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8 October 2012

James Gunn

Technical Director

The International Auditing and Assurance Standards Board (IAASB),

529 Fifth Avenue, 6^{th} Floor,

New York NY 10017

Dear Sir

RE: INVITATION TO COMMENT, IMPROVING THE AUDITOR'S REPORT

The Institute of Certified Public Accountants of Kenya (ICPAK) welcomes the opportunity to comment on the Invitation to Comment: **Improving the Auditor's Report.** This letter provides our comments on the International Auditing and Assurance Standards Board's ITC for consideration.

Specific comments on questions asked

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?***

The current model of auditor reporting has served stakeholders well for many decades. However, following the recent global economic crisis, users have become more vocal in expressing a desire for more informative auditor reporting. Change is therefore inevitable and the current form of the auditor report will need to change. However, we must guard against introducing changes that will only increase the expectation gap on the role of the auditor, or end up with audit reports that only cause more confusion.

We agree with the improvements to the extent that users may not have sufficient understanding of the processes or discussions that led to a particular conclusion by auditors in the presence of

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potentially contentious issues such as judgements by management. However, "Emphasis of Matter" paragraph as it stands today allows for the auditor to make a comment on such matters provided a proper discussion has been made in the financials. We see a potential risk under the proposed changes that the auditor's opinion will become a commentary on the commercial viability of a business. This is NOT the role of the auditor and expansion of auditor reporting will inevitably lead to questions about whether or not they endorse the management of the company. Indeed, this is the job of the very analysts who claim to need the financial statements for analysis. They should not expect the financial statements to be anything more than a fair reflection of the entity based on a pre-agreed accounting framework. **Also, unless the auditor disagrees with management, there should certainly be no additional, helpful points made by them anywhere else. It amounts to participation in decision-making and creates a self review risk which would instantly be challenged in a dispute between the entity and a third party. We also note that there is recognition in the accompanying discussion by IAASB that the auditor should not introduce new material in the audit report. This then raises the question of why the management disclosures are inadequate.**

The overriding principle in the past has always been that the financial statements themselves should contain all the information that a user of the financial statements might require. IFRS already require identification of estimation uncertainties and significant judgements. Introducing a commentary into the auditor's report will only create confusion and increase the misunderstanding of the auditor's responsibility. The auditor is a 'generalist' who is paid to spend only a limited amount of time on the affairs of a particular client, obtaining sufficient and appropriate evidence to support his opinion, including evaluating the reasonableness of any assumptions, estimates, and judgements made by management. The auditor should therefore not be expected to be more knowledgeable about a business than the management of that business, or TCWG. If a commentary is required, then it should be written by management, and reviewed by the auditor.

No amount of auditor commentary will address this gap: if anything, the mere existence of auditor commentary will increase this expectation gap, by suggesting that historical financial statements can be used for predictive purposes. We are skeptical about the conventional wisdom that more information represents better information, and are concerned about the intensifying obsession with knowing more about less.

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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.***

We believe that it is desirable to consider alternative strategies for improving the auditor's report. These could include:

- If the IAASB wishes to address the expectation gap between investors/analysts and preparers/auditors, they should require that all sets of financial statements based on historical data include a clear statement along the lines of: *"Past performance is no guide to future performance"*. This is similar to wording used by investment managers when reporting on the historical performance of investment portfolios.
- Putting more emphasis on quality and not quantity of information presented by the auditor's report.
- *There has been a tendency by auditors to introduce a cautious "early warning system" on going concern matters by drawing attention to negative reserves and or current assets as a response to audit risk even when there is no material uncertainty regarding the entity's ability to continue as a going concern for the foreseeable future. An auditor whose report is silent on going concern matters in the face of potential issues (including management disclosures regarding going concern) may feel a need for an intermediate level commentary to explain their judgement where they feel that is not indicative of a "material uncertainty" but want to indicate that a discussion on this specific issue has taken place. The wording in ISA 705 and 570 is currently designed to highlight "material uncertainties." As currently designed, this kind of report in itself may act as a commentary on performance with negative behavioural implications by third parties especially for SMEs. In effect, it may be a self-fulfilling prophecy. There is therefore a case for commentary on the lines of; "We have considered the negative current assets position and the management's assessment of the prospects set out in Note X as well as supporting information and explanations. In our opinion, there is no material uncertainty regarding the ability of the entity to continue as a going concern."*

Auditor Commentary

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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.)***

On paper, communicating to the users the financial reporting judgements that the auditor views as most significant to the understanding of the financial statements would be valuable. However, such communication is likely to be misunderstood, especially by the less sophisticated users of financial statements who might interpret any comments as being auditor reservation on the financial statements and may cast doubt on their reliability. I see a situation where Annual General Meetings will spend considerable time discussing the auditor comments rather than information presented by management in the financial statements.

We note that by accepting to include such commentary, the auditor is accepting greater responsibility than the current one of giving an opinion on fair presentation of material facts in the financial statements taken as a whole, and this new additional responsibility becomes blurred vis a vis management's responsibility. There is already a requirement under IFRS for management to disclose the significant judgments in the financial statements. The auditor should insist that such disclosures are robust and comprehensive, and probably then only draw attention to them in the audit report. The auditor's report could then help users navigate the financial statements by directing the reader to the disclosures in the financial statements that the auditor believes describe the most significant judgments management has made. *He should only add his own commentary where he considers that the disclosures in the financial statements are inadequate or considers that they require to be supplemented to allow the user to gain better understanding of the issues and risks at hand.*

As a general rule, the auditor should not be an original source of new facts or information about the company. Factual data or information about the entity should be reported by management / directors to avoid blurring the responsibilities of auditors, management and those charged with governance.

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***

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decision-making process in selecting the matters to include in Auditor Commentary? (See paragraphs 43–50.)

We agree that should the "Auditor Commentary" be included, be left to the judgment of the auditor. As it is, the key risk would be that commentaries become standardised - copied and pasted from one report to another. Any additional guidance on what should be included will only increase this risk. The auditor should only add his own commentary where he considers that the disclosures in the financial statements are inadequate or considers that they require to be supplemented to allow the user to gain better understanding of the issues and risks at hand.

5. ***Do the illustrative examples of Auditor Commentary2 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.)***

Our observations on the illustrative examples of Auditor Commentary are as follows:

- **Outstanding Litigation** - We note that this paragraph refers to a disclosure already made in the financial statements which is essentially the same as the existing Emphasis of Matter guidance and do not warrant a change of standard.
- ***Goodwill -*** We note that this paragraph summarizes the key points regarding disclosures in the financial statements and other information, which ideally will be addressed under emphasis of matter.
- ***Valuation of Financial Instruments –*** We observe that this paragraph may add useful information and clarity since it looks at the audit response to a highlighted point, describes certain audit procedures and a conclusion. It may add useful information and clarity.
- ***Recording of revenue, accounts receivable, cash receipts -*** In relation to controls is not relevant to substantive assurance on particular balances and we do not see how it could help a user of the financial statements if there is any unaddressed risk of misstatement of a particular area. It therefore adds no information if the area is properly covered.

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- **Involvement of other auditors** - There may be a case for mentioning the names of other auditors involved in the audit but if this is the case, it should not be part of the discretionary audit commentary.

We observe that Auditor Commentary has little, if any decision-making value, other than warning users not to make decisions on the basis of the financial statements. It has informational value in highlighting the areas of uncertainty within the financial statements and the inherent limitations of an audit. This is likely to reduce the level of reliance placed on audited financial statements, which might be a good thing, but we do not think that this is what was intended by the IAASB. We posit from above responses that the concept of Auditor Commentary amounts to duplication of matters that could well be addressed by the 'emphasis of matter' paragraph.

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.)***

Inclusion of an Auditor Commentary will undoubtedly increase resources required for an audit by the audit team, and may cause increased tension between the auditor and management. Management are likely to resist any commentary in the fear that it might cast doubt on the reliability of the financial statements. It should be appreciated that the auditor will have an additional responsibility in addition to expressing an appropriate opinion, treading a fine line between pointing out uncertainties and damaging the interests of shareholders by unnecessarily casting doubt on the reliability of the financial statements. It is already the case that an 'emphasis of matter' on the appropriateness of the going concern basis can in itself create a material uncertainty as to that appropriateness.

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.)***

We disagree. We have reservations about Auditor Commentary for PIEs, and certainly would not want it extended to non-PIEs, where it would result in additional expense while adding no value.

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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.)***

The current emphasis of matter paragraph is only used when the auditor deems that there is material uncertainty. If there is no material uncertainty, disclosures by management within the financial statements will suffice, with no mention in the audit report. The proposed requirement is for the auditor to explicitly state his concurrence with management's judgement on the use of the going concern principle. We believe that statement on the use of going concern is a step in the right direction provided that it does not put any additional liability on the auditors (contains the necessary cautionary riders). Wordings as suggested by paragraph 27 of the ITC "as not all future events or conditions can be predicted, the statement about the absence of material uncertainties is not a guarantee as to the entity's ability to continue as a going concern" amounts to a disclaimer which may limit reliance on auditor opinion.

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.)***

It is the auditor's responsibility to exercise his judgement, based on experience, as to what additional information should be obtained and what conclusion can be drawn. By giving additional information to users of the financial statements there is a risk that users with less experience than the auditor may draw the wrong conclusion. We are therefore not in favour of including such additional information.

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

We support the proposal since it does not change the auditor's responsibility; it merely requires an explicit statement of that responsibility. However, we also hope that the proposed revision of ISA 720 "The Auditor's Responsibilities to Other Information in Documents containing Audited Financial

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Statements" will not undeservedly broaden the extent of auditor's work and responsibilities regarding Other Information.

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 are in agreement and believe that the enhanced description of the responsibilities of management, TCWG, and the auditor in the illustrative auditor's report are helpful to a user's understanding of the nature and scope of an audit.

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

We do not support this proposal. A partner is signing on behalf of the firm, and it is the firm that should take collective responsibility for the report. The illustration of an audit report starts with the phrase "In our opinion": this clearly refers to the firm's opinion, not the individual partner's opinion. It is the reputation of the firm that should be at stake, not the reputation of the individual partner. This is why a firm needs a system of quality control, including having an Engagement Quality Control Partner. There are also a number of practical issues:

- It may be necessary for the engagement partner to change during the course of an audit (e.g. due to ill health).
- The engagement partner may not be available to sign the report on the day it is required, and may delegate this to another partner
- In some areas the engagement partner may place heavy reliance on another partner within the firm (e.g. a tax specialist) in arriving at the firm's opinion.

However, since local laws and circumstance vary across jurisdictions, we propose that such requirement be left at the discretion of the National Standard Setters.

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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 are of a contrary view to the suggested disclosure regarding the involvement of other auditors. The ultimate responsibility of an audit lies with the primary auditor who ensures procedures conducted address the risks indentified and that all 'risky' areas are covered adequately. S/he takes full responsibility for the audit of the consolidated financial statements. We are not sure what value disclosing the names other auditors adds to the user of the accounts. If anything it may be interpreted to mean that the primary auditor does not accept responsibility for components of the group audited by other auditors.

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 provided that it reduces the length of the audit report, to give more focus to the audit opinion. This will be useful in ensuring that the Audit report is tailored to specific regulatory requirements and also highlight all the responsibilities of the auditor as spelt out by the legislation.

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.)***

We support the proposed structure of order of items in the report; The auditor's opinion is of paramount importance in the auditor's report and therefore should be placed prominently together with an auditor's commentary which seek to address key areas of concerns The new order ensures that crucial items of the audit process are first brought to the attention of the users before they make any informed decision. Giving more prominence to the audit opinion will be helpful to the users, as

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the auditor's report is now likely to run into pages and the user might otherwise find it difficult to figure out what the opinion is.

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.)

We agree with the proposed minimum items highlighted under Appendix 4. We believe that these will ensure that there is a clear benchmark on the contents of an auditor report. This will ensure that their ease of comparison of the reports globally.

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 endorse the IAASB mandated ordering of items as shown in the illustrative report as it serves to promote global consistency and comparability of the auditors' report. The paragraph on other legal and regulatory requirements fairly provides a platform to address specific matters in specific jurisdictions, thus able to accommodate national reporting requirements.

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.)

We disagree. The existing report under ISA 700 is adequate for SMEs since the perception of 'information gap' is less pronounced in the case of SMEs. We therefore support the suggestion to make the Auditor Commentary optional for SMEs.

We thank you for considering our comments on the issue.

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Should you wish to discuss the contents of this comment paper or require further elaboration on any of the items presented herein, please do not hesitate to contact us at standards@icpak.com or alternatively the undersigned at nixon.omindi@icpak.com.

Yours Sincerely,

Nixon Omindi

For: ICPAK-Professional Standards Committee