

Auditor Communications

Consultation Report



OICU-IOSCO

**TECHNICAL COMMITTEE
OF THE
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS**

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This paper is for public consultation purposes only. It has not been approved for any other purpose by the IOSCO Technical Committee or any of its members.

Foreword

The IOSCO Technical Committee has published for public comment this consultation report on Auditor Communications, which has been prepared by its Task Force on Audit Services. The Report is aimed at identifying whether changes to the standard audit report or additional auditor communications are needed to meet investor information needs.

We welcome empirical data and economic information, as well as anecdotal experience from investors, auditors, issuers, and other stakeholders on the following discussion and inquiries

How to Submit Comments

Comments may be submitted by one of the three following methods **on or before 1 December 2009**. To help us process and review your comments more efficiently, please use only one method.

1. E-mail

- Send comments to AuditorCommunications@iosco.org
- **The subject line of your message should indicate “Public Comment on the Auditor Communications: Consultation Report”.**
- Please do not submit any attachments as HTML, GIF, TIFF, PIF or EXE files.

OR

2. Facsimile Transmission

Send a fax for the attention of Greg Tanzer using the following fax number:
+ 34 (91) 555 93 68.

OR

3. Post

Send your comment letter to:

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

Your comment letter should indicate prominently that it is a “Public Comment on the Auditor Communications: Consultation Report”.

Important: All comments will be made available publicly, unless anonymity is specifically requested. Comments will be converted to PDF format and posted on the IOSCO website. Personal identifying information will not be edited from submissions.

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Consultation Report on Auditor Communications

I. INTRODUCTION

Investor protection is one of the primary objectives of securities regulation.¹ To achieve this objective, securities regulators should seek to ensure that investors have at their disposal sufficient, useful, relevant and reliable information upon which to base investment decisions. Financial statements are one of the most important sources of information that investors use in making investment decisions. A financial statement audit is designed to enhance the degree of confidence of intended users in the financial statements.² The standard audit report is the primary means by which auditors communicate to users of financial statements regarding their audits. As such, securities regulators need to carefully consider whether the standard audit report communicates the appropriate information to investors and whether its form and content facilitate audit quality.³

At the International Organization of Securities Commissions (IOSCO) Roundtable on the Quality of Public Company Audits from a Regulatory Perspective (Roundtable),⁴ some panelists questioned whether the standard audit report is effective in communicating important information about the audit and the audit process. Some panelists suggested that the binary nature of the opinion included in the standard audit report (*i.e.*, the “pass/fail” model in which an opinion is expressed on whether or not the financial statements are fairly presented) may not be optimal for today’s complex business environment. Others noted that the standard audit report does not specifically identify the actions that the auditor undertook to render an opinion or issues that the auditor uncovered during the course of the audit, which limits its value to investors. Other panelists noted that an “expectations gap” with respect to fraud detection exists.⁵ Many of the comments made by the panelists at the Roundtable have been echoed in other fora and by other organizations.⁶

¹ *Objectives and Principles of Securities Regulation*, International Organization of Securities Commissions (May 2003) available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>.

² 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*.

³ The United Kingdom’s Financial Reporting Council (FRC) identified the reliability and usefulness of audit reporting as one of five “key drivers” of audit quality. See *The Audit Quality Framework* (February 2008) available at <http://www.frc.org.uk/about/promotingauditquality.cfm>. The FRC is the United Kingdom’s independent regulator for corporate governance and reporting.

⁴ The Roundtable was held in Paris, France, on June 1, 2007. Information regarding the proceedings, including video archives and a copy of the transcript, is available at <http://www.iosco.org/library/index.cfm?section=pubvids>.

⁵ The term “expectations gap” has been defined as “the difference between what the public and users of financial statements perceive the role of an audit to be and what the audit profession claim is expected of them during the conduct of an audit.” See http://mpa.ub.uni-muenchen.de/232/1/MPRA_paper_232.pdf. The expectations gap includes the difference in perception related to the auditor’s role in detecting fraudulent financial reporting.

⁶ See, for example, the *CFA Institute, February 2008 Monthly Question Results* available at <http://www.cfainstitute.org/memresources/monthlyquestion/2008/february.html>, the *Final Report of the Advisory Committee on the Auditing Profession to the U.S. Department of Treasury* (October 6, 2008) (U.S. Treasury Advisory Committee Report) available at <http://www.treas.gov/offices/domestic->

Several changes to the standard audit report have been proposed to address these perceived shortcomings, including changing its structure and language, providing additional communications within the standard audit report and changing the nature of assurance provided by the auditor, with consequential changes to the standard audit report.

In order to address whether changes to the standard audit report or additional auditor communications are warranted to meet investor information needs, the IOSCO Technical Committee Task Force on Audit Services determined that it was appropriate for securities regulators to: (i) review the efforts of those who have already conducted analysis on this issue, (ii) analyze the potential advantages and disadvantages of revising the audit report, and (iii) note areas in which securities regulators might benefit from additional public input.

This consultation report therefore:⁷

- highlights the evolution of the audit report;
- describes perceived shortcomings of the report observed by others;
- identifies possible solutions to these issues proffered by others;
- notes possible advantages and disadvantages of such solutions; and
- solicits comments and feedback from interested stakeholders.

[finance/acap/docs/final-report.pdf](http://www.esma.europa.eu/finance/acap/docs/final-report.pdf), and the June 2007 Committee of European Securities Regulators (CESR) *Survey on the direct communication of auditors with the public on the statutory audit of the annual or consolidated accounts of listed companies* (CESR Survey) available at http://www.cmvm.pt/NR/rdonlyres/542657CE-77E4-47A2-BF28-2A18F392C8C7/7874/07_101.pdf.

⁷ The intent of this report is to examine audit reports that express an opinion on whether the financial statements achieve fair presentation (see footnote 29 for a description of the concept of “fair presentation”). This report does not address other types of opinions that auditors in certain jurisdictions are required to express or express based on market demands (e.g., opinions on the effectiveness of internal control over financial reporting). Further, this report does not address other types of assurance engagements that may evolve over time based on market and regulatory demands (e.g., reports on extensible business reporting language information, reports on prospective financial information or sustainability reports).

II. EVOLUTION OF THE STANDARD AUDIT REPORT

A standard financial statement audit report results from an audit of an issuer's complete set of general purpose financial statements prepared in accordance with a financial reporting framework that is designed to meet the common financial information needs of a wide range of users. Once the audit is completed, the auditor issues a report, which contains information about the audit, including its scope, and an opinion regarding the fair presentation of the financial statements.⁸

This current practice, however, does not fully reflect what has occurred throughout the history of the capital markets. Audit reports first developed in many jurisdictions in response to the development of the corporate form of ownership and legal and regulatory mandates for financial statement audits by independent third parties.⁹ Additionally, audit reports have evolved in response to changes in auditing procedures and in efforts to provide clarity to their intended users. As a result, and in order to identify changes to the standard audit report that may be advisable, it is important to first identify the drivers of change to the report and try to understand how and why it has evolved over the years in various regions.

International Developments

Many jurisdictions around the world have used or based their audit reports on the standards of the International Auditing and Assurance Standards Board (IAASB), which develops International Standards on Auditing (ISA), and its predecessor organizations. For example, the standard format currently used in 24 Member States of the European Union is either ISA 700, *The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements*, or a national standard based on ISA 700.¹⁰

In developing its standard audit report in 2004, the IAASB sought to (i) increase consistency in reporting between jurisdictions and (ii) increase the understandability of the auditor's role and of the auditor's report by using simple, understandable language and being as concise as possible, while still aiming to be informative and including clear explanations.¹¹ In addition to revisions intended to achieve these goals, the audit report was revised to include more robust descriptions of the respective responsibilities of management and the auditor, an updated description of the audit process and to clarify the scope of the auditor's responsibilities with respect to internal control. The revision resulted in a two-part standard audit report, which includes: (i) the auditor's report on the audit of the financial statements and (ii) other reporting responsibilities, as applicable (*e.g.*, where national laws, regulations, and/or auditing standards impose additional responsibilities on auditors beyond the audit responsibilities defined by the ISAs).

⁸ Although almost all audit reports contain such standard information, the form and content of the report, as noted below, varies by jurisdiction. The appendix to this consultation report includes examples of standard reports issued in the jurisdictions referenced in this section.

⁹ King, Darwin L. and Carl J. Case, *The Evolution of the United States Audit Report*, Academy of Accounting and Financial Studies Journal, Volume 7, Number 1, 2003, at 2.

¹⁰ CESR Survey, at 3.

¹¹ See Agenda Item 7-H of the July 21-25, 2003 IAASB agenda materials, available at <http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0003&ViewCat=0046>.

Developments in Europe¹²

In the early 1900's, company laws in the United Kingdom (UK) made annual audits for all registered companies mandatory and required auditors to file a certificate and report on the company's balance sheet.¹³ By the mid-1900's, company laws required the auditor to provide an opinion as to whether the financial statements gave a "full and fair view of the financial position and results of operations."¹⁴ The UK's first auditing standard on auditor reporting was issued in 1980 and required the auditor to identify the financial statements audited and the basis upon which they were prepared and express an opinion as to whether the financial statements gave a "true and fair" view of the state of the company's affairs and of its profit and source and application of funds and whether the financial statements complied with company law.¹⁵

In the 1990's, the UK audit report was modified to describe the respective responsibilities of directors and auditors, set out the basis for the opinion expressed and the main features of the audit process, and draw attention to the way in which certain fundamental uncertainties were treated in the financial statements.¹⁶ Following the 2003 judgment in *Royal Bank of Scotland v. Bannerman Johnstone Maclay and others*¹⁷, and upon the recommendation of the Institute of Chartered Accountants in England and Wales (ICAEW), auditors began to include wording in their reports to disclaim responsibility to any third parties other than the company's members.¹⁸

The UK standard audit report was revised in 2009, primarily as a result of the Companies Act of 2006. The Companies Act of 2006 requires auditors, beginning in 2008, to provide a three-part opinion, in which the auditor must state whether the annual accounts (a) give a true and fair view of the state of affairs of the company; (b) are properly prepared in accordance with the relevant financial reporting framework; and (c) are prepared in accordance with the requirements of the Companies Act of 2006. These new requirements differ from the auditor's opinion previously required, which only required the auditor to give an opinion as to whether the annual accounts gave a true and fair view, *in accordance with the relevant financial reporting framework*, of the state of affairs and profit or loss for the year. This change was made because some considered the scope of the auditor's opinion to be constrained by the use of the italicized phrase.¹⁹

¹² See also the CESR Survey, which describes the actual forms of reporting and communication by auditors in the European Union.

¹³ *The Evolution of the United States Audit Report*, at 3–4.

¹⁴ *Ibid*, at 4.

¹⁵ The Auditing Practices Board (APB) Discussion Paper, *The Auditor's Report: A Time for Change?* (December 2007) (APB Discussion Paper), available at <http://www.frc.org.uk/apb/publications/pub1468.html>. The APB is the part of the FRC that, among other things, establishes standards for auditing.

¹⁶ *Ibid*, at 10–11. In 1998, APB Bulletin 1998/10, *Corporate Governance Reporting and Auditor's Responsibilities Statements*, further recommended that the auditor's responsibilities be included as a separate section within the audit report or set out as a separate statement within the annual report. Practice has since developed in the UK such that the auditor's responsibilities are described within the standard audit report.

¹⁷ The decision is available at <http://www.scotcourts.gov.uk/opinions/mcf1807c.html>.

¹⁸ *APB Discussion Paper*, at 11–12

¹⁹ *Ibid*, at 16.

Elsewhere in Europe, audit reports have likewise evolved over time, sometimes in a manner similar to the changes that occurred in the UK, but at other times, they evolved significantly differently—often in response to unique country-specific factors. For example, in addition to the standard audit opinion on the financial statements, French law requires an explanatory paragraph discussing the auditor’s assessment of certain significant accounting estimates or judgments. This requirement was intended to clarify the key judgments and assessments that the auditor considered in performing the audit, thereby reducing the expectations gap by highlighting more clearly the key areas of audit focus.²⁰

The audit report in Europe may experience additional change, as Article 51a(1) of Directive 78/660/EEC (*i.e.*, the European Commission’s 4th Directive) and Article 28.2 of Directive 2006/43/EC (*i.e.*, the European Commission’s 8th Directive) indicate that the European Commission may adopt or develop a common standard for audit reports.

Developments in North America

Prior to the development of the standard audit report in the United States in 1917, auditors had considerable discretion in the form and content of their audit reports. Some auditors provided “long-form” audit reports, which attempted to describe in a clear and precise manner the work that the auditor had completed. Other auditors issued short-form audit reports based heavily on the British model.²¹

In 1917, the U.S. Federal Reserve developed a memorandum on auditing procedures to, among other things, specify certain auditing procedures that should be performed and the language that should be used in the audit report – including language intended to clarify that auditors do not examine all transactions in a company’s books and records.²² The wording of this short, one sentence report was developed to standardize the language in order to eliminate confusion and enhance consistency.²³

A series of changes to the U.S. standard audit report made between 1929 and 1948 were intended to clarify the nature of the auditor’s work (such as clarifying the inherent judgments that are involved with an audit), the type of opinion to be expressed, the basis upon which the auditor expresses an opinion and the professional standards that govern the auditor’s conduct, and to disclaim responsibility to third parties. Some of the changes included replacing the term

²⁰ ICAEW, *Auditor reporting* (February 2007) (ICAEW Auditor Reporting Paper) available at <http://www.icaew.co.uk/index.cfm?route=144970>. This paper is part of the Audit Quality Fundamentals Reporting series of the ICAEW and explores whether the standard audit report satisfies shareholders’ expectations and possible ways in which it could be improved.

²¹ *The Evolution of the United States Audit Report*, at 6.

²² *Ibid*, at 7. These procedures and the wording and content of audit reports were later set forth in an article appearing in the Federal Reserve Bulletin, entitled *Uniform Accounting: A Tentative Proposal Submitted by the Federal Reserve Board*.

²³ *The Commission on Auditors’ Responsibilities: Report, Conclusions, and Recommendations* (1978), at 72–73 (Cohen Commission Report). The Commission on Auditors’ Responsibilities (the Cohen Commission) was charged with “develop[ing] conclusions and recommendations regarding the appropriate responsibilities of independent auditors....consider[ing] whether a gap may exist between what the public expects or needs and what auditors can and should reasonably expect to accomplish.”

“certified” with the phrase “in our opinion” and introducing phrases such as “tests of the accounting records and such other auditing procedures,” “fairly presented,” “in conformity with generally accepted accounting principles,” and “generally accepted auditing standards.”²⁴

After 1948, the U.S. standard audit report remained essentially unchanged until 1988, when it was modified to more fully describe the respective responsibilities of management and the auditor, expand the scope paragraph to include a brief description of the audit, and add the terms “reasonable assurance” and “materiality.” These changes were intended to clarify the roles and responsibilities of the auditor and the basic objectives of an audit and its limitations, thereby reducing the expectations gap.²⁵

In Canada, the evolution of the standard audit report has been consistent with its evolution in the U.S. In 1951, a standard audit report was adopted that largely followed the U.S. standard report wording, and in 1988, the report was again modified in a manner consistent with reporting practices in the U.S.²⁶ However, the Auditing and Assurance Standards Board in Canada is adopting the ISAs as Canadian Auditing Standards effective for the audits of financial statements for periods beginning on or after December 15, 2009 and as a result, the standard audit report in Canada will be aligned with the IAASB report previously described.

Developments in Australia and Asia

In Australia and Asia, audit reports have likewise evolved over time. For example, in Australia, the audit report has evolved to provide additional detail about the responsibilities of directors for the preparation and presentation of the accounts and to explain the nature, objective and limitations of an audit.²⁷ In Japan, the standard audit report has been modified to state the respective responsibilities of management and auditors, provide a more detailed description of the audit, and to add an “Additional Matters” paragraph to describe the judgments made in forming an opinion or other matters that the auditor chooses to emphasize.²⁸

²⁴ Cochrane, George, *The Auditor's Report: Its Evolution in the U.S.A.*, in *Perspectives in Auditing* (1975), at 16-34.

²⁵ Stawser, Robert H., *The new audit report: will it close the expectations gap in communications?* in *The CPA Journal Online* (May 1990), available at <http://www.nysscpa.org/cpajournal/old/08526920.htm>. Other minor modifications to the U.S. audit report have occurred since 1988, but the most significant change occurred after passage of the Sarbanes-Oxley Act of 2002, which, among other things, required auditors to report on the effectiveness of issuers' internal control over financial reporting (ICFR).

²⁶ Maingot, Michael, *The Evolution of the Standard Unqualified Auditor's Report in Canada*, *Accounting Perspectives* (November 2006), available at <http://www.caaa.ca/AccountingperspectivesCAP/BackIssues/vol5num1/exeartwfYesbpMjj.html>.

²⁷ Chong, Kar-Ming and Pflugrath, Gary, *Do Different Audit Report Formats Affect Shareholders' and Auditors' Perceptions?*, *International Journal of Auditing*, Vol. 12, No. 3, pp. 221-241 (November 2008).

²⁸ Beginning in 2008, auditors in Japan are also required to report on issuers' ICFR, per Article 24-4-4 of the Financial Instruments and Exchange Acts, available at <http://www.fsa.go.jp/en/refer/legislation/index.html>.

Various Policy and Other Objectives Affect the Form and Content of the Standard Audit Report

The evolution of audit reports throughout the world suggests that similarities and differences exist in the objectives of auditor communication, thereby affecting the form and content of standard audit reports. For example, audit reports frequently are addressed to specified parties, identify the entity whose financial statements have been audited, note the titles and dates of those financial statements, briefly describe the respective responsibilities of management and the auditor, identify the auditing standards used by the auditor to conduct the audit and a general description of what those standards require, briefly describe the nature of the audit, express an opinion on the fair presentation of the financial statements,²⁹ and are signed and dated by the auditor.³⁰ Differences also exist, including those related to incremental jurisdiction-specific reporting requirements such as those described above and other differences related to: i) language (e.g., “present fairly, in accordance with...” versus “give a true and fair view...[and] have been properly prepared in accordance with...”) and ii) the level of detail in describing the responsibilities of management and the auditor.

Notwithstanding these differences, the primary objective of audit reports is relatively consistent: to express clearly the auditor’s opinion on the financial statements and to describe the basis for that opinion. The question remains, however, whether this objective is being met and whether it alone satisfies investors’ needs for information about the audit process and its results. Thus, the challenge for regulators and standard setters is to determine how best to achieve and balance various objectives, while recognizing that if they desire global consistency in auditor reporting, the standard audit report must be capable of accommodating the different reporting requirements that exist across certain jurisdictions.

²⁹ The concept of “fair presentation” is described differently in various financial reporting frameworks. ISA 700 (Redrafted), *Forming an Opinion and Reporting on Financial Statements*, describes a fair presentation framework as one that:

requires compliance with the requirements of the framework and: (i) acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or (ii) acknowledges explicitly that in extremely rare circumstances it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements.

International Financial Reporting Standards (IFRS) is an example of the latter type of framework as it explicitly recognizes that in “extremely rare circumstances,” an entity should depart from a requirement in an IFRS if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.

³⁰ Currently, some jurisdictions require only the firm’s signature on the audit report while other jurisdictions require the signature of both the firm and the engagement partner. Further, some jurisdictions are currently debating whether the audit report should be signed by the engagement partner or only the firm. For example, the Public Company Accounting Oversight Board (PCAOB) issued a Concept Release on *Requiring the Engagement Partner to Sign the Audit Report* on July 28, 2009. See http://www.pcaobus.org/Rules/Docket_029/2009-07-28_Release_No_2009-005.pdf.

III. PERCEIVED SHORTCOMINGS WITH THE CURRENT STANDARD AUDIT REPORT IN MEETING THE NEEDS OF FINANCIAL STATEMENT USERS

Despite improvements to the standard audit report over the years, some argue that the current model no longer meets the needs of financial statement users. Some believe that the standard audit report has not been changed to adequately reflect the growing complexity in business, financial reporting and auditing.³¹ Others have questioned more broadly the usefulness of the standard audit report.³²

Common resulting criticisms of the standard audit report can be classified into three categories, each of which is described in further detail below. These criticisms include that the standard audit report –

- Expresses an opinion that is binary in nature (*i.e.*, “pass/fail”),
- Contains boilerplate and technical language, and
- Does not reflect the level of effort and judgment inherent in an audit, thereby exacerbating the expectations gap.

These criticisms are compounded by the limited amount of (if any) direct auditor communications with users of financial statements other than in the standard audit report. For example, in many jurisdictions auditors either do not attend shareholder meetings or do not speak openly at them. Similarly, communications that occur between the auditor and those charged with governance³³ – which often provide insights into the quality of the audit and the entity’s financial reporting – are not shared publicly.

Binary Nature of the Opinion

The standard audit report is generally considered to be a “pass/fail” approach. Because the opinion states whether the financial statements achieve fair presentation (pass) or not (fail), many consider it a binary model.³⁴ The primary advantage of the binary nature of the opinion is that it states the auditor’s conclusion in a simple and straightforward manner, without obscuring it with

³¹ See, for example, comments at the Roundtable and the U.S. Treasury Advisory Committee Report, at VII:17.

³² See, for example, Roundtable comments from former U.S. Securities and Exchange Commission (SEC) Commissioner Roel Campos summarizing the “Audit Quality: Evaluating External Audits in Today’s Environment” panel discussion, at panel four, “Concluding Analysis.”

³³ In this report, the term “those charged with governance” is used consistently with how it is defined in the IAASB Glossary of Terms:

The person(s) or organization(s) (*e.g.*, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process...

³⁴ For example, a report with an unqualified opinion on financial statements prepared in accordance with IFRS under ISA 700 (Redrafted) states in part:

In our opinion, the financial statements give a true and fair view of (*or “present fairly, in all material respects,”*) the financial position of ABC Company as of December 31, 20X1, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

additional information.³⁵ However, this simplicity is also viewed by some as one of the standard audit opinion's biggest disadvantages because it does not allow for any "in-between."³⁶ As such, the binary nature of the opinion does not acknowledge the differences in the financial reporting systems of different companies, meaning there is no way for a financial statement user to tell from the audit report what "letter grade" within the "passing range" the company would receive on the quality of its accounting and financial reporting.³⁷

With limited insight into the auditor's findings related to the quality of the company's financial reporting, such as the level of conservatism employed by management in making accounting judgments in relation to its industry competitors or the company's degree of compliance with its applicable financial reporting framework, investors receive little information from the auditor enabling them to distinguish between companies. This problem is exacerbated in some IOSCO jurisdictions where filing requirements effectively result in few modified opinions.³⁸ However, even in other IOSCO jurisdictions, variations from the standard unmodified opinion are rare.

Boilerplate and Technical Language

Although the language in the standard audit report varies among jurisdictions, the main points are described with substantially similar language. For example, the auditor obtains "reasonable assurance;" plans and performs the audit with "material misstatement" in mind; and opines on whether the financial statements achieve fair presentation. Notwithstanding one of the inherent advantages of using a report with standardized wording (*i.e.*, relatively short and straightforward), it has come to be criticized by some as being boilerplate and too technical.³⁹ The result is that users of financial statements may not understand the meaning of words or phrases contained in the standard audit report or may attach little thought to them, despite the fact that they bear tremendous meaning within the profession. Similarly, the use of such boilerplate and technical language may not adequately communicate the underlying audit effort that those words are intended to capture.

³⁵ See, for example, comments at the Roundtable, during part III, "Question and Answer Session," of panel one, "Audit Quality: Evaluating External Audits in Today's Environment."

³⁶ The paper, *Global Capital Markets and the Global Economy: A Vision from the CEOs of the International Audit Networks* (Nov. 2006), available at http://www.globalpublicpolicysymposium.com/CEO_Vision.pdf, described the current audit opinion as an "on and off" switch, meaning either a company's financial statements do or do not comply with prevailing accounting conventions.

³⁷ See, for example, discussion at the February 2005 PCAOB SAG meeting regarding the *Auditor's Reporting Model* (February 2005 PCAOB SAG Meeting). The archived webcast of the meeting can be found at http://www.pcaobus.org/News_and_Events/webcasts_archive.aspx#28.

³⁸ For example, in the U.S., in order for a registrant to be considered timely and current with its filings, the audit report filed with the SEC must include an unqualified opinion. See Rule 2-02(b) of Regulation S-X and SEC Staff Accounting Bulletin Topic 1E.

For a discussion of circumstances that lead to modified reports, see, for example, ISA 705 (Revised and Redrafted), *Modifications to the Opinion in the Independent Auditor's Report*.

³⁹ See, for example, ICAEW Auditor Reporting Paper, at 11.

For example, the Cohen Commission Report expressed concern with the phrase “presents fairly...in conformity with generally accepted accounting principles.”⁴⁰ The Cohen Commission Report stated that this phrase, which is intended to communicate the auditor’s opinion on whether the financial statements achieve fair presentation, is unclear and ambiguous to average users. Indeed, since the Cohen Commission Report was issued, the international financial reporting community has engaged in a rigorous debate over the circumstances in which it is appropriate for an issuer to “override” the requirements of the applicable financial reporting framework to achieve fair presentation.⁴¹ Although it is beyond the scope of this consultation report to analyze the merits of the views in this debate, some have reasonably questioned whether this *shorthand* expression in the standard audit report clearly communicates to users its intended meaning and the procedures that the auditor has employed to evaluate fair presentation.

The Cohen Commission Report summarized the implications of such boilerplate and technical language in the standard audit report as follows: “One effect of using a standard report is that as a person becomes familiar with its words, he tends to stop reading it each time he sees it....The entire report comes to be interpreted as a single, although complex, symbol that is no longer read.”⁴²

Expectations Gap

Much has been said about the need to reduce the expectations gap.⁴³ The continued existence of the expectations gap is often attributed, at least in part, to shortcomings in the manner in which auditors communicate their findings to users of financial statements,⁴⁴ namely due to the fact that the standard audit report lacks detail around the effort exerted by the auditor in planning and performing the audit.⁴⁵

As it relates to fraud, an oft-cited shortcoming with the standard audit report is its lack of a robust description of the auditor’s role in detecting fraud. For example, although the standard

⁴⁰ An alternative phrase that is used in some jurisdictions is “give a true and fair view.” For a short description of the Cohen Commission, see footnote 22.

⁴¹ For example, in some jurisdictions in which fair presentation frameworks are applied, such as the UK, legislation requires the financial statements to give a “true and fair view” of the balance sheet of the company and its profit or loss and requires the departure from a specific accounting standard to the extent necessary to achieve it. In these jurisdictions, although not common, overrides do occur. Indeed, the UK has not adopted the audit report developed by the IAASB because of, among other reasons, dissatisfaction with the notion that there are or should only be “extremely rare” circumstances where the departure from a specific requirement in the financial reporting framework would be required to achieve fair presentation (for further discussion, see chapter two of the APB Discussion Paper, at 12). In other jurisdictions in which fair presentation frameworks are applied, such overrides are either not permitted or are not used in practice.

⁴² Cohen Commission Report, at 73.

⁴³ See, for example, comments at the Roundtable during panels one and four, “Audit Quality: Evaluating External Audits in Today’s Environment” and “Concluding Analysis.”

⁴⁴ Among other reasons, unrealistic public expectations are often also cited as a cause of the expectations gap. For further discussion regarding public expectations, see http://www.abrema.net/abrema/expect_gap_g.html.

⁴⁵ See, for example, the February 2005 PCAOB SAG Meeting discussion, in which members generally agreed that the current reporting model does not clearly state what an auditor did to reach his or her conclusion as to the fairness of the financial statements.

auditor's report developed by the IAASB mentions fraud, it does so only briefly.⁴⁶ The U.S. Treasury Advisory Committee Report observed that the standard U.S. audit report does not even mention fraud.⁴⁷

Some have also expressed concern that the standard audit report provides little information to evaluate the quality of the audit itself because it fails to reflect the extensive judgments made by the auditor throughout the course of the audit.⁴⁸ Similarly, the CESR Survey highlighted that the IAASB standard audit report provides little or no answers to, for example, the following questions:⁴⁹

- What has the auditor done to ensure his independence?
- What have been specific risks and focal points of attention in the audit and why?
- What audit steps have been taken accordingly?
- What materiality criteria have been used?
- What entities/items have been specifically excluded from the scope of the audit or subject to more limited direct work?
- What has the auditor done to ensure high quality work if he makes use of other auditors?

Standard setters and regulators have also recognized these perceived problems

In the UK, the APB Discussion Paper sought views on what amendments to the audit report are needed to reflect the changes introduced by the Companies Act of 2006 and whether other, more wide ranging, changes should be made to the form and content of the standard audit report.⁵⁰

In the United States, at the February 2005 PCAOB Standing Advisory Group (SAG) Meeting, members discussed, among other things, the advantages and disadvantages of the current

⁴⁶ See the Appendix for the IAASB's standard audit report.

⁴⁷ U.S. Treasury Advisory Committee Report, at VII:15.

⁴⁸ See, for example, the 103rd American Assembly, November 13-15, 2003, *The Future of the Accounting Profession* (New York: The American Assembly, Columbia University), available at http://www.americanassembly.org/programs.dir/report_file.dir/accounting_report_report_file_future%20of%20the%20accounting%20profession%20report%20final.pdf. The American Assembly is a U.S. non-partisan public affairs forum illuminating issues of public policy by commissioning research and publications, sponsoring meetings, and issuing reports, books, and other literature.

⁴⁹ CESR Survey, at 2. Although these criticisms were specifically provided in relation to the IAASB standard audit report, they would apply equally to audit reports in other jurisdictions. CESR suggested that if auditors answered these types of questions, (i) the process that led the auditor to conclude would become more transparent for investors, (ii) investors might be able to better assess the quality and inherent limitation of an audit by themselves and (iii) competition between auditors/audit firms on quality could possibly be enhanced.

⁵⁰ As described later in this consultation report, in September 2008 the APB published an Exposure Draft (ED) of ISA (UK and Ireland) 700 (Revised), *The Auditor's Report on Financial Statements*. The ED contained proposed revisions in response to the comments received on the APB Discussion Paper, and can be found at <http://www.frc.org.uk/images/uploaded/documents/ISA%20700%20FINAL%20Web%20Optimized%20Version1.pdf>.

“pass/fail” auditor reporting model.⁵¹ Although the PCAOB has not made any substantial revisions to the audit report since that meeting,⁵² the U.S. Treasury Advisory Committee Report recently recommended that the PCAOB undertake a standard-setting project to consider improvements to the audit report, including clarification of the auditor’s role in detecting fraud.⁵³ Additionally, the American Institute of Certified Public Accountants, the American Accounting Association, and the IAASB have initiated a joint research initiative to study users’ perceptions of the audit report and explore possible revisions to it to enhance clarity.⁵⁴

In the IAASB’s 2009-2011 Strategy and Work Program, the IAASB acknowledged that “aspects of the standard audit report have become a barrier to its adoption in some jurisdictions.” As such, the IAASB plans to determine actions to be taken based on this research. To address the expectations gap, in the third quarter of 2010 the IAASB also plans to consider whether to develop a consultation paper on audit quality and whether to develop a communication to users of financial statements on the meaning of an audit.⁵⁵

⁵¹ For the *Auditor’s Reporting Model* SAG discussion background paper, see http://www.pcaobus.org/Standards/Standing_Advisory_Group/Meetings/2005/02-16/Auditors%20Reporting%20Model.pdf.

⁵² The PCAOB has made certain revisions to the standard audit report since the February 2005 PCAOB SAG Meeting, but these revisions are unrelated to the concerns that are described in this report. See Auditing Standard No. 5, *An Audit of Internal Control That Is Integrated with An Audit of Financial Statements*, and Auditing Standard No. 6, *Evaluating Consistency of Financial Statements*.

⁵³ U.S. Treasury Advisory Committee Report, at VII:13.

⁵⁴ This research initiative, which will be completed in two phases, is specifically related to how the audit report might be revised to better address the expectation gap. Phase one is expected to be completed in 2009 and involves identifying common misconceptions users have regarding an unqualified auditor’s report. A second phase will explore ways in which the auditor’s report might be revised to address user misconceptions and more clearly communicate the intended message. For more information on the four projects that have been approved to date, see http://www.aicpa.org/download/audits/td/2007_05_agenda_material/Item_7A-Summary_of_proposals.pdf.

⁵⁵ IAASB Strategy and Work Program 2009-2011, at 13 and 17, available at http://www.ifac.org/Members/DownLoads/IAASB_Strategy_and_Work_Program_2009-2011.pdf. The IAASB Strategy and Work Program sets the direction and priorities for the activities of the IAASB for the three year period from January 2009 to December 2011.

IV. QUESTIONS TO BE ADDRESSED IN ASSESSING WHETHER CHANGES SHOULD BE MADE

Before evaluating the merits of any proposed changes to the standard audit report, there are several overarching questions related to whether changes should be made that are worthy of discussion. These questions are outlined below and are followed by a discussion of several possible alternatives to changing the standard audit report.

Are investors receiving inadequate information to make investment decisions? If so, should this *information gap* be filled? By whom?

The first issue that must be addressed before adopting changes to the standard audit report is to determine whether an information gap exists between the information that investors need to make informed investment decisions and the information that issuers publicly disclose. At its most fundamental level, this requires consideration of the financial and nonfinancial information that issuers publicly disclose (*e.g.*, financial statements, management commentary, sustainability and governance information) and the manner in which it is disclosed (*e.g.*, annual and quarterly filings with securities regulators, press releases, corporate websites, analyst presentations). If insufficient, irrelevant or unreliable information is provided to investors, this may require securities regulators to reconsider their periodic reporting requirements.

Some of the perceived shortcomings of the standard audit report described above suggest that investors need more (or better) information to facilitate their investment decisions. It is therefore important to consider *whether* this information gap should be filled through additional disclosure and if so, *by whom*. The former analysis must consider the costs and benefits of additional disclosure; the latter must consider whether the disclosure should be provided by issuers, audit committees, or auditors. In this latter analysis, it is important to recognize that:

- Some information gaps should be filled through disclosure by issuers rather than auditors, particularly as management has the best understanding of its business. In other words, the audit report should not be used as a mechanism to deal with shortcomings in the information disclosed by companies to their investors; and
- Other information gaps, such as those that relate to the key matters discussed by those charged with governance and the auditor, may be better filled through disclosure by those charged with governance.

In considering the information that issuers publicly disclose, it is also important to recognize that the information that is *actually* filed with securities regulators sometimes differs from the information that is *required* to be filed. For example, some have noted that a common deficiency in financial statements that are prepared in accordance with IFRS is that they frequently omit, or provide only boilerplate, disclosure of judgments that management makes about the future and about other sources of estimation uncertainty.⁵⁶ This type of an information gap may not require reconsideration of periodic reporting requirements or changes to the standard audit report, but may require more focused attention by issuers, auditors and securities regulators on compliance.

⁵⁶ See, for example, the report of the UK Financial Reporting Review Panel, available at <http://www.frc.org.uk/images/uploaded/documents/IFRS%20Implementation%20-%20preliminary.pdf>, and the report of the Autorité des Marchés Financiers of France, available at http://www.amf-france.org/documents/general/7565_1.pdf.

For information gaps that should be filled by others, what should be the auditor's role with the additional disclosure?

For information gaps that should be filled by others, it is important to determine what role, if any, the auditor should have. For example, the auditor's responsibility generally covers only the financial information identified in the audit report.⁵⁷ If additional assurance is needed to help ensure that information disclosed outside the financial statements is sufficiently reliable, such assurance may necessitate changes to the standard audit report.

For information gaps that should be filled by the auditor, should changes to the standard audit report be made or are other auditor communications warranted?

As previously noted, the primary purpose of the audit report is to express clearly the auditor's opinion on the financial statements and to describe the basis for that opinion. If additional information is needed about the *audit engagement*, the *auditor* or the *nature of auditing*, it is important to consider whether this information should be provided through changes to the standard audit report or through other auditor communications.

For example, the CESR Survey noted that some of the additional information about the *audit engagement* could be communicated outside of the standard audit report. Examples cited in the survey include: publication of engagement letters; a separate account of the auditor on the scope, conduct and outcome of the audit; an active role of the auditor in answering questions at shareholder meetings; and/or publication of the auditor's communications with those charged with governance.⁵⁸

Other information about the *auditor* might also render changes to the standard audit report unnecessary. For example, some have cited concerns over the lack of information about the firm and the engagement team that conducted the audit, which makes it difficult to evaluate audit quality. While these *transparency* concerns could be addressed, at least in part, through changes to the standard audit report, they might be better addressed through other public disclosures.⁵⁹

Similarly, some have expressed concern that the *nature of auditing* is not widely understood by users of audit reports. Rather than educating users through changes to the standard audit report, information about the nature of auditing could be provided through more general communications to investors. For example, as previously noted, the IAASB plans to consider

⁵⁷ Auditors are generally not obligated to report on other information contained in documents containing audited financial statements, such as periodic filings. Instead, auditors are generally only required to read the other information to identify material inconsistencies with the audited financial statements. See, for example, ISA 720 (Redrafted), *The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements*.

⁵⁸ CESR Survey, at 8.

⁵⁹ See the [Transparency of Firms that Audit Public Companies](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD302.pdf), Consultation Report, Report of the Technical Committee of IOSCO published on 9 September 2009, which is seeking feedback on the types of disclosures about auditors that would help to maintain and improve audit quality and ensure availability and delivery of audit services. This report is available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD302.pdf>.

whether to develop a communication to users of financial statements on the meaning of an audit.⁶⁰

What legal, practical and regulatory issues would result from any changes to auditor communication requirements?

Any proposed changes to the standard audit report or new auditor communication requirements must be evaluated considering legal realities, practical challenges and regulatory or statutory obstacles.

Legal realities

Some believe that changes to the standard audit report could expose auditors to increased litigation if changes introduce more subjective information that can be second-guessed. Others believe that changes to the standard audit report would not necessarily result in an increase in litigation exposure for audit firms. For example, the Cohen Commission Report stated that:

“... an audit report that more explicitly describes the responsibilities assumed by the auditor would, if anything, improve the legal position of auditors...[because it] could provide a setting more conducive for the courts to form their opinions based on a more knowledgeable view of the purposes and capabilities of the function...[and] courts would be able to more easily reach an informed judgment on whether the expanded and varied audit report, in contrast to a short and unvarying report, has informed users of the nature and limitations of the assurances provided by auditors.”⁶¹

Consequently, a potential change in audit firms’ litigation exposure and the effect of any such changes should be considered as part of the total cost-benefit analysis in evaluating any proposed changes to the standard audit report.

Legal obstacles might also exist, such as laws that preclude auditors from disclosing confidential client information. For example, auditors frequently become aware of confidential information related to legal and tax matters that issuers are not required to disclose pursuant to certain financial reporting frameworks.

Practical challenges

Given these legal realities, auditors might feel compelled to perform additional procedures to minimize the associated risks. Additionally, certain changes to the standard audit report could fundamentally affect the nature of an audit, thereby necessitating incremental or different audit procedures. Such procedures could increase audit costs and present challenges for completing audits in a timely manner. Further, changes to the audit report that require more subjective descriptions may lead to inconsistencies in auditor reporting, both within individual jurisdictions and across jurisdictions. Such inconsistencies might be complicated for jurisdictions in which joint audits are performed and jurisdictions in which group auditors assume responsibility for the

⁶⁰ IAASB Strategy and Work Program 2009-2011, at 17.

⁶¹ Cohen Commission Report, at 76.

work of component auditors. Lastly, certain additional communications within the audit report, such as those that would result in changes to the binary reporting model, may make it more difficult for investors to understand whether the financial statements achieve fair presentation.

Regulatory or statutory obstacles

Some national regulatory or statutory frameworks (*e.g.*, those used in Australia and many used in Europe) dictate the form and content of the standard audit report.⁶² Consequently, if global consistency in auditor reporting is desired, any changes to the standard audit report must be capable of accommodating the different reporting requirements that exist across certain jurisdictions.

⁶² Additionally, as previously noted, filing requirements in some jurisdictions effectively result in few modified opinions. See footnote 38. Such requirements may influence auditor reporting even though specific form and content requirements may not exist.

V. POSSIBLE ALTERNATIVES FOR CHANGING THE STANDARD AUDIT REPORT AND ADVANTAGES AND DISADVANTAGES OF EACH

Several solutions have been proposed to address the perceived shortcomings of the standard audit report. While not mutually exclusive, these solutions can be grouped into the following four categories:

1. Changes to the organizational structure of the standard audit report;
2. Changes to the language used in the standard audit report;
3. Additional communications in the standard audit report; and
4. Changes to the nature of assurance provided by the auditor, with consequential changes to the standard audit report.

Changes to the Organizational Structure of the Standard Audit Report

Some have recommended changes to the organizational structure of the standard audit report to convey its primary message (*i.e.*, the auditor's opinion) more directly. For example, the ICAEW Auditor Reporting Paper suggested modifying the standard audit report to move the opinion to the beginning of the audit report and the standard language related to the respective responsibilities of management and the auditor, the nature of an audit and its scope to an appendix, website or another publicly available source.⁶³ This recommendation was partially incorporated into ISA (UK and Ireland) 700 (Revised), which facilitates shorter auditor's reports in the UK by, among other things, allowing cross references to a "Statement of the Scope of an Audit" maintained on the APB's web site.⁶⁴

Advantages and Disadvantages

Changes to the structure of the standard audit report could enable users to more easily identify the auditor's conclusion as to whether the financial statements comply with the financial reporting framework and achieve fair presentation.

However, structural changes could lead to an even larger expectations gap. For example, if the standard audit report relegates the standard language related to the respective responsibilities of management and the auditor and the nature of the audit and its scope to an appendix or a publicly available source, users might not appropriately understand the context in which the auditor's opinion should be read.

Changes to the Language Used in the Standard Audit Report

Some have recommended changes to the language used in the standard audit report to state its messages more clearly by avoiding boilerplate and technical language. For example, the Cohen Commission Report suggested deleting the phrase "presents fairly... in conformity with generally accepted accounting principles."⁶⁵ Instead, the Cohen Commission Report stated that

⁶³ ICAEW Auditor Reporting Paper, at 19.

⁶⁴ ISA (UK and Ireland) 700 (Revised), available at <http://www.frc.org.uk/apb/publications/pub1901.html>.

⁶⁵ Cohen Commission Report, at 74-75.

the audit report should “clearly describe the work of the auditor and findings and avoid unclear technical terminology concerning details.”⁶⁶

Advantages and Disadvantages

Changes to the language used in the standard audit report could help users understand the meaning of the audit opinion and the nature of the audit process, which in turn might reduce the expectations gap. Such changes could also reduce or eliminate the need for users to infer information about the audit, such as whether there are any matters that warrant particular emphasis and what the auditor has done to fulfill his or her responsibilities for detecting fraud.

However, language changes could also lead to less concise audit reports, which may unintentionally add confusion rather than alleviate it. Additionally, the elimination of some technical language, such as “presents fairly” or “give a true and fair view,” may require regulatory or legislative change in jurisdictions in which regulations specifically require the auditor to render such an opinion.

Additional Communications in the Standard Audit Report

Additional communications in the standard audit report could be grouped into two broad categories: information about the subject matter of the audit (*i.e.*, the financial statements) and information about the audit itself (*i.e.*, what the auditor actually did). Additional information about the subject matter could include communications that may already be available but are not publicly disclosed. For example, it could include information that auditors typically share only with management and/or those charged with governance. At the February 2005 PCAOB SAG Meeting and at the Roundtable, some suggested that the standard audit report should contain more information pertaining to the quality of the financial statements, possibly incorporating elements of certain communications the auditor is currently required to have with those charged with governance.⁶⁷ Such discussion could include matters such as the consistency of the company’s accounting policies and their application, and the clarity and completeness of the company’s financial statements, including related disclosures. The discussion could also include items that have a significant impact on the representational faithfulness, verifiability, and neutrality of the accounting information included in the financial statements.

Additional communications could also include information that auditors have not historically communicated to others regarding the audit itself. For example, the Cohen Commission Report recommended providing information on “the auditor’s discharge of the entire audit function in the specific circumstances of the particular client.”⁶⁸ The Cohen Commission Report suggested that the audit report be expanded to include matters such as other information in the annual report, association with interim information, internal accounting controls, corporate codes of conduct, and meetings with those charged with governance. The revised audit report would consist of a series of standardized paragraphs, each describing a major element of the audit function. Some paragraphs would be omitted if they are not relevant to the circumstances of the

⁶⁶ *Ibid.*

⁶⁷ See footnote 37.

⁶⁸ Cohen Commission Report, at 75.

company (*e.g.*, interim information paragraph would be omitted if that information is not disseminated to shareholders, *etc.*); however, the auditor would be required to comment negatively or positively for most topics.⁶⁹

In addition, the ICAEW Auditor Reporting Paper recommended that the standard audit report include a positive statement that there are no matters that the auditor wants to emphasize.⁷⁰ Such a positive statement would represent a change from current practice, in which auditors use such “emphasis of matter” paragraphs in their audit reports only when they wish to draw users’ attention to specific matters (*e.g.*, matters presented or disclosed in the financial statements that are of such importance that they are considered to be fundamental to the users’ understanding of the financial statements or any other matters that are relevant to the users’ understanding of the audit, the auditor’s responsibilities or the audit report).⁷¹

Similarly, the U.S. Treasury Advisory Committee Report recently recommended that the standard audit report more clearly articulate the auditor’s role and limitations in detecting fraud.⁷² Although it did not elaborate on the specific language that should be used, such modifications might include changes to explicitly describe the auditor’s responsibility for:

- Obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, *whether caused by fraud or error*;
- Maintaining an attitude of professional skepticism throughout the audit, considering the potential for management override of controls and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud;
- Discussing among the engagement team how and where the entity’s financial statements may be susceptible to material misstatement due to fraud; and
- Performing procedures designed to identify and respond to the risks of material misstatement due to fraud.⁷³

Others have expressed a desire for auditors to provide a more narrative and detailed explanation of their work in the form of an “auditor’s discussion and analysis.” For example:

⁶⁹ Cohen Commission Report, at 79.

⁷⁰ ICAEW Auditor Reporting Paper, at 17.

⁷¹ See, for example, ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter(s) in the Independent Audit Report*.

⁷² U.S. Treasury Advisory Committee Report, at VII:18.

⁷³ These responsibilities are described in ISA 240 (Redrafted), *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*. Similar responsibilities exist under various national auditing standards.

- The ICAEW Auditor Reporting Paper recommended “providing company-specific information (where it is not already available) within the audit report, identifying significant and particularly subjective issues in relation to the audit,” similar to the French standard audit report;⁷⁴
- Panelists at the Roundtable suggested that it might be useful if audit reports were more descriptive, for example by providing information “in a narrative format to investors” or by explaining “what actions the auditor has taken to ensure their independence and the audit’s specific risks and focal points of attention;”⁷⁵
- Half of the respondents to the CESR Survey believed that a “separate report of the auditor on the scope, conduct and outcome of the audit (audit discussion and analysis) is or could be of value;”⁷⁶ and
- In recent testimony submitted by Richard Fleck, on behalf of the FRC, to the Advisory Committee on the Auditing Profession to the U.S. Department of Treasury, Mr. Fleck stated that he believes that “[i]t will be important to explore what can be done to make such [audit] reports more ‘narrative’ in nature - such as by describing important features of the financial statements or the audit undertaken.”⁷⁷

Advantages and Disadvantages

Additional communications could result in more transparency as to the auditor’s views about the qualitative aspects of the issuer’s significant accounting practices and policies, thereby providing investors with an independent perspective on such matters.

Additional communications could also result in more transparency into the audit process and what the auditor has done to discharge his or her responsibilities, which would provide more information that investors could utilize in making investment decisions. With more transparent information available for investors to assess the quality of the audit that was performed, a greater market incentive may exist for firms to perform high quality audits.⁷⁸

Given the audit report is the main form of communication between the auditor and investors, a more “narrative” report might also enable investors to better understand the nature and inherent limitations of an audit. This, in turn, could help close the expectations gap.

However, tailoring each audit report to the specific company in a free form may not be constructive or practical and the additional time required to prepare such a report may exceed the

⁷⁴ ICAEW Auditor Reporting Paper, at 4. An example of the French standard audit report is provided in the Appendix.

⁷⁵ See, for example, comments at the Roundtable during panel one, “Audit Quality: Evaluating External Audits in Today’s Environment.”

⁷⁶ CESR Survey, at 8.

⁷⁷ Record of Proceedings (February 2008) (Written submissions of Richard Fleck, Global Relationship Partner, Herbert Smith, LLP 17, 21) available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Fleck02042008.pdf>.

⁷⁸ See also *Transparency of Firms that Audit Public Companies*, Consultation Report, Report of the Technical Committee of IOSCO published in September 2009. This report is available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD302.pdf>.

potential benefit. The additional information could lead some to infer that the auditor is introducing qualifications (*i.e.*, limitations) to the opinion. Further, the auditor's ultimate conclusion may be obscured with the inclusion of additional information. Additionally, requiring auditors to make positive statements about whether there are any matters that the auditor wants to emphasize may result in the inclusion of unnecessary emphasis of matter paragraphs. Such a change in practice could reduce the intended benefit of such paragraphs and could also present challenges in jurisdictions in which such reports are considered report modifications.⁷⁹

An expanded audit report that includes certain communications historically provided only to those charged with governance may introduce concerns around the potential lack of context that would surround the additional information. In order to keep the length of the description in the audit report manageable, a summary of the auditor's discussion with those charged with governance has the potential to be incomplete and may fail to appropriately convey the complex judgmental process involved in performing an audit. In addition, it is important to note that these communications were not designed to facilitate investment decision-making but rather to help those charged with governance discharge their oversight responsibilities. A requirement to publicly disclose these communications could lead to a less robust and open dialogue between the auditor and those charged with governance, thereby impeding each from fulfilling their respective responsibilities. Furthermore, an auditor may be unable to meet a requirement for added disclosure without providing client-specific privileged and confidential information.

Further, although the primary purpose of an audit is defined by professional standards, many firms have developed proprietary audit methodologies. Therefore, a requirement for auditors to provide a more narrative audit report, including a description of the work performed and judgments made, may raise concerns that audit firms would be required to disclose proprietary information.

Additionally, since the auditor would have the flexibility to determine how to more fully describe the work performed and judgments made, the question arises as to how such wording would be regulated and enforced to ensure that auditors meet the *spirit* of the expanded disclosure requirements.

Changes to the Nature of Assurance Provided by the Auditor, with Consequential Changes to the Standard Audit Report

Changes to the nature of assurance provided by the auditor, with consequential changes to the auditor's report, could involve adopting a framework such as the one suggested by the American Assembly in its report, *The Future of the Accounting Profession* (Assembly Report).⁸⁰ The Assembly Report called for differing attestation standards for different parts of the financial statements, depending on the amount of uncertainty and judgment required in making certain determinations.

⁷⁹ For example, the Listing Rules of the London Stock Exchange require a new applicant for listing to have published or filed audited accounts that cover at least three years and have been reported on by the auditor *without* modification (modifications include reports that contain an emphasis of matter). For further discussion, see chapter four of the APB Discussion Paper, at 29.

⁸⁰ See footnote 48.

The Assembly Report's suggestion is geared at reducing the expectations gap. To do so, it states that auditor judgment must play a greater role in audits, and this judgment must be more transparent in the auditor's communication to investors. However, in its view, fully achieving this result hinges on a two-part solution.

First, an overhaul of the financial reporting model would be needed by the accounting standard setting bodies, such as the International Accounting Standards Board and Financial Accounting Standards Board (U.S.), under the following premise: "... give preparers... of financial statements the freedom and flexibility they need to inform the users of those balance sheets and income statements when the information contained in them is, by definition, uncertain."⁸¹ In sum, financial statement presentation under the Assembly Report model would consist of the display of different kinds of numbers on the face of the financial statements so that users could better recognize when management has applied judgment. For example, under this approach, cash transactions would be portrayed differently than accounts that are subject to estimation uncertainty, the latter of which would be portrayed as a range of possible outcomes.

Second, a change in auditor reporting would be needed to supplement the change in financial reporting and provide auditors of financial statements the same freedom and flexibility in opining on the uncertain information as preparers would have in presenting it. Under this auditor reporting model, the current standard opinion wording would be used for the most concrete, non-speculative aspects of the financial statements (*i.e.*, historical cost items). For information that is more judgmental, such as the allowance for loan losses, auditors would provide more limited (*e.g.*, procedural) attestation. For example, for the items presented by management as a range, the auditor would not have to attest to a single estimate itself. Rather, the attestation would involve verifying that a company has reached these judgments using a clear and seemingly reasonable process. The Assembly Report suggests that the proposed change in auditor reporting, together with the change in financial statement presentation, would serve as a warning that the attestations have limitations of which investors and other users must be aware.

The Assembly Report audit reporting model was also discussed at the February 2005 PCAOB SAG Meeting.⁸² The discussion noted that although the Assembly Report suggestion first requires revision to the financial reporting model, "some of the goals outlined in the Assembly Report could be explored using the current financial reporting model."⁸³ Rather than calling for different *standards* of assurance for different parts of the financial statements, the SAG discussed the possibility of the auditor providing different *levels* of assurance on different financial statement elements (such as cash and trade accounts payable as compared to the allowance for doubtful accounts and the valuation of stock option grants). Under such a reporting model, the level of assurance provided by the auditor on different financial statement elements would vary based on the level of estimation required for its determination, or if management engaged an expert to perform a valuation (such as in pension valuations).

⁸¹ Assembly Report, at 12.

⁸² See footnote 37.

⁸³ *Ibid.*

Advantages and Disadvantages

Changes to the nature of assurance provided by the auditor, with consequential changes to the audit report, have the potential to contribute to narrowing the expectations gap. Because individual attestation standards would match the nature of the specific financial information to which the auditor is attesting, the audit report would reflect the varying degrees of certainty that are part of financial reporting. Further, because the audit report would explicitly convey the limitations inherent in financial reporting and the corresponding attest function, such a model of reporting may serve as a better reflection of the inherent judgments in an audit. In doing so, the form and content of opinions under this model could help alleviate the auditor's dilemma that arises in jurisdictions where a fair presentation "override" is either not permitted or not used in practice. Additionally, such a model might better reflect the underlying complexity of business, financial reporting and auditing because it might help investors better understand the judgments and estimates made by management and the procedures that the auditor employed to evaluate those judgments and estimates.

Such a change could present a couple of unique practical challenges, however. First, such a change may not be feasible under the current financial reporting model; therefore, the practicality of it is questionable without the preceding change in financial reporting described above. Second, practical challenges would exist in determining the standard or level of assurance applicable to different amounts and disclosures.⁸⁴ Since the level of assurance provided in an audit is not quantifiable, it would be difficult to articulate the level of assurance that would be provided for those portions of the financial statements not subjected to procedural attestation as the notion of providing "reasonable assurance" about whether the financial statements as a whole are free of material misstatement may no longer be relevant. This may exacerbate the expectations gap because users may not understand the assurance that they are actually receiving.

Even if these practical challenges could be overcome, such a change to the nature of assurance may result in a reduction to the overall level of assurance that investors currently receive under today's auditor model. Under this proposed model, auditors would plan and perform the audit to obtain assurance about whether particular amounts and disclosures are free of material misstatement, rather than planning and performing the audit to obtain reasonable assurance regarding the financial statements as a whole. Additionally, for other disclosures and amounts, the auditor might attest only to the process rather than the disclosure or amount (*e.g.*, estimate) resulting from that process. It is unclear what overall level of assurance would result from such a model, but providing different standards or levels of assurance has the potential to undermine the concept of reasonable assurance currently provided on the financial statements taken as a

⁸⁴ As noted in the February 2005 PCAOB SAG Meeting briefing paper, "the challenge is in determining which type of auditor assurance should be applied to different parts of the financial statements and in determining the appropriate financial statement parts." (Page 7).

whole.⁸⁵ Before such a model is accepted, careful study would need to be conducted to ensure it is in the best interests of investors.⁸⁶

Other potential disadvantages of this model also exist, including:

- To gain acceptance in the market, this model may first require a change in investor perception regarding the accuracy of financial reporting;⁸⁷
- Due to the introduction of the possibility of a mix of various procedural attestation standards, this model may introduce more technical language into the audit report beyond the current reporting model, thereby increasing the risk of confusion; and
- There are no standards currently tailored to provide guidance on procedural attestation; therefore, such standards would first need to be devised in order for the auditor to follow.⁸⁸

⁸⁵ In addition, such an auditor reporting model has the potential to undermine the role of auditors. See, for example, comments at the IOSCO Roundtable, at panel one, “Audit Quality: Evaluating External Audits in Today’s Environment: “The role of auditors is... to provide a high level of assurance that [a snapshot of a certain company at a given moment] is accurate. If they are unable to offer such assurance, it would significantly change stock pricing and capital allocation activities.”

⁸⁶ See, for example, the February 2005 PCAOB SAG Meeting discussion, where some members noted that the concept of reasonable assurance is a very high level of assurance and providing less would be a disservice to investors.

⁸⁷ Even the Assembly Report noted, on page 7, that “the most important change must be one of attitude: a recognition that audits are not and cannot be as precise as investors have believed and would like them to be.”

⁸⁸ For a discussion of attestation standards to be applied under this audit report model, see, for example, page 13 of the Assembly Report.

VI. SUMMARY

The primary objective of the current standard audit report is to express clearly the auditor's opinion on the financial statements and to describe the basis for that opinion. Some question, however, whether this objective is being met and whether it alone satisfies investors' needs for information about the audit process and its results. To address the perceived shortcomings in the standard audit report observed by others, a number of solutions have been proposed, including changing its structure and language, providing additional communications within the standard audit report and changing the nature of assurance provided by the auditor, with consequential changes to the standard audit report. Each of these solutions warrants careful consideration, taking into account the information needs of investors, the role of auditors and their audit reports, and the challenges that might preclude modifications thereto. Through this consultation report, the Task Force hopes to facilitate a more informed international debate about auditor communications.

VII. REQUEST FOR CONSULTATION

The Task Force seeks public input on the following matters to facilitate its consideration of the issues surrounding auditor communications:

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

APPENDIX I: ILLUSTRATIVE STANDARD AUDIT REPORTS

This appendix includes illustrative standard audit reports used in the jurisdictions referenced in the “Evolution of the Standard Audit Report” section to this consultation report.

IAASB⁸⁹

Independent Auditor’s Report
[Appropriate Addressee]

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheet as at December 31, 20X1, and the consolidated income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management’s Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor’s Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

⁸⁹ This illustrative standard audit report is included as Illustration #3 in ISA 700 (Redrafted). See <http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=4293>.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, (or “*give a true and fair view of*”) the financial position of ABC Company and its subsidiaries as (of) December 31, 20X1, and (of) their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor’s report will vary depending on the nature of the auditor’s other reporting responsibilities.]

[Auditor’s signature]

[Date of the auditor’s report]

[Auditor’s address]

Notes:

- (1) The sub-title “Report on the Consolidated Financial Statements” is unnecessary in circumstances when the second sub-title “Report on Other Legal and Regulatory Requirements” is not applicable.
- (2) The term “Management’s” may be replaced as necessary with the other term that is appropriate in the context of the legal framework in the particular jurisdiction.
- (3) Depending on the circumstances, the sentence that reads, “Management is responsible for the preparation and fair presentation...” may read: “Management is responsible for the preparation and presentation of consolidated financial statements that give a true and fair view in accordance with International Financial Reporting Standards. ...”
- (4) Depending on the circumstances, the sentence that reads, “In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation...” may read: “In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and presentation of consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control.”
- (5) In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, the sentence that reads, “In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control...” would be worded as follows: “In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances.” In the case of note 2 above, the sentence may read: “In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and presentation of consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances.”

United Kingdom⁹⁰

Independent Auditor's Report to the [Shareholders] [Members] of XYZ PLC

Report on the financial statements

We have audited the financial statements of (name of entity) for the year ended ... which comprise [specify the financial statements, such as the Group and Parent Income Statements, the Group and Parent Balance Sheets, the Group and Parent Cash Flow Statements, the Group and Parent Statements of Changes in Equity], and the related notes. The financial statements have been prepared in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Respective responsibilities of directors and auditors

In relation to these financial statements, the directors are responsible for their preparation and presentation and for being satisfied that they give a true and fair view.

Our responsibility is to audit the financial statements in accordance with the requirements of the Companies Act 2006 and International Standards on Auditing (UK and Ireland) and to express an opinion on the financial statements. In forming our opinion we are also required to comply with the Auditing Practices Board's Ethical Standards. A statement describing the scope of an audit and the auditor's reporting responsibilities in respect of a United Kingdom publicly traded company is available on the APB's web site [*insert reference to web page*].

Opinion

In our opinion the financial statements:

- have been properly prepared in accordance with IFRSs as adopted by the European Union;
- have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation; and
- give a true and fair view of the state of the group's and the parent company's affairs as at ... and of the group's and the parent company's profit for the year then ended.

Opinion

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' Report is consistent with the financial statements.

⁹⁰ This illustrative standard audit report is included in Proposed ISA (UK and Ireland) 700 (Revised) – September 2008. See footnote 50.

We also have responsibilities:

- under the Companies Act 2006 to report to you if, in our opinion:
 - Adequate accounting records have not been kept, or that returns adequate for our audit have not been received from branches not visited by us.
 - The parent company financial statements are not in agreement with the accounting records and returns.
 - The part of the Directors' Remuneration Report to be audited is not in agreement with the accounting records and returns.
 - We have not received all the information and explanations we require for our audit.
- under the Listing Rules of the Financial Services Authority, to review:
 - The statement made by the directors that the business is a going concern, together with supporting assumptions or qualifications as necessary.
 - The parts of the Corporate Governance Statement relating to the company's compliance with the nine provisions of the [2006]/[June 2008] Combined Code specified for our review.

We have nothing to report to you in respect of these responsibilities.

[Signature] Address

John Smith (Senior statutory auditor) Date

for and on behalf of ABC LLP, Statutory Auditor

Notes:

- (1) At present two versions of the Combined Code are in effect. The 2006 edition applies to accounting periods beginning on or after 1 November 2006 and the June 2008 edition applies to accounting periods beginning on or after 29 June 2008.

France⁹¹

Statutory Auditors' Report on the Consolidated Financial Statements

Following our appointment as Statutory Auditors by your Annual General Meeting, we have audited the accompanying consolidated financial statements of XYZ company for the year ended 31 December 2005. The consolidated financial statements have been approved by the Managing Board. Our role is to express an opinion on these financial statements based on our audit. These financial statements have been prepared in accordance with IFRSs as adopted for use in the European Union. They include comparative information restated in accordance with the same standards in respect of the financial year 2004.

Opinion on the consolidated financial statements

We conducted our audit in accordance with professional standards applicable in France. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements give a true and fair view of the assets and liabilities and of the financial position of the [Group] as at 31 December 2005 and of the results of its operations for the year then ended in accordance with IFRSs as adopted for use in the European Union.

Justification of our assessments

In accordance with the requirements of article L. 823-9 of the French Commercial Law relating to the justification of our assessments, we bring to your attention the following matters:

- Regarding the first time adoption of IFRS to prepare the 2005 consolidated financial statements, note 44 sets out all the disclosures required concerning the change in accounting standards at 1 January 2004 and describes the steps taken to ensure that the financial statements presented for 2005 and 2004 in accordance with IFRS are comparable. As part of our assessment of the accounting principles and methods applied, we verified, in particular, the correct application of the method used to record development expenditure within assets (note 1.11A), as well as the amortization method applied in view of the revised useful life of vehicle projects, which is now capped at seven years (Note 44.1A), and the method of testing the recoverable amount of these assets (note 1.13). We also verified the correct calculation of the adjustments in respect of sales subject to a buyback commitment (note 1.5.Aa) in view of the increased accuracy resulting from the new IT programs developed for this purpose (note 44.1.A), and that any other changes described in this note were appropriate.

⁹¹ This illustrative standard audit report is included in ICAEW, *Auditor reporting* (February 2007). See footnote 19.

- As indicated in note 1.10, goodwill is no longer amortized but is tested for impairment at least annually according to the method set out in note 1.13. In 2005, impairment tests conducted by the Automotive Equipment Division, as described in note 8.1, led to a write-down of 180 million euros on assets assigned to the vehicle interior systems and modules segment. As part of our assessment of the significant estimates made by management, we verified that this approach complied with IFRS and that the impairment tests described in the notes to the consolidated financial statements were carried out correctly. We also assessed whether the cash flow projections applied and other assumptions used were reasonable. These assessments were made in the context of our audit of the consolidated financial statements taken as a whole, and therefore contributed to the opinion we formed which is expressed in the first part of this report.

Specific verification

In accordance with professional standards applicable in France, we have also verified the information given in the Group's management report. We have no matters to report as to its fair presentation and its consistency with the consolidated financial statements.

United States⁹²

Report of Independent Registered Public Accounting Firm

We have audited the accompanying balance sheets of X Company as of December 31, 20X3 and 20X2, and the related statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 20X3. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of [at] December 31, 20X3 and 20X2, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 20X3, in conformity with U.S. generally accepted accounting principles.

[Signature]

[City and State or Country]

[Date]

Notes:⁹³

- (1) When performing an integrated audit of financial statements and internal control over financial reporting, if the auditor issues separate reports on the company's financial statements and on internal control over financial reporting, the following paragraph should be added to the auditor's report on the company's financial statements:

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of X Company's internal control over financial reporting as of December 31, 20X3, based on [identify control criteria] and our report dated [date of report, which should be the same as the date of the report on the financial statements] expressed [include nature of opinions].

⁹² This illustrative standard audit report is included in PCAOB Auditing Standard No. 1 - *References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board*, available at http://www.pcaob.org/Rules/Rules_of_the_Board/Auditing_Standard_1.pdf.

⁹³ These notes are included in paragraphs .08 and .09 of PCAOB AU Section 508, *Reports on Audited Financial Statements*, available at http://www.pcaob.org/standards/interim_standards/auditing_standards/index_au.asp?series=500§ion=500.

- (2) The report may be addressed to the company whose financial statements are being audited or to its board of directors or stockholders. A report on the financial statements of an unincorporated entity should be addressed as circumstances dictate, for example, to the partners, to the general partner, or to the proprietor. Occasionally, an auditor is retained to audit the financial statements of a company that is not a client; in such a case, the report is customarily addressed to the client and not to the directors or stockholders of the company whose financial statements are being audited.

Canada

AUDITOR'S REPORT

To the Shareholders of

We have audited the balance sheet of as at, 20..... and 20..... and the statements of income, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on my audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at, 20..... and 20..... and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

City (signed)

Date CHARTERED ACCOUNTANTS

Australia⁹⁴

Independent Auditor's Report

[Appropriate Addressee]

Report on the Financial Report

We have audited the accompanying financial report of [name of entity], which comprises the balance sheet as at 30 June 20XX, and the income statement, statement of changes in equity and cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory notes.

The Responsibility of [Those Charged with Governance] for the Financial Report

[Those charged with governance] are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations). This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by [those charged with governance], as well as evaluating the overall presentation of the financial report.

⁹⁴ This illustrative standard audit report is included in Auditing Standard ASA 700, *The Auditor's Report on a General Purpose Financial Report*, available at [http://www.comlaw.gov.au/ComLaw/Legislation/LegislativeInstrumentCompilation1.nsf/0/BD414F6F9929BBAECA257325001722A0/\\$file/Compiled_AS_A_700_27_June_2007.pdf](http://www.comlaw.gov.au/ComLaw/Legislation/LegislativeInstrumentCompilation1.nsf/0/BD414F6F9929BBAECA257325001722A0/$file/Compiled_AS_A_700_27_June_2007.pdf).

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Auditor's Opinion

In our opinion, the financial report presents fairly, in all material respects, (or “gives a true and fair view of”) the financial position of [name of entity] as of 30 June 20XX, and of its financial performance and its cash flows for the year then ended in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations).

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities].

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

Notes:

- (1) The subheading “Report on the Financial Report” is unnecessary in circumstances when the second subheading “Report on Other Legal and Regulatory Requirements” is not applicable.
- (2) When the auditor is aware that the financial report will be included in a document that contains other information, the auditor may consider, if the form of presentation allows, identifying the page numbers on which the audited financial report is presented in the first paragraph of this report.
- (3) Instead of referring to “those charged with governance,” the auditor may alternatively use the title of those charged with governance (e.g., Directors' Responsibility for the Financial Report) throughout the report.
- (4) In addition to referring to Australian Auditing Standards, the audit report refers, when appropriate, to statutory or other requirements.
- (5) In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial report, the sentence in the fourth paragraph regarding internal control would be worded as follows: “In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances.”
- (6) The auditor's report needs to be signed in one or more of the name of the audit firm, the name of the audit company or the personal name of the auditor as appropriate.

Japan

Independent Auditors' Report

[To the Board of Directors of ABC Corporation]

We have audited the accompanying consolidated balance sheets of ABC Corporation and consolidated subsidiaries as of March 31, 20X5 and 20X4, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to independently express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of ABC Corporation and consolidated subsidiaries as of March 31, 20X5 and 20X4, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles and practices generally accepted in Japan.

There is no conflict of interest between the Company and us or the engagement partner that should be stated in the report as required by the CPA Act.

XYZ Audit Corporation

June XX, 20X5

APPENDIX II

IOSCO TASK FORCE ON AUDIT SERVICES

Consultation Report on Auditor Communications

Interim Chairman: Mr. Ethiopis Tafara
US Securities and Exchange Commission

Comisión Nacional de Valores (Argentina)	Mr. Emilio Ferre
Australian Securities and Investments Commission (Australia)	Mr. Mark Adams Mr. Lee White
Comissão de Valores Mobiliários (Brazil)	Mr. Eduardo Manhães
Ontario Securities Commission (Ontario, Canada)	Mr. Cameron McInnis Mr. James Turner Ms. Ilana Singer
Autorité des marchés financiers (Quebec, Canada)	Mr. Jean Lorrain Mr. Louis Morisset
Autorité des marchés financiers (France)	Ms. Sophie Baranger Ms. Marion Bougel-Bomtemps
Bundesanstalt für Finanzdienstleistungsaufsicht (Germany)	Dr. Christian Schindler Mr. Philipp Sudeck
Securities and Futures Commission (Hong Kong)	Mr. Charles Grieve Ms. Susan Lau
Commissione Nazionale per le Società e la Borsa (Italy)	Ms. Nicoletta Giusto
Financial Supervisory Authority (Japan)	Mr. Toshitake Inoue Mr. Junichi Maruyama Mr. Tomokazu Sekiguchi
Comisión Nacional del Mercado de Valores (Mexico)	Ms. Angelica Gonzalez Saravia
Autoriteit Financiële Markten (Netherlands, The)	Mr. Frank Dankers
Comisión Nacional del Mercado de Valores (Spain)	Mr. Eduardo Manso Mr. Antonio Mas

Eidgenössische Finanzmarktaufsicht FINMA
(Switzerland)

Mr. Jehle Bernhard
Mr. Heinz Meier

Financial Services Authority (United Kingdom)

Ms. Patricia Sucher
Mr. Richard Thorpe

Securities and Exchange Commission (United States)

Mr. Ethiopis Tafara
Ms. Julie Erhardt