Comments on IAASB Exposure Draft “Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing”
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Dear Sir,

I appreciate the opportunity to comment on IAASB Exposure Draft: “Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing”.

My comments are included in the following pages of this document.

It is worth to mention that my comments are written mainly from a financial statements auditor´s point of view but also taking into consideration the perspective of preparers and users.

If you have any questions regarding this document, please feel free to contact me at cristian_munarriz@yahoo.com.ar.

Yours faithfully,

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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?

It depends on the user. I do not think this information will be useful for all financial statements users, but only for some “sophisticated” users, like larger banks, credit rating agencies or some institutional investors (like certain investment funds). Moreover, many users could find this information confusing or could misunderstand the audit approach because of the lack of knowledge about technical concepts about audit procedures, audit risk and control activities, widening the expectations gap.

I think a better approach would be to include this information in a separate report, including a specific “restricted use” clause (similar to ISA 800 reports), with detailed explanations. Including this information in the main audit report on the financial statements could mean that the audit report will be too long for some users with no interest in the additional information, and there is also a risk that the information will be too “brief” for not making the audit report so long. Other disadvantage is that it could delay the discussion of the “draft” report with TCWG because auditors will be reluctant to discuss an audit report with the key audit matters (KAM) until a complete revision (including EQCR) is complete. The separate audit report could be referenced from the audit report on the financial statements.

The inclusion of KAM in a separate report would also avoid the reduction in the quality perception of audits which do not include them (like smaller entities), but could be considered as a “by-product” of audit, like the communication of significant deficiencies in internal control (ISA 265) or the communications to TCWG (ISA 260).

It is reasonable to include an exception to a separate report, if the communication with TCWG is published for the general public (ISA 260, par. A34 to A36).

It should be clarified in the audit report that the information about KAM is not intended to be a basis for an assessment of audit quality because a complete knowledge of the audit process is necessary to do that. For example, if an auditor did not identify significant risks and consequently he/she did not address them, the audit quality will be poor but, in general, this could not be noted only reading the KAM. Also the work of an auditor which performed less but more effective procedures and obtain more relevant evidence could be underestimated in comparison with an auditor who performed many audit procedures but ineffective to address the relevant risks.

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?

I think clarification of what “involving significant auditor judgment” means is needed. A list of some items to take into consideration in considering what “involving significant auditor judgment” means (like ISA 315 definition of “significant risk”) would be useful. Some minimum items to take into consideration are (among others):

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- Auditor´s approach to materiality.
- Audit strategy (ISA 300)
- ISA 600 approach (criteria for determining significant and non significant components, and the audit approach for them)
- Relation between risks of material misstatement (description and source), financial statement assertions (how the risk impacts financial statements assertions, both at engagement level or specific financial statements areas), controls that mitigate the risk (how they mitigate the risk, and if there is any significant internal control deficiencies relating to that risk) and audit procedures responsive to those risks (how they reduce the risk).
- Use of the work of others (clarifying that the auditor´s responsibility is not reduced by the use of work of others).
- Direct assistance of internal auditors (ISA 610)
- Identified threats to independence and related safeguards.

Regarding significant risk of material misstatements, the "presumptions" for revenue recognition and management override should be included as they are significant risks which impact in the audit work. Moreover, besides the ISA 240 presumption, revenue recognition is always an area of interest for financial statements users. Although it is true that these risks are present in all audits, they remain areas of "significance", and by definition are KAM and they need to be treated like that. It would be useful to clarify that risk of management override is present in all audits to make it clear that this risk is not "entity-specific". In relation to revenue recognition, it would be useful to include a requirement to consider specific minimum elements, like the work performed to assess the reasonableness of the revenue recognition accounting policies, and how the audit procedures reduced the risk to an acceptable level (cut-off procedures, analytical procedures, confirmation procedures; test of controls; etc) , especially in entities with complex revenue agreements, like "bill and hold", IFRIC 13; or intense use of electronic transactions.

I think the reference to "areas in which the auditor encountered significant difficulty during the audit, including with respect to obtaining sufficient appropriate audit evidence" is risky because it could be confused with limitations on the scope of the audit. Moreover, I do not see any benefit for users from this information. This information is useful for TCWG because they have direct responsibility for the supervision of the financial reporting process and they are interested to solve every difficulty during the audit to improve the audit process. For example, I do not see why some information like this will be useful to users:

- Significant delays in the reception of information.
- Unavailable information
- Significant audit work effort in certain areas

I think this information will only be useful when it is also a significant deficiency in internal control or a risk of material misstatement (which would have to be reported according to the previous point). If some important information is received near the end of the audit, it will certainly need to be put into consideration of TCWG (to avoid this situation in future audits) but if the information is received at last, and the audit procedures could be performed, I see no usefulness for users.

I also disagree with the inclusion of changes in the audit planned approach. I think users need to know only the final audit planned approach. For example, if the auditor original plan was to test some accounts at an interim date, but then was necessary to perform the tests at year end because the company had not prepared the required information for performing the audit procedures at the required date or because of audit firm resource restrictions (e.g: the need to

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“relocate” audit staff to other audit engagement for an “emergency”), then I do not see any benefit for users from that information.

I think KAM should be considered from an user´s perspective, which could be a significant challenge for auditors because there are many users with different needs. It is different than communications with TCWG or management because the auditor knows them and knows how to address the communications “tailored” to meet their information needs and considering their financial reporting and audit knowledge.

I think a useful approach would be to consider some “primary users”, like some financial reporting frameworks do, and write the KAM paragraphs considering the needs of those “primary users”, which could be institutional investors and creditors, as they will be the users with the broader information needs. The specific needs of other, like regulators or tax authorities need not to be considered. A principles based “framework”, like in financial reporting frameworks, will be useful and should be included in ISA 701.

There is an additional issue: the reference to “fraud risk” could be misunderstood by users as an auditor´s concern about management integrity which is not necessarily the case. It is important to clarify that in the report to avoid misunderstanding, and eventual litigation or conflicts with management and TCWG. For example, if management has a “bonus” which depends on profit, this could be a significant fraud risk because of the incentive to management to overstate profit, but this does not necessarily means that management is committing fraud or is dishonest.

Other problem is the reference in the report to significant risks related to things that the auditor is prohibited to report (like money laundering). Specific guidance about that would be useful.

On last problem, it is the inclusion of significant risk of material misstatements when the knowledge of them by management could undermine the audit effectiveness. For example, when we identify fraud risk factors in certain areas, mentioning them in the report could alert the potential “fraudsters” and make easier for them to reduce the audit procedures effectiveness. Specific guidance would be useful. The same comment is valid for the proposed modification to ISA 260.

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?

See comment above.

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.

I think the examples are useful, but are more common in larger and complex entities. I would try to find additional examples which are more common to smaller entities (like significant transactions with owners and relatives, or difficulty to obtain financing), or certain industries (like valuation of biological assets, or environmental liabilities), or certain countries (like countries with high inflation, or difficulty to recover tax credits).

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?

As it is stated in my answer to the first question, I prefer the inclusion of a separate report. If the auditor is not required to provide such communication but they do voluntarily, the requirements of ISA 701are reasonable. If the "one report" approach in proposed ISA 701 remains, I would prefer KAM to be included in all audits to avoid misperceptions of audit quality because of the substantially different audit reports (with KAM and with no KAM).

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?

I think that the situation where there are no KAM is unlikely, except for entities with no operations (like entities recently created). Therefore, it would be useful to clarify this.
In most other situations, there will be KAM, at least for the RMM of revenue recognition or management override (ISA 240).

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?

I agree, but I think that a clarification in the audit report about this situation would be useful.
However, I think that the "separate report" approach I have mentioned would limit the effect of the "length" problem.

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?

Agree.

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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.

I think the requirements are reasonable, and I do not see any potential misunderstanding. However, I think further clarification about the application of the requirement when a "liquidation basis of accounting" is used, or if a material uncertainty from the prior year is not longer present in the current year.

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?

Agree. Although this situation is generally known by users, I think such clarification is essential to clarify this and avoid the risk of expectations gap for some users. I would include TCWG in the statement if applicable.

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?

I think it is useful to add transparency to the audit. Reference to threats to independence and safeguards would be useful.

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?

In Argentina, we have this requirement for all audits. Therefore, it would not have any impact in our practice. However, it is important to note that in Argentina, the engagement partner has direct responsibility for the audit report, but litigation is not common. I think the requirement should be present for all entities. The meaning of "significant security threat" should be clarified. One example could be when there is a risk that the auditor could be harassed by criminal organizations with financial interest in the audited entity, or suffer persecution by government authorities (for reasons other than professional negligence) because their financial interest in the audited entity is affected.

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?

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Regarding the descriptions of the responsibilities of the auditor on the website, I think the risk of that website to "crash" or be "hacked", or be modified should be considered.
I have no other comments about it.

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?

I think the order should be mandated to make easier for "global" users to read the audit report. Especially if the proposed "one report" approach is applied because the audit report will be considerably longer.
In any case, from a logical perspective, the "identification of the entity's financial statements that have been audited" (you can´t give an opinion without telling before what you are making an opinion on) and a brief description of what an audit is, with reference to the longer paragraph of description of responsibilities (to give a minimum "context" to the audit opinion) should be before the paragraph of opinion.
Basis for modifications to the opinion should be included after the opinion because users are more interested in knowing what the opinion is, and then reading why the opinion is qualified, adverse or disclaimer.