

NAPF RESPONSE TO

IAASB INVITATION TO COMMENT - IMPROVING THE AUDITOR'S REPORT

The NAPF welcomes the opportunity to comment on the IAASB's proposed measures to improve auditor reporting.

The NAPF is the leading voice of workplace pensions in the UK. We speak for 1,300 pension schemes with some 16 million members and assets of around £900 billion. NAPF members also include over 400 businesses providing essential services to the pensions sector.

We believe that the IAASB is right to seek to enhance the value provided to shareholders through the audit report. That report is the auditor's primary means of communication with the audited entity's shareholders and while investors take comfort from knowing that financial information has been through the audit process, they at present often take little else of value from the report itself.

Essentially the present system results in what is in effect a pass or fail mark. Because a "fail" (a qualified audit report) can be highly damaging to a company, great steps are taken to avoid this. If audit reports are to be more useful to investors they need to include some 'colour' and investors will need to learn how to interpret them. We believe it should remain a matter for the audit firm's professional judgement as to what merits being included within the "colour" of the report, but many investors are surprised that at present so little is. The IAASB's proposals, including the "Auditor Commentary" and increased prominence of the auditor's opinion could provide the opportunity to at least provide some shades of grey and thus more value to investors and therefore improve users' ability to make more informed decisions.

In addition to the improved reporting within the audit report, we believe that better communications by those charged with governance (TCWG) to the public, about the audit, will also enhance the understanding and confidence stakeholders have in the audit opinion. We believe that the priority in this area should be to continue to strengthen the role of the audit committee and its oversight of the auditor; this has the potential to enhance significantly audit quality and related financial reporting. As the directly elected representatives of the shareholders, the audit committee ought to be in a position to disclose more frankly through its reporting the key matters discussed with the auditor and how they have been resolved. The introduction of the Auditor Commentary could help provide the basis for discussion between investors and the TCWG and improve reporting by the company itself.

In conclusion, we believe these proposed changes are an important step forwards and we look forward to seeing the exposure draft of the revised auditing standards next summer. The challenge, as is always the case, will be how to encourage the provision of additional information which adds colour and value and avoids descending down the road of further boiler-plate reporting. The emphasis as always should be on better disclosure rather than more disclosure.

NAPF RESPONSES TO INDIVIDUAL QUESTIONS:

Overall consideration

- 1. Overall, do you believe the IAASB's suggested improvements sufficiently enhance the relevance and informational value of the auditor's report, in view of possible impediments (including costs)? Why or why not?**

We are supportive of the introduction of more leverage points for the auditor to influence improvements in reporting. We therefore support the proposals for an audit report with more opportunities for comment.

In addition the auditor commentary and increased prominence of the auditor's opinion could provide the opportunity to provide some colour and thus more value to investors.

These measures should therefore improve the information value and relevance of the auditor's report and thus users' ability to make more informed decisions.

- 2. Are there other alternatives to improve the auditor's report, or auditor reporting more broadly, that should be further considered by the IAASB, either alone or in coordination with others? Please explain your answer.**

Investors are keen to receive greater insight into aspects of the audit and both audit committees and auditors have a role in providing this. There is however, a balance to be struck between the provision of further information and maintaining the quality and usefulness of those disclosures, and between achieving greater transparency into the audit and the auditor's judgements, while maintaining the open dialogue between the auditor and audit committee that is so important.

We are keen to see audit committees continue to take greater ownership of the audit relationship with enhanced reporting to the company's shareholders of their discussions with the auditors and more willingness to engage directly with investors.

Auditor Commentary

- 3. Do you believe the concept of Auditor Commentary is an appropriate response to the call for auditors to provide more information to users through the auditor's report? Why or why not?**

Yes. We agree that there would be value in more pertinent information in the auditor's report about the financial statements and the audit. At present investors take comfort from knowing that a firm's financial statements have been audited, however, due to the heavily boiler plated nature of auditor reports they often pay little attention to the report itself or take no additional value from it.

The proposed auditor commentary could help engage investors in the auditor's report, allowing them at a glance to get an idea of those matters that would be most important to the users' understanding of the audited financial statements or the audit.

Additional areas where we would like to see the auditor commentary touch upon are:

- Some detail on its key audit judgments, including a sense of the risks associated with these and the tolerable error to which the audit is subject;

- The neutrality of the judgments made by management - the external auditor should be able to provide its view, within the audit report, of the overall picture painted to shareholders.
- The key areas of focus for the audit team, the main areas of risk identified and the auditors' approach to materiality.

4. Do you agree that the matters to be addressed in Auditor Commentary should be left to the judgment of the auditor, with guidance in the standards to inform the auditor's judgment? Why or why not? If not, what do you believe should be done to further facilitate the auditor's decision-making process in selecting the matters to include in Auditor Commentary

We believe it should remain a matter for the audit firm's professional judgement as to what merits being included within the auditor commentary of the report, but many investors are surprised that at present so little of added value is. By leaving it to the auditor's professional judgement, users are likely to feel more comfortable that the commentary provided is more relevant and complete than if a more prescriptive approach was adopted.

5. Do the illustrative examples of Auditor Commentary² have the informational or decision-making value users seek? Why or why not? If not, what aspects are not valuable, or what is missing? Specifically, what are your views about including a description of audit procedures and related results in Auditor Commentary?

We agree with the presumption that it would be rare for the auditor to determine that there are no matters which would warrant including within the Auditor Commentary.

The illustrative examples do not perhaps give the level of value to shareholders that the consultation document indicates is the aim of this disclosure. What is needed is genuine information value for shareholders as opposed to descriptions of minor elements of the audit process and we would encourage auditors to utilise this area of the report as an opportunity to discuss some of their findings. We have indicated above areas which we would like to see the auditor commentary touch upon and would expect the commentary to vary from company to company, having regard to the unique circumstances of individual firms.

That said, we believe that there should be flexibility in what is included within the Commentary as it is company-specific disclosures that will add value and prescription tends towards encouraging boiler-plate reporting.

6. What are the implications for the financial reporting process of including Auditor Commentary in the auditor's report, including implications for the roles of management and those charged with governance (TCWG), the timing of financial statements, and costs?

We do not believe that the proposals should have any significant impact on the timing of financial statements. In addition we do not believe that the proposed additional auditor Commentary should have any significant cost implications since this is simply about enhancing transparency around what the auditor is already doing.

7. Do you agree that providing Auditor Commentary for certain audits (e.g., audits of public interest entities (PIEs)), and leaving its inclusion to the discretion of the auditor for other

audits is appropriate? Why or why not? If not, what other criteria might be used for determining the audits for which Auditor Commentary should be provided?

We agree that that auditor commentary should be required, at a minimum, for audits of all listed firms, however, if one believes the concept has merit then it would make sense for this best practice to be promulgated much wider.

Going Concern/Other Information

8. What are your views on the value and impediments of the suggested auditor statements related to going concern, which address the appropriateness of management's use of the going concern assumption and whether material uncertainties have been identified? Do you believe these statements provide useful information and are appropriate? Why or why not?

We welcome the positive changes being made in relation to going concern statements.

Many pension funds have an interest in going concern which goes well beyond that of the shareholder. Where they rely on the strength of the sponsor covenant, they are an unsecured creditor, often without the benefit of the detailed financial information which is provided to the providers of bank finance. They therefore rely heavily on the information provided in the annual report for their covenant assessment, which is becoming of growing importance.

Given the above, we see considerable benefit in improving disclosure in the auditor's report to include, among others, the dialogue with the board and any particularly sensitive accounting assumptions or judgements.

9. What are your views on the value and impediments of including additional information in the auditor's report about the auditor's judgments and processes to support the auditor's statement that no material uncertainties have been identified?

We are supportive of these proposals.

As always, any requirement which risks descending down the route of boiler-plate will only have limited value and as such while the statement on the going concern basis is probably not that helpful in itself, the requirement to disclose material uncertainties is potentially of greater significance, and with quality disclosures could deliver real added value

Where events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern we agree that the auditor should describe the significant judgments made and the audit procedures performed in reaching a conclusion that no material uncertainty exists.

We also believe it is important that auditors consider, in a robust fashion, the interests of shareholders in relation to the provision of relevant additional information with respect to going concern when such information has not been disclosed by management. It would be distinctly unsatisfying if auditors were to remain silent when they were aware of material firm-specific information which had not been disclosed but was relevant to the applicability of the going concern principle.

10. What are your views on the value and impediments of the suggested auditor statement in relation to other information?

We agree with the IAASB suggestion that the auditor identify in the auditor's report the specific other information read – such as narrative sections of a firms' financial report, and provide a statement indicating whether the auditor has identified material inconsistencies between the other information and the audited financial statements.

More generally, we encourage firms to consider the information they report – including non-financial information - and whether investors would benefit from additional independent assurance.

Clarifications and Transparency

11. Do you believe the enhanced descriptions of the responsibilities of management, TCWG, and the auditor in the illustrative auditor's report are helpful to users' understanding of the nature and scope of an audit? Why or why not? Do you have suggestions for other improvements to the description of the auditor's responsibilities?

We agree that the descriptions of the responsibilities of management, TCWG and the auditor may assist in tackling the perceptions gap and increase understanding of the nature and scope of an audit. However, we would not welcome this obscuring the more pertinent information contained within the auditor report.

12. What are your views on the value and impediments of disclosing the name of the engagement partner?

We are supportive of this proposal as it will standardise what is already common practice in some jurisdictions.

13. What are your views on the value and impediments of the suggested disclosure regarding the involvement of other auditors? Do you believe that such a disclosure should be included in all relevant circumstances, or left to the auditor's judgment as part of Auditor Commentary?

ISAs currently make clear that the group auditor is responsible for the direction, supervision and performance of the group audit engagement and we remain supportive of maintaining this "sole responsibility" principle.

However, we believe there is significant merit in disclosing any other auditors involved in the audit without undermining the "sole responsibility" principle. Such a disclosure could aid competition in the audit market – an issue which is the focus of much attention – by highlighting existing work being undertaken by non-Big 4 firms.

14. What are your views on explicitly allowing the standardized material describing the auditor's responsibilities to be relocated to a website of the appropriate authority, or to an appendix to the auditor's report?

While we welcome the attempt to added extra clarity to the auditor's responsibilities we believe all reporting should endeavour to be as firm-specific and as practical and shorter, clearer and less

boilerplate form of reporting would generally always be valued by stakeholders. As such we are content for the standardised descriptor to be relocated to an appendix to the auditor's report.

Form and Structure

15. What are your views on whether the IAASB's suggested structure of the illustrative report, including placement of the auditor's opinion and the Auditor Commentary section towards the beginning of the report, gives appropriate emphasis to matters of most importance to users?

Yes, we welcome the significant prominence given to the auditor's opinion and auditor commentary.

16. What are your views regarding the need for global consistency in auditors' reports when ISAs, or national auditing standards that incorporate or are otherwise based on ISAs, are used?

While we believe that a lack of consistency in aspects of the commentary for example is appropriate and acceptable – indeed, it is the only way to deliver corporate reporting which adequately captures the circumstances of individual organisations – a sufficient degree of consistency is vital to enable comparability.

Each company is unique and professional judgement must be applied to it by management and auditors to ensure reporting is appropriate to its unique circumstances. We believe that there is a stronger argument for consistency of disclosures by an individual entity over time – particularly as it would be unfortunate for a disclosure to be made one year, not the next but then for it to return in a third year, as such would tend to generate cynicism about the company's approach to reporting.

17. What are your views as to whether the IAASB should mandate the ordering of items in a manner similar to that shown in the illustrative report, unless law or regulation require otherwise? Would this provide sufficient flexibility to accommodate national reporting requirements or practices?

The proposed approach by the IAASB seems both sensible and reasonable.

18. In your view, are the IAASB's suggested improvements appropriate for entities of all sizes and in both the public and private sectors? What considerations specific to audits of small- and medium-sized entities (SMEs) and public sector entities should the IAASB further take into account in approaching its standard-setting proposals?

All companies should be encouraged to adopt best practice. However it is recognised that smaller companies may not have the resources to achieve such a standard.