



MALAYSIAN INSTITUTE  
OF ACCOUNTANTS

PROUD HOST:



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Dear Sir

## INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD ("IAASB") INVITATION TO COMMENT – IMPROVING THE AUDITOR'S REPORT

The Auditing and Assurance Standards Board ("AASB") of the Malaysian Institute of Accountants ("MIA") is pleased to provide comments on the International Auditing and Assurance Standards Board ("IAASB") Invitation to Comment – Improving the Auditor's Report ("ITC").

In formulating its response, the MIA has established a platform to solicit views from various stakeholders in Malaysia such as auditors, officers of entities, and minority shareholders where appropriate.

The views expressed here align with the IAASB's overarching principles in making effective changes to auditor reporting. These principles provide useful guideposts and accordingly, are applied to explain the AASB's views on the IAASB's preferred options for change, in response to the specific questions set out in the ITC.

Our comments are as follows:

### Specific Comments:

Q1. 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 ITC captures well the suggested improvements which reflect the responses received from IAASB May 2011 consultation paper. In general, change to auditor reporting is supported. Our specific views about the value and viability of the IAASB's suggested improvements are discussed in the accompanying responses to the questions raised in the ITC, taking into account the overarching principles.

## Specific Comments: (continued)

The AASB believes that the introduction of Auditor Commentary must be guided by adequate criteria and educational collateral such that auditors as well as users will properly understand the context, its limitations and the criteria themselves.

The AASB believes the first step in progressing with this initiative is to closely examine if the existence of the current information gap is attributed to weaknesses in the financial reporting framework or a lack of detailed information in the auditor's report. Accounting standard setters play an important role in ensuring users' needs are met through financial reporting requirements. Also, some deficiencies in financial reporting are the result of preparers' behaviour to comply with minimum reporting requirements, and as such, would be better addressed by means of additional management reporting requirements, given financial reporting is the primary responsibility of management and not the auditors. A more detailed auditor's report will not necessarily rectify such behavioural deficiencies. Regulators can also exert due influence on companies to prepare and provide higher quality information rather than simply complying with minimum reporting requirements.

Q2. 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.

The process undertaken by the IAASB is an appropriate effort towards supporting the needs of the users of auditors' reports. However, as acknowledged in the ITC, it is important that efforts to improve auditor reporting be synchronised with improvements to corporate governance and financial reporting more broadly. In this regard, while there is support for the initiative to improve the auditor's report, there is concern that this initiative would proceed ahead of other desired improvements such as those referred to in question 1 above, and that the effects would be particularly felt in jurisdictions where other such improvements may lag significantly. The IAASB is therefore urged to also engage with key stakeholders such as the Public Interest Oversight Board ("PIOB") and Consultative Advisory Group ("CAG") on the need for these parallel developments to occur.

There would be merit to the IAASB co-ordinating its initiative to improve auditor reporting with initiatives by other bodies internationally such as the US Public Company Accounting Oversight Board ("PCAOB") and the European Commission ("EC").

We also believe there would be considerable benefits in engaging International Accounting Standards Board ("IASB") and UK Financial Reporting Council ("FRC") about considerations relating to going concern. We refer to "The Sharman Inquiry" report published in July 2012 that was commissioned by the FRC.

### Specific Comments: (continued)

Q3. 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?

Although it is recognised that the concept of Auditor Commentary may provide more information to users, the AASB is of the view that the concept needs further consideration and validation on its efficacy in effectively addressing user needs. The ITC acknowledges that further guidance is needed, and such guidance should include clear criteria to be applied if the concept of Auditor Commentary is to be practicable. Such criteria and guidance should address the following:

- I. Clarity on the matters to be included to reduce the risk of including only selective information.
- II. Affirmation that financial reports, including the adequacy of disclosures, prepared by management are matters to be addressed through the financial reporting framework rather than through the application of auditing standards. Management and those charged with governance ("TCWG") are the original source of disclosure of information about an entity. The auditor neither should be expected to nor should disclose or discuss information not otherwise disclosed by management or TCWG. Any uncertainty in this would weigh on the risk of investor confusion because the provision of such information by the auditor may:
  - Raise questions about the nature of the auditor's opinion or commentary provided by the auditor, particularly in relation to discussions of materiality, uncertainty or risks of material misstatement;
  - Result in conflicts, either actual or perceived, between information provided by management and the auditor, particularly in relation to the auditor's assessment of risks and judgments versus the risks and judgments disclosed by management;
  - Call into question whether matters not commented upon are significant, when that is not intended; or
  - Assume a level of investor knowledge about the audit process that does not exist evenly across constituents and therefore leading to potential misinterpretation of such information.

Q4. 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?

As mentioned in our response to question 3, there should be clear criteria and guidance on matters to be addressed in Auditor Commentary to avoid inconsistencies in reporting that could create confusion amongst users, preparers and auditors alike.

## Specific Comments: (continued)

Q5. 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?

The AASB believes that the illustrative examples do not currently provide the informational or decision-making value sought by users as the examples have been presented without the benefit of qualitative or quantitative criteria and measures regarding the type and nature of commentary required. Accordingly, if the Auditor Commentary is adopted in the Exposure Draft that is anticipated, we urge the IAASB to establish the required criteria to guide the preparation of the Auditor Commentary, and we will assess any illustrative examples against such criteria.

The AASB is of the view that the description of audit procedures and related results are not useful to users of the financial statements. Audit procedures, as illustrated in the illustrative examples may be part of the accumulation of audit evidence in an audit to arrive at the audit opinion rendered. It would be difficult to summarise information in a way that would be adequate and meaningful to users. Presenting such incomplete information would not enhance, and could confuse users' understanding of the auditor's level of effort, which may in turn increase the expectation gap.

Q6. 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?

Evident implications of including Auditor Commentary in the auditor's report are additional time, effort and costs. Additional time and costs are expected due to involvement of more senior audit engagement team members in discussing audit and accounting issues with management and TCWG, and will likely involve significant matters of judgement.

It is likely that the audit process will be lengthened and the finalisation of the audit may be delayed. It is imperative to bear in mind that not only all the information will have to be presented to the auditors in time but allowance will also have to be made for deliberations and resolution of any differences in opinions.

Set against the suggestion for a clear criteria to be applied to the concept of Auditor Commentary as mentioned in response to question 3 above, it is not yet clear that there will be significant benefits to the additional time, effort and costs that would be incurred, and nor is there certainty about the appetite of the market to absorb the costs arising.

## Specific Comments: (continued)

Q7. 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?

As demands for Auditor Commentary have come primarily from institutional investors and analysts evaluating financial statements of listed or other public interest entities ("PIEs"), we believe any requirement for auditor to provide an Auditor Commentary should be imposed for the audits of PIEs and not the other audits. The cost benefit analysis of providing Auditor Commentary for other audits will likely not justify its inclusion in the auditor's report.

We also believe that it would not be appropriate to leave the inclusion of an Auditor Commentary as optional for certain audits, which will result in inconsistency in auditor reporting. Users would be left uncertain and confused over when the Auditor Commentary should be expected, and what to conclude regarding the absence of an optional Auditor Commentary.

Q8. 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?

The AASB is supportive of auditor statements related to going concern as these statements can help users to better understand the appropriateness of the going concern assumption used in the preparation of the financial statements, and the respective responsibilities of management, TCWG and the auditor in regard to going concern.

However, in order to add informational value to users, the accounting standards should first include a requirement for management to provide commentary regarding their assessment and conclusion on going concern. The auditor would then be better placed to report on the conclusion drawn during the audit in respect of the management's use of going concern assumption. This would reduce the misunderstanding of the auditor's role.

Q9. 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?

The AASB is of the view that there would be an impediment of inordinate risk as such a statement would amount to a positive assertion regarding the absence of going concern uncertainties that could well become clearer in the future.

## Specific Comments: (continued)

Hence, we do not believe that reporting of the auditor's judgement on such significant issues within the auditor's report would be of any significant value without a high risk of being misunderstood by users.

The alternative of including this in International Standard on Auditing ("ISA") 570, Going Concern or ISA 700, Forming an Opinion and Reporting on Financial Statements as a presumption when not otherwise explicitly addressed in the report would provide an appropriate balance.

Q10. What are your views on the value and impediments of the suggested auditor statement in relation to other information?

The suggested auditor statement in relation to other information would provide clarification on the nature and extent of the auditor's involvement in relation to other information.

However, the conclusion in negative form is not supported by the work effort currently required under existing ISA 720, The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements. Also, it is important to note that some of the subject matter dealt with may not necessarily be within the auditor's expertise. It is therefore recommended that IAASB enhance the auditor's responsibilities regarding the other information under the proposed revised ISA 720 to support the auditor conclusion in relation to other information.

In practice, the audited financial statements may be issued in advance of the documents containing the audited financial statements. This would present practical challenge for auditors to report on the other information where such information is prepared at a later stage than the issuance of the audited financial statements.

Q11. 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?

The AASB supports the enhanced descriptions and believes this will enhance understanding of what an audit represents and the respective responsibilities of auditors, management and TCWG, thereby narrow the expectation gap. These enhancements also do not change the current scope of an ISA audit and would not likely result in additional costs being incurred to implement.

We also recommend the following communications be included as part of the Auditor's Responsibility section of the auditor's report for IAASB's consideration:

- I. Professional Judgement – Highlight the use of professional judgement in assessing audit risks and in the selection of the audit procedures when responding to such risks.
- II. Other Information – Describe the auditor's responsibility relating to other information.
- III. Going Concern – Describe the auditor's responsibility to make an assessment of management's use of going concern assumption.

## Specific Comments: (continued)

Q12. What are your views on the value and impediments of disclosing the name of the engagement partner?

The AASB is of the view that disclosing the name of the engagement partner will encourage greater ownership and responsibility for work performed as well as enhancing overall transparency.

Such requirement has been imposed by the local law in Malaysia.

Q13. 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?

The AASB is of the view that the disclosure regarding the involvement of other auditors is inconsistent with the "sole responsibility" principle under ISA 600, Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors). Such disclosure may confuse users over the responsibilities of the principal auditor, and may even dilute the principal auditor's responsibility over the group audit.

Q14. What are your views on explicitly allowing the standardised 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?

The AASB is of the view that such information is important to users for a proper understanding of the audit report. The relocation of such information to a website may result in users not reading such information as most users may not visit the website. The AASB views that this can be overcome by relocating the standardised material as an appendix to the auditor's report.

Q15. 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?

The AASB is of the view that the IAASB should further consider if the placement of the auditor's opinion paragraph at the front of the report may cause the rest of the information presented to not be read and hence, diminishing the perceived importance of the rest of the report.

## Specific Comments: (continued)

Q16. 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?

The AASB is supportive of global consistency in auditors' reports.

Global consistency is supported on the basis that there will be a "building blocks" approach which would help to achieve comparable auditors' reports while still allowing jurisdictions the ability to tailor auditor reporting requirements in the context of national environments, including their applicable accounting and financial reporting frameworks to enable local legislative requirements to be met. Perfect consistency in all aspects of the auditors' report should not be anticipated, but rather consistency in the core areas of auditor reporting.

Q17. 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?

The IAASB should mandate the ordering of items to promote consistency and comparability of auditor's report and also to minimise potential confusion. Where law and regulation mandates an order that is different from that of the IAASB, and results in the value of a consistent ISA-based report to be significantly compromised, then ISAs should not be referenced as the applicable auditing framework.

Q18. 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?

As mentioned in our response to question 7 above, the requirement for auditor to provide an Auditor Commentary should be imposed for audits of PIEs only. The AASB considers all other IAASB's suggested improvements should be applied to all audit reports.

Yours sincerely,  
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