September 15, 2011

Mr. James Gunn
Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York, New York 10017 USA

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

Dear James:

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors, convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention, and advocates policies and standards that promote public company auditors' objectivity, effectiveness and responsiveness to dynamic market conditions. Based in Washington, D.C., the CAQ is affiliated with the American Institute of Certified Public Accountants. The CAQ welcomes the opportunity to provide comments on questions raised in the International Auditing and Assurance Standards Board's (IAASB) consultation paper on *Enhancing the Value of Auditor Reporting: Exploring Options for Change* (the consultation paper). The IAASB's consultation, which is coincident with similar queries in the United States, the United Kingdom and the European Union, provides an opportunity for standard setters to take a consistent approach to changes to auditor reporting, with attendant benefits for all. We urge the IAASB, the Public Company Accounting Oversight Board (PCAOB) and other standard setters to strive for a coordinated and consistent approach.

This letter represents the observations of the CAQ, but not necessarily the views of any specific firm, individual or CAQ Governing Board member. Moreover, it pertains only to requirements for auditors of publicly-traded companies.

Our comments address high level issues raised in the consultation paper, informed by the work of our Auditor's Reporting Model Working Group, which has developed model reports and other comments in response to the PCAOB's *Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements* (concept release), as well as by observations made during four roundtable discussions on the role of the auditor held by the CAQ during early summer. The roundtable discussions were held in four major U.S. cities and attended by over 80 investors, preparers, Board and Audit Committee members, academics, auditors and other stakeholders. The purpose of these discussions was to examine the role of the auditor and the value of the audit. We will provide a summary report of these roundtable discussions as a supplement to this letter. We also plan to provide the IAASB with the CAQ's comment letter in response to the PCAOB's concept release when it is filed with the PCAOB on September 30, which addresses a number of technical reporting issues raised in the IAASB's consultation paper.

Overarching Principles

As the IAASB recognizes, the role of the auditor and the auditor's report have been examined periodically to assess their relevance in light of changing market practices and investor information needs. This topic was raised again during the recent financial crisis due to concerns about a perceived "disconnect" between what was reported in some companies' annual reports and the companies' subsequent failure, default or need for additional capital. Questions about the continued relevance and value of the audit has led to initiatives by the IAASB, PCAOB and other authorities to explore areas for additional transparency into the audit, as well as areas where auditors could better serve the needs of investors.

The CAQ and the profession welcome this dialogue and are supportive of responsible changes to the auditor's reporting model. We also are willing to consider the need for additional auditor services, beyond the financial statement and internal control over financial reporting audits, where such services may increase investor confidence in the capital markets. As we did with the PCAOB,[1] in considering possible revisions to improve the auditor's reporting model, we urge the IAASB to be guided by five overarching principles, with the needs of investors in mind:

1. Auditors should not be the original source of disclosure about the entity; management's responsibility should be preserved in this regard. As explored further in this letter, a fundamental shift from the auditor attesting to information prepared by management to the auditor providing original information about the company could result in unintended consequences that are not in the best interest of investors.

2. Any changes to the auditor's reporting model need to enhance, or at least maintain, audit quality.

3. Any changes to the auditor's reporting model should narrow, or at least not expand, the expectation gap.

4. Any changes to the auditor's reporting model should add value and not create investor confusion. Specifically, any revisions should not require investors to sort through "dueling information" provided by management, the audit committee, and the independent auditors.

5. Auditor reporting should focus on the objective rather than the subjective. Financial reporting matters assessed by the auditor can be highly subjective; however it is important that auditor communications provide objective information about these highly subjective matters.

[1] http://www.thecaq.org/newsroom/pdfs/CAQ_June28Letter_PCAOBRulemakingDocketMatterNo.34.pdf

Issues Identified and Input from Roundtables

The CAQ agrees that there is both an expectation gap and an information gap regarding the current role of the auditor and the extent of the audit process. These might be addressed by adding clarifying language to the auditor's report and/or modifying the structure of the report (i.e., location of information), as well as by requiring separate assurance on certain management disclosures provided outside the financial statements, as discussed below. To help narrow these gaps, the CAQ published a high level *Guide to Public Company Auditing* and, earlier this year, published an *In-Depth Guide to Public Company Auditing*.[2] The CAQ also is developing additional educational materials for individual investors aimed at explaining the audit process and how it relates to the system of investor protection.

As you will find in our forthcoming summary of the CAQ roundtable discussions, the investors who participated in our roundtables uniformly expressed a view that the audit report continues to have value in providing reasonable assurance on whether the financial statements comply with the applicable financial reporting frameworks, and it is viewed as a necessary "prescreen" or baseline to their decision-making. They and other roundtable participants posited that auditors should continue to provide a binary audit report on financial statements, and that any changes to the role of the auditor should *supplement* and not *replace* the current audit report.

Moreover, roundtable participants representing the full range of stakeholders commented that changes to the role of the auditor without corresponding action to improve the corporate reporting framework may not sufficiently respond to investor financial reporting concerns.

It also is important to note that investors and other roundtable attendees told us that they did not support any changes that would require the auditors to provide their "impressions" of management's accounting practices/assumptions or otherwise act as an assertor of information. Rather, they strongly believe that auditors should remain in the attest role, although there may be additional areas appropriate for auditor attestation or other association.

Exploring Options for Change

A. Format and structure of standard auditor's report. The CAQ supports adding clarifying language to the standard report that further defines management and auditor responsibilities as described in the IAASB and PCAOB's respective releases. As noted in our June 28th letter we also support the addition of language describing the responsibilities of those charged with governance regarding financial reporting and the external audit. We think that those additions should remain within the standard report. Other information, such as a separate link to a standardized description of the audit process – what an audit is and what an audit is not – might be provided to prevent additional "disclosure overload" for investors.

B. Other information in documents containing audited financial statements. The CAQ understands that many investors may not be aware of the auditor's responsibility to read the other information presented in documents containing audited financial statements for material inconsistency with the audited financial statements. Accordingly, we are not opposed to adding an explanation of the auditor's responsibility with

[2] See http://www.thecaq.org/publications/In-Depth_GuidetoPublicCompanyAuditing.pdf and http://www.thecaq.org/publications/In-Depth_GuidetoPublicCompanyAuditing.pdf.

respect to such information, and the results of the auditor's procedures in this area, which roundtable participants believe will add value to investors.

When roundtable participants discussed whether auditors should provide *additional* services beyond their current responsibilities for the audits of the financial statements and, where applicable, internal control over financial reporting, participants identified a number of disclosures that could be improved by management and suggested that auditor association might be a way to spur such improvements. The disclosures most commonly identified related to financial information contained in Management's Discussion and Analysis (MD&A) including the company's critical judgments and accounting estimates; the company's process for assessing risk and developing financial assumptions and estimates; and the risk factors disclosure in the annual report. The CAQ supports consideration of requiring the auditor to provide a separate attestation report on the examination of management's critical accounting estimates disclosure in MD&A, as expressed in its initial comment letter to the PCAOB on its concept release (June 28, 2011, see footnote 1 above). To the extent such an approach is relevant in other countries, a separate attestation report could be responsive to various suggestions made by investors regarding the need for more emphasis on the important judgments made in preparing the financial statements. Importantly, this approach also would retain the auditor's established role of attesting to information provided by management. The CAQ is exploring with stakeholders the extent to which auditors could provide additional services with respect to the areas identified by participants described above.

C. Auditor commentary on matters significant to users' understanding of the audit of the financial statements. In addition, the CAQ believes that use of emphasis of matter paragraphs would be a viable approach to identifying the most significant matters in the financial statements, another area in which investors have expressed keen interest. Consistent with the overarching principles set forth earlier, we believe emphasis paragraphs should be objective, fact-based discussions and should make specific reference to where such matters appear in the financial statements. We question whether investors would benefit from including a reference to the audit procedures performed for the areas emphasized because the level of detail required to adequately describe the work would add to "disclosure overload" without providing significant value to investors.

As noted earlier, investors and other roundtable participants strongly oppose requiring auditors to provide their own discussion or analysis, akin to the AD&A approach described in the PCAOB concept release. Roundtable participants strongly believe that the auditor should not communicate original information about a company, which could blur the different roles of management and the auditor in the eyes of investors. Participants, including investors, want to preserve the auditor's established role of attesting to information provided by management. Some financial reporting stakeholders fear that these auditor's communications would "compete" with management's disclosures; could result in less robust discussions between the auditor, management and the Audit Committee; and could ultimately shift the responsibility for accounting and disclosure away from management to the auditor. Additionally, the role of the audit committee or of those charged with overseeing the financial reporting process, including financial statement disclosures, may be undermined if the potential for "dueling disclosure" compels management to change its disclosure to adhere to the auditor's communication. These "dueling" disclosures could confuse investors, and contribute to disclosure overload, as management and the auditor may often be reporting identical or nearly identical information in separate presentations. Preparation of auditor analysis could delay issuance of the auditor's report and increase cost due to the number of reviews that would be necessary prior to issuance.

D. An enhanced corporate governance reporting model: role of those charged with governance regarding financial reporting and the external audit. The CAQ and the auditing profession are prepared to embrace responsible calls for change related to the auditor's reporting model to meet the evolving information needs of investors. However, roundtable participants posited that if improvements are to be lasting and meaningful, all stakeholders should examine their respective roles and agree on a way forward. Thus, in addition to considering the issues raised that specifically address the role of the auditor, roundtable participants recommended that regulators also examine how preparers could improve their disclosures. It also was suggested that those charged with governance over the financial reporting process including overseeing the external audit could provide expanded and/or improved information regarding their oversight activities and that auditors might provide some level assurance around this expanded communication.

E. Other Assurance or related services on information not within the current scope of the financial statement audit. As noted in our comments on other information in documents containing audited financial statements, some roundtable participants were interested in exploring the possibility of auditor association with certain disclosures outside of the financial statements that provide insight into their understanding of a company's performance (e.g., key performance indicators and risk factors). In the United States, auditors already provide an opinion on internal control over financial reporting for large public companies, which appears to have improved management processes. With respect to other disclosures identified in the consultation paper, the CAQ is exploring with stakeholders the extent to which auditors could provide additional services around other management disclosures. However, it is likely that many investors are unaware of the value provided by the auditors' current responsibility to read management's disclosures in documents containing audited financial statements for material consistency with the audited financial statements. The CAQ encourages the IAASB to work with the PCAOB and other standard setters in considering whether auditors should be required to provide assurance around other management disclosures identified in the consultation paper. Some observations around this issue are contained in our summary of the roundtable discussions that will be shared with the IAASB as soon as it is published.

Implications of Change and Potential Implementation Challenges

In the long run, concerns voiced by investors related to current corporate reporting practices must be addressed; without a broader initiative, only modest improvements can be expected. That is why the CAQ recommends that the IAASB and other regulators/standard setters embrace a more holistic approach -- involving the full range of financial reporting stakeholders -- to develop a new vision for financial reporting that emphasizes investors' need for succinct, relevant information and, where appropriate, the requisite level of assurance from auditors. Such an approach could involve a pilot program or other opportunity for field testing. Moreover, we urge the IAASB, PCAOB and other standard setters/regulators to strive to achieve a consistent approach that meets the needs of investors across jurisdictions.

For purposes of the IAASB's immediate standard setting objectives, the CAQ recommends taking a phased approach, focusing first on needed improvements to the current auditor's reporting model with subsequent consideration given to the role of the auditor as it relates to other information provided by management. Potential changes should be considered in light of the overarching principles, taking investor information needs into consideration. We urge the IAASB to clearly articulate its standard-setting objectives for any changes to the auditor's report at the outset in order to obtain broad consensus on which changes will meet those objectives and to set investor and other stakeholder expectations. To minimize the potential for unintended consequences, changes should be measured and given time to be implemented by the affected organizations and evaluated by investors and other stakeholders.

Moreover, it is critically important that any changes retain the appropriate division of responsibilities (assert versus attest) between management and the auditor and strengthen -- not undermine -- the role of those with governance responsibilities over financial reporting and the external audit. The CAQ believes that any changes should be designed to strengthen the interconnected roles and responsibilities of *all* those that play a role in financial reporting.

Finally, in determining the appropriate way forward, potential changes should be subject to a rigorous cost-benefit analysis. Even changes that leverage work performed during an audit will increase cost because of the need for process formalization, internal review and approval. Certainly any requirements that go beyond the financial statement audit will entail additional resources and time; these costs should be balanced against the need for the additional requirements. A related challenge is assuring that auditors are trained and prepared to provide the additional services, and that regulatory expectations are clearly articulated. Regulators/standard setters, investors and other financial reporting stakeholders must fully understand the costs and challenges of providing additional services in order to make a responsible assessment of the need for particular changes.

The CAQ appreciates the opportunity to comment on the consultation paper. The CAQ and the profession are committed to implementing responsible changes to the role of the auditor and welcome the opportunity for broad dialogue on the issues raised in the consultation paper. As noted in our introductory remarks, we will submit additional material as soon as it becomes available. If you have any questions about our comments, please do not hesitate to contact me.

Sincerely,

Cynthia M. Fornelli

Cynthia M. Fornelli
Executive Director
Center for Audit Quality

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