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Our ref: ICAEW Rep 04/10

Greg Tanzer
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IOSCO General Secretariat
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By email: AuditorCommunications@iosco.org

Dear Mr Tanzer

Consultation on Auditor Communications

The Institute of Chartered Accountants in England and Wales is pleased to respond to your request for comments on the *Consultation on Auditor Communications*

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

ICAEW REP 04/10

CONSULTATION ON AUDITOR COMMUNICATIONS

Memorandum of comment submitted in January 2010 by The Institute of Chartered Accountants in England and Wales, in response to the International Organization of Securities Commission's *Consultation on Auditor Communications* published in September 2009.

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the Institute or ICAEW) welcomes the opportunity to comment on the consultation paper *Auditor Communications* published by the International Organization of Securities Commissions (IOSCO).

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 132,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 775,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.

MAJOR POINTS

4. The ICAEW is pleased to provide comments on the IOSCO consultation on *Auditor Communications*. We are pleased to input into this ongoing debate which is now attracting the attention of stakeholders internationally. Although a number of your questions are directed towards the views of investors, in our view the opinion of the profession is valuable and can provide you with a unique insight into current practice. We therefore hope that our response provides you with some additional high level thoughts on the overall debate and imparts our experiences of the UK on this subject. In our view, it is important that IOSCO encourages the full range of stakeholders, including preparers and users' of the audit report to engage in this consultation process and provide their views and feedback.

Transparency

5. We support the need to improve transparency in financial information, however, our view is that this should be balanced with providing information that is in the public interest and which will serve to enhance users understanding rather than provide further confusion. There also needs to be a balance between what is in the public interest in terms of clarity of message, consistency and comparability of the language from the audit report and the need to provide entity-specific tailored information for each individual audit report.
6. It is often quoted that the investors require more information concerning critical areas and judgements and the main uncertainties contained in the compilation of the financial statements. Although the auditors might have some views about these issues, it is the responsibility of those charged with governance to make such information available to investors and they are in the best position to do so. Currently auditors are required to communicate to those charged with governance, significant matters concerning their audit. If auditors were to disclose this information directly to investors, then the role of those charged with governance role would be brought into question and may impact on the auditor's independence. It is therefore important to understand that the requirement for such information is a function of the wider financial reporting framework and is not an issue that can or indeed should be addressed merely by extending the scope of the audit report. Clearly should such extended information become part of the financial statements then the auditor will have a role in considering this information as part of their audit. We have provided detailed comments on Governance below.

Expectations gap

7. The IOSCO paper acknowledges that although the audit report has evolved significantly over the years, it continues to attract criticism from some stakeholder groups and is often drawn into the “expectations gap” debate. In our view, the audit report is not a panacea and there needs to be separate consideration and analysis of what this expectations gap is and why it still exists to the extent that this expectations gap is an “information gap” between the information that investors need and that which is publicly available.
8. Finally, it will also be important to consider the impacts, (for example, in relation to the public policy and cost) associated with any changes related to audit reports, particularly if those changes extend beyond providing information (and assurance) related to the financial statement audit.

Detailed comments

Wider corporate governance reporting model

9. Our view is that the audit report should not be considered in isolation, it needs to be considered in combination with the wider governance corporate reporting model as the relevant information that investors are looking for may be included within the corporate report rather than the audit report. It would be useful to find out from investors what additional information they think should be in the audit report that cannot be found elsewhere and through other mechanisms such as management/directors and audit committees. Currently the auditor provides information to those charged with governance in the exercise of their governance role. If the auditor were to instead provide this information directly to investors and others, it could raise questions about the role of those charged with governance. To the extent that investors feel there is an “information gap” relating to information about the quality of the financial statements, in our view, management and those charged with governance are in a better position to provide information to users to fill that gap.
10. The current audit report model (either clean or modified) highlights that it is the directors’ responsibility to provide relevant information to shareholders and for auditors to then add credibility to that information through the audit process. Before the financial statements are issued, there will be discussion and resolution of issues hopefully resulting in a clean opinion. However the extent to which the report is clean, will depend on clear disclosure by the directors and a willingness of investors and others to analyse the information properly. A change to this model will inevitably influence the behaviour of directors, auditors and shareholders.
11. Having said that, there is first a need to better understand the nature of the additional information sought by users in order to determine how best to provide that information. When assessing the sufficiency and quality of information available to users currently, it is important to distinguish between information that users need to assess the quality of the financial statements vs. the information that users need to assess the quality of the audit process (including the scope of work performed during the audit).

Quality of audit process

12. The consultation paper also highlights the question that the audit report does not provide users with any indication of audit quality. We strongly believe that the purpose of an audit report is not to assess audit quality as the audit report is a record of the auditor’s opinion on an entity’s financial statements. Adding information about the quality of the audit within the audit report would only serve to confuse users. If investors want information to help them assess the quality of the audit and auditors, there is a need to consider the most useful place and way in which that information can be available. There are already independent oversight bodies that monitor the quality of audits that have been performed. In many countries and jurisdictions there is information published by these oversight bodies. For example, in the United Kingdom the Audit Inspection Unit (AIU), part of the Professional Oversight Board, is responsible for the monitoring of the audits of all listed and other major public interest entities. Since 2007/8 the

AIU have issued individual public reports on the principle themes and findings of their inspections of the largest firms inspected. To the extent that information on audit quality is required then there are better places to obtain this information than the audit report.

13. Additionally, in many countries and jurisdictions, including the United Kingdom, audit firms make available information about their internal controls in relation to audit quality eg transparency statements as required by the EU's Statutory Audit Directive. These, and perhaps other similar mechanisms, are, in our view, a better way to provide investors with the information they require about audit quality rather than an increase in the quantity of data within the audit report.

Reference to other research

14. The consultation paper refers to other work carried out globally and our view is that it is important for IOSCO to ensure that it reviews the results of this other work thoroughly in arriving at its conclusions on this consultation. We assume that IOSCO will use the results of this consultation to feed into the joint IAASB/AICPA audit report research project which began subsequent to the 2007 IOSCO round table and comprises four different research studies which have sought feedback from users of financial statements. This approach supports the vision for development and adoption of single set of high quality international auditing standards.
15. We are pleased to note the reference to the *Audit Quality Forum's* publication *Auditor Reports* which started the debate within the UK in 2006 and indeed, we note that much of the debate that the *Audit Quality Forum* had on audit reports is repeated within IOSCO's consultation paper. At the time of our debate, key questions were raised about the role of audit committees and those charged with governance in respect of information that investors are searching for. Since the publication of this paper, the *Audit Quality Forum* has continued its work in this area and has published a further paper, *The impact of audit on audit committees* which IOSCO may find a useful contribution to this debate.
16. The UK's Auditing Practices Board (APB) also carried out research into the audit report in 2007 (following from the AQF paper *Audit Reports*). Within the UK, there is also the IPSOS MORI *Global Investors Survey* which highlighted that respondents *were unable to make a suggestion for improving transparency without resorting to excessive disclosure and many investors struggle to identify specific information that could be dropped, some make very specific suggestions such as dropping information on accounting standards and dropping corporate governance/share ownership information.*

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