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The Chairman
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17 August 2011

Dear Merran

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

Grant Thornton Australia Limited (Grant Thornton) is pleased to provide the Auditing and Assurance Standards Board (AUASB) with its comments on the International Accounting Standards Board's Consultation Paper – Enhancing the Value of Auditor Reporting: Exploring Options for Change.

Grant Thornton's response reflects our position as auditors and business advisers both to listed companies and privately held companies and businesses, and this submission has benefited with some initial input from our clients, and discussions with key constituents including the AUASB's 28 June 2011 Roundtable, and consultations with Grant Thornton International.

The views expressed here are preliminary in nature, and a more detailed Grant Thornton International global submission will be finalised by the IAASB's due date of 16 September 2011.

General comments

Auditors have an important part to play in rebuilding confidence in capital markets following the global economic crisis. We support users of financial statements having the opportunity to receive more information about companies with the aim of demonstrating how management has acted in their interests and how auditors have exercised appropriate professional scepticism.

In general, we agree that auditors should provide better communication to investors and we need to be more transparent about how we reach opinions and, likewise, there should be greater transparency about management judgment in preparing the financial statements.

In our opinion the ideal option would be to have enhanced reporting, on the oversight of the financial reporting process and external audit, by the Audit Committee and additional reporting on the reasonableness and completeness of the Audit Committee's report by the auditor. We feel that this would narrow the information gap perceived by users of the financial statements.

Our responses to the specific questions are included in Appendix I.

If you require any further information or comment, please contact me.

Yours sincerely
GRANT THORNTON AUSTRALIA LIMITED

Keith Reilly
National Head of Professional Standards

Issues Identified

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

   The key issue identified is that shareholders and the users of audit reports are seeking information that they consider to be relevant and reliable, especially for listed entities.

   It is important that information needs of the users of audit reports and shareholders are considered, especially when the audit report is available to the public. Currently the audit report contains many standard wordings which may not provide relevant information to the users and shareholders on the audit work that is performed. We agree that there should be improved communication of key financial reporting issues. We also concur that the structure and wording of the audit report could be improved to increase its communicative value.

   The manner in which financial and other information is reported to the public could also be improved. We understand that the users would prefer the information to come from the auditors as it would provide more credibility to the information. However, the auditor should not be the original source of disclosure about the entity. This should remain as management's responsibility. This should also be considered when the structure and wording of the audit report are reviewed.

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?**

   In our view the most critical issue to be addressed is the level of disclosure on the additional types of information listed in Section II.

   The key business and operational risks are already disclosed in other statements in the annual report for some jurisdictions. For example the director's report (Business Review) in the UK. In our view this information should not be included in the proposed changes to the audit report; however, auditors must read this information and ensure that there are no material inconsistencies. We agree that the key areas of audit risks and issues, such as revenue recognition, and how those risks and issues have been addressed could be included in the audit report.

Instead of the "auditor's perspective on the key assumptions underlying the judgment that materially affect the financial statements" the "auditor's assessment of key estimates and judgments made by management and how the auditor arrived at that assessment" would be more appropriate. There is a risk that the first statement may widen the expectation gap perception in that the auditor's responsibility would be confused with the management role. Whereas, if we clarify that the key estimates and judgment are made by management and the auditors only report on their assessment, then that would narrow the expectation gap.

Additional information on the appropriateness of the accounting policy and the changes to accounting policies that have a significant impact would, in our view, provide relevant information to the users of the audit report. It is often the case that accounting polices contain standard ('boilerplate') statements, therefore, this additional information in the audit report may provide the users with more insight to the appropriateness of the entity's accounting policy.

The methods and the judgments made in valuing assets and liabilities and disclosure of significant unusual transactions should be disclosed elsewhere by management. There is a risk of widening the expectation gap on the perceptions of auditor's responsibilities. There may also be different views on what are significant unusual transactions for difference users of the audit report.

In our view shareholders and potential investors of listed companies would be most affected by these issues. When assessing their investment they would aim to reduce the level of risk and uncertainty and these additional disclosures may assist in reducing the level of uncertainty. These issues may not affect owner-managed businesses and private companies.

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

As mentioned above, the changes may not be needed for audits of all types of entities. We believe that the changes should only be applied to listed entities and entities with a public interest as these companies would benefit from additional information to be disclosed in the audit report. Whereas, entities which have more straight forward internal controls and are private (such as owner-management business) may not benefit from the additional information. However, we acknowledge that shareholders and lenders to private companies may also benefit from the changes. Therefore we advocate that changes should be permitted and encouraged for other entities, but not mandated.

Exploring Options for Change

A. Format and Structure of the Standard Auditor's Report

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 explanation of management and auditor responsibilities should, in our opinion, be relocated to a separate document used to communicate with users about the financial statements. The model used in the UK is a good example on how relevant information regarding the scope of the audit can be publicly accessible online. In this case the management and auditor's responsibilities could be relocated to make the audit report more relevant to the user.

By relocating the statement of management and auditor's responsibilities, those responsibilities could be expanded. For an example it could highlight the fact that the auditor is responsible for planning and performing the audit to obtain reasonable assurance that the financial statements, taken as a whole, are free of material misstatement, "whether due to error or fraud".

We do not concur with removing the paragraph entirely from the auditor's report. This may result in widening the expectation gap. There is also the risk that some users such as creditors and employees may not be already sufficiently well-informed about the matters addressed in those paragraphs.

We also do not concur with retaining this paragraph on the audit report. If the audit report is to include additional information as mentioned in Section II, then there is a risk that the length of the audit report may significantly increase and users may not regard those sections as 'relevant' to them. However, it should be relocated and made publicly available to users.

Furthermore, it would be beneficial to include explanation of technical words in the 'relocated' explanation of the responsibilities of management and the auditor. This information is useful but it may not be relevant to all users.

We concur with the relocation of the auditor's opinion from the final paragraph to the first paragraph after the introduction. This would give the auditor's opinion greater prominence.

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 expectation gap? Do respondents have a view regarding whether the content of these paragraphs should be expanded?

We believe that the re-location of the management and auditor's responsibilities would not have the unintended consequence of widening the expectation gap. However, by removing the section altogether may lead to this consequence. We observed that the perceived shortcomings in auditing in relation to the financial crisis appear to derive from the misunderstanding about the current scope of an audit as opposed to failures to perform certain task that are required as part of an audit. However, if the scope of the audit and the responsibilities of management and the auditor are expanded and relocated, then this may address the issue of the expectation gap.

B. Other Information in Documents Containing Audited Financial Statements

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?

In some jurisdictions, there is already a requirement to give an opinion on other information in documents containing audited financial statements. For example in the UK, opinion on the information given in the Directors' Report, Directors' Remuneration Report and Corporate Governance Statement are disclosed separately in the auditor's report. We believe that this would benefit users. For example the Directors' Report includes a Business Review which provides key information on the entity's risks and uncertainties, key performance indicators, financial and non-financial information and future plans of the entity. It is important that auditors communicate their responsibilities in giving an opinion on those other information and that there are no material inconsistencies with the financial statements.

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?

The explanation of the responsibilities could be included in the statement of management and auditor's responsibilities which we believe should be relocated. There should also be a separate section in the auditor's report, under 'other matters'.

C. Auditor Commentary on Matters Significant to Users' Understanding of the Audited Financial statements, or of the Audit

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

By using an "emphasis of matter like approach", the audit report may identify specific topics or events, unusual transactions or other matters that were viewed to be areas of audit emphasis by the auditor. We believe that these descriptions should be objective, fact-based discussions and make specific reference to where such items appear in the financial statements. We believe this approach responds to the request that the auditor indicate areas of audit emphasis, and directs the user to where such matters are discussed in the financial statements.

However, we believe that to provide information on:

- key area of risk of material misstatements of the financial statements identified by the auditor, including critical accounting estimates or areas of measurement uncertainty in the financial statements;

- areas of significant auditor judgment;

- the level of materiality applied by the auditor to perform the audit;

- the entity's internal controls, including significant internal control deficiencies identified by the auditor during the audit; and

- areas of significant difficulty encountered during the audit and their resolution,

would create confusion for the users. This may create the misconception that the auditor is expressing an opinion or conclusion on certain elements of the financial statements or certain disclosures.

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 French system of Justification has merit but perhaps does not, in its current form, go far enough to meet investor's needs. We understand that investors want to know more about financial reporting issues such as risk assessment, judgments and estimates, accounting policy choices and controls.

The "justification of assessments" where the auditor identifies certain key areas of the financial statements and provides information about the auditor's procedures in those areas in a separate section in the auditor's report could be considered. However, judgment is required and there may be some level of subjectivity on what constitutes to 'key areas' for different users and stakeholders.

The definition for 'key audit areas' should be clearly defined. It is important that management are aware of these key areas and have already considered their impact and disclosures in the financial statements. As well as the risk of providing information about the entity that has been disclosed by the entity itself, there may be inconsistencies as to what management consider as key areas compared to what auditors may consider to be key audit areas. This may have the unintended consequence of confusing the user.

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

We believe that insights and perception about the entity should remain the responsibility of management. In some jurisdiction, such as the UK, these issues are already the subject of thorough discussion with audit committees, for example judgments relating to financial statements and risk of their misstatements. These discussions conventionally are of a private nature and held in confidence between the audit committee and the auditors. To publish these discussions has the potential to harm the prevailing spirit of openness and disclosure by management to auditors.

It is important that the audit committee makes such communication through an enhanced audit committee report. Auditors can then provide assurance on management assertions on these disclosures where investors perceive benefits of the disclosure.

Where the audit opinion is qualified it should send a clear and important message to the marketplace. However, there is often a negative perception from the users of the audit report. Ideally when a qualified audit opinion is given it should not be a surprise to the market because users should already be in possession of information from the entity.

D. An Enhanced Corporate Governance Model: Role of Those Charged with Governance regarding Financial Reporting and the External Audit

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

As stated in our response to question 10 we concur with the enhanced model of corporate governance reporting. We support regular dialogue between the audit committee and the auditor. On formal internal communications between the external auditor and the audit committee the German system of auditor communication to the supervisory board has merit.

We believe that enhanced communication is critical to maximizing user value derived from the financial statements and the audit. We also concur that such a model will reinforce the entity's responsibility for full and proper disclosure to shareholders and other users as a matter of good corporate governance without fundamentally changing the role of the independent auditor.

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 challenges that we envisage may include the undue reliance placed on the additional disclosures proposed in the auditor's report. To the extent that management is required to make greater disclosures, (particularly around risk information), some form of safe harbour will encourage more meaningful disclosures to users. To the extent that auditors provide assurance on this expanded information, safe harbours would be a necessity that needs to apply to auditors as well.

By safe harbour we mean granting immunity from liability where there has been diligent, good faith reporting in accordance with applicable standards. We believe that this will encourage more meaningful disclosures and thereby maximize benefits to the users.

Other implementation issues will include the form of the report including the wording of the opinion, respective responsibilities of management and the auditor , and the need for international standards describing the work required to form such an opinion.

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

Yes. However, the benefits derived from enhanced dialogue between the auditor and the audit committee, and from enhanced communication from the audit committee to users, are dependent on the quality of audit committees. We understand that robust audit committees are not necessarily prevalent in every jurisdiction. Nevertheless, this should not constrain adoption of such a model in the short term in those jurisdictions where corporate governance appears to be robust.

E. Other Assurance or Related Services on Information Not Within the Current Scope of the Financial Statement Audit

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

The auditor's role could be expanded outside the financial statements audit, perhaps to address aspect of risk and controls to mitigate those risks, being careful to weigh likely costs and benefits. We agree that this will depend on national law or regulations and national auditing standards to be developed accordingly.

In certain jurisdictions, such as the UK, we observe that in documents accompanying Initial Public Offerings there is often a report on disclosures about the risks and fundamentals of a business. It seems reasonable that a similar report could accompany the financial statements, accompanied by an assurance report which supplements, but does not replace the audit of historical financial statements. Such a report would not be dependent on access to large volumes of resources but would require only high quality business analysis.

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

Please refer to our response to question 12

Implications of Change and Potential Implementation Challenges

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.**

As mentioned previously we note that the benefits derived from enhanced dialogue between the auditor and the audit committee, and from enhance communication from the audit committee to users, are dependent on the quality of audit committees. This supports our suggestion that the proposed changes should apply to listed companies only as they are required to have an audit committee. We also understand that robust audit committees are not necessarily prevalent in every member state.

In terms of behaviours of parties who perform those roles and responsibilities, for most jurisdictions discussions between the auditors and those charged with governance tend to be private in nature and held in confidence. To publish these discussions has the potential to harm the prevailing spirit of openness and disclosure by management to auditors.

Where auditors and audit committees or those charged with governance are to provide more information in their auditor's report, there should be some form of safe harbour which will encourage more meaningful disclosures to users.

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**

We mentioned before that the proposed enhancement to auditors reporting should only apply to listed companies. We believe that the benefits, costs, potential challenges and other implications of change are unlikely to be the same for all types of entities. It will depend on the type of organization, complexity of the entities internal control and the strength of its audit committee.

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?

In our view, the most effective option in enhancing auditor reporting is the Corporate Governance Reporting Model. We recognize the critical role of the audit committee in overseeing the audit process and support efforts to strengthen that role on a globally consistent basis. We recognize a number of steps could be taken including requiring that the audit committee:

- be independent from management;
- include the auditor in all committee meetings;
- disclose its reasons for appointing (or reappointing) the auditor and its decisions on auditor remuneration and permitted non-audit services;
- provide expanded reporting on its discussion with the auditor on such items as the auditor's assessment of management's key judgments and the quality of the company's financial reporting; and
- have the auditor report on the completeness and accuracy of the audit committee report.

Another option could be reporting by someone other than the statutory auditor. The framework for provision of assurance reports on company disclosures located outside the financial statements could be designed where it may be appropriate to permit the involvement of a firm other than the statutory auditor. This is a possible method for delivering the benefits of multiple auditors to stakeholders, companies and audit firms which are seeing a foothold in the large listed audit market.

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

Another suggestion could be a global framework for communication between auditors and prudential regulators to improve the flow of information. The elements of such a framework could include:

- increased interaction with prudential supervisors so that auditors in effect operate as part of an "early warning system" to regulators for troubled institutions, as recently proposed by the UK; and

- sharing information with international organizations that monitor financial stability and systematic risk as the Financial Stability Board and the International Monetary Fund.