Federation of European Accountants
Fédération des Experts comptables Européens

Mr. Greg Tanzer
Secretary General
IOSCO General Secretariat
Calle Oquendo 12
28006 Madrid
Spain

auditorcommunications@iosco.org

13 January 2010

Ref.: AUD/HvD/HB/LA/SH

Dear Mr. Tanzer,

Re: FEE Comments on the IOSCO Technical Committee Consultation on Auditor Communications

(1) FEE (the Federation of European Accountants) is pleased to provide you below with its comments on the Technical Committee of the International Organization of Securities Commissions (IOSCO) Consultation on Auditor Communications (the IOSCO Consultation Paper).

(2) FEE welcomes the debate on auditor communications which has attracted the attention of a variety of stakeholders around the globe. The IOSCO Consultation Paper is one of the contributions to the global debate on auditor communication on all entities, whether public interest entities or others, in addition to the views of large and small investors, issuers, preparers, regulators, legislators, standard setters and auditors. FEE would also like to draw attention to two of its own publications, parts of which are relevant to this debate: FEE Issues Paper "Principles of Assurance"[1] and FEE Paper "Selected Issues Relating to Financial Statement Audits"[2] both of which are accompanied by executive summaries.

(3) The users of the auditor's communication consist of a variety of groups in addition to investors as also audit committees, management, boards of directors, regulators and various stakeholders should be considered when identifying user groups of audit reports. This has also been highlighted in the IOSCO consultation paper in its reference to ISA 200[3] *"A financial statement audit is designed to enhance the degree of confidence of intended users in the financial statements*".

[1] http://www.fee.be/search/default_view.asp?content_ref=115
[2] http://www.fee.be/search/default_view.asp?content_ref=771
[3] International Standard on Auditing 200 (Revised and Redrafted), *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*.

(4) FEE therefore strongly believes that all stakeholders as mentioned above should work together to improve communication to investors without any particular stakeholder taking this debate forward unilaterally. FEE would therefore recommend that IOSCO publishes the responses received to this Consultation Paper, as well as a summary thereof to aid transparency towards all stakeholders concerned. It should be noted, however, that IOSCO is likely to receive more comments from investors that believe that auditor communication needs to change as those investors who believe that the current position is working are less likely to respond to this consultation; also investor responses are more likely to be forthcoming from larger representatives of the investor community than from those with smaller holdings, such as private individuals who nevertheless have a direct interest in auditor communications.

(5) The main issue when considering the IOSCO Consultation Paper is in FEEs view the need for clear disclosures and communication to investors made by management and those charged with governance of the entity. Such clear disclosures will enable investors to make proper and informed investment decisions. The role of investors is to conduct proper analyses of the information available from various sources.

(6) The role of auditors is to express an opinion on financial information provided by management and those charged with governance. In our view, auditors do not have a role in providing to investors or other stakeholders additional financial information about the entity that has not been provided by the entity itself.

(7) Our comments and the responses to the questions set out in the IOSCO Consultation Paper should be read in this context and centre on matters of principle that are of relevance to the European accountancy profession as a whole and are not formed from the viewpoint of investors.

Question 1. Is the standard audit report useful to investors? If not, why?

(10) FEE believes that having a standard audit report as set out in the International Standards on Auditing (ISAs)[4] is useful to investors as it promotes consistency across the globe. As stated in ISA 700 on "Forming an Opinion and Reporting on Financial Statements", consistency in the auditor's report promotes credibility in the global marketplace by making more readily identifiable those audits that have been conducted in accordance with globally recognised standards. It also helps to promote the user's understanding of the audit and also to identify unusual circumstances when they occur.

[4] ISAs as issued by the International Auditing and Assurance Standards Board (the IAASB).

(11) In this context, we would like to point out that the IAASB's recent Clarity Project has resulted in certain changes to auditor reporting which have yet to come into force, and thus have not yet been assessed by investors or included in this debate to this date.

(12) Furthermore, the IAASB has also commenced a research project on the auditor's report as referred to in our response to question 2 on pages 4 and 5. FEE supports this report and is open-minded for assessing its results.

(13) The audit report on annual financial statements expresses the opinion of the auditor based on the work carried out and in addition describes the basis for that opinion. The audit is related to the historical information presented and disclosed in the annual financial statements.

(14) As stated above the audit covers historic financial information, however, decisions made by investors are made for optimising future returns on the investments made. Therefore, an inherent gap appears to exist between an audit report on historical annual financial statements and investment decisions made for future benefits. However, FEE continues to believe that the audit report is indispensable for investors as it provides them with an opinion on this historical financial information at a set point in time that can be used to build their forward looking projections.

(15) As the audit report is designed to reflect the opinion formed by the auditor as to whether the financial statements are prepared in all material respects, in accordance with the applicable financial reporting framework, the audit report will contribute to ensure the comparability between financial statements for different entities and for different periods. Considering this objective with the audit report FEE is of the view that a standard audit report is useful for the users of the financial statements, including investors.

(16) The IOSCO Consultation Paper comments on the information gap between investor information needs and the information that entities publicly disclose. FEE agrees with IOSCO that in case of these gaps additional information should be disclosed by the appropriate and relevant party. FEE therefore strongly believes, in line with IOSCO, that information from auditors can not compensate for lack of information from management or those charged with governance as they have the best understanding of the entity. If investors were to bypass management and obtain information directly from the auditors this would fundamentally change the relationship between management and those charged with governance of an entity and the auditors.

(17) In the consultation paper IOSCO also comments on the expectation gap stating that *"the standard audit report lacks detail around the effort exerted by the auditor in planning and performing the audit."* In this connection FEE would like to highlight that part of the expectations gap can be viewed as an education gap. In aiming at eliminating this education gap all involved parties, such as investors, standard setters, regulators, academics and auditors, play an important role in bridging this gap. Each party is responsible for explaining the information needs and the standard audit report forms a part of that. However, it

Avenue d'Auderghem 22-28 • B-1040 Brussels • Tel: +32 (0)2 285 40 85 • Fax: +32 (0)2 231 11 12 • secretariat@fee.be • www.fee.be
Association Internationale reconnue par Arrêté Royal en date du 30 décembre 1986

might be more appropriate that more information on the work undertaken by the auditor is made available in other formats.

(18) The IOSCO Consultation Paper suggests that additional communications in the audit report could result in more transparency which would enable investors to assess the quality of the audit and auditors. FEE is of the view that the purpose of an audit report is not to assess audit quality as the audit report is a record of the audit opinion on this process as a whole. Instead audit quality and improvements to it is the responsibility of audit oversight regimes and their reports should help investors assess audit quality. In Europe a description of the internal quality control system and a confirmation of the effectiveness of its functioning by the management of the audit firm is published by all audit firms auditing public interest entities in accordance with Article 40 of the Statutory Audit Directive. FEE is of the view that such communication on audit quality is sufficient without there being a need to include such information in audit reports.

Question 2. Would investors prefer a more concise audit report (*e.g.*, a one-sentence report that includes only the auditor's opinion on whether the financial statements are fairly presented)? If so, why?

(19) FEE is a long-standing supporter of the implementation of International Standards on Auditing (ISAs) for audits in Europe. FEE also supports the audit report as set out in ISA 700 "Forming an opinion and reporting on financial statements".

(20) The IAASB has undertaken a research project to analyse the usefulness of the audit report, as per its Strategy and Work Program 2009-2011, which is also highlighted in the IOSCO Consultation Paper. When conducting this research project, the IAASB is expected to gather input from a wide range of stakeholders, including investors, in accordance with its rigorous due process.

(21) Some preliminary results of this research project have been discussed at the IAASB Board in December 2009 based on analyses carried out by the IAASB Working Group responsible for the project[5]. The preliminary results show among other things that auditors' reports are valued by users mainly due to its existence rather than its content and that the audit expectations gap surrounding the scope and purpose of an audit of financial statements, and the auditor's role and responsibilities in that regard, is persistent and very hard to change. The IAASB working group has recommended that the information and key messages obtained from this project to date would be a useful preliminary basis for a further consideration of auditor reporting issues.

[5] http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0169&ViewCat=1191

Avenue d'Auderghem 22-28 • B-1040 Brussels • Tel: +32 (0)2 285 40 85 • Fax: +32 (0)2 231 11 12 • secretariat@fee.be • www.fee.be

(22) Although expressing general support for the audit report as defined in ISA 700, FEE would be of the view that improvements to the current standard ISA audit report could be considered as mentioned by other commentators when raising some points of criticisms on the current audit report as highlighted in the IOSCO Consultation Paper.

(23) Therefore, FEE supports the research project of the IAASB and is open-minded for assessing its results. However, it is important to FEE that any changes to the audit report should continue to ensure that the audit report is concise, cost effective and balanced as far as responsibility and liability is concerned. As FEE is a strong believer in the concept of 'an audit is and audit', any changes should ordinarily also be applicable to audit reports for all entities and not solely to audit reports for public interest entities. FEE would therefore recommend to wait for the final outcome of the IAASB research project as FEE believes it is too premature to conclude on the usefulness and quality of the audit report before the IAASB research project has been completed.

Question 3. Are investors receiving information about the audit that they need to make informed investment decisions? If not, who should provide this information—management or the auditor? For information that should be provided by the auditor, should changes to the standard audit report be made or are other auditor communications warranted? What should any new or revised auditor communications address (*e.g.*, an auditor's analysis of risks and other findings in an audit, a report on the quality of an issuer's financial reporting, an auditor's discussion and analysis of their independence and the work performed in an audit) and what form should it take (*e.g.*, a revised standard audit report or a new auditor communication)? How would this additional information affect investors' use of audited financial statements? Over time, would the utility of such information diminish?

(24) The level of auditor's involvement with providing information to investors should be considered from a cost/benefit perspective – the auditor's engagement risk may make some engagements of a prospective and/or subjective nature prohibitively expensive - and from a theoretical perspective it will depend on the ability to identify suitable criteria and the level of assurance agreed.

(25) In addition, auditors' involvement with and responsibilities for providing information to investors regarding the financial situation of an entity cannot exceed the responsibilities assumed by management and/or those charged with governance of that entity. The various parties, management, those charged with governance, auditors, investors, regulators, other users etc, all have different levels of responsibility when it comes to involvement with an entity and its decision-making process. This entails that the different parties also have different information needs for them to successfully assume their respective responsibilities. FEE is therefore not of the view that the same information and the same information flow are equally available to all parties, it should rather be focused and directed in a way that is most relevant for each party to assume its responsibilities.

(26) Furthermore, the audit report provides information to investors annually, whilst investors in general require information to be available for them much more frequently. Such additional information to investors is currently provided under the responsibility of the management of the entity as part of the regular dialogue between an entity and its investors. Auditor's involvement with providing information to investors, if any, can only be secondary to management's primary responsibility for the information provided. In addition, management and those charged with governance, including the board(s) and audit committee, carry out their decisions on behalf of and by delegation from the shareholders and investors of the entity. If investors are not content with the decisions made or the information received, investors will in accordance with the legislative requirements and the statutes for the entity, have the ability to influence the decisions made, including the decision to appoint other individuals.

(27) In this context it is important that management ensures that the entity has provided all the relevant information needed by investors to take informed investment decisions as required under IFRS and European legislation. If management does not comply with the requirements for true and fair presentation of the entity's financial statement, the auditor performing a financial statement audit will have to consider the implications of that on their audit report.

(28) The various users have different information needs, especially considering the broad variety of users of the audit report. Based on the analysis carried out by the IAASB Working Group on Auditor's Report, the preliminary conclusion is that *"users appear to want additional reporting of matters that are covered by an audit of financial statements, and also of matters that are not currently covered by the audit of financial statements"*. One of the research studies commissioned by the IAASB concludes in this context that one example of this additional reporting by the auditor could be *"disclosures of information/messages communicated to the audit committee of the audited entity"*[6].

(29) In this context it should be highlighted that the basic requirements for information submitted to an audit committee of European public interest entities are set out in Article 41 of the Statutory Audit Directive where the statutory auditor is required to *"report to the audit committee on key matters arising from the statutory audit, and in particular on material weaknesses in internal control in relation to the financial reporting process".* This information from the auditor to the Audit Committee is therefore under European legislation directed at the Audit Committee and is not intended to be published. The information is therefore confidential information and cannot necessarily be published by the entity itself. If the information is considered to be price sensitive information, all listed companies under European legislation are in any case required to publish this information in accordance with the requirements in the directives on Market Abuse and Transparency.

[6] http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0169&ViewCat=1191

Question 4. If new or revised auditor communications are desired, would such communications be practicable? What legal, regulatory and practical challenges would preclude such communications? What criteria or principles should regulators use to determine what additional information should be provided? Are there any alternative mechanisms for investors to receive this information without encountering these challenges (*e.g.*, instead of new or revised auditor communications, mechanisms such as new or revised disclosures by management or those charged with governance)?

(30) As stated above, FEE believes that additional information besides information given by the auditor in the audit report on the annual financial statements could be considered to be provided.

(31) In general, auditors' involvement and responsibilities for providing information to investors regarding the financial situation of an entity cannot exceed the responsibilities assumed by management and/or those charged with governance of the entity. In the European Union, direct auditor communications are subject to a variety of more or less restrictive national laws and regulations and are oftentimes limited to private auditor communications to specific regulators. Currently, only in cases where management and/or those charged with governance do not comply with applicable reporting requirements and this lack of information affects the true and fair view of the financial statements, the auditor has to consider to publicly inform investors of this fact.

(32) In response to the second paragraph under 'Advantages and Disadvantages' on page 20, we would also like to point out that transparency in the audit process and audit reporting does not necessarily enhance audit quality. For further detail in this respect, we refer to the FEE comments on the IOSCO Consultation Paper on Transparency of Firms that Audit Public Companies.

(33) Furthermore, investor decisions for optimising future returns on investments made are normally based on prospective and forward looking information. Therefore, management and those charged with governance of an entity supplement the information in the annual financial statements with more timely financial and other information on the entity, which is provided in documents such as analysts' briefings, quarterly and half-yearly financial highlights. The level of auditor's involvement should be considered from a cost/benefit perspective. The level of work required may make some engagements of a prospective and/or subjective nature prohibitively expensive. In addition such prospective information cannot be covered effectively by an audit or assurance engagement and auditors would thus have difficulties in providing a useful opinion on such information. If an opinion on forecast information is to be provided auditor's liability for any forecast information, which with hindsight is revealed as not reflecting the outcome, should be taken into consideration in this context.

(34) Preparers and issuers could be invited to consider which other information could be made public for the benefit of investors without harming the operational, commercial and other interests of the entity.

(35) Therefore, a broad-based debate with all relevant stakeholders is preferable before far-reaching legal and regulatory changes would be envisioned.

For further information on this FEE letter[7], please contact Mrs. Hilde Blomme at +32 2 285 40 77 or via email at hilde.blomme@fee.be from the FEE Secretariat.

Yours sincerely,

Hans van Damme
President

[7] FEE is the Fédération des Experts comptables Européens (Federation of European Accountants). It represents 43 professional institutes of accountants and auditors from 32 European countries, including all of the 27 EU Member States. In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 500.000 professional accountants, working in different capacities in public practice, small and big firms, government and education, who all contribute to a more efficient, transparent and sustainable European economy.

FEE's objectives are:

- To promote and advance the interests of the European accountancy profession in the broadest sense recognising the public interest in the work of the profession;
- To work towards the enhancement, harmonisation and liberalisation of the practice and regulation of accountancy, statutory audit and financial reporting in Europe in both the public and private sector, taking account of developments at a worldwide level and, where necessary, promoting and defending specific European interests;
- To promote co-operation among the professional accountancy bodies in Europe in relation to issues of common interest in both the public and private sector;
- To identify developments that may have an impact on the practice of accountancy, statutory audit and financial reporting at an early stage, to advise Member Bodies of such developments and, in conjunction with Member Bodies, to seek to influence the outcome;
- To be the sole representative and consultative organisation of the European accountancy profession in relation to the EU institutions;
- To represent the European accountancy profession at the international level.