

# IAASB Explores Way to Improve Value of Auditor's Report for Stakeholders



An auditor's report is the mouthpiece of the auditor. An auditor's report is as dynamic as the audit profession itself. Designing an audit report that would match the changing landscape of the global business environment, growing complexities of financial reporting, and the changing face and geographical spread of the stakeholders and their information needs and demands, has always been high on the agenda of the auditing standard setters across the globe. Although, the auditor's opinion on the financial statements was and still remains the most important and critical information that is contained in the auditor's report, over the period, a number of other information, such as the responsibility of the management *vis-a-vis* auditors, has been integrated with the audit reports, primarily with the aim of reducing the expectation gap. The Revised International Standard on Auditing (ISA) 700, *Forming an Opinion and Reporting on Financial Statements*, issued by the International Auditing and Assurance Standards Board under the Clarity Project was issued on these considerations.

The financial crises of 2008, which took down with it the banking and housing finance behemoths like the Lehman Brothers, Bear Stearns, Fannie Mae and the recent European sovereign debt crises, however, again threw up the fact that the audit report probably again needed a relook *vis a vis* expectations of the various stakeholders. The stakeholders have emphasised on the need for the auditors to "provide greater transparency about significant matters in the financial statements as also the conduct of the individual audit". The institutional investors and the analysts, particularly, have indicated that they were looking up to the auditors to assist them in demystifying the increasingly complex financial statements. They also want information on areas of auditor's work efforts, particularly, the most subjective matters within the financial statements.

Accordingly, this time, the focus of the standard setters in revising the format of the audit report would be more on "meaningful change" "rather than incremental change over time".

As a part of its project to identify improvements that may be required to the contents of an audit report so that it, and as a corollary, the audit itself, continues to retain its value among the various stakeholders, the International Auditing and Assurance Standards Board has recently issued an Invitation to Comment (consultation paper), *Improving the Auditor's Report*. Through this consultation paper, the IAASB is proposing certain important changes to the auditor's report. The proposed changes to the contents are based on a general agreement in the IAASB that at a macro level, the users of the auditor's report look for the following information:

- Matters that are, in the auditor's judgement, likely to be most important to user's understanding of the audited financial statements or the audit of public interest entities

(Contributed by Auditing and Assurance Standards Board Secretariat of the ICAI)

- Auditor’s conclusion on appropriateness of management’s use of going concern assumption
- Auditor’s statement on existence of any material inconsistencies between audited financial statements and other information

Accordingly, the IAASB is envisaging the following **new** sections in the auditor’s report.

**Going Concern**

The IAASB is proposing that the auditor’s report, having regard to the financial reporting framework, would contain along with appropriate caveats:

- A conclusion regarding the appropriateness of management’s use of the going concern assumption; and
- A statement regarding whether, based on the audit work performed, material uncertainties related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern have been identified.

This would be supported by a description of the management’s responsibilities with respect to going concern.

**Auditor Commentary**

The section on Auditor Commentary would contain those audit matters that in the auditor’s judgement, are likely to be most important to user’s understanding of the financial statements such as:

- Areas of significant management judgement (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 judgement in conducting the audit, for example:
  - o Difficult or contentious matters noted during the audit, or other audit matters that would typically be discussed with an engagement quality control reviewer or Those Charged with Governance ; and
  - o Other issues of significance related to the audit scope or strategy.

With the introduction of the section on Auditor’s Commentary, the IAASB envisages doing away with the concept of Emphasis of Matter and Other Matter paragraphs, as enunciated in the Standard on Auditing (SA) 706, *Emphasis*

*of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report*, issued by IAASB.

**Other Information**

Presently, the ISA 720, *The Auditor’s Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements*, requires the auditors to read the other information contained in the document containing audited financial statements to identify material inconsistencies, if any, with the audited financial statements. However, the Standard does not envisage any explicit statement in the auditor’s report with respect to this aspect. As per the IAASB’s current proposal, the auditor’s report would now contain an explicit statement to the effect whether, based on reading the other information, the auditor has identified material inconsistencies between the other information (to be clearly identified) and the audited financial statements. This, however, would need to be followed by a disclaimer that the auditor has not audited the other information as part of audit of financial statements.

**Other Proposals to Enhance Transparency about the Audit**

The Consultation Paper contains several other proposals aimed at enhancing the transparency about the audit using the auditor’s report. These are as follows:

**Disclosure of the Name of the Engagement Partner**

The extant ISA 700, issued by IAASB, requires that the audit report can be signed in the name of the audit firm or the engagement partner, or both, as appropriate in a particular jurisdiction. While in India, requirement to give the name of the engagement partner on the audit report dates long back, in many jurisdictions abroad, the audit reports are signed in the name of the audit firms only. In other words, there is no disclosure with respect to the name of the engagement partner. IAASB is now proposing that the audit reports now also disclose the name of the engagement partner so as to instill a greater sense of personal accountability.

  
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### **Statement of Compliance with Ethical Requirements**

Independence and objectivity are the foundations for the value that the stakeholders see in an audit and helps them draw an added measure of comfort from the auditor and auditor's work. Accordingly, the IAASB is proposing, that in all cases, including where the format of the audit report has been prescribed by a national law or regulation, the auditor give a statement in the auditor's report regarding auditor's compliance with the ethical requirements.

### **Involvement of Other Auditors**

It is not unusual in an audit engagement, particularly, where the auditor is auditing the financial statements of the parent entity, that the financial statements of all or some of the subsidiaries are audited by different auditors. The extant ISA 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, is based on the principal of sole responsibility of the parent auditor (the group auditor). Accordingly, it does not permit reference to the fact that the principal (group) auditor has also used the work of other (component) auditors in his work. On the other hand, the corresponding Indian auditing standard has a carve out, permitting the principal auditor to clearly bring out on the extent of other auditors' involvement on the face of the audit report. Similarly, the attest standard issued by the American Institute of Certified Public Accountants also provides an option to the principal auditor to make such disclosures in the audit report. This option has also been included, albeit as a mandate, in the proposed auditing standard issued by the Public Companies Accounting Oversight Board, USA.

IAASB is now exploring the possibility of inclusion of disclosure in respect of involvement of other auditors in the audit since it feels that this is a matter of audit significance. The disclosure could include amount of work performed by other auditors, whether affiliated or not, as also auditor's responsibility particularly in cases of group audit.

### **Auditor's Responsibility**

On suggestions from the auditors, regulators and preparers of financial statements, the IAASB is envisaging enhanced description of the auditors' responsibilities so as to bring in greater transparency about the audit process and understanding of the role of the auditor and nature of the audit work. Accordingly, IAASB suggests that the description of auditor's responsibility include an explanation of the concept of risk-based audit, responsibilities in relation to specific and critical matters such as fraud, internal controls, accounting policies and estimates, evaluating the overall presentation, structure and content of financial statement disclosures, group audits and communications with those charged with governance.

### **Responsibilities of Management and Those Charged with Governance**

IAASB is also envisaging enhanced description of the responsibility of the management and those charged with governance since the users' understanding of the auditors' responsibilities is influenced by their understanding of the responsibilities of the management and those charged with governance with respect to the financial statements.

### **Re-sequencing of Elements of Auditor's Report**

In addition, IAASB is evaluating the possibility of making some structural changes to the auditor's report through placement of the auditor's opinion and other entity's specific information in the auditor's report.

Sl.	Existing ISA 700	Proposed
01.	Title	Title
02.	Addressee	Opinion
03.	Management's responsibility for financial statements	Basis for Opinion
04.	Auditor's responsibility	Going Concern
05.	Opinion	Auditor Commentary
06.	Report on other legal and regulatory requirements	Other Information
07.	Auditor's signatures	Respective Responsibilities of Management, Those Charged with Governance and the Auditor
08.		Report on Other Legal and Regulatory Requirements
09.		Auditor's signatures

### **Comments Invited**

The full text of the Invitation to Comment is available on URL <http://www.ifac.org/publications-resources/improving-auditor-s-report>. The last date for sending comments is 7<sup>th</sup> October 2012. Comments can be submitted through the link <https://www.ifac.org/login?return=publications-resources%2Fsubmit-comment%3Fexposure-draft%3D18332>. ■