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Our ref rd/181

15 January 2010

Dear Sir

### **IOSCO Consultation Report – Auditor Communications**

KPMG International Cooperative<sup>1</sup> (KPMG International) is pleased to respond to IOSCO's consultation on Auditor Communications: Consultation Report issued in September 2009. This response is submitted on behalf of the international network of KPMG member firms.

We agree with IOSCO that consideration as to whether the standard audit report communicates the appropriate information to investors and whether its form and content facilitate audit quality are important areas that merit further consideration. The consultation also sets out clearly many of the issues involved and does not seek to minimize the challenges that will need to be addressed in arriving at solutions that meet the needs of users.

Our comments on the questions posed in Part VII – Request for Consultation are set out below.

- 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?***

We believe that questions 1 and 2 are important questions that need to be posed in order to fully assess whether the current standard audit report is useful to investors.

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<sup>1</sup> KPMG is a global network of professional services firms providing Audit, Tax and Advisory services to a wide variety of public and private sector organisations. KPMG International is a Swiss cooperative, a legal entity formed under Swiss law, with which all the member firms of the KPMG network are affiliated. KPMG International does not provide professional services to clients; audits of public companies together with other services are all provided by member firms.

As acknowledged in the Consultation Paper, the changes introduced by the International Auditing and Assurance Standards Board (IAASB) to the standard audit report in 2004 and again in 2009 as part of the Clarity project were intended to provide a more robust description of the respective responsibilities of management and the auditor, to update the description of the audit process and to clarify the scope of the auditor's responsibilities including those related to internal control. These were seen as necessary changes since there was concern that the auditor's role and responsibilities in relation to that of management's generally were not well understood.

Further, the IAASB introduced a two-part structure to the report which includes the report on the audit of the financial statements as part one and other reporting responsibilities, as applicable (*e.g.*, when national laws or regulations impose additional responsibilities on auditors beyond International Standards on Auditing) as part two. This is an important feature of the report since it increases consistency in reporting between jurisdictions while at the same time providing the flexibility to accommodate national requirements.

While we see the revisions introduced by IAASB as important clarifications and improvements, we recognize that the basic principles underlying the form and content of the standard audit report (*i.e.*, description of scope, responsibilities and opinion) have not changed for many years and may need to be updated in order to reflect changes to investor and other user needs.

We therefore agree that questions 1 and 2 are important questions that need to be posed in order to fully assess whether the current standard audit report is useful to investors and whether it needs to evolve. It also is important that views are obtained from as wide a range of investors, *i.e.*, investors with varying levels of sophistication and understanding of financial reporting, in as many jurisdictions as possible.

Further, while we acknowledge that investors are important users of financial statements and of the audit report, it also is necessary to recognize that they are not the only users. We understand why IOSCO has chosen to focus on investors, in view of its mandate; however, we believe that it would be useful to obtain the views of other users to determine whether there are different perspectives and needs. To this end, we understand that a considerable amount of research on user perceptions of the audit report has been sponsored by IAASB and a number of national standards setters. We therefore encourage IOSCO to share the results of this consultation with these bodies and to work closely with IAASB to help ensure that the end result is a globally consistent approach to auditor communications.

***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?***

We welcome a debate on whether/how communications to investors/users should be expanded to give users further insights on matters relating to the quality of financial reporting and the role of the auditor. However, the question of who should be providing these insights also touches on corporate governance issues that are relevant to the responsibilities of management and those charged with governance, as well as the role of the auditor. Accordingly, in order to address the questions of whether investors and other users are receiving sufficient, appropriate information about the audit and the financial statements and, if not, who should be providing this information, it will be important to understand how a modified auditor communication that addresses more detailed findings might affect both the role of management and the role of those charged with governance.

We therefore strongly encourage IOSCO to work closely with IAASB and other relevant bodies to develop an understanding of:

- The types of additional information investors and other users would like to obtain;
- The purpose of requesting this information (e.g., how it is intended to be used, how relevant this type of information is to the investor-decision making process and the objectives of other users); and
- How the reporting responsibilities of management, those charged with governance and the auditor might change to provide the insights sought by users.

In the event it is determined that the auditor's report should be expanded to provide more information, it would be useful to determine whether it is possible to address the needs of multiple users by separating the opinion on the financial statements from any other information that the auditor may be required to provide in the report. This type of structure would facilitate both a standardized, concise opinion on the financial statements and accommodate a longer more discursive report setting out auditor observations and views to satisfy the needs of other users. As noted above, the two-part auditors' report approved by the IAASB already accommodates this type of structure. Further, auditors in some jurisdictions, e.g., France, already have developed expanded auditor reporting responsibilities. We therefore recommend that any further study in this area includes an assessment of the types of reports issued by auditors in these jurisdictions, the additional time and costs involved in issuing such reports and how the information in these reports is used by investors and other users.

***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)?***

We fully support exploring the types of information users may require from auditors, however as already mentioned above, it is important that any potential changes be assessed in relation to the corporate governance model that exists today and how the role of the auditor is intended to interact with that of management and those charged with governance. It will be important to understand why investors believe that it is necessary for auditors to provide additional information about the company and why they believe that they are not able to obtain this type of information from management. Prior to effecting any change, it also would be in the best interest of all parties for a full cost/benefit analysis to be undertaken of additional reporting requirements.

Further, as noted in the consultation paper, the current standard audit report is designed to clearly explain the role of the auditor and how this differs from management's role. A more concise audit report and opinion on the financial statements may mean that these explanations will no longer be provided in the report. This, coupled with the possible inclusion of additional auditor commentary on the quality of financial information in the report may lead to confusion on the part of users as to the differences between the role of the auditor and that of management. Accordingly, it is important that any exploration of changes to the report includes full consideration of how information on the respective roles of management and auditors will be made available to users in order to avoid creating any confusion.

It also will be necessary to fully assess the legal, regulatory and professional standards implications of any changes to auditor communications. For example, auditors may be restricted by laws or regulation relating to client confidentiality, professional secrecy or professional privilege from communicating certain information concerning their clients to third parties. Auditors will also need to carefully consider the potential impact of any such changes on legal liability.

We would be pleased to discuss the matters raised in this letter. Please contact Rod Devlin, Head of KPMG International Standards Group, at +33 1 55687020 if you wish to discuss any of the issues raised in this letter.

Yours sincerely,

*KPMG IFRG Limited*

KPMG International