK auditor's report contains a reference to the scope of an audit including an assessment of the overall presentation of the financial statements and an opinion on the consistency of the directors' report with the financial statements but is silent on the role of the auditor in relation to "other information". There is no evidence to suggest that the current UK practice is not appropriate and we note that the APB went through an extensive consultation exercise, including public meetings with investors, before concluding that the reference to auditor responsibilities for other information could be located in the scope of audit section on their website and not in the auditor's report. We do not believe that it would be beneficial to users of financial statements to include a paragraph describing the auditor's responsibilities regarding other information in the auditor's report.

- 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?**

As stated above, we do not believe that the standard auditor's report should include a statement about the auditor's responsibilities regarding other information in documents containing audited financial statements.



***C. Auditor commentary on matters significant to users' understanding of the audit or the audited financial statements***

**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 stated above, we strongly disagree with the proposal that the auditor provides additional information about the audit in the auditor's report on the financial statements. Auditors should not be the original source of disclosure about the entity. We do not believe that it is the responsibility of the auditor to fill the perceived information gap identified by the IAASB and consider that the inclusion of additional information by the auditor may only serve to widen the expectation gap. The preparation of the financial statements is the responsibility of management and those charged with governance not the auditors and if auditors start to provide original information about companies there is a danger that they are no longer independent of the information they are reporting on.

In a recent survey of Baker Tilly clients almost 60% of the companies surveyed did not think that providing auditor commentary on matters significant to the users' understanding of the financial statements was a good idea. Only a third of businesses surveyed thought that audit reports should include more information on the auditor's perception of both accounting policies and management's critical accounting judgements. There was a general feeling among those surveyed that auditor's comments in these areas would be far too subjective and would be applied differently by different auditors resulting in inconsistency across the profession potentially bringing auditors more into conflict with their clients and adding to the cost of an audit.

If more of what is discussed between the auditor and those charged with governance is likely to be reported in the financial statements there is a possibility that such enhanced reporting may lead to a greater level of involvement of lawyers in the reporting process and will lead to more cautious exchanges between auditors and management and audit committees. Over time any additional public reporting on significant risks is likely to degenerate into boiler plate wording that will add little to a users understanding and may widen the expectation gap by identifying risk issues and not providing sufficient explanation of their relevance to the financial statements.

**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 do not believe that the justification of assessments approach used in France is an appropriate model for the IAASB to use in the development of audit reports internationally. As we have stated above, management and those charged with governance are responsible for the preparation of the financial statements and, in our opinion, it is not the responsibility of the auditor to fill any perceived

