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Mr James Gunn
Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
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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



information gaps in those financial statements through original reporting of additional information.

In our view, the IAASB should continue to regard “international consistency” as one of its main goals. The French justification of assessments approach is not used in other countries and even within France there have been significant doubts raised about the approach. The survey quoted in the consultation paper pointed out that the technical language typically used is not easily understood by the less knowledgeable users of audited financial statements and overtime the paragraphs develop into boilerplate statements which are of little practical use to the user of the financial statements. We believe that there are sufficient doubts to question whether the French justification of assessments model is “fit for purpose” in the current French environment let alone suitable as a basis for audit reporting worldwide.

In our opinion, management and those charged with governance are responsible for the preparation of the financial statements and for explaining the risk assessments made as a part of that process and it is not the responsibility of the auditors to fill any perceived information gaps with original reporting of their own judgements. We believe that the French “justification of assessments” approach is flawed and will inevitably lead to boilerplate statements that are of little use to anyone. Furthermore, we believe that such “justification of assessments” will be interpreted as qualifying the auditor’s report and this will add considerable cost and delays to the agreement of auditor’s reports.

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.

In our opinion, the term “insights” is too vague and subjective and would need to be defined carefully before the IAASB progressed any further with this idea. As discussed above, we do not believe that the auditor should be the original source of disclosure about the entity and we would extend this to any suggestion that the auditor be responsible for providing “insights” about the entity or the quality of its financial reporting in the auditor’s report.

If the IAASB required auditors to provide insights about the entity as part of the audit reporting process we believe that it would prove to be extremely costly and time consuming to agree the wording used. Any such insights would be interpreted by users as potential qualifications of the auditor’s opinion and, in the current liability regime, companies would question every word used before finally agreeing to possibly less helpful disclosure. Such insights would quickly evolve into boilerplate wording of little practical use to users of the audited financial statements and any wording that deviated from the “accepted” boilerplate wording would potentially be interpreted as a qualification of the report with all the consequences and costs that would entail.



D. An enhanced corporate governance reporting model: Role of those charged with governance regarding financial reporting and the external audit

11. Respondents are asked for their reactions to the options for change relating to an enhanced model of corporate governance reporting, as described in Section III, Part D.

We are pleased that the IAASB is recognising the importance of corporate governance reporting. The Financial Reporting Council in the UK has already consulted on a model proposing that the audit committee report publicly on how it has discharged its responsibility for the integrity of the annual report and the oversight of the external audit process, including any matters of material significance identified by the auditors in their report to the audit committee, with the external auditor responsible for reporting on the completeness and reasonableness of the audit committee's report. Although the UK is consulting on this it may be more difficult to receive support for such an approach in other jurisdictions where the culture of corporate governance reporting is not very advanced and where laws and regulations on such matters differ significantly and we believe that this may be a significant barrier to the IAASB proposals. We recommend that the IAASB take note of the UK FRC consultation which stops short of requiring original reporting by the auditor and consider obtaining the views of different jurisdictions in order to obtain a more in-depth and balanced view on whether an enhanced model of corporate governance reporting would be workable.

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 noted above, the biggest challenge will be international acceptance and we recommend that the IAASB takes note of the UK FRC consultation and obtains the views of different jurisdictions in order to obtain a more in-depth and balanced view.

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

As noted above, the IAASB should obtain the views of different jurisdictions in order to obtain a more in-depth and balanced view. In our opinion, auditors would be conflicted from providing assurance on all aspects of the audit committee report but consideration could be given to the auditor providing assurance on whether the description provided by the audit committee of the dialogue between the audit committee and the external auditors regarding the significant financial reporting judgements was a fair and balanced reflection.



E. Other assurance or related services on information not within the current scope of the financial statement audit

14. Respondents are asked for their reactions to the need for, or potential value of, assurance or related services on the type of information discussed in Section III, Part E.

The examples of the type of information given in Section III of the IAASB paper included information about

- Corporate governance arrangements;
- Business model, including the sustainability thereof;
- Enterprise-wide risk management;
- Internal controls and financial reporting processes;
- Key performance indicators.

We question whether there is a demand for such additional assurance reporting or services in these areas. Such work would inevitably be time consuming and result in increased costs and, in some cases, would require the development of an appropriate reporting framework for the entity concerned as well as the auditor. It could also require the auditor to develop specialist expertise in the area being reported on. It is very unclear whether users would consider that there was sufficient added value to warrant the cost of this additional reporting.

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

As stated above, we question whether there is a demand for such additional assurance reporting or services in these areas. IAASB needs to provide evidence that there is such a demand that will warrant the time and cost involved and would need to develop appropriate reporting frameworks and guidance in each of the areas concerned. Auditor liability provisions would need to be reviewed and the IAASB would need to consider whether existing assurance and related services standards needed revision.

Implications of change and potential implementation challenges

16. Respondents are requested to identify benefits, costs and other implications of change, or potential challenges they believe are associated with the different options explored in Section III.

Please refer to our responses to the questions above where we feel we have covered the benefits, costs and other implications of the different options explored in Section III.

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.

In our opinion, the benefits, costs, potential challenges and other implications of the changes suggested are not the same for all types of entity. As stated in our response to question 3 above, many of the issues raised by the IAASB in this consultation paper are relevant only to listed and larger entities and we do not believe that many of the issues are relevant for smaller entities. We believe the IAASB should, as a matter of principle, retain consistency in auditor reporting for all types of entities, regardless of their size and we do not support the type of two tier audit reporting structure that might emerge from the IAASB consultation.

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?

As stated above, we do not believe that the current pass/fail audit report model is broken and do not consider it to be the responsibility of the auditors to provide original information to fill the IAASB's perceived "information gap".

Although we acknowledge there is a need for greater transparency in the reporting of key financial reporting risks and how these are being addressed we would encourage the IAASB to put more pressure on companies to meet their existing financial reporting responsibilities with regard to this enhanced disclosure.

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?

We have no further comments.