

Auditor Reporting (Agenda Item 4)

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IAASB Meeting
March 13-16, 2012

Outline

- Project Objectives and Scope
- Timing
- Task Force and Subcommittee Structure
- Decision Making – Value and Impediments
- Objective of the March 2012 IAASB Meeting
- Recap of the March 2012 IAASB CAG Meeting
- Subcommittee Discussions
- Plans for Outreach and Consultation
- Recap of the March 2012 IAASB Meeting

Project Objectives and Scope

- Auditor Reporting project with a broad mandate and an accelerated timetable aimed at:
 - Enhancing the communicative value of the auditor's report and narrowing the information gap
 - Determining essential matters about the audit that should be communicated to users, while accommodating national regimes
- Determine core elements that are suitable for a global auditor's report under a Revised ISA 700 for all entities
- Determine additional elements that may be suitable based on the type of entity
- Provide flexibilities in format and content to accommodate additional or different jurisdictional reporting requirements, including corporate governance reporting

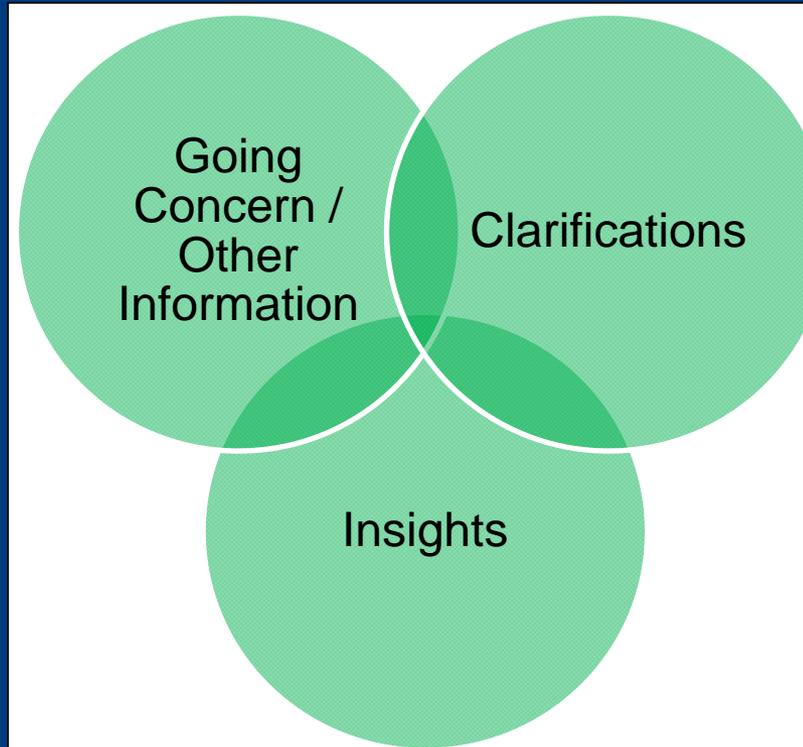
Timing

- 'Consultation paper' demonstrating substantial progress and innovative IAASB thinking on critical issues in June 2012
- Exposure drafts of Revised ISA 700 (others as identified) targeted Q2 2013
- Final standards targeted Q4 2014
- Need for coordination with others in national jurisdictions progressing their own initiatives

European Commission	US PCAOB
Parliament to consider the proposals through mid-2013 to finalize directive or regulation	Proposed rule Q2 2012 Reproposed or final rule Q4 2012

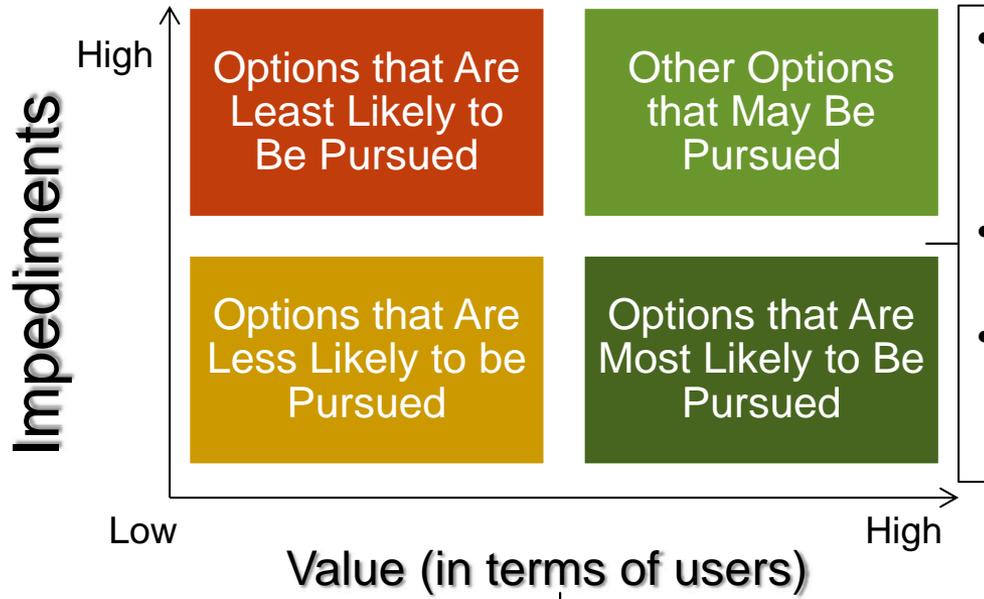
Task Force and Subcommittee Structure

Building Blocks



- Task Force comprised of Subcommittee Chairs, tasked with exploring specific issues with their subcommittees
- **13 / 18** IAASB members involved in TF and SCs
- Structure has enabled the Task Force to make substantial progress in a short period of time
- Will continue at a minimum through June 2012

Decision Making – Value and Impediments



- Does the option go beyond the current scope of the audit? If so, at what cost and to what extent would changes to other ISAs be needed?
- Can the option be operationalized by auditors?
- Does the option raise questions about management's primary responsibility for the financial statements and the auditor's assurance role?

- Enhances the communicative value of auditor reporting (addresses the information gap)
- Enhances transparency about the audit (narrows the expectations gap)
- Provides appropriately tailored language vs. boilerplate

Overarching Considerations: To be mindful of the links to audit quality, remain as open as possible in considering options for change, and think about what might be needed to make options feasible to respond to user demands – including options that may have high impediments but also have high value.

Objective of the March 2012 IAASB Meeting

- With a view towards the approval of a consultation on auditor reporting at the June 2012 IAASB meeting
 - To consider the recommendations of the TF and make tentative decisions on preferred options as a basis for further work by the TF and SCs
 - To highlight areas for further consideration, including those that require outreach with key stakeholders
- Be open to creative thinking and innovative ways to respond to user demands
- Focus on major issues where directional input, and reactions to proposed options, from stakeholders will be important
 - Relevant discussions with the IAASB CAG and EC will be highlighted

Objective of the March 2012 IAASB Meeting (cont.)

- Key questions
 - Do the proposals appropriately respond to user needs and calls for change?
 - Does the IAASB agree with the TF's preferred options? Are there new options to consider?
 - Does the IAASB agree with the TF's characterization of value and impediments for each option?
- During the meeting, IAASB and SCs will also be asked to
 - Consider illustrative report(s) incorporating the TF's proposals
 - Identify key points of focus for the June consultation
 - Consider a preliminary plan for outreach pre- and post-June and confirm its appropriateness

Recap of the March 2012 IAASB CAG Meeting

- Positive reaction to progress and innovative thinking
- Agreement to maintain the current scope of an ISA audit
- Support for Building Blocks approach
 - Need to ensure that different reports for SMEs is not seen as a change from “an audit is an audit”
 - Recognition of the challenges of conditional requirements for PIEs in light of varying national definitions – but need to explain during consultation how PIEs have been taken into account / can be accommodated
- Confirmation of the need to consult with illustrative report(s)
- Suggestion to progress as rapidly as possible
 - To be in a position to influence the finalization of the EC proposals

Subcommittee Discussions

Insights (Agenda Item 4-A)

Why the Need for Auditor Commentary? (Para. 3-5)

- Users believe auditors have valuable information as a result of the audit that could be shared externally, based on
 - What is discussed with TCWG to enable them to discharge their responsibilities
 - What is documented in the audit summary memo
- What do users really want to know about? It varies!
 - Risks of material misstatement (ROMM)
 - Other areas of significant audit effort and significant auditor judgments
 - Significant management judgments?
 - Other matters?

What Other Developments Are Relevant? (Para. 1-2)

- EC proposals to identify key areas of ROMM of the financial statements, including critical accounting estimates or areas of measurement uncertainty
- PCAOB considering options such as expanded use of emphasis paragraphs and Auditor Discussion and Analysis
- UK FRC exploring reporting by TCWG, with a statement in the auditor's report about the completeness and reasonableness of that report

How to Decide When Auditor Commentary on a Matter Should Be Included? (Para. 6-14)

- Need for auditors to have flexibility to comment on matters that may not be significant risks but have a high ROMM (e.g., EC proposals)
- Should the auditor always comment on certain matters?
 - Sources of estimation uncertainty / critical accounting estimates?
 - Concerns relating to the application of accounting policies?
 - Significant internal control deficiencies?
- Flexible criteria is needed to allow for auditor judgment in the context of the engagement
 - But detailed guidance needed to enable consistency in practice and demonstrate how national requirements can be taken into account

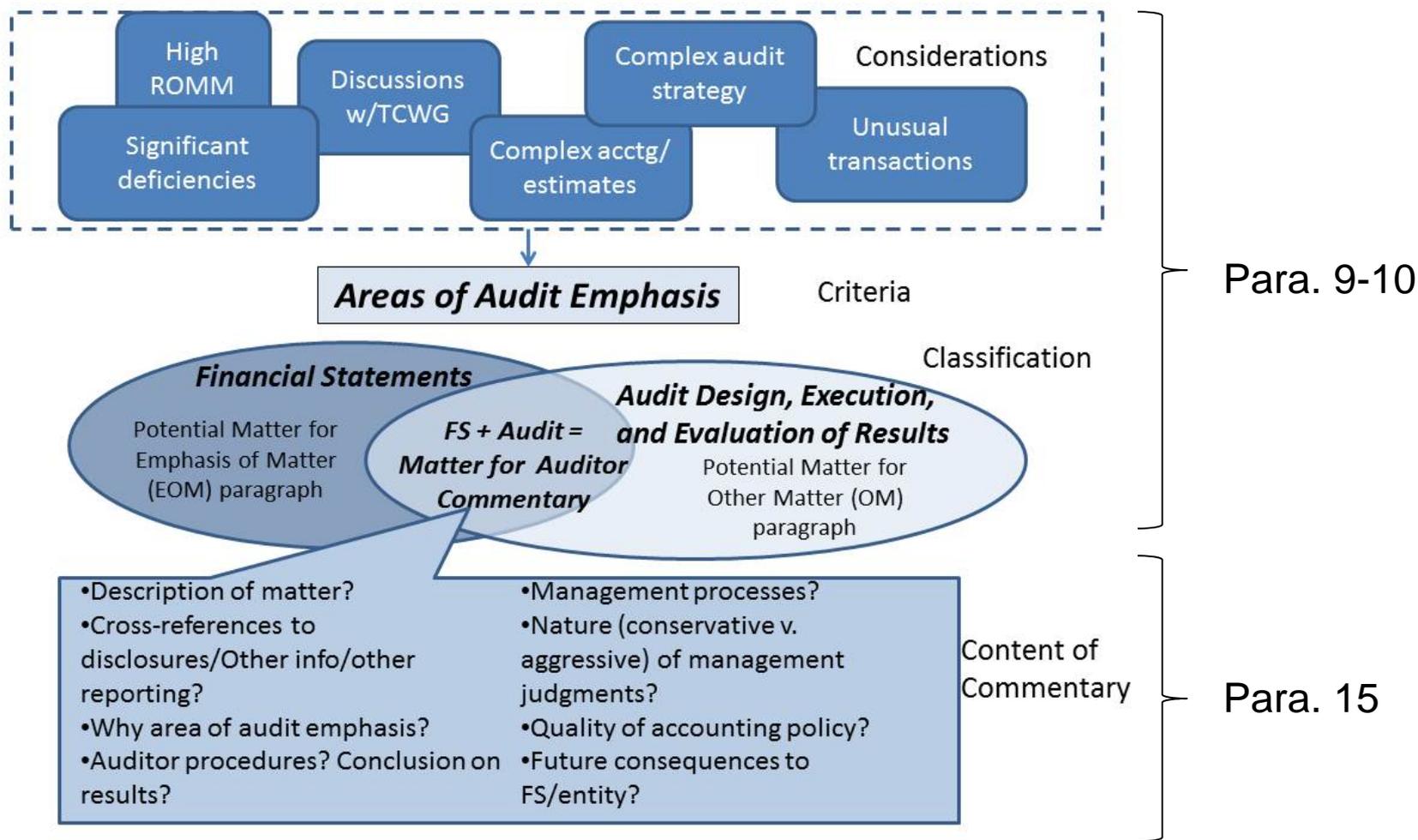
Overarching Consideration (Para. 15-17, 30-32)

- What additional information is the auditor best suited to provide?
 - Likely depends on what may be included – more on that later
 - Can auditors meet user needs without overstepping the role of management and TCWG?
 - What if such information is communicated by TCWG, such as proposed in the UK?
- Building blocks approach intended to allow for flexibility in national regimes where some form of auditor commentary is required to be provided (Agenda Item 4-E)

Matters for IAASB Consideration

- Do you agree that auditor commentary in some form is needed to respond to users' calls for more relevant and transparent information in the auditor's report?
- How can the IAASB lead change in this area?
 - Need to be bold and progressive in our thinking
 - Seize the opportunity to ensure the auditing profession and the audit itself retain relevance and deliver value to users

Auditor Commentary – Proposed Requirements for Criteria and Content



Task Force Recommendations (Para. 9-10, 18, Appendix 1)

- Auditor commentary should address areas of audit emphasis
 - Broader than significant risks, but significant risks should always be considered along with other areas of high assessed ROMMs
 - Areas of significant audit effort and significant auditor judgments
 - Significant management judgments?
 - Unusual transactions, restatements, and other significant changes
- Need to ensure ISA 260 requires these communications be made internally before externally
 - Some respondents to the IAASB's CP believed this communication could encourage management and TCWG to improve their disclosures

Does the IAASB agree with these recommendations?

What Does Auditor Commentary Look Like? (Para. 15-17)

- Flexibility needed
 - In the level of detail based on the matters being described
 - To accommodate national approaches (for example, UK, France, US)
- Users need to understand *why* the matter was an area of audit emphasis and *why* the auditor believes commentary is needed
- Commentary may include a range of information, such as
 - A simple reference to where the matter is described in the financial statements
 - A description of the auditor's procedures or a conclusion
 - Additional information to enhance users' understanding of the matter(s) or the conduct of the audit
 - Discussion of implications to future financial statements

Does the IAASB agree with these recommendations in light of the proposed objective of auditor commentary?

Task Force Recommendations (Para. 22, 28-29)

- Auditors of **listed entities** should provide auditor commentary to meet the needs of users
- Further consideration needed to consider whether auditor commentary should be mandated for **PIEs** or left to NSS
- Guidance can be developed to explain why auditors of **SMEs** may elect to provide auditor commentary

Does the IAASB agree with these recommendations?

Matters for Consultation (Para. 22-30, Appendix 1)

- Value and impediments depends on the level of detail to be provided
- Consultation needed to confirm the IAASB's view about the entities for which auditor commentary should be provided
- Consultation needed to ensure the requirements relating to criteria and content can be operationalized in a way that provides meaningful information to users

Does the IAASB agree with the TF's characterization of value and impediments?

Are there additional matters on which to consult relative to auditor commentary?

Development of Illustrative Examples (Para. 19-21, Appendix 2)

- Started with examples provided by the US Center for Audit Quality in response to the PCAOB's concept release
 - Premised on the auditor providing objective, not subjective, commentary
 - Designed to complement auditor reporting on critical accounting estimates
- Added further context to align with the French justification of assessment model
 - Requirements to describe the auditor's procedures and include a conclusion
- Further considered how to provide greater transparency
 - What were the key areas that required auditor judgment?
 - How did the auditor respond?

Putting the criteria into examples is quite challenging – how can the Task Force improve these pre-consultation?

The Relationship between Auditor Commentary and EOM and OM Paragraphs under ISA 706 (Para. 12-13)

- Once criteria and content of auditor commentary finalized, is there still a need for EOM and OM paragraphs?
 - EC proposals envisage both
- If retained, how do EOMs, OMs, and auditor commentary interact?
 - EOM simply draws attention to disclosures in the financial statements
 - Auditor commentary likely goes a step further
- Requirements in ISA 706 and other ISAs relating to EOMs and OMs will need to be revisited

Does the IAASB have preliminary views about the relationship between auditor commentary and EOMs/OMs?

The Relationship between Auditor Commentary and Reporting to TCWG under ISA 260 (Para. 18, Appendix 1)

- TF proposes auditor commentary is likely a subset of reporting to TCWG
- Differentiation between internal and external reporting
 - TCWG need certain information to discharge their oversight responsibilities
 - TCWG have particular context in which to evaluate reporting from the auditor
 - Communicating all matters externally may have implications for the openness of the two-way communication between auditors and TCWG

Does the IAASB have a view as to how auditor commentary should correlate with matters discussed with TCWG, and related ISA 260 communication requirements?

The Relationship between Auditor Commentary and Reporting to TCWG under ISA 260 (cont.)

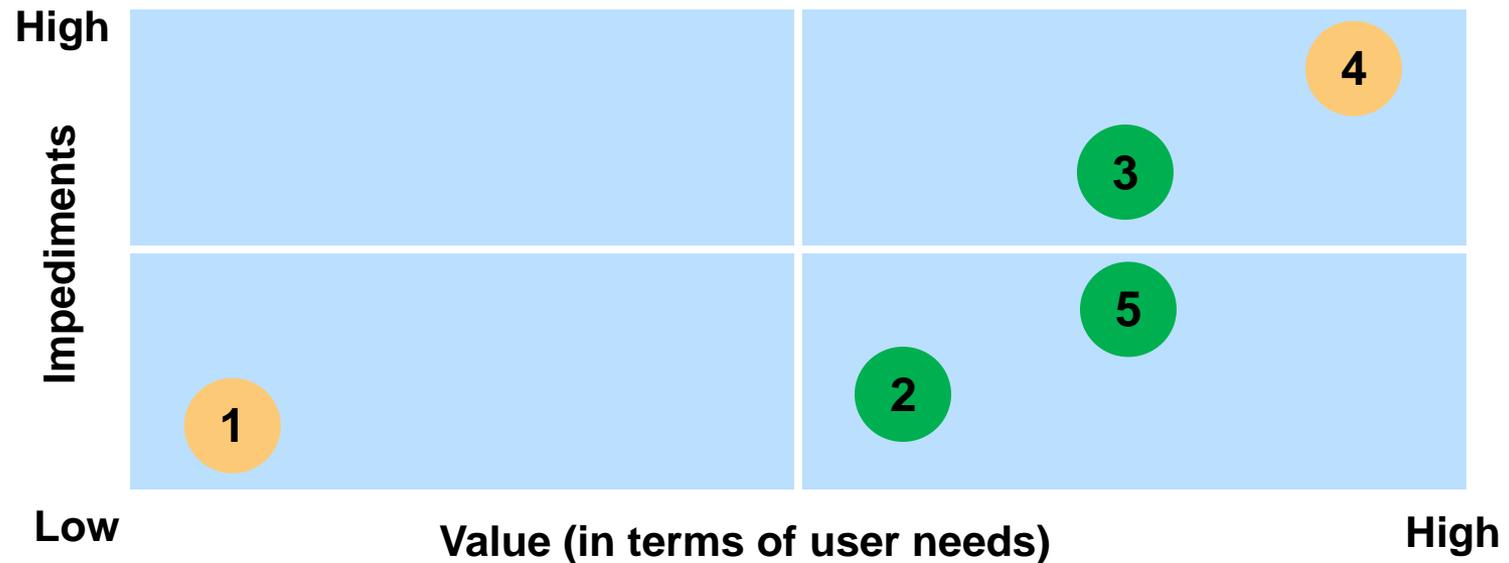
- In light of proposals relating to auditor commentary
 - Is there a need for amendment to ISA 260 to require the auditor to communicate with TCWG about the proposed form and content of the auditor's report?
 - Is there a need to provide additional guidance in ISA 260 to ensure the relationship between communicating with TCWG and reporting externally is clearly described?
- In light of EC Article 23 proposals (Agenda Item 4-G)
 - Is there a need for further enhancement to ISA 260 to accommodate the proposed additional report to the audit committee?

The TF intends to explore these matters further, but would welcome preliminary views from the IAASB.

Subcommittee Discussions

Going Concern (Agenda Item 4-B)

Options Considered



Legend

- Option 1: Description of responsibilities
- Option 2: Description of responsibilities and auditor conclusion
- Option 3: Provision of auditor commentary
- Option 4: Auditor opinion on entity viability
- Option 5: Enhanced guidance in ISAs on use of EOMs

Value and Impediments

- Option 2
 - Value: Greater informational value through the conclusion
 - Impediments: May raise questions as to who has primary responsibility for assessing GC; need to tailor “foreseeable future” to national frameworks
- Option 3
 - Value: Ability to provide information when some events or conditions exist, but no material uncertainty
 - Impediments: Possible confusion with EOMs; other impediments considered further under Auditor Commentary
- Option 5
 - Value: Greater use of GC EOMs and on a more consistent basis, and thus more entity-specific information
 - Impediments: Developing guidance on this important judgment would be challenging; different national frameworks

March 2012 IAASB CAG Discussion

- No support articulated for Options 1 or 4
- EC stated that they were looking for a conclusion on use of GC assumption
- Problems with current model discussed, especially for banks
- Differences in requirements of management IFRS v FASB also flagged
- Some concern that conclusion on use of GC assumption could provide false assurance to investors
- Support for Option 5 from several CAG Representatives, and IASB expressed willingness to talk about it

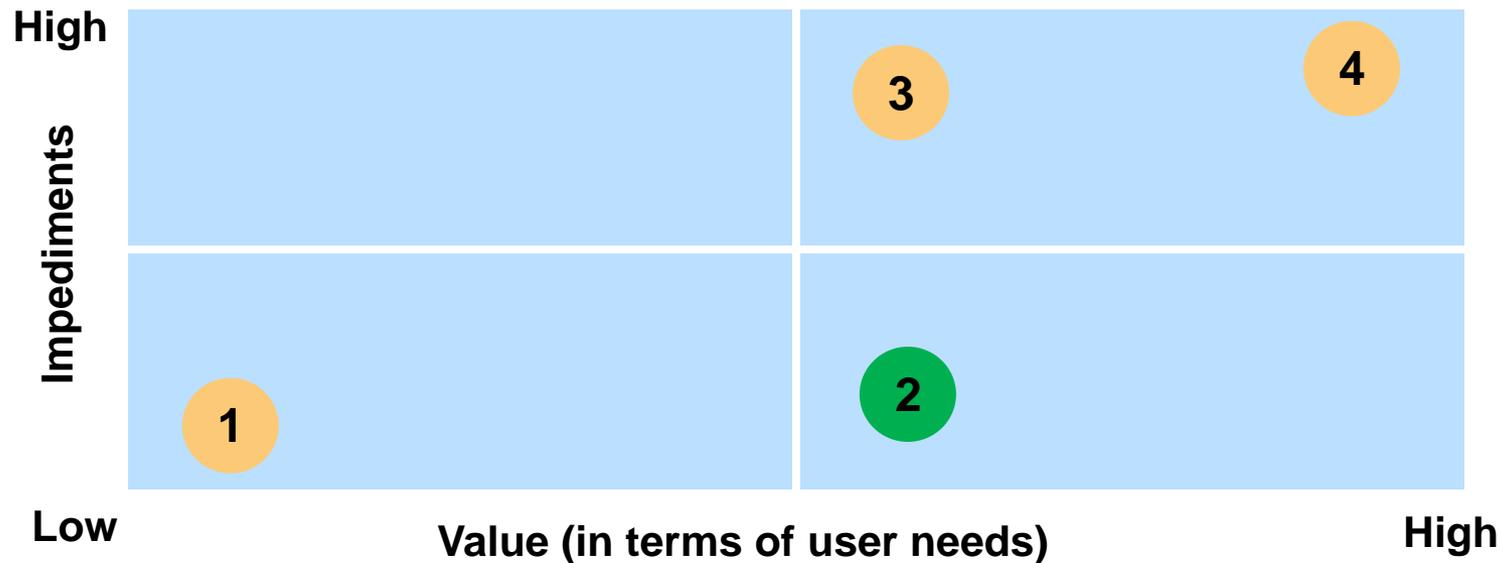
Matters for IAASB Consideration

- Does the IAASB support further Task Force consideration of Options 2, 3 and 5?
- Does the IAASB support the value/impediments analysis for each of these options? Are there any other significant impediments that should be considered for each?
- What are the IAASB's reactions to the illustrative audit report wordings for Options 2 and 3?
- Does the IAASB support the Task Force's preliminary recommendations for the scope of application of Options 2 and 3?

Subcommittee Discussions

Other Information (Agenda Item 4-C)

Options Considered



Legend

Option 1: Description of responsibilities

Option 2: Description of responsibilities and auditor conclusion on consistency

Option 3: Provision of auditor commentary

Option 4: Auditor opinion on the other information

Option 2 Value and Impediments

- Value
 - Greater informational value through the conclusion on the auditor's work regarding the other information
- Impediments
 - A conclusion in the negative form on consistency (limited assurance) is not supported by the work effort currently required under extant ISA 720
 - However, it might be accommodated through evolution in the work effort required under the proposed revised ISA 720

March 2012 IAASB CAG Discussion

- No support articulated for Options 1 or 4
- Most support for Option 2
- Some thought that consistency with financial statements type conclusion too limited
- Limited assurance point raised

Matters for IAASB Consideration

- Does the IAASB support further Task Force consideration of Option 2?
- Does the IAASB support the value/impediments analysis for this option? Are there any other significant impediments that should be considered?
- What are the IAASB's reactions to the illustrative audit report wording for this option?
- Does the IAASB support the Task Force's preliminary recommendation for the scope of application of this option?

Subcommittee Discussions

Clarifications (Agenda Item 4-D)

Clarification of Key Terms

- Nearly all respondents supported clarifying key terms, highlighting the following:
 - reasonable assurance
 - materiality
 - the auditor’s responsibility for fraud and disclosures
- Describing a risk-based audit – a method of reinventing boilerplate language to present auditor’s responsibilities in a more understandable fashion
 - See Appendix 1 of Agenda Item 4-D

Descriptions of Other Technical Terms – Preferred Options

Materiality: “...*Misstatements can arise from fraud or error and are considered material if they would influence economic decisions of a [wide range of users] taken on the basis of these financial statements.*”

Responsibility in respect of fraud: “*Our audit included identifying and assessing the risk of material misstatement due to fraud and obtaining evidence in response to those risks.*”

Responsibility in respect of disclosures : “*Our audit included, in forming our opinion, evaluating the overall presentation, structure and content of the financial statements; and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.*”

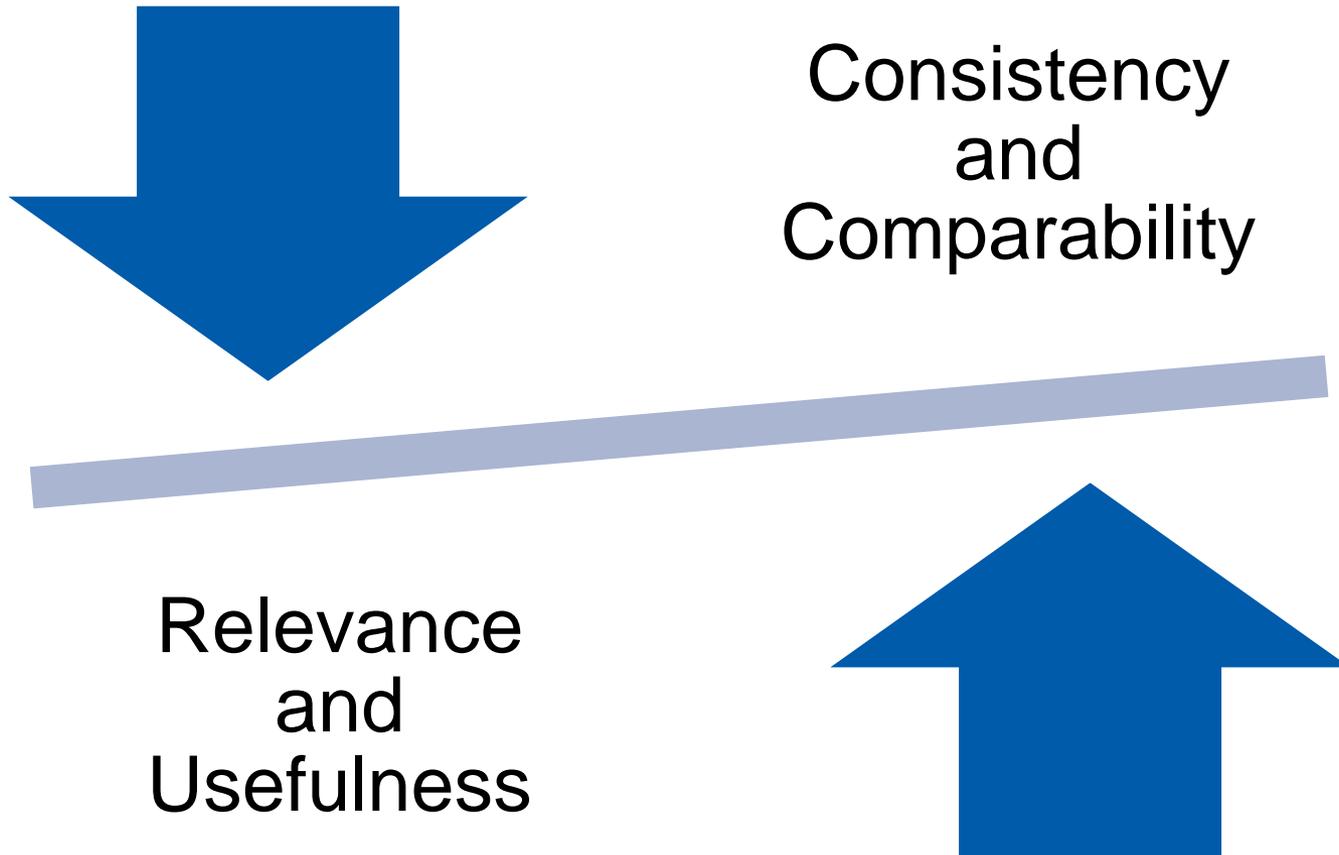
Preferred Options – Transparency

- Push from respondents and stakeholders for greater transparency about the audit
- Areas to explore include:
 - Engagement partner signature/name of engagement partner
 - Role of affiliated firms in the audit
 - Disclosure of engagement team members
 - Statement of compliance with ethical requirements, particularly independence
- Further consideration needed about:
 - Assessment of internal controls (i.e., negative assurance)
 - The description of responsibilities of management, including those charged with governance
- Seeking views on the value and impediments

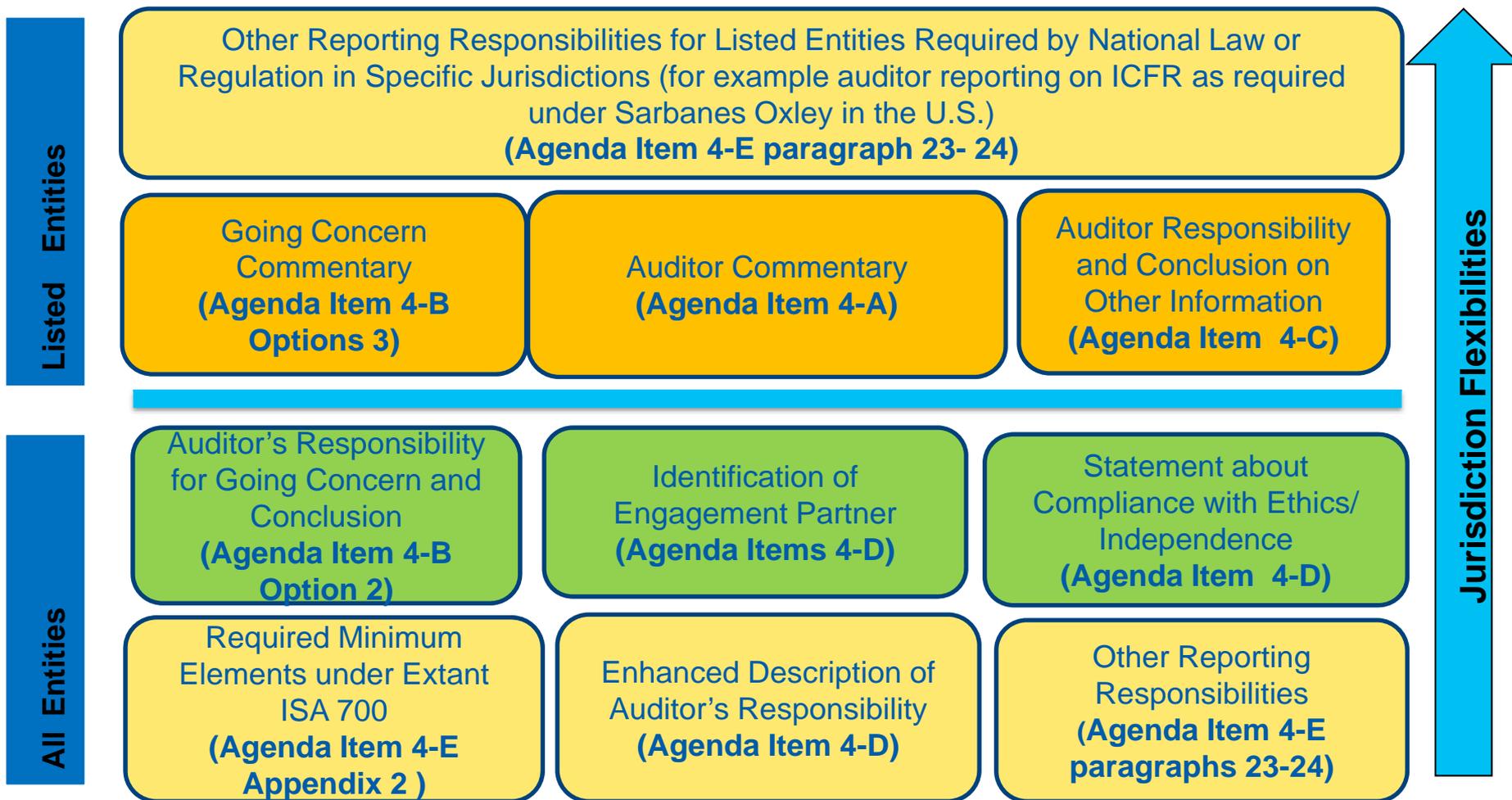
Subcommittee Discussions

Building Blocks (Agenda Item 4-E)

Providing Entity-Specific Information (Para. 1-8)



The “Building Blocks Approach” Applied (Para. 9- 24 and Appendix 1)



March 2012 IAASB CAG Discussion

- Strong support for building blocks approach including new placement for opinion – Approach viewed as responsive to varied needs of users and accommodates SMEs
- Illustrative auditor's report would be useful in seeing how pieces fit together
- Further exploration of PIE definitions needed
- Questions raised about retaining EOM paragraph

Matters for IAASB Consideration

- Does the IAASB agree with the building blocks approach?
- Does the IAASB agree with the core auditor reporting requirements?
- Should conditional auditor reporting requirements apply only to listed entities?
- Does the IAASB support the change in the placement of the auditor's opinion?

General Reactions to Agenda Item 4-E(IR) *Draft - Illustrative Auditor's Report*

Recap of March 2012 IAASB Meeting

- Strong Board agreement of the need to progress change in auditor reporting, and on an accelerated timeline
- Support for the building blocks approach overall, with focus on flexibility for NSS
- Need for further consideration of how “users” are defined
 - Links to the financial reporting framework, but clearly broader than investors
 - May have implications for other ISAs, e.g., ISA 320
- A number of key issues highlighted for TF’s further consideration

Recap of Recent SC and TF Discussions

- Auditor commentary
 - Evolving view that discussion in the auditor's report on going concern and other information is a form of auditor commentary
 - Accordingly, some form of auditor commentary would be in *all* reports
 - But need to describe the objective of auditor commentary clearly
 - EOMs and OMs would be subsumed into auditor commentary

Recap of Recent SC and TF Discussions

- Going concern
 - Exploring extending the conclusion to address material uncertainties, but reservations about length and complexity
 - Further guidance on material uncertainty?
- Other information
 - Wording of conclusion refined
 - 

Recap of Recent SC and TF Discussions

- Clarifications and transparency
 - Further refinement of risk-based audit language describing auditor responsibilities adds length – to be revisited
 - Further dialogue needed on internal control, independence, and identification of other key members of the engagement team

Recap of Recent SC and TF Discussions

- Support for prominently displaying the more tailored information in the illustrative report on an initial basis
 - Opinion first
 - Basis for opinion for all reports to note audit in accordance with ISAs
 - Auditor commentary, with intro always and subheadings as appropriate (mandatory for GC/OI conclusions)
 - Management’s responsibility
 - Auditor’s responsibility
- Plan for one illustrative report on consultation with narrative description of flexibility provided for NSS-prescribed wording and additional reporting responsibilities
 - Targeted questions to test the applicability of the building blocks approach

Planned Outreach and Consultation

- Pre-June 2012 Consultation
 - Small and Medium Practices Committee Forum – March 20
 - Forum of Firms Meeting – March 28
 - Global Auditor Investor Dialogue Teleconference– April 19
 - National Standard Setters Meeting – April 26-27
- Post-June 2012 consultation
 - IFRS Advisory Council, CFA Institute, ICGN, IFIAR, IOSCO
 - 3 Roundtables (Asia, North America, Europe), focused on users
 - Those involved in preparing financial statements for entities of all sizes (financial executives, lawyers, not-for-profits, etc)
- Ongoing
 - IAASB Chairman and Deputy Chairman outreach activities
 - PCAOB SAG and other PCAOB and EC Staff discussions, as appropriate