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545 Fifth Avenue, 14th Floor
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Reference: Consultation Paper: *Enhancing the Value of the Auditor Reporting: Exploring Options For Change*

CFA Institute[1], in consultation with its Corporate Disclosure Policy Council ("CDPC")[2], appreciates the opportunity to comment on the International Auditing and Assurance Standards Board's (IAASB) Consultation Paper: *Enhancing the Value of the Auditor Reporting: Exploring Options For Change* (CP).

CFA Institute is comprised of more than 100,000 investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. CFA Institute seeks to promote fair and transparent global capital markets, and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that the quality of corporate financial reporting and disclosures provided to investors and other end users is of high quality.

General Comments

CFA Institute Support for Changes to the Auditor's Reporting Model

CFA Institute supports the efforts of the IAASB to enhance the quality, relevance and value of auditor reporting. We have long expressed the need to improve the Standard Auditor's Report (SAR) as a means of communicating important information to investors and other users regarding the audit of a company's financial statements. It is our belief that the SAR along with the financial statements and other narrative sections of an entity's financial report (i.e. management commentary, operating and financial review, etc.) should be considered part of a holistic communication of relevant information to investors to make informed capital allocation decisions. Significant efforts and costs go into an audit, yet investors are provided very little information in the report provided by the current SAR. Through increased transparency, a revised auditor's

[1] With offices in Charlottesville, VA, New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 100,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 133 countries, of whom nearly 83,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 135 member societies in 57 countries and territories.

[2] The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

reporting model should heighten user confidence in the audited financial statements and better inform them about the auditor's role.

The current SAR contains largely "boilerplate" language which has contributed to an "expectations gap", commonly understood as the gap between the auditor's performance, the auditor's communication of what they did, and the users' expectations regarding the audit process and findings. It is our belief that enhancements to the SAR hold the greatest promise to narrow this expectations gap and to provide decision-useful information to investors.

We are hopeful that the IAASB will not delay enacting significant changes to the auditor's reporting model.

CFA Institute Surveys Support Changes to the Auditor's Reporting Model

CFA Institute has conducted multiple surveys[3] of our membership over the last few years on the importance of the SAR to investors and its information content. These surveys have consistently shown that the auditor's report is important to the analysis of financial statements, but that it should provide more information about the basis for the auditor's opinion.

Among the more significant survey findings are:

- Seventy-two percent of respondents indicated that the auditor's report is important to the analysis and use of financial statements in the decision-making process.
- Fifty-eight percent of respondents indicated that the auditor's report needs to provide more specific information about how the auditor reaches their opinion.
- A large majority of respondents indicated that more information regarding materiality, the auditor's independence, management's critical accounting judgments and estimates, and key areas of risk is important.

These surveys indicate that investors desire more qualitative information about the audit findings and audit process.

CFA Institute Observations on the Pass/Fail Reporting Model

The SAR has been commonly described as a pass/fail model since the auditor expresses an opinion on whether the financial statements are fairly presented (pass) or not (fail). This aspect of the SAR is beneficial because it is brief, clear, consistent and comparable. It benefits those investors who want to quickly scan the SAR for departures from the unqualified report. However, it has limited utility for those who desire a more thorough and complete understanding of the audit findings and the audit process. For this reason, we believe that the pass/fail element of the model should be retained but, as explained in our responses to the specific questions from the IAASB, it should be supplemented with additional information.

[3] CFA Institute, Usefulness of the Independent Auditor's Report, March 2011
http://www.cfainstitute.org/Survey/usefulness_of_independent_auditors_report_survey_results_march_2011.pdf
CFA Institute, Independent Auditor's Report Survey Results, March 2010
http://www.cfainstitute.org/Survey/independent_auditors_report_survey_results.pdf

Auditor's Commentary vs. Emphasis of a Matter
The principal consideration regarding expanded disclosure of the audit findings and audit process should be the content, irrespective of where the information is reported. We preface our remarks, however, with the assumption that in either form (i.e. auditor's commentary or emphasis of a matter) the additional disclosure will be a component of an auditor's report that will include the audit opinion. Whether the information is presented in auditor's commentary or in emphasis of a matter paragraphs should not be a barrier to requiring the auditor to report the information, provided that in either situation it should carry the same level of professional accountability for quality.

Furthermore, while auditor reports are required to be delivered annually, we believe that the auditor's commentary requirement should extend to interim financial statements as well. Although some entities are required to have quarterly or semiannual reviews, there is generally no associated report. Investors would benefit from the auditor's perception of the interim financial statement reviews through disclosure of many of the same reporting attributes we specify in our response to Question 2.

Improvements to the Current Auditor's Reporting Model will Require a Cultural Shift
Investor needs should be paramount when considering revisions to the auditor's reporting model. Requirements should be set with a view toward providing the highest quality and most comprehensive information possible for investors.

We believe that for meaningful changes to be effective the reporting responsibilities of the audit committee, management, and independent auditors will need to undergo a cultural shift in reporting mindset. The historical reporting relationship has tended to be viewed as the auditor reporting to the audit committee and to management, rather than as a communication to investors. Instead, the reporting considerations of the auditor should be directed to the user, since it is the users (i.e. investors) who contract with the auditor, not management.

Shifting from the current mindset will take time and, given liability concerns, many audit firms are likely to oppose the alternatives in the concept release. Moreover, there is the potential that, even with a new and expanded audit reporting model, liability concerns will quickly cause any new disclosure requirement to revert to boilerplate reporting. *We urge the IAASB to bear in mind that the investor pays for, and is the ultimate consumer of, the auditor's report and that the boilerplate nature of the existing model requires improvement. Use of boilerplate language in the revised report should be discouraged by issuing a well-written standard that is rigorously enforced.*

CFA Institute Response to the U.S. PCAOB Regarding the Auditor's Reporting Model
We are attaching a copy of our letter to the U.S. PCAOB as **Appendix II** in response to their Concept Release on changes to the auditor's reporting model. Many of the same issues are being addressed by both the IAASB and the PCAOB. It is our belief that the IAASB and the PCAOB should work together to develop a common auditor's reporting model to meet the reporting requirements regardless of the jurisdiction in which the entity files their financial reports. This suggestion is also consistent with Recommendation 5 of the *Final Report to G-20 Deputies* issued by the Private Sector Taskforce of Regulated Professions and Industries issued in September

2011[4] which recommends that the G-20 support the development of globally accepted high-quality international standards including audit standards.

A common reporting model will enhance comparability of the auditor's report among entities.

CFA Institute Responses to Specific Questions
CFA Institute responses to specific questions are presented in the **Appendix I** to this letter.

Closing Remarks

We thank the IAASB for the opportunity to express our views on the Consultation Paper. If the IAASB have questions or seek further elaboration of our views, please contact Matthew M. Waldron by phone at +1.212.705.1733, or by e-mail at matthew.waldron@cfainstitute.org.

Sincerely,

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[4] Private Sector Taskforce of Regulated Professions and Industries, *Final Report to G-20 Deputies*, September 2011. http://www.ifac.org/sites/default/files/publications/files/PSTF%20Report.pdf

Appendix I

Responses to Specific Questions

1. **Do respondents have any comments about the issues identified in Section II regarding the perceptions of auditor reporting today?**

   See our comments in the General Comments section in the body of the letter.

2. **If respondents believe changes in auditor reporting are needed, what are the most critical issues to be addressed to narrow the information gap perceived by users or to improve the communicative value of auditor reporting? Which classes of users are, in the view of respondents, most affected by these issues? Are there any classes of users that respondents believe are unaffected by these issues?**

   Classes of Users
   While there are a number of different users of the auditor's report, we believe that the investor is the most affected by the issues being addressed by the IAASB in exploring ways to improve the SAR. Regulators have the ability to request additional information from the entity investors, on the other hand, must rely on the information provided with or within the financial statements to make decisions. For this reason, we believe that the main objective should be to focus on the needs of investors.

   Information Requirements
   In accordance with paragraph A11, of ISA 230 *Audit Documentation,* the auditor identifies all significant findings or issues and often documents this in an engagement completion document. This document identifies and discusses the significant findings or issues and the basis for conclusions reached in connection with each engagement. The information in the completion document would be of interest to investors because it provides the auditor's perspective on significant risks and other matters associated with the audit. Much of this information is already documented in the auditor's working papers in connection with the issuance of the auditor's report. We believe that the auditor should report these same matters in plain, non-boilerplate language. We are not suggesting any change in audit scope or additional procedures, but that the auditor simply report what was done in conducting the audit, using information already largely contained in the audit completion memo.

   We believe that the following elements are considered important:

   - Audit Risk - Provide a discussion of significant risks identified by the auditor and include factors the auditor evaluated in determining which risks are significant and how they were audited and assessed. This risk assessment should include not only specific financial statement risks, but also the auditor's overall client risk assessment factors. Also discuss why the auditor views these risks as significant.
   - Auditor Independence - Provide a discussion of any matters that were reported and discussed with the audit committee concerning independence.

- Auditor Materiality - Provide details about the quantitative and qualitative materiality levels and factors the auditor considered in establishing materiality levels.
- Assessment of Management's Critical Accounting Judgments and Estimates - Provide a discussion of the critical accounting estimates that were discussed with management or the audit committee, the assumptions underlying the critical accounting estimates, and the auditor's assessment of and findings associated with the evaluation of these critical estimates. This could also include a discussion of movements and ranges around critical estimates.
- Accounting Policies and Practices - Provide a discussion of:
  a. Discretionary changes in accounting principles or estimates affecting the consistency of reported amounts.
  b. Qualitative aspects of the company's accounting practices, financial statements and disclosures discussed with the audit committee or management.
  c. Material matters that, while in technical compliance with the financial reporting framework, could have enhanced disclosures to improve investor understanding of the matters.
  d. Significant unusual transactions in the current reporting period.

  This discussion should focus on the reasons why the auditor considers changes in critical accounting policies to be significant and include a statement that they found no inconsistencies in their review. The auditor should also discuss any changes in accounting policies and practices not deemed critical by the auditor and/or management. The auditor should opine on any accounting policies and practices that represent a significant departure from policies and practices commonly applied by comparable firms in relevant industries.
- Summary of Unadjusted Audit Differences - List and discuss all unadjusted audit differences by financial statement line item.
- Audit Scope Changes & Unique Management Representations - Discuss audit scope limitations or expansion in audit scope and the impact on the financial statements. Additionally, include a description of any unique/non-standard representations included as a part of the management representation letter.
- Difficult or Contentious Issues, Including "Close Calls"- Discuss any difficult or contentious issues or "close calls" that arose during the audit and the final resolution of each issue.

3. Do respondents believe that changes are needed for audits of all types of entities, or only for audits of listed entities?

We believe that the requirements should apply to all entities given that information is equally relevant and important to investors regardless of the type of entity. We also note that the distinction between listed and non-listed enterprises has become increasingly blurred in recent years due to the growth in private equity.

4. Respondents are asked for their reactions to the options for change regarding the format and structure of the standard auditor's report described in Part A. Do

respondents have comments about how the options might be reflected in the standard auditor's report in the way outlined in Appendix 1 of this Consultation Paper?

As noted in our opening remarks, we believe that either an auditor's commentary or emphasis of a matter paragraphs would be acceptable means of communicating additional information regarding the audit findings and audit process provided that both carry the equivalent level of professional accountability for quality. Our principal concern is that the information should be reported by the auditor in such a way that it is not construed to be reported by management and while guidelines as to what should be reported should be established, the language should not be boilerplate.

We do not think that the ordering of the auditor's opinion, management's responsibility for the financial statements and the auditor's responsibility is critical, provided that they are all contained in the auditor's report and clear headings are used to indicate each section.

5. **If the paragraphs in the current standard auditor's report dealing with management and the auditor's responsibilities were removed or re-positioned, might that have the unintended consequence of widening the expectations gap? Do respondents have a view regarding whether the content of these paragraphs should be expanded?**

We are not in favor of removing the paragraphs dealing with management's and auditor's responsibilities. Removal of these paragraphs would further widen the expectations gap.

We believe that clarification of the auditor's responsibilities will assist investors to better understand the auditor's role and in narrowing the expectations gap. We draw particular attention to the need to clarify the auditor's responsibility for detecting and reporting material fraud, which would be especially beneficial for users to better understand. It is our belief that further explanation of the extent of the auditor's fraud detection responsibilities, combined with clarification of the auditor's responsibilities under the reasonable assurance standards more broadly, will help narrow the expectations gap.

The benefit of expanded language is that it will close the expectations gap by clarifying the auditor's responsibilities and perspective on the financial statements. For example, auditor independence is not mentioned in the main body of the auditor's report aside from the reference to the "Independent Auditor's Report" in the title. The standard audit report could be strengthened by including additional wording to describe the auditor's duty to be independent of the company.

Also, in the case of the auditor's responsibility for information outside the financial statements it would be helpful to include language clarifying the auditor's responsibility with respect to that information. Presently the auditor is only required to read the other information for consistency with the accompanying the financial statements; however, this limited responsibility is not referred to in the current audit report. If included, it would alert investors to this limited level of responsibility.

6. **Respondents are asked for their reactions to the possibility that the standard auditor‘s report could include a statement about the auditor‘s responsibilities regarding other information in documents containing audited financial statements. Do respondents believe that such a change would be of benefit to users?**

   We agree that the auditor's responsibilities for matters outside of the financial statements should be clarified since currently there is some confusion regarding these responsibilities.

7. **If yes, what form should that statement take? Is it sufficient for the auditor to describe the auditor‘s responsibilities for other information in documents containing audited financial statements? Should there be an explicit statement as to whether the auditor has anything to report with respect to the other information?**

   We believe that the auditor's report should clarify the auditor's responsibility for other information in documents containing audited financial statements. Also, as part of the auditor's commentary or emphasis of a matter paragraph, the auditor should report any significant findings regarding their review of the other information.

8. **Respondents are asked for their views regarding the auditor providing additional information about the audit in the auditor's report on the financial statements.**

   See response to Question 2.

9. **Respondents are asked for their reactions to the example of use of "justification of assessments" in France, as a way to provide additional auditor commentary.**

   We believe that the additional reporting requirements regarding the matters in our response to Question 2 would be sufficiently informative to the users regarding matters of audit significance provided that they do not become boilerplate in nature. Additional reporting in the form of a "justification of assessments" would not add much to the enhanced reporting model, even with the auditor reporting the procedures performed.

10. **Respondents are asked for their reactions to the prospect of the auditor providing insights about the entity or the quality of its financial reporting in the auditor‘s report.**

    Insights About the Entity
    To the degree that business risks, strategic risks or operational risks have a direct bearing on the financial statements – such as those that may impact the valuation of assets and liabilities, the related critical accounting judgments and estimates or the entities ability to continue as a going concern – then the auditor should provide information about how those risk factors were assessed and the overall impact on the financial statements and their audit process and findings. It is our belief that the auditor should also be expected to communicate information with respect to risks associated with the audit and internal controls.

We are not in favor of the auditor reporting on business risks, strategic risks or operational risks outside of those with direct impact on the reported amounts in the financial statements as noted above. Commenting on these areas would require the auditor to be more fully embedded in the management of the company on a more contemporaneous basis in order to have a complete understanding of the matters. This is not, in our view, the role of the independent auditor. Management on the other hand should comment on the business, strategic and operational risks through the management commentary.

Reporting on the Quality of Financial Reporting
We are not in favor of the auditor reporting on the quality of the entity's financial reporting. We believe that developing a suitable framework to make such assessments go beyond what the auditor should be expected to do. As mentioned in our opening remarks, we are not asking for an expansion in audit scope which is what reporting on the quality of an entity's financial reporting might entail. Rather, we are simply asking that the auditor's provide additional transparency into the audit process and audit findings as noted in our response to Question 2.

11. Respondents are asked for their reactions to the options for change relating to an enhanced model of corporate governance reporting, as described in Section III, Part D.

We believe that investors would benefit from enhanced reporting directly from those charged with governance (i.e., boards of directors and audit committees). It is our belief that requiring greater reporting to investors by the audit committee would enhance the overall value of the audit and provide useful information to investors. However, this should come at a later date and not delay the immediate and necessary changes to the current auditor's reporting model.

12. To the extent that respondents support this model, what challenges may be faced in promoting its acceptance? Also, what actions may be necessary to influence acceptance or adoption of this model, for example, by those responsible for regulating the financial reporting process?

See response to Question 11.

13. Do respondents believe assurance by the auditor on a report issued by those charged with governance would be appropriate?

We are not in favor of the auditor providing assurance on any report issued by those charged with governance. We do not believe that such assurance would add any measurable benefit to the audit report and in fact, may only delay its issuance.

14. Respondents are asked for their reactions to the need for, or potential value of, assurance or related services on the type of information discussed in Section III, Part E.

At this time, we are not in favor of expanding the auditor's role to include assurance on matters outside of the financial statements beyond what is already presently required or permitted by the auditing and attestation standards. It is our belief that the IAASB should remain focused on making the necessary and immediate changes to the existing auditor's reporting model.

15. **What actions are necessary to influence further development of such assurance or related services?**

    See response to Question 14.

16. **Respondents are requested to identify benefits, costs and other implications of change, or potential challenges they believe are associated with the different options explored in Section III.**

    While we understand the challenges presented by changing relationships, audit effort, auditor liability, etc. we believe that this should not either individually or in the aggregate override the need to improve the auditor's reporting model. The auditor provides a key service on behalf of the investor and revision of the current ineffective model is essential to adding transparency to the audit process and purpose.

    We are aware that there are those in company management, and with those charged with governance, who will object to changes for a variety of reasons. For instance, they will argue against changes to the already well entrenched auditor's reporting model because of increased exposure to legal actions and increased audit fees. However, investors and other users have been disadvantaged by the lack of transparency and the uninformative auditor's report currently in place. Investors pay either way, through increased costs for additional information or through lacking information to assist them in making informed investment decisions. We do not believe that requiring the auditor to describe the audit process and the audit findings is an expansion of scope or liability. We are simply asking that auditor's report on what they did and their findings, including the factors unique to the company that influenced the auditor's process and decisions.

17. **Do respondents believe the benefits, costs, potential challenges and other implications of change are the same for all types of entity? If not, please explain how they may differ.**

    No response.

18. **Which, if any, of the options explored in Section III, either individually or in combination, do respondents believe would be most effective in enhancing auditor reporting, keeping in mind benefits, costs, potential challenges and other implications in each case? In this regard, do respondents believe there are opportunities for collaboration with others that the IAASB should explore, particularly with respect to the options described in Section III, Parts D and E, which envisage changes outside the scope of the existing auditor reporting model and scope of the financial statement audit?**

    As noted in our opening remarks and in our responses to specific questions, we are not in favor of expanding the scope of the financial statement audit. We are simply asking that auditor's report be expanded to include information on what the auditors did and their findings, including the factors unique to the company that influenced the auditor's process and decisions.

It is our belief that the IAASB, the PCAOB and others should work together to develop a common auditor's reporting model to meet the reporting requirements regardless of the jurisdiction in which the entity files their financial reports. A common reporting model will enhance comparability of the auditor's report among entities.

19. Are there other suggestions for change to auditor reporting to narrow the —information gap perceived by users or to improve the communicative value of the auditor's report?

No response.