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2 November 2011

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

Our Ref: 2011/JE/TCSC1/IAASB/135

Subject Line: IAASB Consultation Paper, *Enhancing the Value of Auditor Reporting: Exploring Options for Change*

Dear Sir:

The International Organization of Securities Commissions Standing Committee No. 1 on Multinational Disclosure and Accounting (SC 1) appreciates the opportunity to comment on the International Auditing and Assurance Standards Board's (the IAASB) Consultation Paper, *Enhancing the Value of Auditor Reporting: Exploring Options for Change* (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 SC 1 seek to further IOSCO's mission through thoughtful consideration of accounting, auditing and disclosure concerns, and pursuit of improved global financial reporting. Our comments in this letter reflect those matters on which we have achieved a consensus among the members of SC 1; however, they are not intended to include all comments that might be provided by individual members on behalf of their respective jurisdictions.

Overall

We support the IAASB's efforts to explore possible improvements to the manner and scope of auditor reporting. Auditor reporting is an important subject due to the role an auditor plays in obtaining sufficient assurance to express an opinion on financial statements and also the prominence of the



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auditor's report in conveying the results of the auditor's work to investors and others. We appreciate the willingness of the IAASB to invest its resources in pursuing this at the international level.

We also highlight the particular keenness of the interest of securities regulators in the subject of auditor reporting, and thus in this work by the IAASB. This is because changes to auditor reporting would mean changes to the only tangible item that gives investors insight about a company's financial reporting from the perspective of an independent party.

SC 1's keen interest in auditor reporting is also evident in 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, and in some places we note relevant points that we have taken away from our outreach work.

I. Conduct of the Project (Questions 1-3 in the Paper)

Applicability of the Board's Work

SC 1 supports the Board pursuing the possibility of changes for auditors' reports for companies that report in the public capital markets. Our experiences as securities regulators do not give us unique insight as to what auditor reporting is most appropriate for investors who provide capital privately.

We observe, however, that to the extent auditors use a similar approach for all—public and private—financial statement audits, the outputs from these efforts become connected as well. What makes this connection complex is the fact that access to information about a company and expectations of what an auditor's communications should entail may vary between those who provide capital privately and those who invest in the public capital markets. For example, an investor who is the sole shareholder of a company may have very different needs and expectations as compared to a retail investor of a widely-held public company.

To better understand applicability matters the Board may find it useful to proactively reach out to members of the investor community. Within this group the Board could focus on those investors who do not have leverage to receive information from the audit client upon demand. Feedback from these investors would help the Board to understand the minimum level of information requested by investors who have no opportunities to obtain information from a company other than through its public reporting. Though investors in public companies are affected by this matter of leverage, we do not see this issue of access to be limited to public companies as other factors such as corporate



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governance structures or statutory requirements may influence the ability investors have to gain information upon demand.

Scope of the Board's Work

SC 1 is supportive of the Board limiting its work to pursuing improvements to the audit firm's reporting that is associated with an audit of a set of financial statements, versus also including review services. The Board can later determine whether to add reporting for review services to its agenda depending upon the Board's conclusions in this project and other relevant considerations.

We believe that exploring options for changing the auditor's report can be progressed separately from a broader project to consider an auditor's association with other documents or information that is separately produced by management at different times, such as preliminary announcements. This is because regardless of the costs and benefits of other such possible auditor associations, the basic question of the optimal manner to report based upon the reasonable assurance obtained from an audit of financial statements still remains. We believe this broader work is best explored as part of the Board's project to update ISA 720, *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements*, as the topic of auditor association with other documents or information provided by management is explored on a more comprehensive basis there.

Due Process for the Board's Work

In paragraph 25 the Paper states:

“This Consultation Paper does not exhaustively address experiences and views of all types of users of audited financial statements. Some types of users have been forthcoming in their views on auditor reporting (large investors and financial analysts in particular). Other types of users may or may not share these concerns about auditor reporting or indeed could have other concerns that have not yet been identified.”

As the auditor's report is important to investment decisions of investors, we believe the Board should consider specific, targeted and proactive outreach to obtain the views of investors. We believe this approach could prove more effective than expecting users to be forthcoming in their views on auditor reporting with respect to the Paper or any subsequent project Exposure Drafts. We also believe it is important that the Board consider a cross-section of investors' views. Accordingly, investor outreach would take into consideration different demographics such as size, sophistication, culture and



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corporate governance/ownership structures. This is because the needs of various investors may vary and the Board also needs the context of any pronounced jurisdictional differences.

We also believe the Board will need to “get the word out” to stakeholders who are directly affected by auditor reporting but who may not traditionally follow the Board’s work because they are not directly affected by the large portion of the Board’s standard setting effort, which relates to how to conduct an audit. For example, during our outreach discussions with audit committee representatives and management personnel of large, multinational companies we noted that they were not aware of the Paper or the project. Their lack of awareness existed even though the Paper was issued more than a month prior to our outreach. While we respect the breadth of input that the Board receives from members of its Consultative Advisory Group, for this project there are so many potentially affected parties with differing concerns that the Board’s consultation efforts would usefully go beyond the discussions at the Advisory Group’s bi-annual meetings.

In addition, various organizations such as the Financial Reporting Council, the European Commission and the U.S. Public Company Accounting Oversight Board are in the process of examining the topic of auditor reporting. As is feasible, we encourage the Board to pursue its work while mindful of the efforts of these and any other similar organizations. This would enhance the international consistency of the final outcomes of these projects as is appropriate and is practicable.

II. Potential Technical Issues in the Project – General Comments (Questions 4-15 in the Paper)

We encourage the Board to identify issues associated with and evaluate potential changes to the auditor’s report in light of whether implementation of the changes would serve the public interest, including protecting the investor and enhancing the confidence of intended users of a company’s financial statements. To assist the Board in doing so, we offer the four principles, below, as initial guideposts for pursuing its work.

- The Board should give high priority to investor protection with consideration given to whether changes to address investors’ needs are consistent with the other points, below, and are supported by evidence as a basis for change. The Board should consider whether investors would welcome or benefit from the change. In addition to investors’ needs, the Board should also consider the views of other users of the financial statements concerning the current auditor’s report and any proposed changes thereto.



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- Any change to the auditor's report should be coupled with robust investor education to enhance investors' understanding and minimize confusion. The Board may consider encouraging its member bodies within IFAC to assist in providing this type of education to various stakeholders or to help in the preparation of education materials.
- Changes to the auditor's report or considerations of the role and responsibilities of management, auditors and/or those charged with governance should serve to improve audit quality, increase the trust investors have in the financial reporting process, and guard against lowering the current responsibilities of the respective parties.
- Information about the company should originate from management and/or those charged with governance of the audited entity, as appropriate. Information concerning the audit or the audit process should originate from the auditor. This said, information provided by the auditor may inherently impart information about the company.

In addition to these principles, the Addendum to this letter contains input on the five technical issues raised for consideration in the Paper. One SC 1 member reserves judgment with respect to providing input on those technical issues in light of a current consultation paper on auditor reporting by its national standard setter.

Our input on the technical issues encompasses the pertinent feedback we received as a result of our outreach efforts in IOSCO's workstream on auditor communications. By way of background, IOSCO began this work by hosting a roundtable on audit quality in Europe in 2007, followed by a public Consultation Report in 2009.¹ During 2010 and 2011, SC 1 held a total of four outreach sessions in Asia and in the Americas with individuals from (i) investor and corporate governance groups, (ii) audit firms, (iii) audit committees/those charged with governance (from large, multinational corporations) and (iv) financial management of companies (from large, multinational corporations) to further its understanding of the views of relevant stakeholders. Each session comprised four participants within the same stakeholder group. We recognize that our outreach sessions represent a small sample size, and the views expressed by those outreach participants, including investors, may not be the same as those of the broader populations of the stakeholder groups.

¹ The Report is available at www.iosco.org/library/pubdocs/pdf/IOSCOPD303.pdf. The 22 letters received and a summary of those responses is available at www.iosco.org/library/pubdocs/pdf/IOSCOPD337.pdf.



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We also wish to note that considering technical issues at this stage of the project differs from considering them at the point at which the Board has thought them through and developed an actual proposal. We would offer our final thoughts at that time. Further, at this stage of the process—before the Board has set the particular parameters for its project—we did not attempt to identify additional technical issues for the Board’s consideration.

III. Potential Challenges for the Project (Questions 16-19 in the Paper)

The conduct of this project will bring unique practical challenges for the Board because of the much wider stakeholder interest in the outputs of an audit (auditor reporting) than in the inputs to an audit (the steps involved as an auditor plans and then conducts its field work). We have cited some of the reasons for this keen interest by securities regulators and by investors. We have also noted the interest shown by the financial management and audit committee members with whom we spoke.

This project will also bring practical challenges because while Board members who have experience conducting audits bring first-hand experience regarding what forms of auditor reporting may be practicable, they may not bring as much direct experience as to what output is both desirable and warranted for use by investors. This is where additional forms of consultation would seem helpful.

This project will also bring technical challenges due to jurisdictional differences in corporate governance structures. These structures may influence what information investors—versus their representatives on Boards, Audit Committee, or the equivalent—may access. Jurisdictional governance differences, which also may be a result of variations in regulations from country to country, can also influence the expectations of investors and the work effort of auditors.

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, Standing Committee No. 1
International Organization of Securities Commissions



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Addendum

II. Potential Technical Issues in the Project (continued) – Specific Comments

A. Format and Structure of the Standard Auditor's Report (Questions 4-5 in the Paper)

SC 1 Comments

The standard auditor's report is the means through which the auditor communicates the results of its audit to investors and other financial statement users, historically providing a simple and quick means of identifying whether a company's financial statements are presented fairly in all material respects. As such, the auditor's report is useful to enhance the confidence intended users have in the integrity of the financial statements of a company.

Frameworks

We believe it is important for the auditor to state within the auditor's report what was audited and the framework under which the audit work was performed. While it may be possible to improve how the auditor's report communicates this information relative to the manner in which it does so today, the auditor's report should communicate generally the same type of information about these matters.

Conclusions and Other Relevant Information

We believe it is also important for the auditor to state within the auditor's report its conclusion(s) from its work. The difficult aspect about this is whether the auditor should communicate one or more than one conclusion, and whether the auditor's conclusion(s) should include any form of associated commentary (e.g., assessment, explanation, justification, area of emphasis, or similar). We believe that these two matters should be at the heart of what the Board will pursue and deliberate as it develops its proposal(s) in this project.

Responsibilities

Some of our members believe it is important that the information about management's and the auditor's responsibilities (the "scope paragraph") be retained with its current content and in its current location within the auditor's report, while others believe it should be moved with its current content to an annex that accompanies the auditor's report. In contrast, yet other members believe that the scope paragraph should be entirely eliminated rather than being retained or moved. These members believe that it may be useful for users of financial reports to have access to appropriate and unbiased information on the roles and responsibilities of all parties in the financial reporting cycle including



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directors, management, auditors, standard setters and regulators. Any such education on roles and responsibilities would be made available by means other than the auditor's report, such as training sessions or an independently prepared publicly available document on roles and responsibilities of all parties in the financial reporting cycle.

Underlying these varying points of view about the scope paragraph is the question of whether the information currently provided is extensive enough to adequately inform investors about the roles and responsibilities of the various parties involved in the company's financial reporting process and, even if it is, whether locating this information within the auditor's report serves to detract from the proper understanding of the auditor's role. For example, while including it can assist in narrowing the audit expectation gap to the extent that the gap may relate to any misunderstanding of the role of the auditor, it may not adequately explain the role of the auditor, and an adequate explanation may require a much more extensive and lengthy document. And as it is reasonably concise it does not adequately or correctly explain the role of management under reporting frameworks in various jurisdictions, and even when it does it does so only in the context of the auditor's responsibilities.

Results of SC 1's Outreach

Some investors believe that information provided by the auditor should also be useful for assisting users to determine if a material misstatement exists in the financial statements. Investors cite the following as examples:

- an audit firm which appears better suited to perform an audit engagement suddenly resigns and an apparently less well suited firm becomes the successor auditor; or
- an audit client suddenly changes an accounting policy or its fiscal year-end date.

These investors believe more information related to changes such as those above should be provided by the auditor so that investors can determine if they need to change their investment positions.

B. Other Information in Documents Containing Audited Financial Statements (Questions 6-7 in the Paper)

SC 1 Comments

In paragraph 73 the Paper states:



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“... it is generally recognized that the auditor is not responsible, and should not take responsibility, for disclosure of information about the entity to users of the entity’s audited financial statements: that must remain the responsibility of management and those charged with governance. This is necessary not only for there to be clarity about the respective roles and responsibilities of management and those charged with governance, and of the auditor, but also for the effectiveness of the independent audit function.”

We agree with these points, however, this is a threshold issue in the Board’s project and thus not one that can be completely summed up in these sentences. We believe it is not appropriate for the auditor to be the initial or primary communicator to the general public of financial information concerning the audit client. Although auditors may understand the company’s business and industry, management is the only one who can compel the resources to establish systems and processes to collect and prepare information about the company. However, information provided by the auditor may inherently impart information about the company. However, as a practical matter this does not mean that we think the current responsibilities of the auditor as per paragraphs 17, 18 and 19 of ISA 705 (Revised and Redrafted), *Modifications to the Opinion in the Independent Auditor’s Report*, should be changed.

C. Auditor Commentary on Matters Significant to Users’ Understanding of the Audit or the Audited Financial Statements (Questions 8-10 in the Paper)

SC 1 Comments

The Paper notes in paragraph 62 that:

“It has been suggested that additional paragraphs could be used in the standard auditor’s report to provide further information about the audit. For example, users have suggested that it would be helpful for information to be provided about:

- Key areas of risk of material misstatement of the financial statements identified by the auditor, including critical accounting estimates or areas of measurement uncertainty in the financial statements.
- Areas of significant auditor judgment, for example judgments about material uncertainties that may cast doubt about an entity’s ability to continue as a going concern, or judgments pertaining to the recognition, de-recognition, measurement or disclosure of relevant items within the financial statements.
- The level of materiality applied by the auditor to perform the audit.



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- The entity's internal controls, including significant internal control deficiencies identified by the auditor during the audit.
- Areas of significant difficulty encountered during the audit and their resolution.”

Further, paragraph 72 notes that:

“...there have been calls for the auditor to share insights and perceptions about the entity or the quality of its financial reporting based on the work done for the financial statement audit. For example, some have suggested that the auditor should share insights and perceptions about:

- The quality of the entity's internal controls and financial reporting processes.
- Qualitative aspects of the entity's accounting policies, including the relative conservatism or aggressiveness reflected in management's selected policies.
- The auditor's assessment of management's critical accounting judgments and estimates, including where each critical judgment or estimate falls within a range of possible results.
- The quality and effectiveness of the entity's governance structure and risk management, and the quality and effectiveness of its management.”

We are concerned that, while involving judgments by the auditor, a number of the matters detailed in paragraphs 62 and 72 are matters that also involve judgment by management or those charged with governance. This includes sources of estimation uncertainty, material judgment uncertainties (for example, going concern or accounting policy choices), establishing and maintaining internal controls, and an entity's governance structure and risk management. These matters may be the subject of disclosure requirements for the company's financial reports or related documents under the applicable financial reporting framework. Such disclosures would be the responsibility of management or those charged with governance. For example, as the Board explores the auditor's role in potentially providing information about the auditor's view on critical accounting estimates, we believe careful consideration should be given to avoid the presentation of information that introduces more confusion to investors and other users of financial statements.

Further, we believe the Board may find it useful to understand the experiences of those jurisdictions that currently have a requirement for the auditor to obtain sufficient assurance to express an opinion on the entity's internal controls in an attempt to consider the costs and benefits of auditors providing



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assurance over internal controls over financial reporting versus relying on alternative audit procedures for those companies in which it may be more appropriate.

We are also concerned as to the usefulness of information on the materiality level applied by the auditor to perform the audit. Quantitative measures of materiality require the application of professional judgment and may vary depending on the item and the relevant base amount and qualitative factors also need to be considered (for example, in relation to disclosure of remuneration of management). As such, users of financial statements may not understand disclosures about the level of materiality. On the other hand, it can also affect any gap in expectations as they will become aware that auditors perform selective testing on transactions and account balances. This gap is more related to over reliance than under reliance.

Similarly, we believe that under the current reporting framework disclosure by the auditor of the areas of significant difficulty encountered in the audit which are not resolved to the auditor's satisfaction should be treated as a scope limitation for which the auditor would not be able to issue an unqualified opinion. If the matters are resolved to the satisfaction of the auditor, it is unclear how disclosure would assist financial report users.

Results of SC 1's Outreach

Based on our outreach and consistent with the Paper, some investors expressed a desire to have access to more and better information. These investors view changes to the auditor's report as a solution to address this desire.

In contrast to investors' views expressed above, both the preparer management and audit committee members who participated in our sessions did not favor changes to the current standard auditor's report. These preparers indicated that changes to the auditor's report would only serve to further confuse investors, and at the same time could result in a loss of comparability depending on the proposed changes. The audit committee members indicated that value is derived in the audit process itself. They believed that more important than the wording in an auditor's report is the mechanism whereby management's assumptions are challenged and risks are investigated during the course of an audit. Both preparer management and audit committee members did acknowledge, however, that there is perhaps a gap in investor/user understanding of what an audit is, and the roles of the auditor, audit committee, and management. Both groups believed that this gap could be better filled by education and outreach to investors/users.



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Some audit committee members indicated that it would be beneficial if the auditors were to explicitly disclose their views to management and to the audit committee regarding the degree of aggressiveness of management's estimates, policy choices and assumptions. They believe, however, that communication with the public is the role of management – not the auditor. Others felt this information would be useful if disclosed to the audit committee, but did not see the need for public disclosure, given that inherently the audit report already communicates the auditor's concurrence with management's choices. It was also noted by some audit committee members that if public disclosures on the degree of aggressiveness were required, then there could be a tendency for the company to gravitate towards overly conservative choices.

During our outreach sessions some investors mentioned that more information should be disclosed by both management as well as the auditor, though these investors preferred to obtain the information directly from the auditor as a third party independent from management. They believe that the level of information currently provided by financial statements is not sufficient and that more information about the audit process and/or audit procedures and the risky areas that required more audit work should be included in the auditor's report. They also desired more information on the main assumptions used in preparing the financial statements, main audit issues, reasons for the company's selection of certain accounting policies, unusual transactions, quality of corporate governance and audit and business risks. With respect to risks, investors believe each company has different types of risks which may require different types of audit procedures. They believe such information should be provided.

Certain investors were also concerned that additional information could become boilerplate or standardized; they strongly desired entity specific information which could even be presented separate from the audit report. They believe the auditor should exercise professional skepticism to determine the appropriateness of those disclosures.

D. An Enhanced Corporate Governance Reporting Model: Role of Those Charged with Governance Regarding Financial Reporting and the External Audit (Questions 11-13 in the Paper)

SC 1 Comments

We believe any potential role of the audit committee or those charged with governance should take into consideration the increasing workload and roles and responsibilities of those charged with governance in different jurisdictions. This increase in the workload and in the roles and responsibilities of those charged with governance may make it more challenging to find individuals



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with the ability to fill these roles. The Board may find varying degrees of maturity and strength of the corporate governance structures in different jurisdictions which may impact the effectiveness and application of any standard that requires reporting by those charged with governance.

The Paper states in paragraph 81 that:

“An enhanced model of corporate governance reporting could provide a platform for further reporting to users of audited financial statements, for example:

- (a) Reporting by those charged with governance (or the audit committee) to the entity’s shareholders (or other external stakeholders); in conjunction with
- (b) Expanded reporting by the independent auditor on the report provided by those charged with governance.”

Though it may not be the Board’s intent to influence the reporting requirement of those charged with governance (or the audit committee), we believe any proposal to change the reporting requirement of those charged with governance is beyond the remit of the Board as it may require the establishment of or changes to the reporting framework on a jurisdiction by jurisdiction basis.

Nonetheless, we believe if the relevant reporting framework for those charged with governance was in place there may be potential value in the auditor providing assurance on a report issued by the audit committee. For this type of model to be effective, we believe communication between the auditor and the audit committee must be transparent and complete and should not be compromised. It follows then that any proposed change patterned after this model or any other model should serve to enhance the effectiveness of communication between the auditor and those charged with governance which we believe can result in a positive impact on audit quality. In addition, any proposed change should weigh the pros and cons with the goal of promoting the public interest. Further, we noted during our outreach sessions that audit committee members felt strongly that the functioning of the relationship between senior members of the specific audit team and the audit committee and management was of paramount importance, and can influence audit quality.

E. Other Assurance or Related Services on Information Not Within the Current Scope of the Financial Statement Audit (Questions 14-15 in the Paper)

SC 1 Comments



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We believe that the desire to change the auditor's report could be indicative of more fundamental issues such as a lack of investor education, a need for an increase in the auditor's professional skepticism or a need for improved audit quality. For example, if investors were educated about the comprehensiveness of the audit process and the depth of audit procedures undertaken by auditors prior to issuing the auditor's report, would investors be less inclined to demand changes to the current auditor's report? Moreover, could an increase in the auditor's professional skepticism or improvements in audit quality lead to fewer audit deficiencies and the associated negative press for firms thereby limiting the negative perception investors have about financial statement audits and investors' desire to change the auditor's report? We believe prior to exploring other assurance or related services on information not within the current scope of the financial statement audit the Board should explore these issues. The Board should also consider how outputs from its Audit Quality project may impact or address investors' desire for changes to the auditor's report.

Results of SC 1's Outreach

Although investors would like more and better information, some investors mentioned that they do not anticipate that additional costs would be incurred by the auditors since, in the view of these investors, the auditor would only be reporting on work already conducted under the current scope of the audit. Conversely, during our outreach to auditor representatives these representatives believed additional cost would be incurred to cover additional review, develop a report and to address potential liability exposure, at a minimum.