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26 August 2011

Ms Merran Kelsall
Chairman
Auditing and Assurance Standards Board
PO Box 204
Collins Street West
MELBOURNE VIC 8007

Dear Ms Kelsall

RE: Consultation Paper - Enhancing the Value of Auditor Reporting: Exploring Options for Change

We appreciate this opportunity to comment on the above.

We recognise that there has always been a need for improved communications between the auditor and investors. The current auditor's report is described as a pass/fail model. Whilst this "pass/fail" opinion is still considered necessary, the investors need more information from the auditors.

We are responding on behalf of the Hayes Knight Australian Network of firms, each of which is a separate and legal entity.

We have provided responses to request for specific matters on the attached Appendix 1.

Please contact me on (02) 9221 6666 if you require any further information.

Yours faithfully,

Pran Rathod FCPA
Director – Audit Services

Specific Matters for Comments

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

   The current auditing standard ISA700 now contains (i) an introductory paragraph identifying the financial statements audited, (ii) a scope paragraph describing the nature of the audit and (iii) a separate opinion paragraph expressing the auditor's opinion. This report can be described as a pass/fail model because the auditor's opinion states either that financial reports presents fairly or gives a true and fair view (pass) or they do not present fairly or do not give a true and fair view (fail). For large entities, an audit involves a great deal of time and human resources, which the company may incur substantial cost.

   An auditor's report at the end of the day reflects such work in a relatively few paragraphs.

   Over the years the users of the financial statements differ in their perception of an audit to what the audit profession expects the auditors in conducting an audit. Part of the expectation gap has been due to lack of sufficient appropriate communications between auditors and the users of financial statements.

   Financial statements are becoming more complex and involves an increasing use of estimates and judgments. The investors need more information and audit reports need to be more useful, and provide investors assessments of the company's financial health.

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?

   We consider that changes in auditor reporting are needed. Currently auditor reporting communicates the auditor's overall conclusion. This report is not viewed as being as useful or informative as it could be.

   We suggest that the following be included to narrow the information gap:

   - **Auditor's assessment of estimates and judgments used by management to prepare financial statements.**
   - **Auditor's discussion on how they addressed the areas that presented the most significant risks that the financial statements might be materially misstated.**
   - **Going concern.**
   - **A specific assurance on an entity's internal controls.**
   - **A report on the adequacy, and effectiveness of a company's risk management programme.**
   - **Commentary on the appropriateness of key accounting policies adopted by management in preparing the statements.**

- **Auditing the non-financial information (such as corporate governance practices) and corporate social responsibility issues. However, there are no existing established frameworks to guide the auditor in auditing such information.**

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

   We consider the categories are needed for the following types of entities:
   - **Listed entities**
   - **Large reporting entities, as defined under the Corporations Act.**

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?

   The general consensus of investors is that the current auditor's report is of limited relevance as it only provides a pass-fail opinion. The audit in large companies requires substantial time and effort, and the financial statements have now become more complex. With this background investors want deeper insight from the auditor, especially in the aftermath of the financial crisis.

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 consider that the paragraphs dealing with the auditor's responsibilities and management responsibilities be retained. These paragraphs were included, over time to reduce the expectation gap. Furthermore, these should not be repositioned.

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 believe that such a change could improve the quality, completeness and reliability of such information and provide investors and other users of financial statements with a higher level of confidence in that information.

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?

   Please refer to item 14.

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.

We consider that additional information about the audit will provide the investing public a better understanding of what an audit is through enhanced transparency. This information will relate to how an audit has been conducted and may cover the following:

- **Risk**

The risks in the following and the auditor's responses to those risks:
  - **Industry and economic conditions increasing the risk of material misstatement in account balances**
  - **Management's judgment or estimates and the application of critical accounting policies**
  - **Going concern capabilities for a reasonable period of time**
- **Adjusted and unadjusted errors**
- **Nature of non-audit services provided and the process used to confirm the auditor's independence**

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.

Whilst we do not agree to the title "justification of assessments", we nevertheless concur with the contents that this paragraph contains. We believe that the contents:

- **Enhance the communicative value of the auditor's report, even where the auditor's report is unqualified**
- **Serve as an aid in reading the financial statements**
- **Serve as an alert to readers by highlighting specific areas of financial statements.**
- **Focus readers' attention on more subjective areas of the financial statements that are of interest and enable the auditor to explain what the audit involved and what areas were of concern.**

However, there would be difficulties in disclosing the contents under the paragraph of "justification of assessments". These may not be readily understandable by less knowledgeable users of audited financial statements because they typically use technical language and sometimes complex to read. Furthermore, such disclosures may increase auditor's exposure to liability.

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.

Depending on the nature and extent of the additional information to be communicated in the auditor's report, this could have implications on the boundaries between the respective roles and responsibilities of management and those charged with governance, and the auditor with respect to the financial reporting process. Furthermore, this may have implications for liability exposure for all parties and new auditing requirements which might be necessary or appropriate would need to be developed accordingly.

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 consider the importance of audit committees as a crucial element of corporate governance. The success of audit committees in fulfilling their oversight responsibility depends on their working relationships with other participants of corporate governance, including the board of directors, management extend auditors, internal auditors, legal counsel, professional advisors, regulators and standard setting bodies.

In its role, the audit committees represent the most reliable guardians of the public interest. However, there is very little information from the Audit Committee that is made available to the users of the financial report.

An Audit Committee Report should be prepared and included in the Annual Report.

We believe that the Auditor should separately provide an assurance report on the reasonableness and completeness of the Audit Committee Report.

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?

The preparation of Audit Committee Report for users of financial report would raise certain concerns:

- **As the members of the Audit Committee are not thoroughly involved in the preparation of financial statements, this may increase the audit committees liability. This may result in either higher compensation for its members or fewer qualified directors willing to serve on audit committees.**
- **Management is primarily responsible for fair presentation of financial statements in confirmity with GAAP.**
- **Auditors are responsible for providing reasonable assurance regarding fair presentation in confirmity with GAAP.**

We note that in the US, whilst Audit Committee reports are prepared for listed entities, a number of reports contain disclaimers, or statements as follows:

- **The Audit Committee is not responsible for fair presentation.**
- **The auditor is responsible for providing a reasonable assurance.**

We are supportive of the inclusion of the Audit Committee report and the Auditors providing an assurance and completeness of the report. However, to gain acceptance by the Audit Committee, we suggest the following in the Audit Committee's report:

- **State that the Audit Committee is not being held to a higher standard than the Board**
- **State that the Audit Committee is able to rely solely on its communications with the auditors.**
- **Consider a more general statement of review rather than attestation to individual misstatement of omission.**

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

    We believe the report would be appropriate. However, such report be provided separately and not included as additional communication in the Auditor's report.

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.

    The current Auditing Standard, ASA 720 "Information in Documents containing an audited financial report" deals only with the following:

    - **In the absence of any separate requirement in the particular circumstances of the engagement, the auditors opinion does not cover other information.**
    - **The auditor has no specific responsibility for determining whether or not other information is properly stated.**
    - **The auditor, however, reads the other information because the reliability of the financial report may be undermined by material inconsistencies between the audited financial report and other information.**

    We are of the view that the auditor should provide some level of assurance or information outside the financial statements. Information outside the financial statements contain valuable information about the company and assists in better understanding and interpreting the audited financial report.

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

    Providing an auditor assurance on such information will result in additional auditor responsibilities and the additional costs.

    Furthermore, new reporting framework will need to be established and will require the development of new auditing standards.

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.

    We believe the options would not change the fundamental role of the auditor to perform an audit and attest to management assertions. These options are focussed on enhancing the relevance of auditors communications to investors.

    Currently the external auditors do communicate with the Audit Committee on various issues including significant risks and issues. However, no such information is made available to investors and or to public at large.

    There would be a number of challenges, for both the profession, and the Auditors and for those charged with governance. These are:

- **The financial statements are the responsibility of the management and the Board of Directors. The Auditor may be exposed to risks when for example, the Auditor express subjective views about the company's financial condition.**
- **The professional bodies would need to issue new auditing standards to guide auditors in the performance of the new tasks.**
- **There would be an increase in audit costs.**
- **The auditor will be subject to a greater scrutiny over auditing judgments including those on which a clear opinion is issued but is based on "close calls".**
- **With increased responsibility there could be a pressure on meeting/reporting deadlines.**
- **Increased concerns with auditor litigation, client confidentiality and privacy.**
- **Impact the additional auditor reporting may have on the relationship with management and the audit committee.**

17. <u>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.</u>
We consider that benefits, costs, professional changes would be same for all types of entities.

18. <u>Which, if any, of the options explored in Section III, either individually or in combinations, 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?</u>
We consider that the alternate option dealing with inclusion of Auditors Discussion and Analysis in the Audit report would provide further context to an investors understanding of the company's financial statements. This will also provide the auditor with the ability to communicate to investors and other users of financial statements the auditors significant judgments in forming an audit opinion.

19. <u>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?</u>
We consider that the investors are keen to have specific assurance on a company's internal controls and a report on the adequacy and effectiveness of a company's risk management programme.