

Prof. Arnold Schilder, Chairman of the International Auditing and Assurance Standards Board

Panel 3: International Developments on the Auditor's Report – April 2, 2014

PCAOB Public Meeting on Auditor's Reporting Model

Thank you for the opportunity to speak with you today about the International Auditing and Assurance Standards Board's work on auditor reporting. As an independent global standard-setter, an important aim of our work is to facilitate adoption and convergence of national and international auditing standards. So I commend the PCAOB for arranging this global panel, and note that collaboration with the PCAOB has been a critical part of our work to date.

Why is the IAASB seeking to change the auditor's report? The topic has been on our radar screen for some time. We first commissioned academic research jointly with the Auditing Standards Board of the AICPA. Ted Mock, a panelist this afternoon, and others provided us with global input about users' perceptions of the auditor's report. The financial crisis has heightened the demand for more communication from auditors, and has highlighted overarching concerns about the value of an audit and the relevance of the accounting profession.

This sparked the IAASB's work to consider how best to respond to the needs of users, and auditor reporting has been our top priority for the past two years. We issued two public consultations on the topic and note the continued support for moving forward to enhance the communicative value of the auditor's report.

Our most recent consultation in July 2013 focused on auditor reporting on key audit matters, other information, and going concern. It also included other initiatives to increase transparency about the audit and the auditor's responsibilities. Overall, there is strong global support for the IAASB finalizing its proposals in 2014.

The topic of what we refer to as key audit matters or KAM, similar to the PCAOB's critical audit matters, is viewed by many as the most significant enhancement to auditor reporting. We proposed to require auditors of listed entities to communicate KAM in the auditor's report.

We define KAM as those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. KAM are selected from matters communicated with those charged with governance – thereby providing transparency about communications investors have said are important to audit quality.

Investors, regulators and auditors largely support what we have proposed but have asked for more guidance on how auditors should apply the decision framework. They have also urged us to take steps to ensure that both the matters identified, and how they are described in the auditor's report, results in meaningful communication to investors. Robust application guidance in our standard, as well as revised examples of KAM, will give an indication of how the IAASB expects the concept of key audit matters to be applied in practice.

Preparers and others who do not support the concept of KAM often cite concerns with the auditor providing "original information" – that is, information that is not otherwise required to be disclosed in the financial statements. And auditors have asked for more guidance on how to deal with circumstances that might result in the auditor communicating about sensitive matters. The Board is exploring how to find an appropriate balance between auditors providing useful information about the most significant matters in the audit that was performed, while at the same time respecting the important concepts of client

confidentiality, as addressed in the auditor's relevant ethical code or requirements, and law and regulation.

We are pleased with the support we have heard from global groups like the International Corporate Governance Network, IOSCO, IFIAR, the Basel Committee, and the World Bank for our concept of KAM. Including KAM in the auditor's report will be a significant change in practice. So the IAASB will do all it can to support effective implementation to achieve its intended aims.

Similar to the PCAOB, we have also substantively revised our standard addressing the auditor's responsibilities for "other information". Investors and others have emphasized the importance of information included in MD&A and other areas of a company's annual report. While this information is not audited, the auditor's attention to it helps to increase users' confidence in such information. Our proposals included required auditor reporting on other information, including identification of which information has been read by the auditor. We will re-expose this proposal in mid-April for a 90-day comment period.

Our project also addresses the topic of auditor reporting on going concern. Feedback to our proposals has highlighted the need for a holistic approach – that is, that changes in auditing standards need to be considered in tandem with changes or clarifications to accounting standards. We know the PCAOB's separate project in this area is closely tied to the work of the Financial Accounting Standards Board (FASB). We have had similar liaison with the International Accounting Standards Board (IASB) to understand how they may address this topic, and are following their developments with interest as we seek to finalize our proposals.

In relation to other improvements, the Board supports requiring disclosure of the name of the engagement partner in the auditor's report for listed entity audits. We note the PCAOB has a similar proposal in process and we look forward to hearing about the Board's plans for a way forward.

We are also taking into account relevant developments in Europe, as consensus was recently achieved about similar proposals aimed at audit reform. As you will hear from Nick Land, the UK FRC has already finalized its improvements to auditor reporting, which recognize the important interactions between auditors and audit committees in audit quality. These new reports are now coming into the market, proving it can be done and does result in helpful information for investors and others.

Stakeholders, including bodies such as the CFA Institute and the Center for Audit Quality, have encouraged us to take every opportunity to seek to minimize differences among the various approaches to auditor reporting. We take that seriously – recognizing that we all have a duty in the public interest to respond to what we have heard through our multiple consultation processes.

In conclusion, through its work on auditor reporting, the IAASB believes it has a unique opportunity to increase the relevance of the audit and trust in the profession. Not only will the auditor's report become more informative, but we expect that this increased reporting could change the behaviors of not only auditors, but also management and those charged with governance. A renewed focus by the auditor on matters to be addressed in the auditor's report, together with increased attention by management and those charged with governance on financial statement disclosures, stands to benefit investors and have a corresponding effect on audit quality and the credibility of the financial statements.