



**REPORTING ON AUDITED FINANCIAL STATEMENTS: PROPOSED
NEW AND REVISED INTERNATIONAL STANDARDS ON AUDITING
(ISAs)**

RESPONSE FROM ICAS TO THE IAASB

22 November 2013

CA House 21 Haymarket Yards Edinburgh EH12 5BH
enquiries@icas.org.uk +44 (0)131 347 0100 icas.org.uk

Direct: +44 (0)131 347 0236 Email: aadrain@icas.org.uk

Background

1. ICAS welcomes the opportunity to comment on the IAASB's Exposure Draft on *Reporting on audited financial statements: Proposed new and revised International Standards on Auditing (ISAs)*. Our CA qualification is internationally recognised and respected. We are a professional body for over 19,000 members who work in the UK and in more than 100 countries around the world. Our members represent different sizes of accountancy practice, financial services, industry, the investment community and the public sector. Almost two thirds of our working membership work in business, many leading some of the UK's and the world's great companies.
2. Our Charter requires its committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Key Points

We welcome the proposals from the IAASB for new and revised International Standards on Auditing (ISAs) and acknowledge that the proposals are likely to have a positive effect on the perceived value of the audit process and the profession by providing users with greater visibility over the work undertaken by the auditor.

We believe that improved auditor reporting and commentary is only part of what is required to ensure that users obtain the information they need about a company's position and performance. In our opinion, there is also a need for improvements in corporate reporting and disclosures therefore responsibility for the process of providing more useful information to users should also rest with those charged with governance.

We would emphasise, however, the importance of the inclusion of sufficient guidance on the key audit matters' disclosures to permit the auditor to exercise some discretion over the extent of information provided on what might be perceived as commercially sensitive or confidential matters.

Our responses to the specific consultation questions are as follows:

Key Audit Matters

Question 1

Do users of the audited financial statements believe that the introduction of a new section in the auditor's report describing the matters the auditor determined to be of most significance in the audit will enhance the usefulness of the auditor's report? If not, why?

Response 1

We welcome the proposal to introduce a new section in the auditor's report describing those matters that the auditor considers to be of greatest significance and believe that this new section will enhance the usefulness of the auditor's report and increase the perceived value of the audit. Ultimately however, we believe that there is a need for auditors to be asked to provide assurance over the whole of the annual report to enhance the value of corporate reporting and to supplement the proposed improvements in auditor reporting.

Question 2

Do respondents believe the proposed requirements and related application material in proposed ISA 701 provide an appropriate framework to guide the auditor's judgment in determining the key audit matters? If not, why? Do respondents believe the application of proposed ISA 701 will result in reasonably consistent auditor judgments about what matters are determined to be the key audit matters? If not, why?

Response 2

We believe that the proposed requirements and related application material in proposed ISA 701 provide an appropriate framework to guide the auditor's judgement in determining the key audit matters.

However, we do not believe that the application of proposed ISA 701 will result in reasonable, consistent auditor judgements about what matters are determined to be the key audit matters, nor do we believe it should. This determination will be a subjective one and specific to individual entities, therefore consistency should not be the main consideration in this respect, but completeness, significance and relevance. Although we do accept that there may be certain key audit matters which will feature in many audits.

We do agree, however, that the process undertaken in applying the guidance material is likely to be a standard and consistent one.

Question 3

Do respondents believe the proposed requirements and related application material in proposed ISA 701 provide sufficient direction to enable the auditor to appropriately consider what should be included in the descriptions of individual key audit matters to be communicated in the auditor's report? If not, why?

Response 3

We believe that the proposed requirements and related application material in proposed ISA 701 provide sufficient direction to enable the auditor to appropriately consider what should be included in the descriptions of individual key audit matters to be communicated in the auditor's report.

Question 4

Which of the illustrative examples of key audit matters, or features of them, did respondents find most useful or informative, and why? Which examples, or features of them, were seen as less useful or lacking in informational value, and why? Respondents are invited to provide any additional feedback on the usefulness of the individual examples of key audit matters, including areas for improvement.

Response 4

The most useful and informative example of a key audit matter is that describing revenue recognition relating to long term contracts. The description details: how the revenue is measured; an explanation of why this area is considered a significant risk and a description of the audit procedures undertaken to supplement the internal controls already in place. There is also a clear conclusion which includes a reference to the related financial statement disclosures. However, some of the more specific detail, for example in relation to the side agreement, could be removed to keep the example more concise.

The least useful or informative example of a key audit matter is that of the Acquisition of XYZ Business as it does not offer a great deal of clarity over why it was considered a key audit matter, the implications of any misstatement nor is there a conclusion as to whether the auditor is satisfied with management's approach and judgement.

Furthermore, the Goodwill key audit matter description is very technical in its description and does not inform users of what the issues might be.

Question 5

Do respondents agree with the approach the IAASB has taken in relation to key audit matters for entities for which the auditor is not required to provide such communication – that is, key audit matters may be communicated on a voluntary basis but, if so, proposed ISA 701 must be followed and the auditor must signal this intent in the audit engagement letter? If not, why? Are there other practical considerations that may affect the auditor's ability to decide to communicate key audit matters when not otherwise required to do so that should be acknowledged by the IAASB in the proposed standards?

Response 5

Although we agree with the approach the IAASB has taken in relation to key audit matters for such entities we do have concerns surrounding some practical considerations, for example, disclosure of confidential information and commercially sensitive details. We would therefore welcome some provision within the guidance for discretion to be exercised over the level of detail required in the information disclosed.

Question 6

Do respondents believe it is appropriate for proposed ISA 701 to allow for the possibility that the auditor may determine that there are no key audit matters to communicate?

- (a) If so, do respondents agree with the proposed requirements addressing such circumstances?
- (b) If not, do respondents believe that auditors would be required to always communicate at least one key audit matter, or are there other actions that could be taken to ensure users of the financial statements are aware of the auditor's responsibilities under proposed ISA 701 and the determination, in the auditor's professional judgment, that there are no key audit matters to communicate?

Response 6

We believe that it is appropriate for proposed ISA 701 to allow for the possibility that the auditor may determine that there are no key audit matters to communicate. We agree that it would be appropriate for this assessment and conclusion to be discussed with those charged with governance. In addition, the requirement to include a statement in the auditor's report confirming that there were no significant matters will demonstrate that the auditor has given consideration to the fact that key audit matters may exist.

Question 7

Do respondents agree that, when comparative financial information is presented, the auditor's communication of key audit matters should be limited to the audit of the most recent financial period in light of the practical challenges explained in paragraph 65?

If not, how do respondents suggest these issues could be effectively addressed?

Response 7

We agree that, when comparative financial information is presented, the auditor's communication of key audit matters should be limited to the audit of the most recent financial period in light of the practical challenges explained in paragraph 65.

Question 8

Do respondents agree with the IAASB's decision to retain the concepts of Emphasis of Matter paragraphs and Other Matter paragraphs, even when the auditor is required to communicate key audit matters, and how such concepts have been differentiated in the Proposed ISAs? If not, why?

Response 8

We agree with the IAASB's decision to retain the concepts of Emphasis of Matter paragraphs and Other Matter paragraphs, even when the auditor is required to communicate key audit matters. However, we anticipate that if key audit matters cannot be concluded upon positively, then they should also result in an emphasis of matter paragraph as a minimum.

It is unclear what the IAASB's intentions are in such situations and whether an identified area subject to an Emphasis of Matter will be also described in an inconclusive manner within the key audit matters section of the auditor's report. If this treatment is adopted, the distinction between an Emphasis of Matter and key audit matters, and when each should be used may cause confusion. .

Greater guidance and further clarification is required in this regard.

Going Concern

Question 9

Do respondents agree with the statements included in the illustrative auditor's reports relating to:

- (a) The appropriateness of management's use of the going concern basis of accounting in the preparation of the entity's financial statements?
- (b) Whether the auditor has identified a material uncertainty that may cast significant doubt on the entity's ability to concern, including when such an uncertainty has been identified (see the Appendix of proposed ISA 570 (Revised)? In this regard, the IAASB is particularly interested in views as to whether such reporting, and the potential implications thereof, will be misunderstood or misinterpreted by users of the financial statements.

Response 9

We welcome the statement in the auditor's report referring to the appropriateness of management's use of the going concern basis of accounting but we believe that a similar statement should also appear within the report of those charged with governance.

- (a) We believe that the auditor should also be required to make a positive statement about the entity's ability to continue as a going concern but would prefer to see more detail provided on how they have arrived at this assessment by detailing on what information this conclusion has been based and the extent and nature of the testing undertaken thereon. This will give the user a greater insight into the amount of audit work that has been carried out. For that reason, we consider that the current statement in the illustrative example is insufficient as it reports in the negative: that is, reporting that we have not identified a material uncertainty, rather than a more positive statement confirming the entity's ability to continue as a going concern.

We believe that it is appropriate to include a caveat over the auditor's and management's ability to guarantee the entity's ability to continue as a going concern in recognition of the fact that auditors cannot give a guarantee that an entity will not fail. However, requiring an explicit statement from management, as referred to earlier, coupled with an affirmation of this statement from the auditor, should enhance the perception of what is being provided.

- (b) We consider that the identification of a material uncertainty that may cast significant doubt on an entity's ability to continue as a going concern should in the first instance be referred to in the report from management so that the auditor is not seen as the originator of such information, and, as a result, may be seen as the cause of a loss of confidence in the entity's ability to continue as a going concern. However, we believe that there should be sufficient scope for the auditor to reference this information in his/her report and state whether he/she has anything material to add to this information.

Question 10

What are respondents' views as to whether an explicit statement that neither management nor the auditor can guarantee the entity's ability to continue as a going concern should be required in the auditor's report whether or not a material uncertainty has been identified?

Response 10

We welcome the inclusion of the explicit statement that neither management nor the auditor can guarantee the entity's ability to continue as a going concern and believe that this should be required in the auditor's report whether or not a material uncertainty has been identified.

Compliance with Independence and Other Relevant Ethical Requirements

Question 11

What are respondents' views as to the benefits and practical implications of the proposed requirement to disclose the source(s) of independence and other relevant ethical requirements in the auditor's report?

Response 11

We do not believe that disclosing the source of relevant ethical requirements is necessary and consider that expressing compliance with the relevant ethical requirements and regulations should be sufficient. Nor do we see any reason to make an explicit statement confirming the auditor's independence as the title of the report actually refers to the auditor's independence. The inclusion of these references will simply increase the length of the auditor's report and result in more boilerplate commentary.

Disclosure of the Name of the Engagement Partner

Question 12

What are respondents' views as to the proposal to require disclosure of the name of the engagement partner for audits of financial statements of listed entities and include a "harm's way exemption"? What difficulties, if any, may arise at the national level as a result of this requirement?

Response 12

We see no implications of disclosing the name of the engagement partner for auditors of financial statements of listed entities as this is currently disclosed within the UK for auditors of all entities. However, we do acknowledge that a situation may arise in other jurisdictions where a 'harm's way' exemption would be required if the disclosure of the name of the engagement partner may expose him/her to a significant security threat.

Other Improvements to Proposed ISA 700 (Revised)

Question 13

What are respondents' views as to the appropriateness of the changes to ISA 700 described in paragraph 102 and how the proposed requirements have been articulated?

Response 13

We find the references to reasonable assurance and high assurance in the auditor's responsibilities paragraph confusing. High assurance implies a greater level of assurance than reasonable assurance and might mislead the user into assuming that they are receiving a greater level of assurance than that which is being provided. We would suggest that reference is made to the definition of reasonable assurance in ISQC1 as 'high but not absolute assurance' to give greater clarity.

We would also welcome, as a minimum, an expanded explanation of the materiality concept and some indication of how materiality is calculated within the auditor's report to give the user some context to the references to the word 'material' within this paragraph as included in the expression 'material misstatements'.

Question 14

What are respondents' views on the proposal not to mandate the ordering of sections of the auditor's report in any way, even when law, regulation or national auditing standards do not require a specific order? Do respondents believe the level of prescription within proposed ISA 700 (Revised) (both within the requirements in paragraphs 20–45 and the circumstances addressed in paragraphs 46–48 of the proposed ISA) reflects an appropriate balance between consistency in auditor reporting globally when reference is made to the ISAs in the auditor's report, and the need for flexibility to accommodate national reporting circumstances?

Response 14

We welcome the greater prominence given to the audit opinion by positioning it at the beginning of the report. While we acknowledge that the placement of specific elements in a prescribed order may not be possible in some jurisdictions due for cultural reasons, in our opinion, mandatory ordering is useful to ensure the prioritisation, consistency and completeness of all the mandatory disclosures. We do not consider that this should represent a barrier to providing sufficient flexibility to accommodate national reporting requirements or practices.