

11 October 2012

J. Gunn  
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Dear James

### **INVITATION TO COMMENT: IMPROVING THE AUDITOR'S REPORT**

IMA represents the asset management industry operating in the UK. Our members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of £4 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, the Annual IMA Asset Management Survey shows that IMA members managed holdings amounting to 34% of the domestic equity market.

In managing assets for both retail and institutional investors, IMA members are major investors in companies whose securities are traded on regulated markets. Therefore, IMA has an interest in the requirements governing the audit of these companies' accounts and the auditor's report to its members as users.

A concern of investors is that the judgements made and processes followed during the preparation of the accounts and their audit are often opaque. Accounts are primarily the responsibility of the company and as stated in the ITC, a holistic approach is needed to corporate reporting in that effecting meaningful change will involve a company's board and audit committee, as well as the auditor. We also recognise that corporate governance frameworks vary internationally in that there are no international standards for an audit committee's responsibilities and practices. Thus whilst in jurisdictions with a more advanced corporate governance framework, it may be more appropriate for many of the disclosures proposed in the Auditor Commentary to be reported by the audit committee, in others it may fall to the auditor to provide. In this context, we support the recommended disclosures for a company's audit or other relevant committee in the enhanced disclosure guidelines developed by the Global Auditor Investor Dialogue.

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Moreover, many of the concerns investors have about the quality of audits are a product of the fact that they feel excluded from the audit process and real findings. This includes evaluating: risks and controls; valuation judgments; and write downs and impairments. But currently the only communication auditors have with investors is through an audit report which is of limited use with its binary opinion, pass or fail, and boilerplate, technical language. Investors would value a more enlightened audit report.

Thus we welcome the IAASB looking at this and issuing this invitation to comment. The suggested improvements go a long way towards enhancing the relevance and value of the auditor's report; in particular, the conclusion on going concern and the Auditor Commentary. There are, however, certain matters that we consider need to be disclosed which are not mentioned in the ITC. We set out in the attached our comments on the detailed questions raised and our main observations below.

- Auditors should disclose the level at which they have set audit materiality and how it is used. It would be helpful if the IAASB gave examples of this disclosure.
- As specified in the ITC auditors should disclose areas of significant management judgement, significant and unusual transactions, and matters of audit significant risk. However, we consider it important that they also positively confirm that there are no other matters they wish to draw attention to by way of emphasis.
- As well as concluding on management's use of the going concern assumption and whether material uncertainties have been disclosed, auditors should report whether there are any conditions that cast significant doubt on the company's ability to continue as a going concern, regardless of whether the information has been disclosed by management.
- Reporting on material inconsistencies should not just be between the audited financial statements and other information disclosed as identified, but between the statements and any information obtained during the course of the audit.
- Where certain of the disclosures proposed are provided by the audit committee, it is important that the auditor forms an opinion and reports on the completeness and reasonableness of the audit committee's report.

Please contact me if you would like clarification on any of the points in this letter or if you would like to discuss any issues further.

Yours sincerely



Liz Murrall  
Director, Corporate Governance and Reporting

## IMA's ANSWERS TO THE DETAILED QUESTIONS RAISED

### *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?**

Currently, the audit report is the only output whereby investors can form a view as to the value of the audit and its quality. But its usefulness is undermined by the binary nature of the opinion and boilerplate, technical language. Investors may not attach much to terms such as "reasonable assurance" and "material misstatement". In particular, many of the concerns about the quality of audits are a product of the fact that investors feel excluded from the audit process and real findings. The IAASB's suggested improvements go a long way towards addressing the relevance and informational value of the audit report. In particular, we welcome:

- the auditor's conclusion over management's use of the going concern assumption and whether material uncertainties have been identified – see also Question 8;
- the Auditor Commentary and additional information likely to be important to investors' understanding; and
- the assurance over other information – see also Question 10.

**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.**

A particular concern of investors is that the judgements made and processes followed during the preparation of the accounts and their audit are opaque. We do not want to see dual reporting by companies and auditors in that the accounts are primarily the responsibility of the company. As stated in the ITC, a holistic approach is needed to corporate reporting in that effecting meaningful change will involve a company's board and audit committee, as well as the auditor. However, we also appreciate that corporate governance frameworks vary internationally and there are no international standards for audit committee responsibilities and practices. Thus whilst in those jurisdictions that have a more advanced corporate governance framework it may be appropriate for certain of the disclosures proposed in the Auditor Commentary to come from the audit committee in others it may fall to the auditor to provide. In this context, the enhanced disclosure guidelines for boards and others developed by the Global Auditor Investor Dialogue, of which we are part, at [enhanceddisclosure.org](http://enhanceddisclosure.org) recommend more transparency and that a company's audit or other relevant committee's disclosures include:

- what steps it took to satisfy itself that the risk and control processes are effective;
- the significant assumptions for determining fair values, particularly mark to model;
- the factors considered when endorsing material write downs and impairments;
- the work to ensure material securitisations and off balance sheet liabilities are disclosed; and
- how often the external and internal auditors are evaluated and the key conclusions.

Where such disclosures are provided by the audit committee, we consider it important that the auditor then forms an opinion and reports on the completeness and reasonableness of the audit committee's report.

## IMA's ANSWERS TO THE DETAILED QUESTIONS RAISED

### *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.)**

Subject to our comments in 2 above, IMA welcomes the proposal to include an Auditor Commentary. The more entity specific this can be the more it will assist investors. The matters raised should help build investors' confidence in the quality of the auditor's work and act as a trigger to raise questions of management.

**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.)**

IMA agrees that the matters to be addressed in the Auditor Commentary should largely be left to the auditor's discretion. There is a risk that prescriptive requirements in Auditing Standards could engender boilerplate disclosures aimed at ensuring compliance as opposed to allowing meaningful reports tailored to particular circumstances. However, there are certain matters that we consider need to be discussed which are not mentioned in the ITC in that:

- auditors should disclose the level at which audit materiality is set and how it is used; and
- whilst the ITC specifies that auditors should disclose areas of significant management judgement, significant and unusual transactions, and matters of audit significant risk, they should also positively confirm that there are no other matters they wish to draw attention to by way of emphasis.

**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 principle, IMA welcomes the illustrative report in that the topics, content and tone offer flexibility and can be tailored to a company's circumstances based on the auditor's judgement. There are certain areas where we believe it could be improved as set out below.

- Whilst the illustrative report sets out disclosures on the extent to which other firms were used, it would be helpful if it also addressed issues of significance related to the scope or strategy<sup>1</sup> and the level and use of audit materiality (see 4 above).
- The examples in the illustrative report on measurement uncertainty in the valuation of financial instruments and matters of audit significance in the strategy for the recording of revenue, accounts receivable and cash receipts are helpful. Such disclosures help give investors a more in depth explanation of any "risks" than that provided by

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<sup>1</sup> Paragraph 45

**IMA's ANSWERS TO THE DETAILED QUESTIONS RAISED**

management and some reassurance that the auditor has reacted appropriately. It would also be helpful to include other examples and a positive statement by the auditor that there are no other matters they wish to draw attention to by way of emphasis.

- In the disclosure of what an auditor would do as part of the audit on the last page of the illustrative report, it would be helpful if this was in the past tense and confirmed what the auditor had done.

**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.)***

As noted above, a holistic approach is needed to corporate reporting but corporate governance standards and practices vary internationally. This means that in jurisdictions with a more advanced corporate governance framework certain of the disclosures proposed in the Auditor Commentary would be made in the audit committee report whereas in others, it may fall to the auditor to provide. It would be helpful for the IAASB to recognise this in the final text of any standard and provide an illustrative audit report where certain of the disclosures are made by the audit committee or other body.

**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.)***

In principle, we support the Auditor Commentary being provided for Public Interest Entities (PIEs). However, it is important that PIEs are carefully defined in that it should be limited to the listed sector and entities of systemic importance. We do not support the expanded definition currently being used by the European Commission in relation to its audit reforms. This not only includes financial institutions and listed companies but also UCITS and alternative investment funds. The latter two are numerous, small and do not present any real systemic risk and it would be disproportionate to include them within the scope of these proposals.

***Going Concern/Other Information***

**8. *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.)***

Going concern disclosures have assumed a high profile following the global financial crisis. Whilst financial statements tend to be prepared on a going concern basis, investors would welcome some assurance that the auditor is satisfied that the directors have exercised due care in undertaking their going concern assessment and that the assumptions are 'reasonable'. Thus we welcome the proposal that the auditor should conclude on management's use of the going concern assumption and whether or not material uncertainties have been identified. Auditors should also report on whether there are any

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conditions that cast significant doubt on the company's ability to continue as a going concern, regardless of whether the information has been disclosed by management.

**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.)**

IMA considers it sufficient for the auditor to state in the report that 'based on the work we have performed we have not identified material uncertainties' i.e. the text in the illustrative report. To require a description of the judgements and processes risks the use of 'boiler plate' disclosures. Whilst the auditor may have reservations that a statement that no material uncertainties have been identified could be perceived as a 'guarantee' of the company's going concern, we consider the text in the illustrative report to the effect that such a statement is not a guarantee addresses this issue.

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

Whilst we welcome the auditor being required to state whether there are any material inconsistencies between the audited financial statements and other information disclosed as identified, we do not consider this goes far enough. Certain investors would value auditors providing a reasonable and balanced assurance on matters in such narrative reports, including certain CSR information. Others fear that this could result in boilerplate reporting and dumb down the information disclosed. Nevertheless, investors do consider that this disclosure should be extended to cover whether there are any inconsistencies with the information reported and that obtained by the auditor during the course of the audit.

**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.)**

IMA considers that the enhanced descriptions of the responsibilities of management, TCWG, in the illustrative report are helpful. IMA members invest internationally. Thus it is important that any standard on audit reports addresses this international dimension and audit reports of companies from countries where responsibilities may be different to that in the UK or EU.

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

It is established practice in the UK that the name of the engagement partner is disclosed. A number of our members consider that this emphasises the partner's responsibility for the audit and as such, should be at least encouraged if not mandated. There are others, however, that do not consider that this practice necessarily adds value.

**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.)**

IMA supports the disclosure of the involvement of other auditors. Investors value

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information on whether there has been more than one audit firm involved in the audit albeit the group auditor is solely responsible for the audit report on the group financial statements.

**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.)**

Given that the text describing the auditor's responsibilities is likely to be standard in given jurisdictions, IMA agrees that it could be located on a website of the appropriate authority, or in an appendix to the auditor's report. However, it is important that the audit report includes a link to the information so that it can be easily located.

**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.)**

IMA supports the structure in the illustrative report. Investor's first interest is whether there is a qualified audit report and the important issues the auditor has had to deal with in relation to the financial statements not the least of which is going concern.

**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.)**

IMA believes it important to aim for global consistency in the presentation of the audit report because it is helpful when information can be located easily. Where national standards require additional or different information this should be in a special section for this purpose at the end of the report.

**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.)**

IMA agrees there is merit in mandating the ordering of the items in the audit report across entities and jurisdictions unless otherwise required by law or regulation. The IAASB has clearly demonstrated in Appendix 4 its endeavours to ensure uniformity.

**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.)**

This question is outside IMA's remit.