<u>APPENDIX A</u>

"Enhancing the Value of Auditor Reporting: Exploring Options for Change"

1. **<u>Do respondents have any comments about the issues identified in Section II regarding the perceptions of auditor reporting today?</u>**

   We agree there may be an expectation gap regarding the perception of auditor reporting; and additionally, an information gap may exist. There are discussions of the roles and responsibilities of external auditors in conducting financial statement audits, detecting fraud, assessing risks and responding to warning signs in the context of the recent global financial crises. However, the solution should not cause the auditor to assume the responsibilities of management nor the governance body (such as boards of directors, hereinafter referred to as the Directors) by determining how much of the entity's competitively sensitive information and not-yet public information should be disclosed. The financial statement auditor should retain its independent, **objective**, assurance responsibilities and not be put in a position to make determinations on the timing of disclosure of certain information before management and the Audit Committee deem it appropriate.

   While an important factor for making investment decisions, auditor reporting is only one element of the broader corporate reporting process which also includes disclosures about an entity's financial condition and operating results and a wide range of other non-financial information and made available in a variety of ways, including through formal public filings. Also, users of financial statements are presumed to have the competence to understand a broad set of critical information that influences investment decisions.

   The four pillars of quality financial reporting are: the legal environment, regulatory infrastructure, corporate governance and external auditors. While external audit plays an important role and is an essential part of the regulatory and supervisory infrastructure, it is only one of the key pillars of quality financial reporting. Feedback received provides compelling reasons for external audit to close the expectation gap. However, these efforts alone cannot address the user's concerns and full range of issues identified. Continuous improvement in financial reporting requires an ongoing commitment by regulators, investors and other users, standard-setters and policy makers to review and strengthen the components of the financial reporting infrastructure process that they influence.

   We believe that the regulators should highlight the use of internal audit activities as a complement to the other pillars, in particular the corporate governance and independent auditor's responsibilities. The company's Directors should ensure that the internal audit activity is able to retain its objectivity from management's influence.

2. **A) <u>If respondents believe changes in auditor reporting are needed, what are the most critical issues to be addressed to narrow the information gap perceived by users or to improve the communicative value of auditor reporting?</u>**

It is important to recognize that the auditors should not be solely responsible for narrowing the information gap. It requires a concerted effort of all those involved in the governance and disclosure processes, management and the Directors, as well as the regulators who set the rules and the financial reporting infrastructure.

For external auditors, the most critical issues are to be transparent about the processes behind the output of an audit. The external auditor's report should include information about the nature of an audit, including its objectives, and the auditor's ability to detect financial statement fraud, the auditor's responsibilities relating to fraud under existing professional standards, and inherent limitations of an financial statement audit. The information should be communicated in plain English, free of technical jargon and boiler plate language. Additionally, users would benefit from an additional paragraph to the financial statement auditor's report describing their responsibility with respect to other information included in the document with the financial statement filing For example, their ability to detect financial statement fraud, their responsibilities relating to fraud under existing professional standards, and inherent limitations of financial statement audits and a statement that the external auditor has read [external auditor should note the specific areas] and found such information and disclosures to be materially consistent with information the external auditor observed as part of the financial statement audit.

The auditor should state clearly if they relied on third parties in respect to their comments. In addition, auditors should offer comments as to whether management has appropriate steps in place to prevent fraud.

B) <u>Which classes of users are, in the view of respondents, most affected by these issues?</u>

There are many users of financial statements. It is important to consider who is paying the costs and who is benefitting from the audited financial statements and related disclosures. Those who seek assurance on all types of information may not be the ones to bear the costs.

Institutional investors, large investors, and financial analysts who have responsibilities to their constituents and use the information to make or influence investment decisions, as well as standard-setters and regulators who have oversight and rule-making responsibilities are most affected by these issues. The financial crisis also showed that financial institutions and insurance companies need more than a technical assurance on the way in which the financial statements have been prepared and presented. We are not certain that the external auditor should be the "first line of defence" for such matters.

<u>C) Are there any classes of users that respondents believe are unaffected by these issues?</u>

No, all are affected; however, the extent differs on the various classes of users.

3. <u>Do respondents believe that changes are needed for audits of all types of entities, or only for audits of listed entities?</u>

We agree that it is difficult to draw clear and consistent boundaries between entities on the basis of size as well as between different countries or jurisdictions. In fact, doing so may cause a greater expectation gap and further confusion. As a matter of principle, we believe in having a consistent auditor reporting baseline for all types of entities, regardless of their size, countries or jurisdictions. More stringent industry or country requirements could override the baseline requirements. However, as corporate governance regulations mostly cover listed companies and investors in most cases are international, changes should only cover listed companies. Changes will impact the costs related to the audits, therefore I fully agree that changes should just cover listed companies.

4. **<u>Respondents are asked for their reactions to the options for change regarding the format and structure of the standard auditor‘s report described in Part A. Do respondents have comments about how the options might be reflected in the standard auditor’s report in the way outlined in Appendix A of this Consultation Paper?</u>**

The auditor’s report remains a stand-alone communication from the independent auditor. We believe that a third option (Report on auditing procedures required by ISA 720) would be most appropriate from a perspective of the users. It should lead with the audit opinion, significant matters, auditor’s review of other information, report on other legal and regulatory requirements, and close with the standard information about the audit and auditor’s and management’s responsibilities for the financial statements.

5. **<u>A) If the paragraphs in the current standard auditor’s report dealing with management and the Auditor’s responsibilities were removed or re-positioned, might that have the unintended consequence of widening the expectations gap?</u>**

We don’t believe that the auditor’s report should be re-positioned. However, as to change considerations, the auditor’s and management’s responsibilities should not be removed and repositioning the nature of an audit and role of auditor should not widen the expectations gap, so long as the information is reasonably accessible to a reader of the auditor’s report.

<u>B) Do respondents have a view regarding whether the content of these paragraphs should be expanded?</u>

If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor’s judgment is relevant to the auditor’s responsibility or the auditor’s report, this could be presented in another paragraph. We believe that it is important to keep the language on a generic level. We also recommend adding the Oversight Role of Those Charged with Governance.

6. **<u>Respondents are asked for their reactions to the possibility that the standard auditor’s report could include a statement about the auditor’s responsibilities regarding other information in documents containing audited financial statements. Do respondents believe that such a change would be of benefit to users?</u>**

Yes. As exists today, the auditor is required to review other information that is included in a document containing audited financial statements to determine whether such information and disclosures are materially consistent with information acquired as part of the financial statement audit. The auditor's report should include a statement about the auditor's responsibilities regarding "other information" and specifying such "other information."

7. **<u>If yes, what form should that statement take?</u>**

<u>A) Is it sufficient for the auditor to describe the auditor's responsibilities for other information in documents containing audited financial statements?</u>

Yes. The auditor is responsible for reporting material inconsistencies between the disclosure and the financial statements or any apparent material misstatements in "other information" and should inform the users of these responsibilities.

<u>B) Should there be an explicit statement as to whether the auditor has anything to report with respect to the other information?</u>

Yes. The auditor should make an explicit statement as to whether the auditor has anything to report with respect to the other information, if yes; the auditor should identify any material inconsistencies in "other information" with the audited financial statements, as required by the ISA.

8. **<u>Respondents are asked for their views regarding the auditor providing additional information about the audit in the auditor's report on the financial statements.</u>**

In general, we support providing additional information about the audit that would enhance the user's understanding of the audited financial statements and enable them to make informed investment decisions. The volume and relevance of additional information should be balanced with the risk of confusing or diluting the attention of the users and duplicating disclosures provided by management.

The items which would warrant specific auditor mention include the following (in each case, the auditor's report should refer to management's disclosure which would be expected to be adequate unless otherwise noted by the auditor):

1. If the entity is a part of a larger enterprise.
2. If GAAP in an area material to the entity is undefined, evolving or there are significant divergences in practice.
3. Areas of significant leverage or exposure (derivatives, off balance sheet commitments, contingencies, etc.) which are not included in the gross figures displayed on the balance sheet.
4. Disclosures by the entity are deemed by the auditor to be inadequate.
5. Material, unusual transactions impacting the financial statements.

9. **<u>Respondents are asked for their reactions to the example of use of "justification of Assessments" in France, as a way to provide additional auditor commentary.</u>**

The perceived benefits of using "justification of Assessments" can be achieved by integrating these concepts into the proposed enhancements in disclosure by management or the Directors. The challenges and difficulties of implementing "justification of Assessments" "as is" are substantial.

10. **<u>Respondents are asked for their reactions to the prospect of the auditor providing insights about the entity or the quality of its financial reporting in the auditor's report.</u>**

We believe that the auditor should not be required to communicate such matters in their report on the financial statements.

Additionally, many of these matters should be discussed by the external auditors and also brought to the Director's and management's attention through work done by internal auditors.

If the Directors and management had received and read an internal audit report identifying certain deficiencies, the Directors and/or management should consider communication to users of the financial statements.

11. **<u>Respondents are asked for their reactions to the options for change relating to an enhanced model of corporate governance reporting, as described in Section III, Part D.</u>**

We support the proposed model. We believe that information about key areas of risk of material misstatement in the financial statements, critical accounting estimates and management judgments, as well as management's selection and application of accounting policies could provide greater transparency when communicated by management or those charged with governance. This information would be subject to the external auditor's responsibilities with respect to "other information" which is included in a document contain audited financial statements.

12. **<u>A) To the extent that respondents support this model, what challenges may be faced in promoting its acceptance?</u>**

One potential challenge is for the external auditor to render an opinion about the reasonableness and completeness of the audit committee's report, since the audit committee has oversight responsibility for the external auditor. And even further it is the auditor who has to give an opinion on the governance process of the organization (e.g. how does the Board fulfill its job); not an easy task.

<u>B) Also, what actions may be necessary to influence acceptance or adoption of this model, for example, by those responsible for regulating the financial reporting process?</u>

Adoption or revision of accounting and financial reporting regulations by appropriate regulatory bodies will be required.

13. **Do respondents believe assurance by the auditor on a report issued by those charged with governance would be appropriate?**

There is a risk with such a reporting model. The auditor could be criticized for, and could influence the user's view of an auditor's objectivity, particularly if the auditor started to disclose in lieu of management. If the auditor's views are open to public disclosure, information flows to and from the auditor might diminish.

In addition, costs and benefits of implementing the enhanced reporting model warrant consideration, together with the parties bearing the costs and those savouring the benefits.

14. **Respondents are asked for their reactions to the need for, or potential value of, assurance or related services on the type of information discussed in Section III, Part E.**

It is inappropriate to expect external auditors to be involved in, or provide assurance on the range of items listed in paragraph 88, except that is appropriate to expect auditors to report on internal controls and financial reporting processes, so long as there are clear regulations that management is responsible for establishing and testing such controls and processes.

Internal audit supports the Directors with information regarding the company's control environment, industry conditions, and operating characteristics of the company which could aid in their reporting.

15. **What actions are necessary to influence further development of such assurance or related services?**

Directors should coordinate the development of these assurance activities with management and internal audit.

16. **Respondents are requested to identify benefits, costs and other implications of change, or potential challenges they believe are associated with the different options explored in Section III.**

The costs would appear to outweigh the benefits, in part because the benefits have not been well-defined. However, more appropriate cost benefit balance can be gained with more effective use of and higher expectations by the Directors of the internal audit activity, including consideration of and coordination with financial statement audit needs. We caution that additional financial reporting matters should not distract from internal audit's responsibilities.

Changes to the financial statement auditor's report should be limited to a) additional explanatory information when warranted, b) state the auditor's responsibility with respect to other information included with the financial statements (either as is current practice by reading for material inconsistencies or omissions, the auditor‘s ability to detect financial statement fraud, the auditor‘s responsibilities relating to fraud under existing professional standards, and inherent limitations of an financial statement audit, and c) reference to clarifications of various terms and concepts used in the auditor’s report and a description of an audit.

The response to this request would be wide ranging as the external auditor’s responsibilities and reporting differs between countries and industries as laws and regulations vary by country, along with a wide range of expectations. Suffice it to say any changes by the IAASB should serve to increase quality and should not cause the external auditor to assume the responsibilities of management nor the Directors. The external auditor should retain its independent, objective, assurance responsibilities and not be put in a position to make initial determinations on the timing of disclosure of certain information.

17. **Do respondents believe the benefits, costs, potential challenges and other implications of change, are the same for all types of entity? If not, please explain how they may differ.**

The potential challenges and repercussions of the full spectrum of options discussed in Section III could be wide ranging as the external auditor’s responsibilities and reporting differs between countries and industries as laws and regulations vary by country, along with a wide range of expectations.

18. **A) Which, if any, of the options explored in Section III, either individually or in combination, do respondents believe would be most effective in enhancing auditor reporting, keeping in mind benefits, costs, potential challenges, and other implications in each case?**

The auditor should have clear and robust communications with the Audit Committee on numerous matters. The Directors/Audit Committee is responsible for disclosing appropriate information. Additionally, please see response to item 16 above.

B) In this regard, do respondents believe there are opportunities for collaboration with others that the IAASB should explore, particularly with respect to the options described in Section III, Parts D and E, which envisage changes outside the scope of the existing auditor reporting model and scope of the financial statement audit?

IAASB should collaborate with groups such as OECD, NACD, PCAOB, SEC, IIA, and King III of South Africa regarding corporate governance and IIA and King III on combined assurance, assurance or related services on other information or matters not within the scope of the financial statement audit.

19. **Are there other suggestions for change to auditor reporting to narrow the “information gap” perceived by users or to improve the communicative value of the auditor’s report?**

It is extremely important that investors define that information which is deemed “more relevant and useful” to fill the information gap; then this can be communicated to the

Directors so they can execute the responsibility of accurately and completely disclosing such relevant and useful information. The Directors and management should decide what information to disclose in the financial statements and/or related attachments, potentially including information which was disclosed by the auditor to management and the Directors.

The external auditor should not be responsible for filling the information gap. Furthermore, potential inclusion of subjective information by an auditor to the public is not appropriate. The financial statement auditor role is differentiated from the current typical role of and disclosures by the internal audit activity which, while retaining objectivity, should share subjective judgments with management and the Board and as appropriate, unframed personal views with its constituents. The sharing of such subjective information in an external environment is inappropriate, because the users do not possess the same contextual knowledge, lack the ability to discuss information in a two-way dialogue to gain clarity, and do not know the competency and reliability of the person(s) expressing the judgments.

An entity's governance structure warrants further consideration and potential changes to regulations. These would include:

1. The Directors - We suggest disclosure of its governance and responsibilities in documents which include management disclosures, interactions between the Directors and financial statement auditor, and guidance to Directors as to consideration of additional disclosures, and possibly of its interactions surrounding key areas of discussion with management and with auditors, both financial statement auditors and the entity's internal audit activity.
2. Internal Audit - IAASB should consider the implications more effective use of and higher expectations by the Directors of the internal audit activity, including consideration of and coordination with financial statement audit needs. The internal audit activity could report to the Directors on certain matters, in some cases in lieu of the external auditor. These could include a) testing controls (financial reporting, operational), b) assurance provided on other specified information (possibly in lieu of the external auditor, c) Information bearing on the independence and objectivity of the internal audit activity, d) Earnings releases (in lieu of external auditor).

   Lastly, there must be a consideration of costs and benefits related to levels of assurance. It would be reasonable to expect that if additional disclosures were required of the independent auditor, audit fees would surely rise. The Board should consider who is paying the costs and who is deriving the benefits; there are many users of financial statements and related information who may seek to influence the Board's views on assurance; some of those users may not be concerned with or consider the costs of such assurance.