

October 8, 2012

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Dear Arnold,

**Re.: Invitation to Comment, “Improving the Auditor’s Report”**

We would like to thank you for the opportunity to provide the International Auditing and Assurance Standards Board (IAASB) with our comments on the Invitation to Comment, “Improving the Auditor’s Report” (hereinafter referred to as the “ITC”).

Auditor reporting is the “product” of the audit visible to users external to the entity. Consequently, auditor reporting is closely linked by such users to the value of audits and audit quality. In the context of questions about the value of auditing that have arisen during the financial crises of the last several years, we recognize that in the long run, careful consideration could be given to exploring whether the added value of audits to users could be enhanced by expanding the scope of the audit, which would require the involvement of legislators and regulators and further consultation with other stakeholders, as well as an assessment of the costs and benefits and their incidence. However, any expansion of the scope of the audit needs to be carefully considered so as to not engage in “scope creep” and to distinguish those matters that ought to be engaged separately from an audit because they are not or only tenuously related to audits of financial statements.

GESCHÄFTSFÜHRENDER VORSTAND:  
Prof. Dr. Klaus-Peter Naumann,  
WP StB, Sprecher des Vorstands;  
Dr. Klaus-Peter Feld, WP StB CPA;  
Manfred Hamannt, RA

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For these reasons, in the short- to medium-term prior to the commencement of a long-term exploration of possible expansions to the scope of the audit, consideration of improvement in auditor reporting needs to be limited to the current scope of the audit. Such potential improvements need to be considered in the political context of the proposals by legislators and regulators of improvements to auditor reporting – particularly the recent proposals by the European Commission and by the European Parliament. The issuance of the ITC is therefore timely, and we commend the IAASB for issuing it at this time.

It should also be recognized that the provision of additional information in audit reports – even if the scope of the audit is not expanded – involves greater work effort and hence the incurrence of additional costs by auditors, which must ultimately be borne by preparers and then indirectly by other stakeholders, including investors.

In addition to the issues of principle and a summary of our responses in relation to the major issues we have addressed in this letter, we have responded in the Appendix to this letter to the questions posed in the ITC.

The IAASB had issued a Consultation Paper, “Enhancing the Value of Auditor Reporting: Exploring Options for Change” in 2011, to which we had responded in our comment letter dated September 19, 2011, to which we refer. In that comment letter, we identified a number of principles that ought to be applied when considering improvements to auditor reporting. Those principles that we consider to be relevant to the ITC are:

- The selection of public policies in relation to enhancing audit reporting ought to be decided on the basis of the public interest (not just the interests of certain investor groups), which involves consideration of who all of the users of financial statements are as well as of the costs and benefits to the public of potential policies, including the incidence of such costs and benefits among affected stakeholders.
- It is important for public policy decisions in relation to audit reporting to consider whether “better” information needs to be provided, rather than just “more”, and the impact of additional information provided by auditors on the timing of the communication of information and the ability of most users, including investors, to process that information and understand it given the increasing complexity of financial reporting.
- It is important that legislators, regulators and standard setters perform serious cost-benefit analyses to determine the need for additional information prior to prescribing its provision.

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- Public policy decisions in relation to audit reporting must consider the proper delineation of the roles and responsibilities of management, those charged with governance, the auditor, and users, including investors, and the appropriate nature and extent of the risks that ought to be borne by each in those roles and responsibilities to facilitate the efficient and sustainable operation of capital markets. In this context, when considering enhancements to the nature and extent of audit reporting to users, including investors, based on information that is made available by the auditors to those charged with governance, it is critical that policymakers consider the nature and extent of that information that is important for these users without having auditors make public information that may unduly impair the operations of the entity.
- Differentiation in auditor reporting to the public by size or type of entity alone is generally not appropriate: “an audit is an audit”. However, this does not preclude the scope of the audit for certain kinds of entities from covering additional financial reporting required for those entities, which means that auditor reports will be different due to varying financial reporting requirements.

Our responses to the ITC continue to be guided by these principles.

On September 7, 2012 the IDW held a roundtable in its premises on the proposals in the ITC. Representatives from the preparer, user, auditor and regulatory community took part. The views expressed by those parties have been reflected in this comment letter, and we refer to these views in answering the questions posed in the ITC when relevant.

Based on the principles noted above, in summary, our views as detailed in our responses to the Questions posed in the ITC are as follows:

- Subject to our responses to individual questions, we believe that, as a whole, the suggested improvements would tend to enhance the relevance and informational value of the auditor’s report in view of possible impediments (including costs).
- Consideration should be given in the long run to expanding the scope of audits (e.g., obtaining and communicating assurance on selected other information or on communications by those charged with governance to the public) to the extent that the benefits of such expansions of scope exceed the costs and this is supported by legislators and regulators of audits of financial statements. On the other hand, care needs to be taken

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that the engagement “audit of financial statements” not be subject to “scope creep”.

- Auditor commentary in some form is an appropriate response to the call for auditors to provide more information to users through the auditor’s report and thereby help increase the value of the audit to users, but would need to focus on audit matters in relation to items or disclosures in the financial statements.
- Significant risks of material misstatements in the financial statements (and perhaps risks of material misstatements in the financial statements for which substantive procedures alone do not provide sufficient appropriate evidence) ought, with certain exceptions, to form the basis for the criteria for matters included in auditor commentary.
- We are not convinced that providing details of audit procedures in auditor commentary to be helpful because it is difficult to describe the full nature and extent of procedures within the confines of auditor commentary. In addition, when audit procedures are not described, there is little benefit in describing related results. However, if the audit approach were to be described, then a description of the factual results may be needed, but without engaging in piecemeal opinions.
- We also expect significantly higher costs for auditors to arise from auditor commentary because more involvement of senior experienced staff and of partners would be required when wording auditor commentary, consulting with internal firm quality control and technical departments, and consulting with management and those charged with governance.
- Based upon our initial consultations, we have formed a preliminary view on whether auditor commentary should be required for only PIEs or for all audits, which may change once we have completed our consultations. At the present time, we are not convinced that requiring auditor commentary only for certain audits, such as PIEs, is appropriate.
- On the whole, we believe that there is a slightly greater net benefit to including the two proposed statements on going concern together with the appropriate caveats in the report than not including them.
- When the existence of material uncertainties is a significant risk (see our response to Question 4) we believe there would be value to including additional information in the auditor’s report about the auditor’s judgments and processes to support the auditor’s statement that material uncertainties have not been identified. However, if there is no significant

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risk in this respect, then such additional information should not be included.

- On the whole, we believe that the benefits of providing the proposed assertions on other information are likely to outweigh the impediments together with appropriate caveats in the report.
- We believe that the enhanced description of the responsibilities of the auditor is helpful to users' understanding of the nature and scope of an audit. However, we do not believe that the description is adequate because it does not address the single greatest source of the expectations gap: that is, many users continue to believe that the audit opinion assures the future viability of the entity, the efficiency or effectiveness with which management has conducted the affairs of the entity, or entity compliance with laws and regulations. We do not believe that the description of the responsibilities of those charged with governance is useful because these responsibilities vary so widely by jurisdiction and type of entity. We believe that the description of the responsibilities of management is appropriate: this description should not be eliminated or watered down – in particular in relation to management responsibility for internal control because this is a premise of an ISA audit of which users should be made aware.
- Although we are not convinced that providing the engagement partner's name is useful information for users, we do not have an issue with this because the engagement partner personally signs the auditor's report in Germany.
- We would not support including disclosure of the involvement of other auditors because it undermines sole responsibility and because we do not believe that any increase in the quality of auditor reporting is achieved through a reference to the involvement of other auditors under sole responsibility.
- On the whole, we consider the description of the standardized material to be important enough to be included either in, or in an appendix to, the auditor's report and would therefore not support including this information on a website only. Accordingly, we would not support permitting relocation of the description of management responsibilities for preparing the financial statements or for internal control because these are premises of an ISA audit – that is, an ISA audit cannot be performed without these conditions applying, and it is important that users are informed of this.

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- Our first reaction is to keep the audit opinion at the end of the report, since auditor commentary is closer to the beginning, but this is not a crucial issue.
- Because of the importance of comparability of auditors' reports for users across jurisdictions, unless law or regulation requires departures from the structure, form or wording prescribed in the ISAs, we would not support permitting flexibility in structure, form or wording of the report with the exception of auditor commentary (which, by definition, would vary by entity), the description of management, the identification of the financial statements subject to audit, and the description of the financial reporting framework. Consequently, we support mandating the ordering of items unless law or regulation require otherwise.
- Based on our preliminary views, the suggested improvements, as amended by our suggestions, would be appropriate for entities of all sizes (including small and medium-sized entities, as well as PIEs) in both the public and private sectors.

Various parties are currently deliberating on audit reporting and the scope of the audit, including the Public Company Auditor Oversight Board (PCAOB) in the U.S. and the European Commission together with the European Parliament. We would encourage both the IAASB and the PCAOB to strive for consistency between their respective future standards in this regard. It is crucial that the IAASB consult on auditor reporting, with regulators in the world's major jurisdictions – especially with the European Commission, the European Parliament, and the PCAOB.

We hope that our views will be helpful to the IAASB. If you have any questions relating to our comments in this letter, we would be pleased to be of further assistance.

Yours truly,



Klaus-Peter Feld  
Executive Director



Wolfgang P. Böhm  
Director Assurance Standards,  
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## APPENDIX:

### Responses to Questions Posed in the Invitation to Comment

#### Overall Considerations

1. *Overall, do you believe the IAASB's suggested improvements sufficiently enhance the relevance and informational value of the auditor's report, in view of possible impediments (including costs)? Why or why not?*

As a matter of principle, we believe it to be important that improvement in auditor reporting occurs to provide better information to users. The potential costs of improvements alone should not be the main criterion for determining whether, and what kind of, improvements might be made. Rather, such a determination should be based on an assessment of the potential increased value of an audit by evaluating the potential benefits to users through improved reporting versus the potential costs that may be incurred by preparers and auditors and other impediments.

Subject to our responses to the following questions, we believe that, as a whole, the suggested improvements would tend to enhance the relevance and informational value of the auditor's report in view of possible impediments (including costs). However, the degree of such enhancement (or impairment, in individual cases) will depend upon the precise nature of the proposals made. To this effect, our responses to the following questions note when we believe the suggested improvements ought to be amended to mitigate impediments or better enhance the relevance and informational value resulting from the proposals.

2. *Are there other alternatives to improve the auditor's report, or auditor reporting more broadly, that should be further considered by the IAASB, either alone or in coordination with others? Please explain your answer.*

As a matter of principle, we are also prepared to consider proposals beyond just auditor reporting that expand the scope of audits (e.g., obtaining and communicating assurance on selected other information or on communications by those charged with governance to the public) to the extent that the benefits of such



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expansions of scope exceed the costs. On the other hand, care needs to be taken that the engagement “audit of financial statements” not be subject to “scope creep” for matters that ought to be subject to a separate engagement because they are not or only tenuously related to a financial statement audit. Prerequisite for expanding the scope of audits of financial statements is the involvement of legislators and regulators and further consultation with other stakeholders, as well as an assessment of the costs and benefits and their incidence.

### **Auditor Commentary**

3. *Do you believe the concept of Auditor Commentary is an appropriate response to the call for auditors to provide more information to users through the auditor’s report? Why or why not? (See paragraphs 35–64.)*

As a matter of principle, we welcome the idea that the auditor’s report provide more relevant information to users because it would increase the value of audits to users. However, it seems to us and to the user, regulator, and preparer participants of our roundtable that not enough research has been done to determine which information is really of interest to users and what they would do with that information if it were available through the auditor’s report.

In relation to the assertions in the second bullet points in paragraphs 9 and 36 in the ITC, we question whether it is the role of the auditor to “enhance the ability of users to navigate and better understand increasingly complex financial reports” or to “provide a ‘roadmap’ to help users better navigate complex financial reports and focus them on matters likely to be important to their decision-making,” respectively. We note that most financial reporting frameworks require the financial statements to be “fairly presented”. Therefore, it is management’s responsibility to help users navigate through the financial statements, to provide a roadmap to help users better understand the financial statements, or to highlight those assertions in the financial statements most relevant to users – not that of the auditor. To this extent, the objective noted in the ITC to “provide transparency about matters ... most important to users’ understanding of the audited financial statements...” is perhaps too broad. Rather the objective should be focused on matters that are most important to the users’ understanding of the audit – which, as a byproduct, helps users understand the financial statements. It appears to us that the concept of “significant risks of material misstatement in the financial statements” seems to be particularly well-suited to bridging the gap between matters of audit focus and helping users’ understand the financial statements (see our response to Question 4).



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In any case, if additional information about the financial statements were to be provided to users through the auditor's report on the financial statements, such information should affect user decision-making (i.e., be "material"). However, as a matter of principle, material information in relation to the financial statements would already need to be included in the financial statements. Consequently, under the current paradigm in ISA 706, any additional information in the auditor's report in relation to the financial statements can only be an "emphasis of matter" without the provision of additional information – that is, just a "pointer". If such information is not in the financial statements, then the auditor would need to qualify the auditor's report for the omitted material information

Overall, our analysis indicates that the current audit model (management provides the information that auditors evaluate and opine on with the possibility of rare emphases of matter) is in fact well-conceived – even if there may be concerns by some parties about whether it is operating as it should be. The primary impetus for change is therefore, in our view, not any technical deficiency in the current model, but arises from the political inability to improve reporting by management in the financial statements (i.e., dysfunctional accounting standard setting), perhaps from concerns about whether the model is operating as it should be, and from the objective of seeking to improve the value of audits by enhancing the content of auditors' reports so as to help reduce the expectations gap. Audit legislation and standard setting by the IAASB can address the latter two issues, but not the first issue, which is a financial reporting issue that is primarily within the purview of accountings standard setters and preparers. Therefore, in its efforts to improve auditor reporting, the IAASB should focus on improving the operation of the current audit model and improving the value of audits by enhancing auditor reporting about the audit, rather than seeking to provide additional information about the financial statements or help users navigate through the financial statements.

In this context, we believe that, in principle, auditor commentary in some form is an appropriate response to the call for auditors to provide more information to users through the auditor's report and thereby help increase the value of the audit to users. However, to increase the value of auditor reporting, such audit reports would need to go beyond highlighting matters in the financial statements alone or simply repeating matters that are already in the financial statements: auditor commentary would need to focus on audit matters in relation to items or disclosures in the financial statements.

4. *Do you agree that the matters to be addressed in Auditor Commentary should be left to the judgment of the auditor, with guidance in the standards to inform the auditor's judgment? Why or why not? If not, what do you believe should be done to further facilitate the auditor's decision-making process in selecting the matters to include in Auditor Commentary? (See paragraphs 43–50.)*

Most decisions that auditors make are subject to auditor judgment. However, auditor judgment is not a substitute for clear requirements upon which to base that judgment. Therefore, we do not believe that the matters to be addressed in auditor commentary should be left to the judgment of the auditor without clear criteria that help the auditor exercise that judgment. There was general agreement among the participants of our roundtable that clear criteria are needed for the determination of what should be addressed in auditor commentary.

The concept of „most important to users“ as used in the ITC is unclear and would lead to inconsistent interpretation and application from a user point of view. Furthermore, due to the ambiguous nature of that concept, management will seek to influence the matters addressed in auditor commentary and auditors will not have clear criteria to fall back on in their discussions with management. Without clear criteria, it is likely that agreements with management on the matters addressed in auditor commentary will represent the “lowest common denominator” and that the matters addressed would be expressed using “boilerplate”.

We also believe that it is not possible to appropriately summarize what is „most important to users“ in the financial statements when the notes to the financial statements extend to more than a hundred pages: it is not practicable to determine what would be “most important” from a user perspective. We therefore continue to believe that pure “emphases of matter” (that is, highlighting financial statement items or disclosures only) should remain a rare occurrence by retaining the concept of “matters of ‘fundamental’ importance”.

In our view, the matters addressed in the bullet points in paragraph 45 are not unambiguous enough to drive consistent auditor reporting or provide a reasonable basis for quality control or inspections. Furthermore, the justification for including or excluding certain matters from auditor commentary would require considerable documentation.

In addition, unless the three matters for consideration mentioned in paragraph 45 are also significant risks, there does not appear to be a reasonable basis for addressing them in auditor commentary – that is, why should auditors seek to address such matters that do not relate to significant risks of material misstate-

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ment (i.e., risks of material misstatement in the financial statements that require special audit treatment)?

On the whole, we have concluded that the concept of significant risks of material misstatement (hereafter, “significant risks”), and perhaps risks of material misstatement for which substantive procedures alone do not provide sufficient appropriate evidence, ought to be the basic criteria for determining which audit matters ought to be addressed in auditor commentary.

The main advantages in requiring commentary on these risks are:

- the three matters addressed in paragraph 45 (areas of significant management judgment, significant or unusual transactions, and significant auditor judgments) will often have been identified as significant risks, and therefore the broad objective of the ITC for auditor commentary would be achieved in relation to reporting about the audit;
- these risks are already identified during the audit and therefore no additional audit effort is required to identify matters that would be addressed in auditor commentary;
- these risks relate to the audit, and therefore addressing them would focus auditor commentary on matters related to the audit that are disclosed in the financial statements.

Consideration might be given to not addressing all such risks because some may not be of interest to users. In particular, exceptions might be made for risks that are always significant risks or are always presumed to be significant risks for all audits (e.g., fraud, management override, and revenue recognition) to avoid boilerplate when these risks are low or not intractable. Nevertheless, these risks should be the starting point for the determination of what ought to be addressed in auditor commentary. This does not preclude the auditor from addressing any other matters that the auditor wishes to address.

In conclusion, we believe that significant risks (and perhaps risks for which substantive procedures alone do not provide sufficient appropriate evidence) ought, with certain exceptions as noted above, to form the basis for the criteria for matters included in auditor commentary. This position was generally supported by the participants in our roundtable. Using these risks as the criteria would fulfill the objective noted in paragraph 39 of the ITC in relation to the provision of information about the audit. In this context, use of other auditors in a group audit can never be a significant risk of material misstatement in the financial statements (since significant risks exist prior to the audit). Hence, the example commentary in relation to the use of other auditors should not be included in auditor

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commentary. Furthermore, by applying the concept of significant risks to drive auditor commentary, the application of auditor commentary would be more consistent and can be enforced by quality control and inspections. In addition, the concept of “significant risks of material misstatement” used in the ISAs would be strengthened.

5. *Do the illustrative examples of Auditor Commentary have the informational or decision-making value users seek? Why or why not? If not, what aspects are not valuable, or what is missing? Specifically, what are your views about including a description of audit procedures and related results in Auditor Commentary? (See paragraphs 58–61.)*

In our view, the criteria used to determine the matters addressed in auditor commentary and how to address them are more important than any examples provided in the illustrative report (see our response to Question 4).

On the whole, we are not convinced that providing details of audit procedures to be helpful because it is difficult to describe the full nature and extent of procedures within the confines of auditor commentary. In addition, when audit procedures are not described, there is little benefit in describing related results of those procedures.

However, if the IAASB were to choose to have auditors provide additional information beyond the identification of significant risks (and perhaps risks for which substantive procedures alone do not provide sufficient appropriate audit evidence), then a description of the overall audit approach in relation to the identified risks would be more practicable than seeking to describe detailed procedures.

We note that not for every matter addressed in the illustrative examples for which audit procedures are described the results of those procedures are described. For example, in the matter related to “audit strategy relating to recording of revenue, accounts receivable and cash receipts”, only the audit procedures are described without any description of the results of those procedures. On the one hand, describing the overall approach in relation to identified risks without disclosing some results might be frustrating for users of the report. On the other hand, care needs to be taken not to include conclusions in auditor commentary that go beyond the scope of the audit (e.g., conclusions that might be construed as SOX 404 opinions) or that might be perceived as piecemeal opinions. Consequently, if the audit approach were to be described in addition to identifying the significant risks etc., any description of results would need to be limited to “statements of fact”.

6. *What are the implications for the financial reporting process of including Auditor Commentary in the auditor's report, including implications for the roles of management and those charged with governance (TCWG), the timing of financial statements, and costs? (See paragraphs 38 and 62–64.)*

One of the implications is a change in the role of auditors as an additional originator of information about the entity (that is, in addition to situations in which a modified opinion is issued) as part of the provision of information about the audit. However, as long as the information provided is directly related to explaining the audit by providing clear criteria for auditor commentary (see our response to Question 4) auditors would not be usurping the role of management. Management would need to adjust to the fact that auditors would be providing information about the entity based on the auditor's risk assessment. The result may be that management would seek to get more involved in auditor risk assessment processes: it is not clear whether this would be, on balance, of advantage or disadvantage to the quality of audits – it may depend upon the integrity of management, the robustness of auditors, and the effectiveness of firm quality control and external inspections. Since those matters included in auditor commentary would need to be discussed with those charged with governance, auditor commentary may also increase the involvement of those charged with governance in the oversight of audit engagements at an operational level. This is likely to increase the quality of audits because those charged with governance are likely to have an interest in the quality of auditor risk assessments.

In terms of the timing, we surmise that the need for considerable consultation with firm quality control, management and those charged with governance will have an impact on the timing of the issuance of financial statements.

We also expect significantly higher costs for auditors because more involvement of senior experienced staff and of partners would be required when wording auditor commentary, consulting with internal firm quality control and technical departments, and consulting with management and those charged with governance.

7. *Do you agree that providing Auditor Commentary for certain audits (e.g., audits of public interest entities (PIEs)), and leaving its inclusion to the discretion of the auditor for other audits is appropriate? Why or why not? If not, what other criteria might be used for determining the audits for which Auditor Commentary should be provided? (See paragraphs 51–56.)*

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We have not had the opportunity to consult fully with the members of our profession and other stakeholders. However, based upon our initial consultations, we have formed a preliminary view, which may change once we have completed our consultations. On this basis, we are not convinced that requiring auditor commentary only for certain audits, such as PIEs, is appropriate because:

- It would violate the principle that audits of financial statements are comparable for all kinds of entities and therefore would form the basis for future differentiation into full audits and “light audits”. It is unclear why two entities that are the same in every respect other than one being classified as a PIE and another that is not would have auditors’ reports that are different. In particular, such differentiation would lead to the situation in the auditor’s report for a listed entity, for example, would include information about the audit (i.e., audit risks) that would not be included in the auditor’s report of a similar entity that is a competitor within the same industry. This would certainly confuse users by causing them to believe that listed entities are “riskier” than unlisted entities.
- We believe that the concept of auditor commentary is scalable – that is, capable of proportionate application. We surmise that there will be generally more, and more complex, significant risks for more complex entities compared to less complex entities and that often, larger entities tend to be more complex than smaller ones. Hence, the number and description of matters for larger, more complex entities will tend to be greater and of greater extent, respectively, than for smaller, less complex entities.
- The concept of public interest entities (PIEs) as described in the IESBA Code of Ethics (and in EU audit legislation) was designed solely for independence in appearance purposes, and does not exist in many jurisdictions outside of the EU (e.g., the U.S.). The concept was not designed to be a basis for the differentiation of audit effort or reporting in auditing standards. On this basis, it is not clear to us why users of audit reports of PIEs as defined have different reporting needs than users of audit reports of non-PIEs. Furthermore, if the Ethics Board or the European Commission were to expand or contract the definition of PIEs for independence purposes, it would cause an automatic expansion or contraction of auditor commentary for audit reporting purposes, even though such expansion or contraction may not be relevant to auditor reporting.



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- We do not believe it to be conducive to good standard setting for the IAASB to then develop its own definition of PIEs for audit purposes, which would confuse users of the Code of Ethics and ISAs.

However, if the IAASB were to come to the conclusion that the information needs of the users of the audit reports of some entities were different than for others, then the differentiation into audits that require auditor commentary and those that do not should be based on those different user needs. The distinction would then be between those users that have access to information about the audit beyond the financial statements and auditor's report and those that do not (i.e., "public reporting entities" vs. "non-public reporting entities"). There may be circumstances in which auditors should be subject to the more stringent ethical requirements for audits of PIEs under the Code of Ethics due to concerns about independence in appearance, but where users do not require the additional information available through auditor commentary because they have other sources for that information. Consequently, the concept of PIEs is not useful for distinguishing between those circumstances when users require auditor commentary and when they do not.

It appears to us that those users that cannot gain access to additional information under the laws applicable to certain entities (e.g., shareholders of widely-held corporations), as opposed to being able to gain access through contract law (e.g., creditors), ought to be given access to additional information, such as auditor commentary. On this basis, for example, there could be a presumption that publicly listed entities would require auditor commentary, but also a presumption that it would not be required for owner-managed entities unless there were important users without access to additional information.

Based on the presumption included in the ISAs as proposed, legislators, regulators or standard setters in a particular jurisdiction should determine which kinds of entities should be subject to audits with auditor commentary in the auditor's report (e.g., listed entities, etc.). In other circumstances, the entity should be able to choose when to subject itself to audits with auditor commentary in the auditor's report when agreeing the terms of engagement. However, if an entity chose not to be subject to an audit with auditor commentary in the auditor's report, this would not preclude the auditor from including such commentary at the auditor's discretion.

In conclusion, we do not support differentiating between entities when requiring auditor commentary. However, if the IAASB were to consider such differentiation, a differentiation based on PIEs vs. non-PIEs does not appear to be appropriate; there should be a presumption of the need for auditor commentary for



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listed entities, but otherwise the matter should be left to legislators or to contractual arrangements.

### Going Concern/Other Information

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|--|
| <p>8. <i>What are your views on the value and impediments of the suggested auditor statements related to going concern, which address the appropriateness of management's use of the going concern assumption and whether material uncertainties have been identified? Do you believe these statements provide useful information and are appropriate? Why or why not? (See paragraphs 24–34.)</i></p> |
|--|

It is not clear whether the benefits of the suggested auditor statements related to going concern exceed the impediments. On the one hand, the statements only make explicit auditor conclusions that have always been implicit, which provides for greater transparency. On the other hand, the statements may lead to a widening of the expectations gap because most users do not understand the following subtleties:

- that the “use of the going concern assumption in the preparation of the financial statements” means that an entity may use the going concern assumption in preparing the financial statements because it will not need to be liquidated even though it is insolvent, or
- the fact that reasonable assurance as to the existence of material uncertainties is not achieved because the auditor does not actively search for these under ISA 570, and therefore is not in a position to identify or predict all existing or future events or conditions that may cause material uncertainties.

Generally, the participants in our roundtable did not believe that making implicit assertions explicit in the auditor's report helps knowledgeable users of the auditor's report. On the other hand, knowledgeable users might benefit from the additional statements given appropriate caveats.

On the whole, we believe that there is a slightly greater net benefit to including these statements on going concern together with the appropriate caveats in the report than not including them.

The proposed disclaimer in relation to material uncertainties “Because not all future events or conditions can be predicted ...” addresses only “future” events or conditions. This suggests to users that auditors are able to identify all “existing” events or conditions. However, we note that under the work efforts required in

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ISA 570 auditors are not in a position to identify all relevant “existing” events or conditions. We therefore suggest that the wording of the disclaimer be broadened as follows “...not all future or existing events or conditions can be identified”.

We also recognize that ISA 570 is not without its technical weaknesses and would welcome a project to revise ISA 570. However, we also recognize that the underlying problems result from ambiguities in IAS 1 and US GAAP and that therefore the IAASB has limited room for amendments in this respect. For this reason, we suggest that the IAASB not engage in a project to amend ISA 570 beyond adding reporting requirements as proposed in the ITC until the reporting project has been completed and greater clarity as to agenda of accounting standard setters has been obtained.

9. *What are your views on the value and impediments of including additional information in the auditor's report about the auditor's judgments and processes to support the auditor's statement that no material uncertainties have been identified? (See paragraphs 30–31.)*

When the existence of material uncertainties is a significant risk (see our response to Question 4) we believe there would be value to including additional information in the auditor's report about the auditor's judgments and processes to support the auditor's statement that no material uncertainties have been identified. However, if there is no significant risk in this respect, then such additional information should not be included.

We note that most financial reporting frameworks require adequate disclosures about material uncertainties (either in the notes to the financial statements, or in Germany, in the management report, which is audited). Consequently, if there is a high inherent risk in relation to the existence of material uncertainties, to achieve fair presentation there should be some disclosure by management in relation to the fact that management has come to the conclusion that no material uncertainty exists.

The primary impediment seems to relate to the fact that management is generally loath to address the issue of material uncertainties in the financial statements (or in Germany, in the management report) unless the auditor comes to the conclusion that they exist and must therefore be addressed in an emphasis of matter paragraph in the auditor's report. However, if the criterion of significant risk is applied for auditor commentary (which would also apply to going concern matters), then auditor commentary may engender disclosure by management in this respect.

10. *What are your views on the value and impediments of the suggested auditor statement in relation to other information? (See paragraphs 65–71.)*

The primary value of the suggested auditor statement in relation to other information is supposed to be greater transparency in relation to the work effort and results of auditor work in that area. However, the primary impediment is that users are unlikely to understand the meaning of the terms “read” and “material inconsistency”, which might lead to greater assurance being attributed by users to that information and therefore a wider expectations gap. In addition, due to potential liability risks associated with making explicit statements, the statements will likely lead to auditors doing more work than just that required by existing ISA 720.

The participants in our roundtable did not believe that making these implicit assertions explicit aids knowledgeable users; on the other hand less knowledgeable users might benefit from these assertions with the appropriate caveats.

On the whole, we believe that the benefits of providing the proposed assertions on other information together with the appropriate caveats are likely to outweigh the impediments.

In our view, the caveat that an audit has not been performed and therefore an opinion not expressed on the other information needs to be expanded to clarify that a review has not been performed and therefore a review conclusion not expressed on the other information. Hence the words of the caveat should read:

“However, we have not audited or reviewed this information and accordingly do not express an audit opinion or review conclusion on it.”

### Clarifications and Transparency

11. *Do you believe the enhanced descriptions of the responsibilities of management, TCWG, and the auditor in the illustrative auditor’s report are helpful to users’ understanding of the nature and scope of an audit? Why or why not? Do you have suggestions for other improvements to the description of the auditor’s responsibilities? (See paragraphs 81–86.)*

We believe that the enhanced description of the responsibilities of the auditor is helpful to users’ understanding of the nature and scope of an audit because of these enhanced descriptions. However, we do not believe that the description is adequate because it does not address the single greatest source of the expectations gap: that is, many users continue to believe that the audit opinion assures the future viability of the entity, the efficiency or effectiveness with which management has conducted the affairs of the entity, or entity compliance with

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laws and regulations. We therefore believe that, somewhat aligned with the third sentence of ISA 200.A1, the last sentence of the first paragraph of “Auditor’s Responsibility” should include the following sentence:

“An audit of the financial statements does not assure the future viability of the entity, the efficiency or effectiveness with which management has conducted the affairs of the entity, or entity compliance with laws and regulations”.

We do not believe that the description of the responsibilities of those charged with governance are useful: these responsibilities vary so widely by jurisdiction and type of entity, reference should not be made to those charged with governance unless they are “management” for purposes of responsibility for financial statement preparation in the particular jurisdiction and for the entity in question.

We believe that the description of the responsibilities of management is appropriate: this description should not be eliminated or watered down – in particular in relation to management responsibility for internal control because this is a premise of an ISA audit of which users should be made aware. If there are legal impediments to the inclusion of management’s responsibility for internal control because there is no such legal responsibility in a particular jurisdiction, we suggest requiring reference to such responsibility as a „precondition of an audit under ISAs“, which is a true statement regardless of the legal situation in any jurisdiction.

We also suggest that the description of management’s responsibility in relation to going concern be moved to the beginning of the section dealing with the auditor’s going concern statements. This would highlight the difference between the responsibilities of management and those of the auditor in this respect and may serve to narrow the expectations gap with respect to the auditor statements made with respect to going concern.

12. *What are your views on the value and impediments of disclosing the name of the engagement partner? (See paragraphs 72–73.)*

Since in Germany the engagement partner must be one of the signatories to the auditor’s report, naming the engagement partner does not provide any additional information for users. However, we recognize that having a requirement to name the engagement partner might be useful for those jurisdictions in which the engagement partner does not sign the report with his own name.

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We are not convinced that having users know who the engagement partner is is actually useful to users. We consider this issue to be one related to local law rather than to a matter of public confidence in audits.

13. *What are your views on the value and impediments of the suggested disclosure regarding the involvement of other auditors? Do you believe that such a disclosure should be included in all relevant circumstances, or left to the auditor's judgment as part of Auditor Commentary? (See paragraphs 77–80.)*

We would not support including disclosure of the involvement of other auditors because it undermines sole responsibility under ISA 600: it is “divided responsibility” through the “back door”. There was general agreement by the participants in our roundtable on this issue.

In this context, it should be considered that the PCAOB has expressed concerns about the separation of those actually performing the audits („performing firm“) and those that sign the auditor's report (“signing firm”). This is why the PCAOB suggests such disclosure might be helpful under divided responsibility. However, such disclosure is not relevant under sole responsibility in accordance with ISA 600.

We also believe that this kind of disclosure may cause further pressure to have audits of components done within one firm or network, which would increase insourcing of audits and thereby further audit concentration. Such disclosure may also further concentration of audit work among jurisdictions. We therefore believe that the European Commission is unlikely to support this kind of disclosure.

In conclusion, we do not believe that any increase in the quality of auditor reporting is achieved through a reference to the involvement of other auditors under sole responsibility. This was also the view expressed by the participants in our round table.

14. *What are your views on explicitly allowing the standardized material describing the auditor's responsibilities to be relocated to a website of the appropriate authority, or to an appendix to the auditor's report? (See paragraphs 83–84.)*

We support the proposal to allow the standardized material describing the auditor's responsibilities to be relocated outside of the body of the auditor's report. However, in some circumstances (prospectuses) the relevant information always needs to be complete to ensure that the preparer is not subject to legal ac-

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tion. For this reason, we suggest only permitting relocating the material to an appendix to the auditor's report – we would not support relocation to a website. Furthermore, we would like to point out that for liability reasons, a link included in a report would need to be inextricably connected to the report. On the whole, we consider the description of the standardized material to be important enough to be included either in, or in an appendix to, the auditor's report. This was also the general view expressed in our roundtable.

We would not support permitting relocation of the description of management responsibilities for preparing the financial statements or for internal control because these are premises of an ISA audit – that is, an ISA audit cannot be performed without these conditions applying and it is important that users be made aware of this.

### **Form and Structure**

15. *What are your views on whether the IAASB's suggested structure of the illustrative report, including placement of the auditor's opinion and the Auditor Commentary section towards the beginning of the report, gives appropriate emphasis to matters of most importance to users? (See paragraphs 17–20.)*

Our first reaction is to keep the audit opinion at the end of the auditor's report, since the auditor commentary is closer to the beginning. This would tend to cause users to read the entire report (e.g., auditor commentary etc.) before reading the opinion. However, this is not a crucial issue. The user participants in our roundtable asserted that as long as the opinion can be found easily (i.e., at the beginning or the end), then that is acceptable.

16. *What are your views regarding the need for global consistency in auditors' reports when ISAs, or national auditing standards that incorporate or are otherwise based on ISAs, are used? (See paragraphs 21–23 and 87–90.)*

In our view the consistency of auditors' reports around the world is of great value for users and therefore is also important for preparers and firms, which would not need to deal with different reports in different jurisdictions. Furthermore, a comparable report is important to retain an ISA-brand for audits. For these reasons, unless law or regulation requires departures from the structure, form or wording prescribed in the ISAs, we would not support permitting flexibility in structure, form or wording of the report with the exception of auditor commentary (which, by definition, would vary by entity), the description of management,



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the identification of the financial statements subject to audit, and the description of the financial reporting framework,. The description of the auditor's responsibilities under an ISA audit should be the same around the world, as should the preconditions of an ISA audit with respect to management responsibilities, regardless of local law or regulation in this respect. The second section of the auditor's report permits sufficient flexibility for matters that are outside of the scope of an ISA audit.

We believe that permitting flexibility beyond auditor commentary, the description of management, the identification of the financial statements subject to audit, and the description of the financial reporting framework, unless law or regulation requires departures from the structure, form or wording prescribed in the ISAs, would encourage local standard setters to diverge from the ISA structure, form and wording and therefore would actually reduce harmonization of reports in the long run.

This was the unanimous position of all participants in our roundtable of users, preparers, regulators and auditors.

17. *What are your views as to whether the IAASB should mandate the ordering of items in a manner similar to that shown in the illustrative report, unless law or regulation require otherwise? Would this provide sufficient flexibility to accommodate national reporting requirements or practices? (See paragraph 17 and Appendix 4.)*

We support mandating the ordering of items unless law or regulation require otherwise. See our response to Question 16.

18. *In your view, are the IAASB's suggested improvements appropriate for entities of all sizes and in both the public and private sectors? What considerations specific to audits of small- and medium-sized entities (SMEs) and public sector entities should the IAASB further take into account in approaching its standard-setting proposals? (See paragraphs 91–95.)*

Based on our preliminary view, the suggested improvements, as amended by our suggestions, would be appropriate for entities of all sizes (including small- and medium-sized entities) in both the public and private sectors.

We refer to our response to Question 7 in relation to auditor commentary, in which we assert, on a preliminary basis, that there does not appear to be a need to distinguish between PIEs and non-PIEs for auditor reporting. As noted, if the IAASB distinguishes between the audits of those entities for which auditor



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commentary is required and for those for which it is not, then this distinction should be on the basis of user needs.