

Auditor Reporting—Insights¹

I. Summary of Recommendations and Preferred Options

- Auditor commentary should be included in the auditor’s report for listed entities. Further consideration needs to be given as to whether auditor commentary should be required for all entities or public interest entities (PIEs), in addition to listed entities.
- The types of matters to be addressed in auditor commentary should be linked to areas of audit emphasis, but the IAASB will need to highlight key factors for the auditor to consider in determining what should be included in auditor commentary to help promote consistency.
- Consideration is needed as to whether the focus of auditor commentary should be primarily on significant audit effort and significant *auditor* judgments, or whether commentary is needed more broadly to also point to significant *management* judgments. Related, it will be necessary in due course to determine whether an auditor commentary section within the auditor’s report would replace Emphasis of Matter (EOM) paragraphs and Other Matter (OM) paragraphs as currently defined in ISA 706,² or whether clarification is needed in the ISAs to explain their interrelationship.
- Requirements relating to the content of auditor commentary will need to allow for flexibility to accommodate different auditor reporting models in national jurisdictions, but should be premised on the auditor’s evaluation of the appropriate degree of detail that would provide users with an understanding of areas of audit emphasis, including those involving significant judgment by the auditor in conducting the audit and relating to significant judgments¹ by management in preparing the financial statements and
- Auditor commentary may involve discussion of a range of matters, but is likely to be a subset of matters discussed with those charged with governance (TCWG) in accordance with ISA 260.³

II. User Demand / Calls for Change

1. The European Commission (EC) proposals directly relevant to auditor commentary include the requirements in Article 22(2) to, in the body of the auditor’s report:
 - Identify key areas of risks of material misstatement of the annual or consolidated financial statements, including critical accounting estimates or areas of measurement uncertainty⁴ (point k); and
 - Refer to any matters to which the statutory auditor(s) or the audit firm(s) draw attention by way of emphasis without qualifying the audit opinion (point u).⁵

¹ Consideration will be given after the March 2012 IAASB meeting as to whether the Insights Subcommittee should be renamed to better align with its proposals.

² ISA 706, *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report*

³ ISA 260, *Communication with Those Charged with Governance*

⁴ The ISAs do not define measurement uncertainty, but IAPN 1000, *Special Considerations in Auditing Financial Instruments*, uses the term “measurement uncertainty” to refer to the estimation uncertainty associated with fair value measurements. Estimation uncertainty is defined in the ISAs as “the susceptibility of an accounting estimate and related disclosures to an inherent lack of precision in its measurement.”

2. The US Public Company Accounting Oversight Board (PCAOB) is also currently developing standard-setting proposals, which it anticipates issuing in Q2 2012, to require auditors to provide additional information in the auditor's report, following from its June 2011 Concept Release (CR) on auditor reporting.
3. As noted in the responses to the IAASB's May 2011 Consultation Paper (CP), users believe that having the auditor provide additional commentary would enable them to:
 - Better navigate financial information, for example by providing a "roadmap" to the most important areas.
 - Understand more about how the audit was conducted, and the areas on which the auditor focused in light of the auditor's assessment of the risks of material misstatement (ROMMs), as well as the auditor's procedures and conclusions.
 - Benefit from the auditor's perspectives on entity-specific matters, including:
 - Significant matters in the entity's financial statements, such as the accounting policies and management's critical accounting estimates;
 - Those areas where significant judgments were made by management; and
 - Unusual transactions and other significant changes in the entity's financial statements.
 - Have greater information to assist in making their buy/sell/hold decisions, which should result in higher returns to investors and improved capital allocation within society.⁶
4. The CP noted there have been calls for the auditor to share in-depth insights 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.
5. Although many respondents to the CP saw the value of the auditor providing insights about the audit, including commenting on areas that involved significant judgment by management, most of these respondents were generally not supportive of mandating the level of specificity included in

⁵ Other more specific EC proposals that may fall under the broader objective of auditor commentary considered by the Insights Subcommittee are cited throughout this paper. However, further understanding of the intent and practicality of these proposed requirements may be needed.

⁶ It is acknowledged, however, that some investors have communicated that their initial buy/sell/hold decisions are based on an entity's preliminary announcements, which are issued well before the auditor's report. Greater transparency in auditor reporting would likely serve as an anchor for investors to look to in making broader investment decisions, rather than at a point in time.

paragraph 4, because they agreed with the position in the CP that the responsibility of management and TCWG for disclosure of information about the entity to users of the entity's audited financial statements should be clearly separately from the role of the auditor. There has also been considerable concern expressed about the possible situation where users are faced with the challenge of interpreting competing disclosures about the entity from management and the independent auditor. However, a few users, as well as certain members of the PCAOB's Investor Advisory Group, felt strongly that the auditor should discuss the quality, not just the acceptability, of the entity's accounting practices and policies, and suggested that the auditor's perspective on whether management's estimates and judgments are at the low, most likely, or high end of a range of possible outcomes would be valuable to understand management's aggressiveness or conservatism in preparing the financial statements.⁷ These users noted that ISA 260 would require matters of this nature to be discussed with TCWG, and that such matters would typically be documented in the "audit summary memo." The TF believes that, in light of the requirements of ISA 260, the proposals below would not preclude the auditor from commenting on the quality of the entity's financial statements, should it be deemed to be necessary to provide the appropriate context to the auditor's commentary on areas of risk, the entity's accounting policies or other matters more broadly.

III. Basis for Recommendations and Preferred Options

Criteria for Determining Matters on which to Provide Auditor Commentary

6. The TF considered, and rejected, the use of significant risks as the primary criterion for auditor commentary, because significant risks may not be all-inclusive of matters on which to provide insights (e.g., areas where the auditor used judgment) or conversely may include risks that are not necessarily significant auditor judgments or areas that have a high assessed ROMM (e.g., certain fraud risks). In addition, conceptually, significant risk is not as easy for users to understand as terms such as "judgments" and "uncertainty" (both generically and in terms of measurement uncertainty).
7. In proposing to require auditor commentary for listed entities (further discussed in paragraph 22), the TF agrees that having broad "criteria", linked to areas of audit emphasis, would allow the necessary flexibility for the auditor to:
 - Tailor the commentary to the engagement-specific risks of material misstatement (ROMMs) and, where considered appropriate, describe the audit procedures performed to respond to those risks and significant findings or conclusions resulting from those procedures; and
 - Allow for, and possibly encourage auditors to include, commentary on the overall risk assessment and approach to the audit, as these decisions are made in light of the auditor's

⁷ One user suggested that, if the reporting framework is one based on neutrality, the auditor should be obliged to make a statement as part of its audit report that the accounts are a neutral representation, rather than commenting specifically on aggressiveness or conservatism.

understanding of the entity and its environment and relate to the financial statements as a whole.⁸

It was particularly noted that it is important for the auditor to approach auditor commentary from the point of view of users, to determine what would likely be most relevant to include in order to enhance their understanding of both the financial statements and the audit. This would necessitate, among others, consideration of matters that are not only quantitatively, but also qualitatively, material.

8. However, the TF also believes that, to promote consistency in auditor commentary and respond to calls from users as highlighted in paragraph 3, the auditor should be required always to consider key areas, based on matters typically communicated to TCWG, in determining what should be included in auditor commentary (i.e., the nature of the auditor commentary).
9. In considering how ISA 700⁹ might be revised to take into account the need for auditor commentary for listed entities, the requirement could be drafted as follows:

For audits of listed entities, the auditor's report shall describe matters that involved:

- (a) Significant audit effort; or
- (b) The exercise of significant judgment by the auditor;

with the objective of providing users of the auditor's report with an understanding of areas of audit emphasis, which may relate to significant judgments by management in preparing the financial statements.

The following considerations are likely to be relevant in all circumstances:

- Areas of high assessed ROMMs, which may include significant risks identified during the audit.
- Unusual transactions, restatements, and other significant changes in the financial statements, including the related notes.
- Other areas of significant discussion with management and TCWG about the entity's financial statements or the conduct of the audit, including significant findings.

10. During the course of the Insights Subcommittee and TF discussions, it was noted that the requirement for auditor commentary could be worded a bit more broadly, which may be useful if the existing concept of EOM and OM paragraphs was subsumed into a broader category of auditor commentary (see paragraphs 12 and 13 below regarding further discussion on this point). Broadening the proposed requirement would effectively also capture significant *management* judgments that may not necessarily be areas of significant audit effort or significant auditor judgment, and may be responsive to calls for the auditor to provide perspectives on those management judgments. Possible wording of a broader requirement could be as follows:

⁸ Some users have suggested having an understanding of how the audit was designed, including the level of materiality and how the work of others was used in the audit (for example, group audit considerations, the internal audit function, experts, shared service centers and other service organizations), would help them to assess audit quality.

⁹ ISA 700, *Forming an Opinion and Reporting on Financial Statements*

For audits of listed entities, the auditor's report shall include audit commentary with the objective of providing users of the auditor's report with an understanding of areas of audit emphasis. Areas of audit emphasis include those matters that involved:

- (a) Significant judgment by management in preparing the financial statements;
- (b) Significant judgment by the auditor in conducting the audit; or
- (c) Significant audit effort.

[The following considerations are likely to be relevant ...]

While this may appear to be a subtle distinction in terms of how the two possible requirements are phrased, it will be important at its March 2012 meeting for the IAASB to consider the implications of this distinction and identify a preferred approach to guide the TF in further developing these matters for the June 2012 CP.

11. To support either proposed requirement, application material could be developed to:
- Explain that the purpose of auditor commentary is to enhance the ability of users of the auditor's report to see clearly and intuitively into the nature of matters that are both complex and which require a significant degree of judgment by the auditor;
 - Explain that auditor commentary also provides a link between management's significant judgments and the auditor's assessment of those judgments in connection with the audit procedures performed in the related areas; and
 - Explain that, in considering which matters involved significant audit effort, the auditor would consider those areas that were identified in the auditor's initial planning and risk assessment as well as areas in which the auditor's planned approach changed in response to changes in its risk assessment or difficulties encountered in the audit.¹⁰

Relationship between Auditor Commentary and EOM and OM Paragraphs

12. On a preliminary basis, the TF believes that EOM and OM paragraphs as currently defined by ISA 706 could potentially be subsumed into the broader auditor commentary. This is because the simplest form of auditor commentary may point to the relevant disclosures in the financial statements (replacing an EOM paragraph) or may involve additional information about matters related to the audit, the auditor's responsibilities or the auditor's report (replacing an OM paragraph). However, if the explicit objective of auditor commentary is to provide users with additional information on areas of audit emphasis or key auditor judgments, retaining EOM and OM paragraphs under ISA 706 (or another mechanism) would perhaps provide flexibility in communicating other matters at the auditor's discretion. In addition, the EC proposals seem to acknowledge the use of both auditor commentary relating to key areas of risk of material misstatements and the ability for the auditor's report to refer to other matters for which the auditor may want to draw attention (see paragraph 1).

¹⁰ It was noted that areas of significant audit effort, while often correlated to the level of judgment involved by management or the auditor, may also be broader and would encompass areas that required special audit attention and that were discussed with TCWG.

13. Further analysis about the relationship between auditor commentary and EOM/OM paragraphs, including whether conforming amendments are necessary to ISA 706 and other ISAs to clarify this relationship, will need to be considered in due course as the proposals on auditor commentary develop. Should the IAASB conclude that EOMs in particular would fall under the scope of auditor commentary, it will be necessary for the proposed requirement in ISA 700 (discussed in paragraphs 9-10) to be worded in such a way that it retains the objective of EOMs under extant ISA 706 (i.e., used to draw attention to a matter that is of such importance that it is fundamental to users' understanding of the financial statements) and that effort is made to alleviate the perception that EOMs (and therefore auditor commentary of this nature) would be expected to be rare, in light of the proposed requirement to include auditor commentary for listed entities.

Mandatory Elements of Auditor Commentary

14. Given the views of user respondents and the EC proposals, there may be areas on which auditor commentary would always be expected.¹¹ By nature of the considerations in paragraph 3, these may include:
- Sources of estimation uncertainty (i.e., critical accounting estimates);
 - Concerns related to the application of accounting policies;¹²
 - Going concern (to be explored by the Going Concern / Other Information subcommittee);
 - Discrepancies noted between the audited financial statements and other information (to be explored by the Going Concern / Other Information subcommittee); and
 - Identified significant internal control deficiencies.¹³

The TF has not yet concluded on whether any particular elements of auditor commentary would be mandatory. However, there is likely a balance between prescribing discussion of these matters with the need for auditors to step back and consider what is likely to be most relevant to users of the auditor's report and tailor it accordingly.

¹¹ The French Justification of Assessments model focuses on accounting policies, accounting estimates and overall presentation, and the work performed by the auditor to be satisfied that the matter is appropriate, including whether it is properly accounted for and disclosed. The PCAOB's CR noted that emphasis paragraphs could be required in areas of critical importance to the financial statements, including significant management judgments and estimates, areas with significant measurement uncertainty, and other areas that the auditor determines are important for a better understanding of the financial statement presentation. With respect to each matter of emphasis under this alternative, the PCAOB has noted that the auditor also could be required to comment on key audit procedures performed pertaining to the identified matters.

¹² Article 22(2)(o) of the EC proposals note the requirement for the auditor to indicate and explain any violation of accounting rules or violation of laws or the articles of incorporations, accounting policy decisions and other matters that are significant for the governance of the entity.

¹³ For example, point m of Article 22(2) of the EC proposals would require the auditor in the auditor's report to "assess the entity's or, in case of consolidated financial statements, the parent undertaking's internal control system, including significant internal control deficiencies identified during the statutory audit, as well as the bookkeeping and accounting system."

Content of Auditor Commentary

15. Recognizing the criteria to provide auditor commentary is intentionally broad, in order for the auditor commentary to be meaningful, the TF agreed that certain factors need to be taken into account by the auditor in determining the content to be included, including the level of detail to be provided. The resulting auditor commentary would vary depending on the matter being described, ranging from a simple reference to the matter and where it is disclosed in the financial statements (similar to an EOM paragraph as defined in ISA 706), to including additional auditor views judged to provide context necessary to enhance users' understanding of the matter. The requirement in ISA 700 relating to the content to be included in auditor commentary could be drafted as follows:

In determining how the matter(s) shall be described in the auditor's report, the auditor shall evaluate the appropriate degree of detail that would [provide users with an understanding of the areas of audit emphasis, including significant judgment by the auditor in conducting the audit and relating to significant judgment by management in preparing the financial statements] or [achieve the objective of auditor commentary (as described in paragraphs 9-10)]. Relevant considerations include:

- The extent to which the matter(s) are appropriately disclosed in the financial statements, including the related notes and "other information".¹⁴
 - Whether a description of the auditor's procedures, or a conclusion based on these procedures, would enable users to understand the importance of such matters and the basis for the auditor's judgments.
 - Whether additional information would enhance users' understanding of the matter(s) or the conduct of the audit, for example:
 - Whether significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statements disclosures, could be described to provide context to management's judgments; or
 - When the audit approach was highly tailored based on the facts and circumstances of the entity.
 - Whether there are implications to future financial statements that may be described, for example in relation to risks and uncertainties.
16. Many respondents to the CP expressed a strong view, supported by the TF, that auditors generally should not be the original source of disclosure about the entity. However, based on the considerations in paragraph 15, in particular in the third and fourth bullets, it is possible that auditor commentary could result in the auditor being the original source of information about the entity, if the auditor considers it necessary to do so to provide users with an improved understanding of certain matters and their effects on the financial statements. Further discussion and consultation on the implications of these considerations will be critical (see paragraph 30).

¹⁴ As defined in ISA 720, *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements*. Reference to "other information" within auditor commentary may require additional context within the auditor's report, for example a description of the auditor's responsibilities for other information, in order to ensure that readers of the auditor's report are aware that this information is not audited. The Going Concern / Other Information Subcommittee is considering proposals in this regard.

17. The TF also agreed that requirements relating to the content of auditor commentary will need to allow for flexibility to accommodate different auditor reporting models in national jurisdictions. Application guidance could be developed to illustrate how this spectrum of auditor commentary that may be provided would align with various auditor reporting models. For example, the application of the French justification of assessments model would result in auditor commentary that encompasses the first and second bullets in the proposed requirement in paragraph 15. Guidance could also explain that the nature of matter(s) to be discussed in auditor commentary, and the level of detail to be provided, may also be prescribed by law or regulation (for example, EC proposals relating to discussion on risks of material misstatement and the forthcoming PCAOB proposals).

Factors that May Be Relevant in Determining the Content of Auditor Commentary

18. The TF agrees that the auditor's primary consideration of whether and to what extent to highlight particular matters in auditor commentary should be largely driven by matters required to be communicated to TCWG in accordance with ISA 260. Taking the requirements and guidance of that ISA into account and the proposed requirement in paragraph 15, additional guidance for auditors may be helpful to ensure key matters are being communicated. Appendix 1 highlights factors that may be relevant in determining the content of auditor commentary.

Illustrative Examples

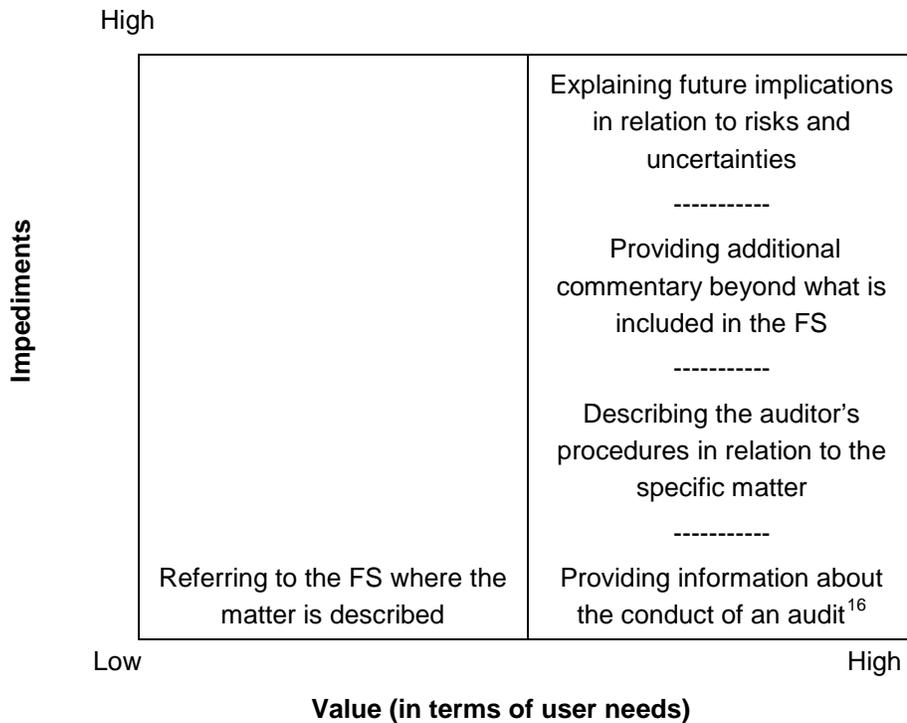
19. In responding to the PCAOB's CR,¹⁵ the U.S. Center for Audit Quality (CAQ) had provided illustrative examples of how EOM paragraphs could be used to provide auditor commentary, in light of their overarching principles, including that auditor reporting should focus on the objective rather than the subjective. While it recognized the challenges in providing more subjective information, the TF was of the view that, in light of the comments received on consultation and the demands identified in paragraph 3, auditor commentary may need to do more than simply direct attention to matters presented and disclosed in the financial statements. This is in part based on what the TF believes the objective of auditor commentary should be (as described in paragraphs 9-10). Accordingly, while finding merit in the examples provided by the CAQ as a starting point for considering auditor commentary, the TF has explored how these examples may be further tailored, including taking into account the French justification of assessments model, which also requires the auditor to discuss procedures performed.
20. Given the expected focus on the examples in outreach with users and the planned June 2012 consultation paper, the TF has given consideration as to whether detailed examples could be provided, drawing from auditor reports to audit committees and seeking to describe circumstances relevant to audits of listed entities. Appendix 2 to this paper provides illustrative examples intended to explore how the proposed objective of auditor commentary may be met, and is presented for discussion purposes only. These examples will be subject to further revision, as the TF and IAASB reflect on the practicality and viability of these options in an international reporting environment.
21. The TF also further developed introductory language to the auditor commentary section, based on the CAQ example, with the aim of providing context to users about why the auditor commentary

¹⁵ The CAQ included their response to the PCAOB as an Appendix to its response to the IAASB's CP.

had been included (based on the considerations included in paragraphs 9-10). It should be noted that this language is included for discussion purposes only, and is subject to possible revision based on changes that may be pursued by the Clarifications Subcommittee in describing the auditor’s responsibilities.

Consideration of Value and Impediments

- 22. Based on the demands from users and how they have characterized its potential value, the TF agrees that providing auditor commentary in the auditor’s report should be explored at the international level. The TF recommends that the inclusion of auditor commentary be mandatory for listed entities, as a starting point to promote international consistency. This is based on its consideration of the value and impediments of doing so, described in more detail below.
- 23. The TF believes that both the value and the impediments of auditor commentary alternatives are dependent upon the level of detail to be provided in the auditor commentary, and agrees that it is necessary to enable auditors to have flexibility to determine the appropriate level of detail depending on the matter being discussed (see discussion in paragraphs 15-17). The following illustrates the TF’s views as to where the possible range of auditor commentary may fall, recognizing that views may differ among stakeholders about the value and impediments.



- 24. Based on the responses to the CP and the TF’s discussions, the following are noted as the overall value of providing additional auditor commentary:

¹⁶ See paragraph 31 about impediments to describing engagement-specific materiality.

- Doing so is responsive to user demands, particularly calls from investors and analysts, TCWG and regulators, and is a means of holding the auditor accountable to an entity's stakeholders.
 - Providing such additional information is likely the most significant way to enhance the communicative value of the auditor's report.
 - It helps to clarify the value of an audit and importance of the independent role of the auditor in enhancing the credibility of the financial statements.
 - Enabling auditors to provide additional commentary on matters of key audit judgment will lead to greater focus on these areas and related disclosures by management and TCWG, thereby strengthening the financial reporting process and audit quality in turn.
 - Requiring auditor commentary may enhance auditor behavior in the areas on which such commentary would be anticipated, and potentially increase audit quality, as transparency into individual audit judgments may allow users to better assess whether the auditor had delivered an objective and independent audit.
25. Respondents to the CP indicated that a significant impediment to providing additional auditor commentary relates to the potential cost of doing so, to both auditors and preparers. In terms of cost to auditors, although based on the existing work effort, providing auditor commentary may require processes within audit firms to develop the commentary itself and review auditor reporting at the engagement and firm level. The TF recognized, however, that shareholders of an entity may be willing to ask the entity bear this additional cost in light of the value they have suggested auditor commentary would have. In addition, preparers would incur additional cost directly in terms of the dialogue that would ensue between management and TCWG, and with the auditor, in particular when the auditor commentary is proposed to include additional entity-specific information on a matter beyond what is included in the financial statements. In this regard, further consideration will need to be given as to whether the auditor should be required to communicate the expected form and content of the auditor's report with management and TCWG prior to its issuance.¹⁷
26. The TF also noted that, while not necessarily impediments, there are a number of risks relating to providing additional commentary that would need to be considered as the IAASB develops and consults on its proposals:
- Audit reports will likely lack comparability, even among entities in the same industry.
 - There is a risk of increasing the expectations gap, to the extent that readers interpret the inclusion of commentary as providing assurance on individual accounts or disclosures.
 - Auditor commentary could become boilerplate over time.
 - Provision of certain information beyond what is included in the financial statements could blur the different roles of management, the auditor and TCWG, and may compete with management's disclosures, thereby resulting in "dueling information."

¹⁷ For reference, the auditor is required to discuss the form and content of the auditor's report with TCWG only when the auditor expects to modify the opinion or include an EOM or OM paragraph in the auditor's report.

27. These risks, and indeed the value of the audit commentary itself, may vary depending on the nature of the matter being addressed by the auditor. For example:
- Auditor commentary that is directly linked to the auditor’s risk assessment will likely provide valuable insight to users to understand the areas of key management and auditor judgment.
 - Auditor commentary about specifics of the audit (for example, the level of materiality applied or detailed discussion of how a group audit was conducted) may be less useful to investors if they do not have the proper context in which to place this information and may result in incorrect perceptions about audit quality.
 - Auditor commentary about materiality and details about audit procedures performed may potentially compromise the effectiveness of the audit (e.g., by making procedures too predictable) and therefore decrease audit quality.
 - Auditor commentary in relation to “other information” may be of high value given the nature of this information (for example, information about liquidity, risks and uncertainties, etc.), however, there are higher implications in doing so because the audited financial statements and the auditor’s report thereon may later be included in other documents. In such circumstance, the other information may have been updated while the audited financial statements and the auditor’s report thereon have not been.
 - While it has been suggested that information provided to TCWG could be directly added to the auditor’s report, it is more likely that auditors will need to further consider how best to provide a sufficient level of detail and context for users to receive that information, as such users would not have the benefit of the two-way dialogue that exists between audit committees/TCWG and auditors.
28. In light of its preliminary assessment of the value of auditor commentary, the TF agreed that further consideration is needed regarding the application to PIEs as defined by the International Ethics Standards Board for Accountants (IESBA) in the Code of Ethics for Professional Accountants,¹⁸ . Should the IAASB conclude it is not appropriate to mandate auditor commentary for PIEs, additional guidance within a revised ISA 700 to explain that some jurisdictions may nevertheless prescribe auditor commentary for PIEs (as defined in the context of that jurisdiction) would likely be useful.
29. The IAASB will also need to consider and consult on the specific impediments related to mandated implementation for smaller or closely-held listed entities, recognizing the strong responses on consultation for changes in auditor reporting not to unduly burden small- and medium-sized entities (SMEs) and their auditors. Finally, it is acknowledged that, for nationally listed entities, there may be other mechanisms in place to enhance transparency about the audit (for example, reporting by TCWG and auditor association with that report proposed by the UK Financial Reporting Council (FRC)) that are deemed to be an appropriate alternative to auditor commentary. The Building Blocks Subcommittee will further consider these matters with advice from the IAASB and CAG.

¹⁸ **Agenda Item 4-E** further explains that particular jurisdictions may define PIEs differently than the IESBA Code.

30. In moving proposals on auditor commentary forward, it will be critical for the IAASB to liaise with a variety of stakeholders to confirm the TF's initial assessment of value and impediments. The IAASB will also need to seek views on the proposals relating to the inclusion of auditor commentary and the flexibility needed in the level of detail that may be provided, including:
- Users' views on whether the varying level of detail in auditor commentary is appropriate in light of what the auditor commentary is intending to achieve, and whether the inherent lack of consistency in auditor reporting that would result is appropriate.
 - Preparers' and TCWGs' views on whether the provision of auditor commentary blurs the distinction of responsibilities of management and the auditor, and how the process to include auditor commentary would be operationalized.
 - Audit firms' views on the impediments, including costs, of providing auditor commentary, including the level of detail that may be provided in light of the considerations in paragraph 14.
 - Regulators' and audit oversight bodies' views as to how a principles-based requirement for auditor commentary would be viewed in light of audit inspections.

IV. Other Matters Considered

31. Recognizing the input from some users, the TF considered whether the matters described in paragraph 4 should be explicitly included in the factors to be considered by the auditor in determining whether to include auditor commentary. The TF was of the view that, while there may be merit in communicating these matters to TCWG, providing commentary of such a subjective nature may have high impediments, in particular in light of the current scope of the audit and the concerns expressed that the disclosure of such information is the responsibility of management and TCWG. However, should auditors judge it necessary to do so, the proposed model for auditor commentary would not prohibit discussion of these matters. It is envisaged that, on consultation, the IAASB will request feedback on the criteria for the inclusion of auditor commentary and the factors to be considered in determining the content of such commentary, to determine whether the needs of users would be met by these proposals.
32. The TF expressed concern about suggesting the auditor should always provide engagement-specific materiality levels within the audit commentary.¹⁹ In addition to the risks that such information may widen the expectations gap and detract from the value of the audit and the auditor's opinion on the financial statements as a whole, it was also noted that materiality levels may not be communicated to TCWG in all instances. Accordingly, a discussion of engagement-specific materiality within auditor commentary may be characterized as having high impediments (as compared to providing other information about the conduct of an audit, which may be considered as having lower impediments). However, further discussion with stakeholders, in particular users, to understand the value of providing engagement-specific materiality levels and debate with the IAASB about the potential for mandatory elements of auditor commentary (see paragraph 14) is necessary.

¹⁹ Within the EC proposals, point 2(j) of Article 22 would require the auditor to "lay out the details of the level of materiality applied to perform the statutory audit."

V. Matters for Further TF Consideration

Planned Outreach with the PCAOB

33. On a preliminary basis, IAASB leadership has agreed with PCAOB representatives that coordination on matters of mutual interest would be beneficial. As the PCAOB is considering whether and, if so, how to mandate auditor commentary, the TF Chair and Staff have proposed to meet with the PCAOB staff to discuss criteria that may be used in doing so. The TF Chair will report on progress in this area during the IAASB and CAG meetings.

VI. Matters for IAASB Consideration

1. The IAASB is asked to comment on the following areas:
 - Whether, based on the demands from users, the IAASB agrees with the TF’s assessment that there would be value in providing auditor commentary in the auditor’s report.
 - On a preliminary basis, does the IAASB have a view as to whether matters that had previously been addressed in EOM and OM paragraphs could be covered by auditor commentary?
 - Whether the proposals in paragraphs 9-10 relating to the objective and requirement for auditor commentary would be supported.
 - Whether the proposed wording of the requirement to include auditor commentary provides sufficient flexibility to accommodate different approaches (for example, the EC, PCAOB, and UK FRC)?
 - Whether certain matters may always be expected to be included in auditor commentary. If this idea is supported, how should this be addressed? For examples, should boilerplate language be used to draw attention to critical accounting estimate disclosures?²⁰
 - Whether the considerations in paragraph 15 relating to determining the content of auditor commentary are sufficient in light of the proposed objective of auditor commentary. Are there other factors that should be highlighted to ensure the level of detail provided is meaningful to users, yet balanced?
 - Whether, in light of the proposed criteria and content, the IAASB agrees that auditor commentary should be mandated for listed entities, and whether the IAASB has a view that such commentary should also be mandated (or otherwise encouraged) for PIEs or all entities.
2. Subject to Board deliberation of the criteria for, and possible content of, auditor commentary, the IAASB is asked to consider whether the illustrative examples in Appendix 2:
 - Are useful in illustrating what the auditor commentary is intended to achieve.
 - Include an appropriate level of detail, including how the auditor’s procedures are described.
3. On a preliminary basis, the IAASB is also asked for its views as to whether matters that had previously been addressed in EOM and OM paragraphs could be covered by auditor commentary as proposed.
4. Finally, does the IAASB agree with the characterization of these proposals as “auditor commentary” or would another term be more useful in light of what the IAASB is intending to achieve?

²⁰ In further considering how to provide context to the matters to be described in auditor commentary, it may be necessary for the TF to consider whether there are other matters that could be better described as part of the auditor’s responsibilities more broadly (for example, to highlight the auditor’s responsibilities relating to ISA 540).

Appendix 1

Factors that May be Relevant in Determining the Content of Auditor Commentary

The following is intended to illustrate further considerations beyond those in paragraph 14, to assist auditors in determining the level of detail that would be appropriate to include in auditor commentary. These factors are premised on the need for the auditor to first consider the extent to which matter(s) on which commentary would be provided are described in the audited financial statements, including the related notes. If the information is already disclosed in the financial statements, the discussion in the auditor commentary would not be intended to repeat that disclosure, but would draw readers' attention to it and add any additional context the auditor judges necessary in the circumstances.

1. In the case of accounting policies, whether they are appropriate to the particular circumstances of the entity, including:
 - The auditor's consideration of, and views about, alternative accounting policies or changes to policies during the period under audit.
 - The effect of significant accounting policies in controversial or emerging areas, or those unique to an industry (particularly when there is a lack of authoritative guidance or consensus).
2. In the case of accounting estimates and estimation uncertainty:
 - Whether the estimate is highly dependent on judgment, uncertain events, or reflects the possibility of events or outcomes many years into the future.
 - The sensitivity of significant assumptions used in making the estimate.
 - Whether assumptions are at the low, most likely, or high end of the range of possible outcomes.
 - If there are changes in the methods for making particular accounting estimates, when it is unclear why management has done so.
 - Whether the disclosures in relation to estimation uncertainty are adequate in light of the range of possible outcomes of the estimate, taking into account materiality.
 - Whether there are significant external factors, such as the economic environment, that affect management's process for valuation of particular accounting estimates, the auditor's procedures to test the valuation, and the evidence available to support it.
3. In the case of significant unusual transactions:
 - What circumstances led to the unusual transactions, and whether the extent to which such transactions are separately disclosed.
 - The implications of doing business in a particular industry, for example, the effects of changes in regulation that may unduly impact the entity (as compared to its competitors).

- Whether a description of the procedures performed would be meaningful (i.e., can the auditor's work effort be described in clear way that does not overburden the auditor's report?).
4. Whether commentary on management's processes in relation to the matter would be useful. For example:
- Were significant deficiencies in internal control noted?
 - Are there possible indicators of management bias?
5. In relation to the conduct of the audit:
- The auditor's approach to, and balance of testing of, controls and substantive testing.²¹
 - Whether there were particular difficulties encountered during the audit, for example in a group audit situation.
 - Whether discussion of the level of materiality applied in the audit would be meaningful, for example if the auditor has used an industry-specific or tailored measure based on the entity's facts and circumstances.
 - Whether further discussion of the use of the work of others, for example, internal audit, specialists, or other firms, in the audit would provide useful context to understanding the auditor's key judgments.

²¹ Within the EC proposals, point 2(h) of Article 22 would require the auditor to "describe the used methodology, including how much of the balance sheet has been directly verified and how much has been based on system and compliance testing" and point 2(i) would require the auditor to "explain any variation in the weighting of substantive and compliance testing when compared to the previous year, even if the previous year's statutory audit had been conducted by another statutory auditor(s) or audit firm(s)."

Appendix 2

Illustrative Example

Note: Given the expected focus on the examples in outreach with users and the planned June 2012 consultation paper, this Appendix provides illustrative examples intended to explore how the proposed objective of auditor commentary may be met, and is presented for discussion purposes only. These examples draw from auditor reports to audit committees and seek to describe circumstances relevant to audits of listed entities. These examples will be subject to further revision, as the TF and IAASB reflect on the practicality and viability of these options in an international reporting environment.

Commentary on Significant Matters Related to the Audit

In connection with our audit, we highlight the matters listed below [for the purpose of providing an understanding of areas of audit emphasis[, including those involving significant judgment by us in conducting the audit and relating to significant judgment by management in preparing the financial statements]. We have discussed these matters with [name of applicable body constituting TCWG] as required by the ISAs. This is not intended to be a complete list of all areas that our audit procedures addressed in response to identified risks of material misstatement nor is it a complete list of all matters discussed with TCWG. Our audit procedures relating to these matters were designed in the context of our audit of the consolidated financial statements taken as a whole, and not to provide assurance on individual accounts or disclosures.

Example of Auditor Commentary	Notes / Reference to Para. 15
1. We draw your attention to the discussion in Note 3 about the early application of IFRS X relating to the Company's revenue recognition policies for its software products, which had a material effect on the amounts recorded for revenue and deferred revenue in the consolidated financial statements for the periods ended December 31, 20X1 and December 31, 20X0.	Intended to illustrate bullet #1 in paragraph 15. Akin to the current definition of an EOM paragraph.
2. During 20X1, the Company implemented a new commissions and fee information technology (IT) system. Because this system is the basis on which the Company records revenue for commissions, fees and premiums earned, we determined it was necessary to expand our audit procedures to obtain sufficient appropriate audit evidence that transactions were being appropriately processed and revenue appropriately accounted for following the launch of the new system. We obtained an understanding of the new system, including relevant transaction processes and reports as well as the design and implementation of related internal controls, through discussion with management and review of relevant reports from the internal audit function, which included results of internal audit's review and testing of the implementation. Based on exceptions noted during our testing of controls,	Intended to illustrate bullet #2 in paragraph 15. Similar to the French justification of assessment model in that it provides details about the auditor's procedures and a conclusion.

<p>we expanded our planned substantive procedures to obtain sufficient appropriate audit evidence about commissions, fees and premiums earned. Our procedures included:</p> <ul style="list-style-type: none"> • Testing non-standard journal entries made during the closing process. • Evaluation of the propriety of revenue recognition for brokerage agreements, fee agreements and multi-year policies. • Reviewing transactions that occurred close to the Company's year-end, to determine that adequate support exists, as per Company policy, for any unbilled commissions with a policy effective date prior to year-end. • Evaluation of the recoverability of amounts due from brokerage agreements and consulting services. <p>Based on the results of our procedures, we believe the Company's policy and application for revenue recognition is reasonable and consistent with prior years.</p>	
<p>3. As noted in Note 4, XYZ Company is a jointly controlled entity. ABC Company accounts for its investment in this entity under the equity method in accordance with [applicable financial reporting framework]. In planning our audit, we considered the investment to be material to the entity's results of operations and, as such, were required by the ISAs to [have sufficient involvement in the identification of risks of material misstatement to the group financial statements, and the responses to those risks, to] obtain sufficient appropriate audit evidence about the investment in XYZ Company as a basis for forming our opinion on ABC Company's financial statements as a whole. The joint venture agreement with MNO Company did not provide for access to the independent auditors responsible for the statutory audit of XYZ Company. We obtained an understanding of the XYZ Company business activities through discussions with XYZ Company and ABC Company management, including the ABC Company representatives on the XYZ Board of Directors, to assist in our identification of the risks of material misstatement to the group financial statements. We also reviewed the monthly financial information provided to ABC Company, discussed such information with ABC management, and tested the controls in place at ABC Company to monitor the preparation and submission of XYZ Company's financial information to ABC Company. [We discussed this alternative approach with ABC Company's management and those charged with governance.] We also reviewed the audited financial statements of XYZ Company. Based on our procedures, we concluded that the risks of material misstatement to ABC Company's financial statements related to its joint venture investment in XYZ</p>	<p>Intended to illustrate bullet #3 in paragraph 15.</p>

<p>Company were appropriately addressed.</p>	
<p>4. We draw your attention to management's discussion of its Summary of Significant Accounting Policies [Sources of Estimation Uncertainty per IFRS] in Note 1, in particular the discussion of the Company's processes to value its financial instruments using a model. As disclosed in Note 1, management has previously valued these instruments using quoted market prices but, in light of the illiquidity in the market for these instruments, management believed it was necessary to use a model to estimate the fair value of these instruments as of December 31, 20X1.</p> <p>Based on discussion with management and our own expert, we concluded the use of a model and the design and operation of the model itself was appropriate in the circumstances. Management has appropriately documented the model in accordance with its formal valuation policy. The model considers all relevant market observable information that is available. To obtain audit evidence about the fair values of the financial instruments described in Note 1, we tested internal controls around the model, including how it has been developed, calibrated and tested for validity. We tested the data that the model used as described in Note 1. We also confirmed that no adjustments had been made to the output of the model. In testing assumptions used in the model, we focused on those assumptions that management had developed and that materially affect the fair value measurements. We also considered whether the individual assumptions are reasonable in the aggregate and were alert for indications of management bias given our understanding of the significance of the individual assumptions to the fair value measurement. We have also tested the Company's sensitivity analysis and note that the valuation of the financial instrument would change significantly with moderate changes in the assumptions used in the model. Based on the audit work performed, we believe that management has used the best information available in the circumstances, which management has appropriately disclosed in Note 1 in accordance with [applicable financial reporting framework].</p>	<p>Intended to illustrate bullets #3 and #4 in paragraph 15.</p>