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3 October 2012

By post and email to [jamesgunn@iaasb.org](mailto:jamesgunn@iaasb.org)

Dear James,

IMPROVING THE AUDITOR'S REPORT: INVITATION TO COMMENT

Standard Life Investments Limited is a wholly owned subsidiary of Standard Life plc. We are a major global investor with assets under management of US \$247.1 billion as at June 30 2012.

In fulfilling our responsibilities on behalf of our clients, we place significant reliance upon audited financial statements of investee companies. We use the audited information to not only analyse the investment prospects of the company's securities but also hold to account the boards of the companies in which we invest for their stewardship of the company.

For many years, we have been critical of the auditor's report insofar as it has failed to enable us to assess either the quality of the audit or the issues which the auditor has had to address during the course of the audit. Furthermore, we regard the auditor as the "steward's steward" because of the privileged access that they have to the company's books and records and the opportunity that is implicitly afforded to them to report their professional views on management's account of its stewardship of the company's assets to the shareholders, an opportunity which is never used.

In the light of our long held concerns, we very much welcome the enlightened approach which the IAASB has taken in developing its suggested improvements. We believe these improvements, taken as a whole, will significantly enhance the auditor's report and improve considerably its usefulness to shareholders. We are aware of the on-going debate as to whether the substance of the Auditor Commentary should be included in the auditor's report or in the audit committee's report. From our perspective, we are agnostic in a global context as to whether the auditor or the audit committee provides the information, provided that if it is the audit committee that does so, then we believe it is important that the auditor should provide the shareholders with assurance that the audit committee report is fairly presented and complete, in all material respects.

Our responses to the questions posed in the ITC are set out in the attachment. The most significant of these are as follows:

- We should like to see the scope of the assurance provided by the auditor in respect of "other information" to be expanded to include whether or not there are material inconsistencies with information included in the normal course of the audit, which would include their review of post balance sheet date events.

- The Auditor Commentary should include an entity specific explanation of the auditor's approach to materiality.
- The IAASB should require auditors to report on conditions that may cast significant doubt on the entity's ability to continue as a going concern irrespective of whether that information has been disclosed by management.

In conclusion, we should like to express our appreciation of the IAASB's resolve to tackle the long standing issues associated with the quality of the auditor's report. We are confident that the proposed improvements will improve the quality of corporate reporting and thereby assist us in fulfilling our responsibilities.

Yours sincerely

  
Guy R Jubb  
Global Head of Governance & Stewardship  
*Standard Life Investments*

## **IAASB**

### **IMPROVING THE AUDITOR'S REPORT: INVITATION TO COMMENT**

#### **COMMENTS FROM STANDARD LIFE INVESTMENTS <sup>1</sup>**

##### Overall Considerations

***Q1 Overall, do you believe the IAASB's suggested improvements sufficiently enhance the relevance and informational quality of the auditor's report in view of the possible impediments (including costs)? Why or why not?***

**A1** We believe the suggested improvements will significantly enhance the relevance and informational value of the auditor's report. In particular:

- The assurance provided regarding the going concern assumption and material uncertainties are important improvements, which will give shareholders greater confidence in the financial statements and/or greater insights regarding the uncertainties which may impact on the company's ability to continue as a going concern.
- The Auditor Commentary provides shareholders with valuable insights regarding how the audit procedures were designed and applied, as well as useful objective signposts to key accounting and audit issues in respect of the matters included in the audited financial statements.
- The assurance provided in respect of other information (as identified in the auditor's report), will significantly enhance the reliance which shareholders can place on such information and will, of itself, serve to ensure that management uses due care when compiling and presenting such information. However, we believe that the assurance provided by the auditor should be extended to cover whether or not there are material inconsistencies with the information obtained by the auditors in the normal course of their audit, including their review of post balance sheet events. We believe that this will, in particular help to ensure that the other information provided by the company is consistent with the knowledge gleaned by the auditor in fulfilling their professional responsibilities.

We believe that implementing these suggested improvements should be broadly cost neutral. Furthermore, that the auditors currently do much of the underlying work in fulfilling their audit responsibilities, and the suggested improvements are, to a large extent, merely providing transparency regarding the conclusions and comments that are otherwise set out in the auditor's working papers. We do have some concern that implementing the suggested improvements may be seen as an opportunity by some auditors to significantly increase their fees when this is not justified by the circumstances. Accordingly, we believe it is important that the IAASB, assuming it agrees with our view, should communicate authoritatively its own expectations in this regard.

##### **Recommendations**

1. The scope of the assurance provided by the auditor in respect of "Other Information" (as discussed in paragraphs 65 -71 of the ITC) be extended to include whether or not there are material inconsistencies with the information obtained in the normal course of their audit, including that obtained by their review of post balance sheet date events.
2. When publishing the final proposals, the IAASB's press release should express its expectation that implementing the proposals will be broadly cost neutral and should not, of itself, give rise to significant increases in audit fees.

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<sup>1</sup> These comments are to be read in conjunction with the letter from Standard Life dated 3 October 2012 Investments to Mr James Gunn of the IAASB.

**Q2 Are there other alternatives to improve the auditor's report or auditor reporting more broadly, that should be further considered by the IAASB, or in other case, either alone or in coordination with others, please explain your answer.**

**A2** There are two aspects that we commend to the IAASB.

- As noted in A1 above, we believe that the auditor's report in respect of other information should be extended to provide assurance that the relevant other information is consistent with the information obtained by the auditors in the course of their audit. This would be in addition to providing other information and the audited financial statements. This is particularly important in respect of post year end information provided by the company. For example, it could relate to post year end trends in order intake, which is something we would expect auditors to review as part of their post balance sheet review.
- We are mindful that there is a difference of view in a number of jurisdictions in which the IAASB's standards are adopted as to whether the additional information proposed for disclosure by the IAASB should be included in the auditor's report or in the audit committee's report. We are content in principle to defer to local custom and practice, and, when appropriate, legal requirements, in this regard provided that if the information is included, in whole or in part, in the audit committee's report then the auditors should include in their report appropriate assurance that the relevant information in the audit committee report is fairly presented and complete, in all material respects.

#### **Recommendation**

The IAASB should recognise that in certain jurisdictions it may be more appropriate for some of the information mandated for disclosure by the auditors to be disclosed by audit committee. We recommend that the IAASB require that the auditors, in such circumstances, assure the shareholders that the relevant information in the audit committee's report is fairly presented and complete in all material respects.

#### **Auditor Commentary**

**Q3 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?**

**A3** Yes. We believe the concept is an appropriate and welcome response to the call for auditors to provide more information. The illustration of a possible improved auditor's report that is set out in the ITC provides useful and additional information to users, which should strengthen the reliance that they can place on the audited financial statements. In this regard, it is relevant to note that the Auditor's Commentary also provides users with a good sense as to how the auditors fulfilled their professional responsibilities.

**Q4 Do you agree that the matters to be addressed in Auditor Commentary should be left to the judgement of the auditor, with guidance in the standards to improve the auditor's judgement? 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 the Auditor Commentary?**

**A4** We agree that the matters to be addressed in the Auditor Commentary should be left to the judgement of the auditor, with the benefit of the guidance provided in the standards. We believe this approach provides an important onus on the auditor to bring professional judgement to bear. Also, we are concerned to avoid any boilerplate reporting by auditors in their Commentary. Lastly by leaving it to the auditor's professional judgement, users should be confident that the Commentary is complete; if a more prescriptive and standardised approach were taken, there is a risk that there could be significant omissions from the Commentary on the grounds that the prescriptive approach did not require the auditor to render any comments on a significant matter.

***Q5 Do the illustrative examples of the Auditor Commentary 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?***

**A5** We found both the tone and substance of the illustrative examples of the Auditor Commentary to have the informational and decision-making value that we as professional users of audited financial information would seek. We would anticipate that the Auditor Commentary will vary from company to company, having regard to the context. We found it particularly useful to have key issues signposted for us by the Auditor Commentary. Also, we would note, in particular, that the references in the illustrative examples to audit strategy in respect of new systems, and the involvement of other auditors to be useful and insightful.

As well as the substance of the comments from the auditors, the Commentary provides an appropriate degree of transparency regarding the auditor's views that enables the users to form a view regarding the overall approach taken by the auditor in conducting its audit. Thereby, it provides reassurance (or otherwise) regarding the quality of the audit.

We understand that the UK's Financial Reporting Council ("FRC") is giving consideration to disclosure by auditors of their approach to evaluating materiality. Our informal discussions with the FRC about this lead us to conclude that the information will be very useful to us in assessing not only the audited financial statements but also the quality of the audit. Also, that auditor should not only object to – and even welcome - such transparency.

**Recommendation**

The Auditor Commentary should include an explanation of the auditor's approach to materiality. The explanation should be specific to the audit in question, and refer to and quantify the materiality thresholds used by the auditor.

***Q6 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, the timing of financial statements, and costs?***

**A6** We believe, as previously noted, that the implications will vary from jurisdiction to jurisdiction and will be a function of both legal responsibilities, and custom and practice. Accordingly, we believe that the final pronouncement by the IAASB should afford a degree of flexibility to accommodate the different approaches whilst seeking to uphold the benefits that will accrue from the proposed improvements. We do not believe that the proposed improvements will have any significant bearing on the timing of financial statements (unless there are contentious issues to resolve). Also, we do not believe, as previously noted, that the Commentary should have a significant adverse effect on costs.

**Recommendation**

The IAASB should provide an illustrative auditor's report to cover circumstances where some of the relevant disclosures are made by the audit committee or other appropriate governance body.

***Q7 Do you agree that providing Auditor Commentary for certain aspects of audits (eg audits are public interest entities) 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?***

**A7** We agree with the approach proposed. In view of the separation of ownership and management with most public interest entities, it is appropriate for a consistent approach to be taken to the Auditor Commentary. Conversely, with other entities, where often the ownership structure and governance arrangements may be rather different to those at public interest entities, a more flexible, discretionary approach seems appropriate.

## Going Concern / Other Information

***Q8 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?***

**A8** We believe that the proposed statements relating to going concern and other information will be valuable to users. Going concern, and the assumptions associated therewith, has always been, and always will be, of critical importance to users. The transparency afforded by the additional reporting requirements should give users greater confidence than otherwise regarding the appropriateness of applying the going concern principle.

***Q9 What are your views on the value and impediments of including additional information in the auditor's report about the auditor's judgements and processes to support the auditor's statement that no material uncertainties have been identified?***

**A9** We believe that it is critical that the auditors are expected to take a robust position regarding providing additional information with respect to going concern when that information has not been disclosed by management. A failure to do so by the auditors would, in our judgement, seriously undermine our perception of the role of the auditor, who we regard as the "steward's steward." Consequently, we expect the auditor to have the professional courage to make difficult disclosures. It is in the gift of management, if they do not agree with the auditors' views, to comment themselves regarding the views of the auditors. Shareholders can then form their own view regarding the merits of the situation. It would be unacceptable for auditors to remain silent if they believe there is material entity-specific information that has not been disclosed by management that is relevant to the applicability of the going concern principle. The ambiguity of auditor silence is not something we would wish to countenance.

### **Recommendation**

The IAASB should require auditors to not only draw users' attention to material uncertainties but also report on conditions that may cast significant doubt on the entity's ability to continue as a going concern, irrespective of whether that information has been disclosed by management.

***Q10 What are your views on the value and impediments of the suggested auditor's statement in relation to other information?***

**A10** As previously noted, we believe that the auditor's statements would be more useful if they provided assurance that the auditors had not identified material inconsistencies between the other information and not only the audited financial statements but also the information and evidence obtained by the auditors in the normal course of their audit. This assurance would be particularly useful to users in respect of other information relating to matters arising after the year end. It would be unfortunate if management were to manipulate such post year end information in the knowledge that, on the one hand, it would not be within the scope of the audit report, and, on the other hand, it could have a material impact on the price of the company's shares. The failure of the auditors to comment on this as a mere consequence of applying the standards and without due regard to exercising professional judgement could undermine significantly the credibility that users place on both the enhanced auditor's report and the reliability of information provided by companies in respect of post balance sheet date transactions.

## Clarifications and Transparency

***Q11 Do you believe that the enhanced descriptions of the responsibility of management, TCWG, and the auditor in the illustrative auditor's report are helpful to use as' understanding of the nature and scope of the audit? Why or why not? Do you have suggestions for other improvements to the description of the auditor's responsibilities?***

**A11** These descriptions are helpful. In our experience, we are generally in our “comfort zone” in respect of the boundaries of responsibility in companies that operate in our own home jurisdiction. However, our understanding is less well developed in other jurisdictions, to varying degrees. Accordingly, mindful that the IAASB’s proposals will have a global scope, we believe that the enhanced descriptions will enable us to improve our understanding of the situation.

**Q12 What are your views on the value and impediments of disclosing the name of the engagement partner?**

**A12** This disclosure has been prevalent in the UK for several years and it has not presented significant problems. In the event that there are particular issues that make it inappropriate to disclose the engagement partner, there should be appropriate disclosure by the auditor or by the management of the reasons for this so that the justification can be considered in a thoughtful and well informed way by the shareholders.

That said, we do not have a strong view, one way or the other, as to whether the name of the engagement partner should be disclosed. Of itself, it is of limited value and we are not fully persuaded by the merits of the arguments pertaining to personal accountability.

**Q13 What are your views on the value and impediments of the suggested disclosure regarding the involvement of other auditors? Do you believe such a disclosure should be included in all relevant circumstances, or left to the auditor’s judgement as part of the Auditor Commentary?**

**A13** We believe that this information is particularly valuable. We are aware of some major entities where a very material subsidiary or joint venture is audited by a different firm of auditors to those attesting to the reporting entity’s financial statements but our awareness of this is usually gleaned from engagement with the entities concerned. This is not necessarily a matter of public disclosure. It is important to us because it impacts on our assessment of the inherent risks in the audit and could influence our views regarding the quality of the audit, particularly if we have differential views as to the audit quality of different auditors. We believe that over the coming years, we shall, as a consequence of improved engagement, be more discerning than has been the case in the past regarding the differential attributes of audit firms. Leaving the disclosure to the judgement of the auditor, would not be satisfactory because, in our view, there are inherent conflicts of interest (for example, not wishing to give credit to competing auditors) and, more fundamentally, there is no reason whatsoever why an auditor should not be willing to provide transparency on this matter.

We believe it is important that the scope of the reporting requirements in respect of the involvement of other auditors should extend to joint ventures and similar entities in which the reporting entity has a significant interest. This should be made explicit in the IAASB’s final pronouncement.

**Recommendation**

The IAASB should proceed with the suggested disclosure regarding the involvement of other auditors. In addition, it should make clear that the scope of the auditor’s disclosure in this regard should include joint ventures and similar entities in which the reporting entity has a significant interest or are otherwise material to the entity’s financial statements.

Form and Structure

**Q15 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?**

**A15** We are comfortable with the suggested structure of the illustrative report. It seems an appropriate way to convey the information. Furthermore, we support the IAASB in prominently positioning new sections related to entity-specific letters before the sections of the auditor’s report that include more standardised language.

**Q16 What are your views regarding the need for global consistency in auditor's reports when ISAs or national auditing standards that incorporate or are otherwise based on ISAs, are used?**

**A16** Global consistency, especially with the benefits of the proposed improvements in the auditor's report, is highly desirable. As a practical matter, in view respect the sovereignty issues that arise in respect of ISA application in relevant jurisdictions, we tend to share the IAASB's view that the building blocks approach will help to achieve some degree of comparability. We would note, in addition, that it is generally in the gift of the audited entity to request the auditors to provide an additional auditor's report prepared in accordance with ISAs when it is felt that that would be beneficial. No doubt, such additional reporting would require additional cost. It is for reporting entity to determine whether such additional reporting is cost effective.

**Q17 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?**

**A17** We do not have a strong view. The proposed approach by the IAASB seems reasonable.

**Q18 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 and public sector entities should the IAASB further take into account in approaching its standard-setting proposals?**

**A18** We do not have significant interaction with the financial statements of small and medium sized entities and public sector entities. Therefore, we do not have a substantive comment to render in response to this question. However, as a matter of principle, we believe that reporting standards should permit proportionality such that the burden of complying with relevant standards should be proportionate to the size of the entity and the benefits accruing.

3 October 2012