



International Organization of Securities Commissions  
Organisation internationale des commissions de valeurs  
Organizaç o Internacional das Comiss es de Valores  
Organizaci n Internacional de Comisiones de Valores

2 November 2012

Technical Director  
International Auditing and Assurance Standards Board  
545 Fifth Avenue, 14th Floor  
New York, NY 10017 USA

Our Ref: 2012/JE/C1/IAASB/11

**Subject Line: IAASB's Invitation to Comment: *Improving the Auditor's Report***

Dear Sir:

The International Organization of Securities Commissions' Committee on Issuer Accounting, Audit and Disclosure (Committee 1) appreciates the opportunity to comment on the International Auditing and Assurance Standards Board's (the IAASB) Invitation to Comment: *Improving the Auditor's Report* (the Paper). As an international organization of securities regulators representing the public interest, IOSCO is committed to enhancing the integrity of international markets through promotion of high quality accounting, auditing and professional standards, other pronouncements and statements.

Members of Committee 1 seek to further IOSCO's mission through thoughtful consideration of accounting, auditing and disclosure concerns, and pursuit of improved global financial reporting. Unless otherwise noted, the comments we have provided herein reflect a general consensus among the members of Committee 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

***Overall Considerations (Questions 1-2 in the Paper)***

We support the IAASB in pursuing potential improvements to the auditor's report in response to users' desire to know more about the audit, the audited entity and the entity's financial statements. We recognize the Paper reflects the Board's current thinking on the journey toward a final standard and we appreciate the Board's effort in continuing to work towards that end. We have prepared our letter



International Organization of Securities Commissions  
Organisation internationale des commissions de valeurs  
Organização Internacional das Comissões de Valores  
Organización Internacional de Comisiones de Valores

based on what we think the Board should consider as it takes the next steps in its standard setting work.

As you are aware, based on our previous letter to the Board dated 2 November 2011, we have a keen interest in the topic of auditor reporting as demonstrated by the exploratory and consultation work on this subject that IOSCO has undertaken over the course of the past few years. Our comments in this letter are informed by these efforts.

As the Board continues to pursue potential improvements in auditor reporting, we offer below some overarching guideposts to inform the Board's work.

### **Implications of Change**

We believe changes should be implemented if they would directly benefit users or provide incentives to improve audit quality or otherwise improve management's financial reporting process. It is therefore important for the Board to continue to consider how the outputs from this standard-setting project could affect the behavior of auditors, management and those charged with governance.

### **Auditor Commentary**

We would like to better understand how the Board's proposed concept of Auditor Commentary differs from existing emphasis of matter (EOM) or other matter (OM) paragraphs.

It is our understanding that the proposed threshold of matters "likely to be most important to users' understanding of the financial statements" to be reported under the Auditor Commentary does not significantly change when compared to the current requirements on EOM or OM paragraphs. Hence, there seems to be no clear line between matters which would require inclusion as an Auditor Commentary as opposed to those matters auditors are required to report as an EOM or OM. As a result, we were not sure how the two concepts are proposed to work together. We raise this matter because historically what has been reported in EOM and OM paragraphs have been important to information made available to investors.

Most of our members are of the view that the current framework of disclosure, whereby auditors only in cases where this is necessary as part of the justification of the modified opinion or an EOM or OM paragraph may provide additional detail as compared to the financial statements, is suitable.

For any Auditor Commentary, we believe it will be critical for the Board to develop suitable criteria for what should be included therein so that the information presented is understandable, useful,



International Organization of Securities Commissions  
Organisation internationale des commissions de valeurs  
Organizaç o Internacional das Comiss es de Valores  
Organizaci n Internacional de Comisiones de Valores

relevant and entity-specific, while at the same time being cost effective and, at a minimum, comparable in structure across entities. Requirements should be structured so that the matters covered and comments made are unique to the situation, versus “generic” or “boilerplate”.

Importantly, Auditor Commentary should not be used as a substitute to qualifying the auditor’s opinion or for management’s lack of disclosures otherwise required in the financial statements.

Our members believe that only in rare instances and based on the auditor’s judgment may it be appropriate for the auditor to provide information about the audited entity that was not presented in the financial statements when the auditor issues a modified opinion that includes EOM or OM paragraphs. However, one member believes the Board should explore expanding this concept, which in which falls within ISAs 705 and 706, to other instances that may call for the auditor to provide information about the audited entity that was not in the financial statements.

Information concerning the audit or the audit process should originate from the auditor. This is because the auditor is in the best position to provide this type of information to financial statement users. In the same regard, we believe information about the audited entity should in principle originate from management and/or those charged with governance of the audited entity, as appropriate, because it is management that has the responsibility for timely, ongoing financial reporting. Requiring original information about the audited entity that was not presented in the financial statements could place the auditor in the role of preparer which may engender independence concerns.

We strongly believe that criteria should be developed in such a manner as to be enforceable by audit oversight bodies or other relevant authorities. We believe the greater the level of subjectivity of information as a result of criteria, the more challenging it would be for (1) regulators to enforce the standard and (2) audit firm quality control departments to implement and monitor compliance with the standard.

### **Going Concern**

As the Board evaluates the input it will receive on the proposals related to going concern within the Paper, we encourage the Board to also consider if other approaches such as robust investor education may assist in enhancing investors’ understanding of the current role and responsibilities of the auditor with respect to an entity’s ability to continue as a going concern.

In addition, we concur with the Board’s proposal to consider whether relevant ISAs such as ISA 570, *Going Concern*, could be enhanced to clarify and strengthen what is required of auditors as a means of addressing the needs of users in lieu of changes to the auditor’s report itself.



International Organization of Securities Commissions  
Organisation internationale des commissions de valeurs  
Organizaç o Internacional das Comiss es de Valores  
Organizaci n Internacional de Comisiones de Valores

## **Clarifications and Transparency**

Most of our members do not see added value in including in the auditor's report the enhanced descriptions of the various responsibilities of the auditor, those charged with governance and management. They believe it is standardized information and, as such, boilerplate without adding information specific to an individual audit of financial statements. As these paragraphs are standard in a given jurisdiction, these members suggest that an appropriate body such as the professional body, the national standard setter or the audit oversight body could include these paragraphs on its website in a manner reflecting a balanced view of the responsibilities of the relevant parties. The auditor could then simply refer to that location in its auditor's report. On the contrary, one of our members is in favour of the enhanced descriptions in the auditor's report as proposed in the Paper.

## **Form and Structure**

The "pass/fail" model of the current standard auditor's report provides an unequivocal means of identifying whether an audited entity's financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. We believe this unambiguous communication continues to have value and, as such, any proposed change to the auditor's report should not detract from or obscure this information.

We support the Board's pursuit of global consistency in the structure of the auditor's report while at the same time providing flexibility for national standard setters and local audit oversight bodies to implement the resulting standard in a manner that is appropriate for the given jurisdiction.

## **Next Steps**

We suggest the Board consider some form of field testing of its proposals prior to finalizing any standard-setting activity related to the project. Field testing could assist in assessing the operational effectiveness of the proposal including the ability to issue the auditor's report within the time constraints of regulatory requirements. For example, the Board could evaluate how audit reports issued during the financial crisis may have been different, and if those reports would have been more helpful to financial statement users, had those reports been adjusted to reflect the Board's proposals related to going concern.

In addition to the benefits, the Board should fully consider the costs and enforceability of how it might choose to proceed based on what is expected of auditors, management and those charged with governance as a result of this standard-setting project.



International Organization of Securities Commissions  
Organisation internationale des commissions de valeurs  
Organizaç o Internacional das Comiss es de Valores  
Organizaci n Internacional de Comisiones de Valores

The Board states that “it is important that efforts to improve auditor reporting are synchronized with improvements to corporate governance and financial reporting more broadly.” We believe that if it becomes apparent that some of the demands of users of the financial statements can be better addressed by enhancing the accounting and/or disclosure standards, including the extent of periodic reporting and the auditor’s involvement with such reporting, we favor the IAASB’s coordination with the IASB to improve those standards. Nonetheless, we believe meaningful changes to the auditor’s report could benefit investors, separate and distinct from other improvements to corporate governance and financial reporting.

In the remainder of our letter we have addressed some more specific matters relating to the Paper that we believe are important for the Board to consider before determining its next steps.

#### *Auditor Commentary (Questions 3-7 in the Paper)*

#### **Forming Criteria**

Paragraphs 45 and 46 of the Paper state that:

“On a preliminary basis and in light of feedback received on the May 2011 consultation about what users value (see paragraphs 35–37), the IAASB is of the view that auditors should consider the following matters, at a minimum, in determining whether to include Auditor Commentary:

- ✦ Areas of significant management judgment (e.g., in relation to the entity’s accounting practices, including accounting policies, accounting estimates, and financial statement disclosures).
- ✦ Significant or unusual transactions (e.g., significant related party transactions or restatements).
- ✦ Matters of audit significance, including areas of significant auditor judgment in conducting the audit, for example:
  - Difficult or contentious matters noted during the audit, or other audit matters that would typically be discussed with an engagement quality control reviewer or TCWG; and
  - Other issues of significance related to the audit scope or strategy.



International Organization of Securities Commissions  
Organisation internationale des commissions de valeurs  
Organizaç o Internacional das Comiss es de Valores  
Organizaci n Internacional de Comisiones de Valores

Accordingly, the IAASB plans to specify considerations for auditors based on these and perhaps other areas that users may identify as important to them.”

We agree that the Board would need to specify considerations for auditors as we believe criteria would provide a framework to guide the auditor in writing Auditor Commentary that would be useful to financial statement users. Nonetheless, we would encourage the Board to consider the pros and cons of any criteria, including matters listed above, prior to finalizing its proposal.

For example, we think that “Difficult or contentious matters noted during the audit, or other audit matters that would typically be discussed with an engagement quality control reviewer or TCWG,” might cause the audit partner to be more reserved in those discussions knowing that public disclosure would be required. Further, the Board should give due consideration of the risk of confusing investors rather than informing them as a result of a requirement to disclose such matters.

We believe the development of criteria for Auditor Commentary should be of high priority to the Board as this will inform auditors’ judgment as to what information should be included. Thoughtful, practical criteria can provide a framework through which the auditor can appropriately balance what should be included in Auditor Commentary. Criteria should assist the auditor in presenting information specific to the audited entity based on the auditor’s performance of audit procedures and the auditor’s understanding of the audited entity.

In addition, as the Board navigates investors’ and other stakeholders’ input with respect to Auditor Commentary, we believe consideration should be given to the auditor describing the methodology used as part of the audit.

### **Guarding Against “Soft Qualifications”**

Paragraph 50 of the Paper states that “It also will be necessary in future standard-setting for the IAASB to clearly state its view that Auditor Commentary should not be used as a substitute for either (a) the auditor expressing a qualified opinion or an adverse opinion, or disclaiming an opinion, when required by the circumstances of a specific audit engagement; or (b) disclosures in the financial statements that the applicable financial reporting framework requires management to make.” We strongly agree that the requirements in future standard-setting activities relating to Auditor Commentary should guard against auditors providing “soft qualifications” through the use of Auditor Commentary. We believe the Board should provide clear and definitive provisions to auditors that Auditor Commentary should not be used as a substitute to qualifying the auditor’s opinion or for management’s lack of disclosures otherwise required in the financial statements.



International Organization of Securities Commissions  
Organisation internationale des commissions de valeurs  
Organizaç o Internacional das Comiss es de Valores  
Organizaci n Internacional de Comisiones de Valores

### **Impact of Changes on the Relationship between the Auditor and Management**

One of the impediments to providing Auditor Commentary in paragraph 62 of the Paper is “A more iterative process to finalize the auditor’s report, which may affect the timing of release of the financial statements and the auditor’s report.” While we agree with this statement, we believe the dialogue that may occur between the auditor and management creates a different dynamic and potentially unique tensions between the two parties as the auditor may have more latitude to make nuanced commentary in the auditor’s report based on the current proposal. It would be important for the Board to understand if these additional tensions promote enhancements to the financial reporting process, including better communications between the two parties, or if these tensions stifle the openness of the parties and the flow of information.

### **Avoiding Assurance on Individual Accounts**

The Board states in paragraph 63 (b) of the Paper that “There is a risk of increasing the expectations gap, to the extent that readers interpret the inclusion of Auditor Commentary as providing assurance on individual accounts or disclosures.” We agree with the risk observed by the Board. While most of our members see this as a significant risk that may mislead investors, some do not. For example, one of our members that currently requires a justification of assessment in the auditor’s report within its jurisdiction does not believe there are risks regarding investors perceiving assurance on individual accounts based on inclusion of the accounts in Auditor Commentary. This member considers Auditor Commentary as a means for the auditor to justify their opinion with a greater degree of focus on specific items to which the auditor would like to draw attention.

### **Illustrative Report**

Auditor Commentary as reflected in the illustrative report of the Paper heavily relies upon and refers to the financial statements and does not seem to present any valuable information that is incremental to that which is already provided and thus which would be incrementally useful to investors in making investment decisions. The ongoing challenge in promoting the presentation of incremental, valuable information is where to draw the line such that the requirements result in both (1) an enforceable standard; and (2) disclosures that provide a succinct description that is neither too voluminous and complex nor too short and generic – which may not benefit investors. As such, it would be incumbent upon the Board to provide clear guidance on the level of detail it would expect the auditor to provide regarding Auditor Commentary.



International Organization of Securities Commissions  
Organisation internationale des commissions de valeurs  
Organizaç o Internacional das Comiss es de Valores  
Organizaci n Internacional de Comisiones de Valores

Some of our members believe that inclusion in Auditor Commentary of a more detailed description of audit procedures performed by the auditor may be useful to investors by increasing transparency of the work performed by the auditor while, at the same time, potentially compelling auditors to be more thorough in performance of the procedures described in Auditor Commentary. On the other hand, other members are concerned that inclusion in Auditor Commentary of procedures performed by the auditor may serve to reduce the perceived responsibility of auditors and transfer from the auditor to investors the responsibility to assess the sufficiency of audit procedures performed.

We believe providing examples in the illustrative report could be an effective means of establishing the quality of information that the Board expects auditors to disclose in Auditor Commentary. Having said this, our members believe that the examples presented in Auditor Commentary within the illustrative report in the Paper seem to refer to information in the financial statements, without adding new information. This increases the risk that in practice such examples will be minimally tweaked and applied to unrelated companies. This would result in boilerplate language, which provides little value to investors. We believe the Board should present examples that are entity-specific and more tailored to the audited entity.

#### ***Going Concern/Other Information (Questions 8-10 in the Paper)***

##### **Going Concern**

Paragraph 26 of the Paper states that:

“The IAASB’s suggested improvements in relation to going concern make explicit in auditors’ reports the auditor’s work effort required by ISA 570.”

We agree that the Board’s suggested improvements with respect to going concern would make explicit procedures already required under current auditing standards. As noted above, some of our members believe that explicit statements made in the auditor’s report will encourage auditors to increase their focus on the sufficiency of procedures performed. Other members believe that explicit statements made in the auditor’s report about the auditor’s work effort required by ISA 570 will provide no additional value to investors but, on the contrary, may inappropriately increase the comfort users perceive from the statement.

Paragraph 30 states that:

“There are also situations where the auditor may have determined that no material uncertainty exists, but certain events or conditions nevertheless have been identified that





International Organization of Securities Commissions  
Organisation internationale des commissions de valeurs  
Organizaç o Internacional das Comiss es de Valores  
Organizaci n Internacional de Comisiones de Valores

may cast significant doubt on the entity’s ability to continue as a going concern. In such circumstances, there may be merit in the auditor describing in the auditor’s report significant judgments the auditor may have made, and audit procedures the auditor may have performed, in reaching a conclusion that no material uncertainty exists.”

Though increased transparency is generally beneficial, we are concerned that the auditor describing those situations contemplated in the paragraph above may actually confuse users of the financial statements and cause users to inappropriately question either the quality of audit work performed or the ultimate audit opinion. In addition, it is not clear how the identification of an event or condition “that may cast significant doubt about the entity’s ability to continue as a going concern” does not result in there being a “material uncertainty.”

The illustrative report on page 9 of the Paper states that:

“Based on the work we have performed, we have not identified material uncertainties related to events or conditions that may cast significant doubt on the Company’s ability to continue as a going concern that we believe would need to be disclosed in accordance with IFRSs. Because not all future events or conditions can be predicted, this statement is not a guarantee as to the Company’s ability to continue as a going concern.”

We are concerned with these statements because they could be perceived as the auditor’s attempt to limit liability and to disclaim responsibility for work that was not performed. Qualifying language such as “based on the work we have performed” seems to be indicative of a different type of assurance, that is, negative assurance, which is inconsistent with the positive assurance the current auditor’s report implicitly provides with respect to going concern. Further, it is difficult, if not impossible for an auditor to predict future events and therefore such a statement may be seen as simply stating the obvious and providing little value to investors.

### **Other Information**

Paragraph 68 states that:

“When the auditor has identified a material inconsistency for which revision of the other information is necessary and management refuses to make the revision, the statement that no material inconsistencies have been identified would be replaced by a detailed explanation of this matter (see paragraph 2 in Appendix 2).”

Further, paragraph 2 in Appendix 2 states that:



International Organization of Securities Commissions  
Organisation internationale des commissions de valeurs  
Organizaç o Internacional das Comiss es de Valores  
Organizaci n Internacional de Comisiones de Valores

**“A Material Inconsistency Exists between the Audited Financial Statements and Other Information for Which Revision of the Other Information Is Necessary and Management Refuses to Make the Revision**

**Other Information**

As part of our audit, we have read Management’s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) contained in the Company’s Annual Report for the year ended December 31, 20X1, for the purpose of identifying whether there are material inconsistencies with the audited financial statements. Based on reading the MD&A, we have noted a material inconsistency in this information compared with the audited financial statements. Specifically, the audited financial statements indicate that total income from continuing operations was XXX. However, the MD&A indicates that income from continuing operations for the first, second, third and fourth quarters of 20X1 were XXX, XXX, XXX and XXX, respectively, amounting to a total of XXX. We have not audited the information in the MD&A and accordingly do not express an opinion on it.”

While the example reflects the auditor’s disclosure of the inconsistency when management refuses to revise the other information, we question whether the auditor should even continue to associate with the audited entity based on this type of a disagreement.

***Clarifications and Transparency (Questions 11-14 in the Paper)***

Paragraph 74 states that:

“Because of the importance of compliance with ethical requirements as a basis for the audit, and the increased focus on auditor independence, the IAASB believes that an explicit statement of compliance with relevant ethical requirements should be required in all auditors’ reports.”

While we are supportive of the inclusion of a statement concerning compliance with relevant ethical requirements, we believe that with respect to independence it may be more appropriate for the opinion to specifically state that the auditor is independent of the audited entity. More specifically, we believe where a breach of an auditor independence provision of the Code has occurred, if objectivity was deemed not to be compromised, the auditor should report the occurrence and nature of the breach and the impact on the auditor’s objectivity in jurisdictions where such reporting is either required or



International Organization of Securities Commissions  
Organisation internationale des commissions de valeurs  
Organização Internacional das Comissões de Valores  
Organización Internacional de Comisiones de Valores

encouraged under the capital markets regulatory regime. Such a statement would be consistent with the title of the auditor's report ("Independent Auditor's Report"). Implicitly, we believe if the auditor is not independent and objectivity has been compromised then the auditor will not be able to issue the auditor's report.

Paragraph 79 states that:

"In relation to the ISAs, permitting or requiring disclosures regarding the role of other auditors is seen by some to run counter to the "sole responsibility" principle. Nevertheless, the IAASB acknowledges that the involvement of other auditors may be considered a matter of audit significance suitable for inclusion in Auditor Commentary. Alternatively, the IAASB could decide to mandate disclosure of the involvement of other auditors, which may therefore require it to be separately presented."

With increasingly complex and international business structures, the Board should ascertain whether users of financial statements are interested in the extent that the auditor used the work of other auditors and experts and how the auditor organized the audit to be able to maintain sole responsibility for the audit report in accordance with ISA 600.

Some of our members believe that disclosures relating to the work performed by other auditors may appear to transfer from the auditor to investors the responsibility to assess the sufficiency of audit procedures performed particularly as investors may be placed in the position to compare the quality and quantity of audit procedures outlined in one auditor's report with another. Other members see value in providing such information to investors. Therefore, if the Board decides to permit or require the auditor to disclose the role of other auditors, the auditor's report should include a specific statement to reflect, not only the auditor's "sole responsibility" for the audit but, how the auditor organized the audit to be able to meet its sole responsibility.

#### ***Form and Structure (Questions 15-18 in the Paper)***

We have no additional comments on specific paragraphs within the Paper related to the form and structure of the auditors' report.



International Organization of Securities Commissions  
Organisation internationale des commissions de valeurs  
Organizaçào Internacional das Comissões de Valores  
Organización Internacional de Comisiones de Valores

Thank you for the opportunity to comment on the Paper. If you have any questions or would like to further discuss these matters, please contact either Nigel James or me at 202-551-5300.

Sincerely,

Julie A. Erhardt

Chair

Committee on Issuer Accounting, Audit and Disclosure  
International Organization of Securities Commissions