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Dear Sirs,

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

#### ***Introduction***

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance is a founder member of European **Issuers**, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Financial Reporting and Corporate Governance Expert Groups have examined your proposals and advised on this response. A list of members of the Expert Groups is at Appendix A.

#### ***Response***

We welcome the opportunity to respond to this consultation. As outlined in our answers to the questions below, we have some reservations about the proposals in their current form, but we do believe that the IAASB proposals are a step in the right direction in addressing the concerns of users.

We would note that any cost/benefit analysis for changes to the auditor's report should be evaluated in particular for small and mid-size quoted companies, which have much less resource available to them. Overall, we believe that any changes should be proportionate for smaller companies and take into consideration their size and complexity.

#### **Overall Considerations**

**1. Overall, do you believe the IAASB's suggested improvements sufficiently enhance the relevance and informational value of the auditor's report, in view of possible impediments (including costs)? Why or why not?**

We believe that the IAASB should consider whether it is appropriate to mandate a single solution across the globe. Whilst the aim of providing users with more information about the audit process is a laudable one national standard setters should retain the ability to implement it as they see fit. In a UK context this may well be by encouraging greater disclosure from audit committees.

The Quoted Companies Alliance is the independent membership organisation that champions the interests of small to mid-size quoted companies.

**2. Are there other alternatives to improve the auditor’s report, or auditor reporting more broadly, that should be further considered by the IAASB, either alone or in coordination with others? Please explain your answer.**

We believe that the IAASB should not consider auditor reporting in isolation. Both company management and those charged with governance have obligations in respect of the preparation of accounts, making accounting judgements, setting estimates and overseeing the audit process and we would like to see the IAASB consider these disclosures, as well as the audit report, in a more holistic approach to improved reporting.

**Auditor Commentary**

**3. Do you believe the concept of Auditor Commentary is an appropriate response to the call for auditors to provide more information to users through the auditor’s report? Why or why not? (See paragraphs 35–64.)**

Whilst we support the aim of the IAASB’s proposals, to provide users of financial statements with greater information, we are concerned that the Auditor Commentary, as currently defined, would result in an auditor initiating disclosure on the company.

In our opinion the inclusion of an Auditor Commentary should be part of a wider revision of company reporting. Under IAS 1 Management should disclose significant areas of estimate and judgement and in many jurisdictions those charged with governance (‘TCWG’), often in the form of Audit Committees, are encouraged or required to report on how they have exercised their oversight role. We would encourage the IAASB to work with national standard setters and the International Integrated Reporting Committee in considering how to ensure that the disclosures given by Management, TCWG and auditors are clear and their respective responsibilities not blurred.

If an Auditor Commentary is considered necessary it should enhance the disclosures made by TCWG by discussing the auditor’s procedures in significant risk areas but should not seek to replace these disclosures. The auditor should retain the right to include additional information in the Auditor Commentary if, in the auditor’s opinion, the disclosure provided elsewhere is either misleading or omits material facts concerning the audit process.

We would also encourage the IAASB to be clear about who any commentary is addressed to. An audit report is addressed to the members of the company yet this question and the Invitation to Comment consistently make reference to ‘users’, a much wider group than just the members and consequently a group likely to have a wider range of concerns. Being clear on this point is important if the contents of the commentary are to be left to an auditor’s judgement.

**4. Do you agree that the matters to be addressed in Auditor Commentary should be left to the judgment of the auditor, with guidance in the standards to inform the auditor’s judgment? Why or why not? If not, what do you believe should be done to further facilitate the auditor’s decision-making process in selecting the matters to include in Auditor Commentary? (See paragraphs 43–50.)**

Please see our response to Question 3.

**5. 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? (See paragraphs 58–61.)**

To be useful any disclosure in the Auditor Commentary should provide an insight into the auditor's procedures and not merely cross references to notes to the accounts, for this reason we do not feel that the disclosure given on Outstanding Litigation and Goodwill is useful to users. Additionally we do not feel that the auditor should be initiating disclosure on the company, except in the circumstances noted in our answer to question 3, and consequently we are concerned that the disclosure on Revenue is inappropriate. We do, however, consider that the disclosure on Financial Instruments gives a user an insight into the audit process and is therefore appropriate.

We are concerned with the wording concerning Other Auditors. Firstly we are concerned that such a disclosure may be seen as a way for the group auditor to disclaim part of their opinion, or be seen as such by users of the financial statements. Secondly we believe that such disclosure should be made by TCWG, explaining to shareholders their choice not only of group auditors but also the auditors of significant components. TCWG should also explain how they assess and monitor audit quality for both the group auditors and those of significant components.

**6. What are the implications for the financial reporting process of including Auditor Commentary in the auditor's report, including implications for the roles of management and those charged with governance (TCWG), the timing of financial statements, and costs? (See paragraphs 38 and 62–64.)**

There are likely to be both time and cost implications. An Auditor Commentary is likely to be a sensitive disclosure and will need to be discussed with both Management and TCWG, this will need to be factored into the audit timetable and will have additional cost implications. The additional cost is difficult to quantify and will depend on the issues raised and their complexity.

**7. Do you agree that providing Auditor Commentary for certain audits (e.g., audits of public interest entities (PIEs)), and leaving its inclusion to the discretion of the auditor for other audits is appropriate? Why or why not? If not, what other criteria might be used for determining the audits for which Auditor Commentary should be provided? (See paragraphs 51–56.)**

We acknowledge that the proposals will be of benefit to users but, particularly for small and mid-size companies, the costs could well outweigh those benefits. Consequently we believe that the proposals should be voluntary for all listed companies on a 'comply or explain' basis. It would then be left up to the discretion of TCWG, where appropriate in discussion with users of the financial statements, to decide whether to adopt the proposals. Where a listed company has not applied the proposals they should explain why not.

Additionally we do not believe that the inclusion of an Auditor Commentary should be discretionary for other entities; in these circumstances companies, or other stakeholders, could perceive the inclusion of a commentary to be akin to a modified report. Additionally for many private companies there is likely to be less of a division between those charged with governance and the shareholders hence the costs of the additional reporting may well outweigh the benefits. Consequently we do not support the extension of the Auditor Commentary beyond public interest entities.

We also note that a definition of a public interest entity, other than being a listed company, has not been given. We would question whether all listed companies are automatically public interest (many small and mid-size quoted companies may not have widely held shares and would not pose a systemic risk) and consider that other organisations whose shares are not listed may well meet the definition of being public interest. We are also concerned that there is a risk that there will emerge multiple definitions of public interest entities (the EU is looking at a size based definition, the Audit Inspection Unit in the UK has a wider definition), which could cause confusion amongst users.

### **Going Concern/Other Information**

**8. What are your views on the value and impediments of the suggested auditor statements related to going concern, which address the appropriateness of management’s use of the going concern assumption and whether material uncertainties have been identified? Do you believe these statements provide useful information and are appropriate? Why or why not? (See paragraphs 24–34.)**

Whilst these disclosures would seem to address a need highlighted by users, we are concerned that an expectation gap will remain over an auditor’s responsibility in this area. The example disclosure makes it clear that the statement is “not a guarantee as to the Company’s ability to continue as a going concern”; however, we note the result of the academic studies which suggest that such caveats do not help close the expectation gap and may even widen it (see in particular the study “Financial Statement Users’ Perceptions of the IAASB’s ISA 700 Unqualified Auditor’s Report in Germany and the Netherlands”). Indeed we are concerned that including this as a separate area in the audit report gives the impression that the auditor has provided an explicit and direct sign off on the company’s ability to continue as a going concern. Given the danger of this expectation gap, we do not believe that these disclosures are appropriate to be provided by the auditor, but would suggest that the IAASB considers whether Management should provide greater disclosure in this area.

**9. What are your views on the value and impediments of including additional information in the auditor’s report about the auditor’s judgments and processes to support the auditor’s statement that no material uncertainties have been identified? (See paragraphs 30–31.)**

The disclosure envisaged is likely to be highly commercially sensitive and could well have a detrimental impact on the company by providing, for example, significant suppliers, customers or even employees with enhanced bargaining power if a reliance on them was identified or inferred. Consequently we consider the impediments too great to justify the additional requirement. As noted above we would continue to encourage more disclosure by company management on the basis on which they consider it appropriate to adopt the going concern assumption, the IAASB should consider the work of the UK’s Financial Reporting Council in this area.

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

The suggested statement merely makes more explicit the existing responsibility of the auditor. We note again the risk of increasing the expectation gap but given the existing wording in the audit report consider this to be less significant than in respect of going concern. We would recommend that the IAASB and national standard setters consult further as to whether users would value a more explicit statement being provided by the auditors on the other information presented in an annual report.

Overall we would recommend that all comment relating to the audit opinion (going concern and responsibilities regarding other information) are given adjacent to the opinion.

### **Clarifications and Transparency**

**11. Do you believe the enhanced descriptions of the responsibilities of management, TCWG, and the auditor in the illustrative auditor’s report are helpful to users’ understanding of the nature and scope of an audit? Why or why not? Do you have suggestions for other improvements to the description of the auditor’s responsibilities? (See paragraphs 81–86.)**

As noted above we question, based on the academic studies, whether lengthening the report in this respect will close the expectation gap and result in greater clarity on the relative responsibilities in the minds of users. We would prefer such boilerplate narrative is removed from the report and replaced by a clear cross reference to where such information can be found (as is currently possible in the UK).

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

In many countries, including the UK, this is already disclosed and in our experience no serious impediments have been identified in doing so.

**13. What are your views on the value and impediments of the suggested disclosure regarding the involvement of other auditors? Do you believe that such a disclosure should be included in all relevant circumstances, or left to the auditor’s judgment as part of Auditor Commentary? (See paragraphs 77–80.)**

We do not agree that this disclosure is required and it should not automatically be included in the Auditor Commentary. By including the disclosure the impression is given that, contrary to ISA 600, an auditor is seeking to give some responsibility for the opinion to another auditor. By automatically including it in the Auditor Commentary, along with significant risks, the impression is created that having more than one auditor in the group is a risk. This could result in increased pressure for the use of one audit firm across the group.

We do, however, acknowledge that this might be an area of interest to users, but would suggest that this should be disclosed by TCWG as part of their report on the assessment of the group’s auditor and their oversight of the audit process.

**14. What are your views on explicitly allowing the standardized material describing the auditor’s responsibilities to be relocated to a website of the appropriate authority, or to an appendix to the auditor’s report? (See paragraphs 83–84.)**

Consistent with our answer to question 11, we would encourage the relocation of such material to a website and a suitable cross reference being provided.

### **Form and Structure**

**15. What are your views on whether the IAASB’s suggested structure of the illustrative report, including placement of the auditor’s opinion and the Auditor Commentary section towards the beginning of the report, gives appropriate emphasis to matters of most importance to users? (See paragraphs 17–20.)**

The relocation of the opinion paragraph to the beginning of the report has been a consistent demand of users from the evidence presented. Given this we support the suggested structure.

**16. What are your views regarding the need for global consistency in auditors' reports when ISAs, or national auditing standards that incorporate or are otherwise based on ISAs, are used? (See paragraphs 21–23 and 87–90.)**

Whilst a single global audit report is a laudable aim, it is unlikely to be practical given national variations in company law and business practice. We would therefore support national standard setters retaining maximum flexibility in deciding how best to implement to principals set forth by the IAASB. In the UK context this may well mean greater disclosure in Audit Committee Reports as opposed to an Auditor Commentary as envisaged by the IAASB.

**17. What are your views as to whether the IAASB should mandate the ordering of items in a manner similar to that shown in the illustrative report, unless law or regulation require otherwise? Would this provide sufficient flexibility to accommodate national reporting requirements or practices? (See paragraph 17 and Appendix 4.)**

To encourage consistency wherever possible, it would be helpful for audit reports to be ordered in a similar manner unless prohibited by local law or regulation.

**18. In your view, are the IAASB's suggested improvements appropriate for entities of all sizes and in both the public and private sectors? What considerations specific to audits of small- and medium-sized entities (SMEs) and public sector entities should the IAASB further take into account in approaching its standard-setting proposals? (See paragraphs 91–95.)**

As noted in our answer to question 7, we would question whether the additional benefits of the Auditor Commentary are outweighed by the costs for private entities and the same concern would apply to the additional disclosure on going concern and other information. Other areas of the report should be as consistent as possible with the report provided by public interest entities and hence the other suggestions made by the IAASB, such as moving the opinion paragraph, should apply to all companies.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'T. Ward', with a stylized flourish at the end.

Tim Ward  
Chief Executive

**List of Expert Group Members****Financial Reporting Expert Group**

Anthony Carey, Mazars LLP (Chairman)  
Anthony Appleton, PKF (UK) LLP  
Edward Beale, Western Selection Plc  
Peter Chidgey, BDO LLP  
Jack Easton, UHY Hacker Young  
Bill Farren, Deloitte LLP  
Jonathan Ford, PricewaterhouseCoopers LLP  
David Gray, DHG Management  
Usman Hamid, Ernst & Young LLP  
Shalini Kashyap, Ernst & Young LLP  
James Lole, RSM Tenon Group PLC  
Jonathan Lowe, Baker Tilly  
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David Fuller, CLS Holdings PLC  
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