



European Federation of Accountants and Auditors for SMEs

International Auditing and Assurance Standards Board (IAASB)
529 Fifth Avenue, 6th Floor
New York, New York
10017 USA
Attn. IAASB Technical Director
Brussels, 22 November 2013

Dear Sir

Comment on IAASB Exposure Draft - Reporting on Audited Financial Statements Proposed New and Revised International Standards on Auditing

The European Federation of Accountants and Auditors for SMEs (“EFAA”) represents accountants and auditors providing professional services primarily to small and medium-sized entities (“SMEs”) both within the European Union and Europe as a whole. Constituents are mainly small practitioners (“SMPs”), including a significant number of sole practitioners. EFAA’s members, therefore, are SMEs themselves, and provide a range of professional services (e.g. audit, accounting, bookkeeping, tax and business advice) to SMEs.

EFAA appreciates the opportunity to comment on the International Auditing and Assurance Standards Board (“IAASB”) Exposure Draft - Reporting on Audited Financial Statements Proposed New and Revised International Standards on Auditing.

General Remarks

Appreciation and support

Firstly, EFAA would like to express support and appreciation for the work that the IAASB has done on this project. It is clear that a significant amount of high quality work has been undertaken and we congratulate the IAASB and its staff on the progress made on the Auditor Reporting project to date.

It is abundantly clear that the quality of the work and effort that has been put into this project from the initial acknowledgement and acceptance that there was a need for change, throughout the significant amount of outreach undertaken by the IAASB and the call for input to both the Consultation Paper (Enhancing the Value of Auditor Reporting: Exploring Options for Change) and the Invitation to Comment (Improving the Auditor’s Report) has resulted in an Exposure Draft that is very well written and is testimony to the detailed and exhaustive thought processes that have been required to produce it.

We are appreciative of the IAASB’s decision to provide marked up copies of the proposed ISAs detailing the changes from the extant standards. These direct the attention of the reader and so simplify the task of responding to the exposure draft. We would be supportive of this approach for all future proposed revisions to IAASB standards.



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Field Testing

The introduction of field testing is an important and welcome step. This project will shape Auditor Reporting for the foreseeable future and we are therefore encouraged to see that the IAASB has introduced a methodology to try to identify, collate, evaluate and assist where possible with the resultant likely practical and implementation issues and challenges prior to finalisation of the proposed standard. In this regard, we further welcome the staff paper produced on the field testing (Guidance to Assist in Field Testing of Proposed ISA 701).

We note, however, and this is mentioned later in our response, that it is possible that certain matters will be identified during the field tests that may call for, or require consideration of, likely changes to the proposed standard or alternatively an extension of the field testing period to allow for further deliberations. If this were to be the case then, despite external pressures, we would encourage the IAASB to carefully consider the merits of having an extended field testing stage.

Post-Implementation Reviews

EFAA has in the past called for the introduction of such reviews and therefore we welcome and support the IAASB's intention to undertake a post-implementation review of the Proposed Standard. We agree with the IAASB that this standard will ultimately be judged on the effect that it has once it has been in issuance. We agree with the IAASB that a 2 year period is a suitable timeframe after which to do this and we welcome consideration at that time of not only post implementation challenges but of whether further enhancements could be made to improve Auditor Reporting and to consider the wider public interest.

Changes following the Invitation to Comment

We comment below on certain matters that were discussed in the Invitation to Comment ("ITC") but are not directly addressed in the current Exposure Draft.

Boiler plating – We raised concerns in our response to the ITC that the disclosure of key audit matters could become boiler plate in nature over time. Whilst accepting that the onus for avoiding boiler plate disclosure will lie with the auditor and those charged with governance ("TCWG")¹ we are encouraged to see the introduction of a post-implementation review (as already referred to above) which does have the possibility to positively address this issue.

Mandatory disclosure of Key Audit Matters for listed entities – EFAA earlier supported the mandatory disclosure of key audit matters ("KAM") for listed entities only. EFAA recognised that there may well be a demand for the voluntary disclosure of KAM in the SME sector but we were of the opinion that mandatory disclosure should not be required for SMEs. To that end we are supportive of the direction that the IAASB has now taken in this regard.

Non-disclosure of other auditors involved in group audits – EFAA did not support actions that would result in the disclosure of the involvement of other auditors. We are pleased to see that such disclosure has not been pursued by the IAASB.

Building block approach to reporting / Flexibility of disclosure of standardized material – EFAA supported the IAASB's flexible approach. We continue to be of the view that it allows for both consistency and flexibility across national jurisdictions and for relevant information to be provided for individual entities.

¹ Where "Management" is used please also read as "Those Charged with Governance" for the purpose of this response



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Publicity / General awareness / Education – EFAA observed that substantial efforts would need to be made to increase user understanding of the proposed changes to Auditor Reporting. We are pleased to note already the significant amount of awareness raising activities and we feel that the field testing may well also help to maximise user understanding of the changes.

Translation, Adoption and Implementation Date

The Exposure Draft suggests an effective date such that December 2016 year ends would be the first for which the changed reporting would be mandatory. If there are no significant changes to the proposed standards, EFAA believes that the suggested approach is acceptable.

We caution that earlier mandation is unlikely to be feasible, especially where the standard has to be translated, because national standard setters will need to observe due process in considering the standards' interaction with national requirements.

EFAA supports an approach where early adoption is permitted but we do not support a phased approach to mandation, as that may confuse users.

Request for Specific Comments

Our comments on specific matters are set out below.

KEY AUDIT MATTERS

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?

We are in favour of reporting KAMs and that such disclosure should be mandatory for listed entities. We believe that an increase in transparency may result in an improved audit report as well as having positive consequences for financial reporting in general. This is because management may seek to ensure that they have adequately reported matters which could then reduce the impact of having the auditor highlight such matters in his audit report.

We believe that disclosure by the auditor within this section of matters that refer to “uncertainty” or “risk” could prove of higher value to investors than those disclosures that seek only to provide further context or focus. Issues of valuation, for instance, are not black and white and investors often value information that highlights where a range of possible answers could have existed.

It is likely that disclosure of such matters immediately brings with it a negative tone and as such the auditor may be challenged to disclose these matters in a balanced way. That said, this project is about changing auditor behaviour and ultimately disclosure of the matter should be the final act that follows the gathering of audit evidence and discussions between auditor and management and application of professional scepticism and judgement. In this regard, it is possible that field testing could assist auditors in the drafting of certain matters, and how that can be done in a balanced way, prior to implementation of the standard.



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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?

We believe that the standard provides, in the main, an appropriate framework to enable the auditor to identify KAMs and to decide the manner of their disclosure. We do wonder if the definition should be clearer and we would suggest that this is reconsidered by the IAASB. We feel that the auditor should be sure about what is, and what is not, a KAM. The use of "most significant" in this regard is not as helpful as intended.

It is difficult to conclude that the use of this standard will result in reasonably consistent auditor judgement about matters because this will ultimately come down to the experience of individual auditors and the exercise of their personal judgement. This is unlikely to always be the same and it is possible that this is not the role of the proposed ISA; instead the auditor should be given sufficient guidance to enable him to exercise his own judgement.

In time, it is possible that the true "standard" is that of "industry, sector or common" practice as auditors, especially in the very early stages, look to each other's reports. Such matters may be identified as part of the IAASB's intended post-implementation review.

Lastly, however disclosed, we are of the opinion that piecemeal audit conclusions should be avoided and it is important in this area to ensure that this is not the case as to do so could undermine the entire audit conclusion and methodology. In this regard the IAASB may wish to consider strengthening the cautionary wording in paragraph 25 of the Application and Other Explanatory Material.

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?

Yes we believe that the application material gives sufficient direction subject to our comments made in relation to question 2 above.



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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.

The illustrative example in respect of the “Valuation of Financial Instruments” was considered to be the most useful and informative. This example highlights an area where both management and the auditor had to use judgement and there was a significant amount of risk and uncertainty involved. The reader of the report is given context to why the use of judgement was high (structured financial instruments not based on quoted prices in active markets) and also to how the instruments have been valued, the methodology used and what the auditor did to assess this valuation. The paragraph also manages to convey that the auditor challenged management’s views, no adjustments were ultimately required and yet the disclosure does not give a piecemeal conclusion. Because of these points we felt that this was a good example.

The example “Acquisition of XYZ Business” seems to give very little qualitative information. The paragraph is almost a description of how one accounts for an acquisition including the availability of a hindsight review and the reader is likely to have not learned much more. The fact that the acquisition is large and new would probably suggest that it is well reported by management in their financial statements and the information given in the audit report is likely to be a repetition of that information. We feel that in this particular example the auditor has given no further insight to this issue.

We read the example entitled “Revenue Recognition Relating to Long-Term Contracts” with interest. We are of the opinion that such an example is unlikely to be used in practice as the tone within the paragraph is one that we feel would not be accepted by management and we do not believe that an auditor would wish to phrase the existence of “side agreements” in a way that questions the integrity of management. This example has a negative tone (such side agreements may be inadvertently unrecorded or deliberately concealed) but then concludes that no such side agreements were found.

The Goodwill example could have been improved if more information had been given as to what the expert did as in the example on “Valuation of Financial Instruments”.

Overall we are very much appreciative of the efforts of the IAASB as the exercise to produce such illustrative reports highlights the difficulties that will be faced. The field testing may well inform this aspect as it allows the auditor and management to drill down to where the issues are and how to overcome them.

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?

The approach appears reasonable. The existence of a standard that can be applied when such matters are to be disclosed voluntarily is of value.

Practically we are unclear as to whether an auditor could decide after discussion with TCWG to apply ISA 701 mid-way through the audit and still use this standard when the planning and early audit discussions (and the engagement letter) had not foreseen this occurrence. Clarification on this point by the IAASB may be of value.



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- 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?**

We agree that in some rare circumstances the auditor may determine that there are no KAMs to communicate. However, we feel that these occurrences are likely to be the exception as the term “key audit matters” is a relative term.

In circumstances where this arises we would advocate the auditor making an explicit statement - “There are no key audit matters to report”. Whilst proposed ISA 701 summarises the requirements we believe that there is merit in the auditor being more explicit. Stating that the auditor has determined that there are no matters to report is not the same as simply stating “there are no key audit matters to report”. This more direct approach has foundations in national jurisdictions where auditors are often asked to report on certain matters and to state when they have considered these matters that there are “no matters to report”.

- 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?**

Yes we agree that ordinarily KAM should be limited to the most recent financial period. There may, nevertheless be circumstances where the auditor decides to include in KAM a matter resulting from a prior period.

- 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?**

We agree with the IAASB that the concepts of Emphasis of Matter paragraphs and Other Matter paragraphs be retained. These are important tools for the auditor to use and will remain so especially in the SME sphere where KAM will not be mandated.

EFAA has previously raised concerns that the existence of Auditor Commentary (now KAM) could reduce the impact of an Emphasis of Matter paragraph but we accept the fact that (because the ordering of sections has not been mandated) the auditor has the opportunity to give such matters prominent placement in the audit report.



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GOING CONCERN

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.

EFAA was sympathetic to the IAASB's proposals in the earlier ITC to make explicit what was implicit.

However, our comments above (response to question 1) refer to the challenges that would arise from being able to provide an appropriate tone and balance whilst communicating KAMs. The likelihood is that in the first instance all KAMs could be seen in a negative way and it follows that the statement on going concern will be negatively construed and will have greater emphasis placed upon it in financial statements where KAMs are not being reported than in those financial statements that do report KAMs. This is one concern.

We are also concerned about the use of the word "conclude" as we do not agree that this is the appropriate word to use. In our view the reporting of going concern should be in line with that of KAMs. In this respect we would advocate that no piecemeal conclusions be drawn and also that further context is given to readers to the conclusion being drawn, for instance, "management prepared a [x] year forecast and business plan which we considered and discussed with management".

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?

As drafted, this appears to be an example of the Auditor Reporting on matters that should be reported by management, "Neither management nor the auditor can guarantee the entity's ability to continue as a going concern". Firstly, we feel that it should be for management to make this statement and not for the auditor to speak on their behalf. Secondly, whilst one can never predict the future, there may well be some instances where management can guarantee that a business is a going concern for example if management is aware of sufficient external support. Thirdly, the wording could be interpreted as meaning that there is a choice – management and the auditor could or could not guarantee the future. This would seem to be unhelpful. We would prefer to see this sentence reworded, therefore, and the language reconsidered.

If we also consider that the intention of the statement is to highlight that the future is uncertain then the statement is helpful in this context. We cannot conclude on the future. The dilemma is that as drafted the statement seems to be read as both one of fact (the future is not able to be predicted) or a conclusion reached after deliberation and a decision made (management and the auditor cannot guarantee the going concern).

As suggested above, if there was further elaboration (see our response to question 9) then the cautionary wording may then have the required context to act as such and would possibly be better pitched.



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COMPLIANCE WITH INDEPENDENCE AND OTHER RELEVANT ETHICAL REQUIREMENTS

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?

We agree with this approach. We feel that it is of value to readers to have clarity on the ethical standing of the auditor. The practical challenges should be few.

DISCLOSURE OF THE NAME OF THE ENGAGEMENT PARTNER

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?

We agree with the proposed approach.

OTHER IMPROVEMENTS TO PROPOSED ISA 700 (REVISED)

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?

We agree with the proposals regarding improved description of the responsibilities of the auditor and key features of the audit and those in respect of referencing to whom in the entity is responsible for overseeing the Company's financial reporting process.

We welcome provision for the descriptions of the responsibilities of the auditor and key features of the audit to be relocated to an appendix in the auditor's report and the ability to combine the auditor's other reporting responsibilities. In general, we believe that the proposals provide an option that gives the auditor sufficient flexibility and caters for requirements in different jurisdictions.



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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?

We agree with the proposal to not mandate the ordering. This allows auditors to respond to the particular client circumstances and also strikes an appropriate balance between global consistency and national flexibility.

I trust that the above is comprehensive but should you have any questions on our comments, please do not hesitate to contact me.

Yours faithfully,

Federico Diomeda
Chief Executive Officer