



For the attention of Prof Arnold Schilder
Chairman
International Auditing and Assurance Standards Board (IAASB)
529 Fifth Avenue, 6th Floor
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USA

21 November 2013

Dear Prof Schilder

IAASB Exposure Draft: Reporting on Audited Financial Statements

We¹ welcome and thank you for the opportunity to comment on the proposed new and revised International Standards on Auditing (ISAs) for a more informative auditor's report on audited financial statements. The Exposure Draft is a key milestone in the debate around the auditor's report – taking it beyond weighing the merits of changing the model to shaping what the new report will look like.

Opening remarks

We fully support the IAASB's initiative to expand auditor's reports to make them more informative by sharing insight from the audit. Such expanded reports would help to reaffirm the relevance and value of the audit to users. We can also see the benefits this will bring to the robust dialogue about significant matters we have with those charged with governance and management.

Making changes as fundamental as those being proposed – the most fundamental changes to the auditor reporting model in decades – will present some challenges. Our focus in developing our response to the proposals has been to explore those challenges and look to how the desired outcomes can be achieved practically. With the refinements we set out in this letter, we believe that the Board's proposed requirements and guidance will achieve the desired aims.

In developing our views, we took the conversations about the proposals beyond the backroom and into the field. We wanted to go beyond a technical analysis to bring a practical perspective to our deliberations, which is important as the debate moves from concept to prototype. As a first step, in August and September, we asked engagement teams if the proposed requirements in draft ISA 701 would enable them to make the judgments that will be needed in selecting key audit matters. That insight has informed the views we express in this response. We are now taking our field testing one step further, engaging with

¹ This response is being filed on behalf of the network of member firms of PricewaterhouseCoopers International Limited and references to "PwC", "we" and "our" refer to the PwC network of member firms.



boards/audit committees and management across a range of our clients in territories around the world to get their reactions.

We do not yet have the full results of this second stage to our field testing. We are asking engagement partners and teams to go beyond high-level conversations with boards/audit committees and management about what is being proposed, and to discuss with them what our new reports would look like for the audits of their financial statements and how our engagement with them might need to change as a result. Our aim is to understand better the operational practicability and perceptions of possible prospective market impact. Doing that robustly needed planning and time and it was not possible to complete the process prior to the IAASB's November 2013 response deadline. As a result, we expect to have more insight into the benefits and possible unintended consequences of the proposed standard once that exercise is complete in early 2014; we will share relevant observations and further insights at that time.

Based on our analysis of the proposed standards and insights obtained so far, overall, we believe that the Board has appropriately weighed the views of stakeholders. Other than in areas that we have identified as requiring refinement, we believe that the proposed model responds to the requests for auditor's reports to provide more insight without contravening key overarching principles (see Appendix 1). The comments and suggestions we set out in this letter and in our answers to the detailed questions posed in the Exposure Draft in Appendix 2 aim to be constructive and help the IAASB move the proposed standards forward. In particular, we provide suggestions for refinements to the proposed requirements and guidance that we believe can, and should, be made to achieve the overall objective of relevant and valuable reporting by:

- refining and making clearer the framework that guides the judgments auditors will need to make in selecting the key audit matters that are reported, and
- avoiding the reporting of matters that could inadvertently risk unintended market consequences, which would not be in the public interest.

Aiming for global convergence

Before getting into our comments on the Exposure Draft, we want to emphasise the importance of continuing to pursue global convergence on the auditor reporting model.

We are pleased that there is a high degree of consistency with the proposed new auditor reporting models of other national regulators and standard setters. In our view, there is room for further convergence in the proposals that are on the table now and we should all be using best efforts to facilitate that aim. Substantively different models would be confusing to global capital markets. Given that the starting points vary across jurisdictions, convergence may take some time to achieve and there may need to be some flexibility between jurisdictions. However, unintentional and unnecessary differences in approach should be avoided.

To that end, we urge the IAASB to continue to liaise with the European Commission and work in collaboration with the US Public Company Accounting Oversight Board (PCAOB) in finalising their respective reporting requirements. In our comments, we highlight the areas in which we believe that the IAASB could make changes to its proposals in the interests of greater convergence with the proposals on



which the PCAOB is seeking comment at the same time as the IAASB. For example, as we explain in our response to Q13 in Appendix 2, there would be significant benefit in the standard description of the auditor’s responsibilities being the same in auditor’s reports and we question whether the advantages of the longer description proposed in the Exposure Draft are worth creating a substantive difference with the PCAOB’s proposed report wording.

Key audit matters

The most significant proposal in the Exposure Draft is undoubtedly the introduction of a new section of the auditor’s report describing *key audit matters*. Other proposals make the work the auditor already does more transparent. Describing key audit matters is a more fundamental change. Although the audit model itself is not fundamentally changing, the need to identify the matters of *most significance* in the audit will require changes in processes to facilitate their selection. It will also require greater engagement with management and those charged with governance around the basis for our selection of these matters and what we will say about them in our reports.

Of all of the proposed changes to the auditor’s report, we believe that introducing key audit matters is the most valuable to users.

Deciding which matters to highlight in the auditor’s report (“the filter”) and what the auditor should describe about them are critical to getting the model right. It is not easy. We believe that, with some further refinement, the proposed standards can provide the judgment framework needed to guide the auditor’s selection of key audit matters that were most important in the audit and to provide insight into why from the auditor’s perspective.

Why we believe further refinement of the filter is necessary

When we asked engagement teams to identify key audit matters, they intuitively had a strong – and consistent – sense of the types of matters they believed would be most relevant to users. They thought that these would always be matters that they discuss with those charged with governance (TCWG), but they applied a second filter to identify those matters they felt were *relevant* to users. They viewed users as a different audience to TCWG, in both their roles and their interests. The key audit matters that the engagement teams identified as being most relevant in providing insight from the audit to users were related to areas in the financial statements that involved complex financial reporting estimates and significant management judgment – the more subjective areas in the financial statements.

However, almost to a person, the engagement teams said that applying the proposed requirements and guidance in the Exposure Draft would not necessarily have led them to select those matters. Many found that the proposed requirements and guidance in the Exposure Draft were (1) not sufficient to guide their judgments and, therefore, might not result in auditors making comparable judgments in similar circumstances, and (2) could lead to matters being identified that they would not have considered a key audit matter if they were telling their story of the audit. Both are problematic, but not insurmountable with some refinement of the filter.



Our proposals to refine the filter

We support the IAASB’s approach of having a principles-based requirement that defines the filter the auditor uses to identify the key audit matters. We agree that the answer is not a requirement that sets rules – i.e., a requirement that specifies the matters that must always be included (e.g., all significant risks of material misstatement). Auditors are capable of making reasoned and informed judgments about the matters that would be relevant in the circumstances. But we believe that clearer requirements that embody a more explicit judgment framework are needed to enable auditors to make appropriate judgments that are comparable in similar circumstances.

We considered what we thought the reporting of key audit matters should achieve:

- *Insight that is relevant to users’ understanding of the financial statements.*

Although not explicitly stated in the proposed standard, there is an underlying impression in it that the IAASB believes that most key audit matters will be rooted in the financial statements – an impression supported by the illustrative examples. We agree that a focus on why and how the audit addressed key financial statement areas is the insight from the audit that is the most meaningful and valuable to users because it is relevant to their understanding of the financial statements.

Viewed this way, key audit matters would provide an auditor’s “lens” into the areas in the financial statements that were the most important from an audit perspective and why – a different dimension that may be useful to users in obtaining their understanding of the financial statements. Importantly, clarifying the scope of key audit matters in this way would also help to eliminate some of the unintended consequences we discuss further below and in more detail in Appendices 2 and 3.

The proposed wording of the definition of key audit matters and the requirements on their selection is too broad and needs to be clarified. For example, “*matters of most significance in the audit*” or “*areas of significant auditor attention*” could refer to a broad range of matters related in one way or another to audit acceptance, design, and process, whereas it is the outcome that is of most relevance. Factors such as “*circumstances requiring modification to the auditor’s planned approach*” also seem more focussed on the audit process than the transaction or event that led to the modification. It is the transaction or event that is meaningful rather than the fact that the auditor changed the approach. In fact, as we explain more fully in response to Q2 in Appendix 2, in the absence of proper engagement with stakeholders on particular engagements, we are concerned that a focus on audit input judgments could lead to inferences by stakeholders regarding perceived differences in audit quality that are not warranted. For that reason, we believe that key audit matters should not include audit input judgements unless the corporate governance structure in a particular jurisdiction provides the framework for the engagement necessary to avoid unintended consequences.

- *Focussed on the **most significant** matters.*

We believe auditor’s reports will be the most effective when the key audit matters highlight the most significant matters in that particular audit. The auditor’s report will lose impact if there is an extensive list and description of a wide range of matters rather than focussed insight into those issues that were the most important. Drawing an arbitrary limit would not be consistent with principles-based



standards. However, we believe that the requirement needs to clarify that the auditor selects what he or she believes are the most significant matters. It would help if the guidance established an expectation of what range would be considered reasonable, depending on the circumstances. At present, the proposed standard makes clear that key audit matters are a subset of matters communicated with those charged with governance, but the wording of the requirement does not emphasise that the auditor uses judgment to select the most significant matters. In fact, it implies that the factors provided would trigger a matter being considered a key audit matter rather than the factors being illustrative of the matters from which the auditor selects the most significant.

We offer wording suggestions that would refine the proposed requirements to provide a more clearly articulated decision framework for the filter to select key audit matters in our response to Q2 in Appendix 2.

Unintended consequences of changing the trigger point for reporting certain matters

Today's reporting models reflect established consensus, with regard to the public interest, on the nature and timing of disclosure of particular information to users and by whom. While that does not necessarily mean that those reporting models and thresholds cannot be changed, if they are to be changed, it should be after full consideration of the impacts.

There are a few areas in which we believe that the proposed requirements and guidance for key audit matters could have the effect of lowering the threshold for disclosing information to markets, in the sense of triggering reporting at an earlier point. In each case, communicating these matters in the auditor's report would make the auditor's report the original source of information about that matter – which is a breach of an overarching principle on which there is broad consensus among stakeholders – but changing the trigger point could also have unintended market consequences.

One such area is disclosing the auditor's judgment in evaluating whether identified and uncorrected misstatements are material. This evaluation can involve significant auditor attention. However, unwarranted conclusions could be drawn by users by disclosing identified uncorrected immaterial misstatements because it would not be a complete population – the focus of the audit is identifying material misstatements, not all possible misstatements of a lower amount. If the focus is material misstatements, that seems the appropriate threshold for reporting (by modifying the auditor's opinion on the financial statements as a whole). We believe it would be appropriate to clarify in ISA 701 that the auditor's evaluation of identified misstatements in ISA 450 is not considered to be a key audit matter.

Another area of particular concern to us is "close calls" regarding going concern (i.e., circumstances when events or circumstances raise doubt, triggering additional work effort, but the auditor is ultimately able to conclude that a material uncertainty does not exist). A number of our engagement teams thought such "close calls" would meet the requirement for identifying key audit matters because evaluating whether a material uncertainty exists could involve significant auditor attention. Going concern is a critical accounting judgment underlying the preparation of all financial statements and greater transparency into those judgments a worthy aim. But for the reasons we articulate in Q2 and Q9 in Appendix 2, we do not believe that transparency should be provided in the first instance through the auditor's report. We also believe that a more clearly articulated framework would be needed for when such disclosures should be made, for both audit and financial reporting purposes. Otherwise, there would be an increased likelihood



of inconsistency in the nature and timing of disclosures to which there may be a significant market reaction, which could have unintended consequences. Again, we believe this could easily be addressed by clarifying in the scope of ISA 701 that the auditor’s responsibilities regarding reporting going concern matters are addressed in ISA 570.

Similar arguments apply to suspected illegal acts, suspected fraud and internal control deficiencies.

As discussed more fully in our responses to Q2 and Q3 in Appendix 2, by making a few clarifications to the scope of ISA 701 and anchoring key audit matters in the financial statements, the risk of concluding that such matters might be considered a key audit matter would be mitigated.

Communicating the key audit matters

Equally important to selecting the matters to describe in the auditor’s report is what the auditor says about them.

We agree that it is appropriate for the description to have an audit focus. It was very clear in the responses to the earlier consultations that users are looking for more than a “roadmap” to important disclosures in the financial statements. Neither is it the role of the auditor’s report to fill in any gaps in the financial statements or be the original source of information about the entity.

Although the description can refer to related financial statement disclosures, we agree that the description should not merely reiterate what is disclosed in the financial statements or simply point to those disclosures without providing additional context from the auditor. Furthermore, lists of procedures on their own are unlikely to be meaningful. Rather, we believe what would be meaningful in describing a key audit matter is for the auditor to explain why it is of particular importance to the audit, and, at a high level, how it was addressed in the audit. In doing so, the description can explain what it was about the financial statement area that required significant audit attention, which can provide insight to users that is useful in understanding the nature of the matter and the judgments inherent in it.

We believe it is important that the auditor’s report clarify that the description of how the audit addressed the key audit matters needs to explain that the auditor’s procedures for them are designed in the context of obtaining sufficient appropriate audit evidence on the financial statements as a whole. Therefore, we support the introductory language for the section proposed in the Exposure Draft. We also believe there can be confusion if the descriptions of how the auditor addressed the key audit matters in the audit include conclusions on specific procedures. We recommend that conclusions not be included in the illustrative examples or otherwise encouraged.

Going concern

We consider going concern to be an area of corporate reporting that is of fundamental importance – it is a key principle underlying the preparation of financial statements. The current audit and financial reporting models link disclosures regarding the entity’s ability to continue as a going concern to circumstances when there is material uncertainty. There has been demand to revisit whether that model is robust, or whether earlier disclosure would be appropriate. There have been a number of initiatives looking into those issues



– e.g., the Sharman Inquiry in the UK, and the FASB project in the US – but to date, the discussions are ongoing and consensus not yet reached. We strongly encourage the IAASB to continue to work with others to seek a holistic and more integrated solution that considers enhanced financial reporting, corporate governance and audit responsibilities to achieve greater transparency into going concern judgments.

There is undoubtedly demand from some stakeholders to hear from the auditor on going concern and for this reason we would be prepared to support the new section and statements regarding going concern proposed in the Exposure Draft. Initial feedback from our field testing and from what we hear from some other stakeholders does, however, indicate that the proposed new section on going concern may be perceived as “boilerplate” – which does not provide the transparency around going concern judgments that users are seeking. We therefore consider it all the more important that more holistic approaches to reporting on going concern judgments are pursued. The optimal solution would be for the statements being made by auditors in the auditor’s report to complement an explicit explanation by preparers of the rationale for their going concern conclusion.

As noted above, and as explained in more detail in our response to Q9 in Appendix 2, we have significant reservations about the treatment of “close call” situations that do not constitute material uncertainties, and suggest that the Board scopes out going concern from proposed ISA 701 and explains that the consideration of, and auditor reporting related to, going concern is dealt with in ISA 570 – at least until such time as accounting standard setters have addressed how to provide greater transparency into going concern judgments.

Other proposals

We support the other proposals in the Exposure Draft, although we do provide suggestions in our responses to the Exposure Draft questions in Appendix 2 on such matters as:

- The need to simplify the reporting model with respect to the interaction of key audit matters, emphasis of matter paragraphs and other matter paragraphs.
- Recognising that there may be equally appropriate vehicles for identifying the engagement partner that can take into account jurisdictional legal implications.
- The need to clarify the proposed requirement to identify the sources of independence and other ethical requirements, including in the circumstances of a group audit.

In conclusion, we strongly support enhancements to the auditor’s report that will address the needs of today’s users. The proposed auditor reporting model, in particular expanding auditor’s reports to describe the key audit matters, should help to reaffirm the relevance and value of the audit to users, as well as inform robust engagement with management and boards/audit committees. We believe that with the refinements we describe in this letter and explain in more detail in Appendix 2, the IAASB’s proposed standards will provide the direction and judgment frameworks needed to guide the implementation of the new expanded reporting model. We are already starting to shift our energies towards what will be needed to deliver the new style reports across our network. The field testing we are undertaking will provide invaluable insight to what will be needed to meet the significant implementation challenges.



Success of the new auditor reporting model will depend on effective implementation. To a considerable extent that depends on auditors embracing the change and working with the new model in the spirit in which it is intended to share meaningful insight from the audit. The legal and regulatory environment in which auditors operate will undoubtedly affect how the new auditor reporting model is and can be implemented. The judgments auditors are being asked to make in selecting the matters to communicate are difficult and in many jurisdictions will result in increased legal risk for the profession. To fully achieve the meaningful insight that we are all aiming for in the auditor's report, policymakers in local jurisdictions should consider what protections may be needed to protect auditors when making judgments in good faith.

Recognising the global nature of today's capital markets, global consensus on the auditor reporting model for capital markets is desirable. The path to having a common global model for the auditor's report is not insurmountable and, indeed, shorter than it might have been. The proposed models recently implemented or being considered are very similar, but there is room for greater convergence. We encourage the IAASB, and all national standard setters, regulators and other stakeholders to use best efforts to achieve global alignment.

We would be happy to discuss our views further with you. If you have any questions regarding this letter, please contact Diana Hillier, at diana.hillier@uk.pwc.com, or me, at richard.g.sexton@uk.pwc.com.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Richard G. Sexton', written in a cursive style.

Richard G. Sexton
Vice Chairman, Global Assurance



Appendix 1

Overarching principles for effective auditor reporting

In evaluating how the auditor's report could be improved, we have consistently referred to a number of principles that we believe are important to achieving constructive changes and avoiding changes that inadvertently do harm.

1. Changes made to auditor reporting should:
 - maintain or improve audit quality;
 - enhance the value of audit to users; and
 - increase the reliability of information the entity provides in public reports.
2. Changes should maintain or enhance the effectiveness of the relationships and interactions of auditors, those charged with governance (e.g., audit committees) and management in the financial reporting process.
3. Auditor reporting should be sufficiently similar to facilitate users' comparison of the underlying economic reality / state of affairs of different entities.
4. Auditor reporting can provide greater insight based on the audit but the auditor should not be the original source of factual data or information about the entity.

We continue to believe these principles are relevant in evaluating the proposed requirements and they, therefore, provide the context for our comments.

We also found the following considerations valuable when evaluating the merits of possible insights that could be added to the auditor's report. In particular, that additional information added to the auditor's report is unlikely to be effective if it:

- focusses on information that does not inform users about the financial statements;
- could create misconceptions that could undermine confidence in the audit rather than inform users' understanding of the financial statements and audit; and
- is not capable of being explained or understood without broader context regarding the audit approach, methodology and findings.



Appendix 2

Answers to questions posed in the Exposure Draft

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?**

Of all of the proposed changes to the auditor’s report, we believe that the proposed reporting of “key audit matters” will be the most valuable to users. Based on our own outreach with the investment community, and listening to what they told us they would value in the auditor’s report, we believe this new section of the report, given the right focus, will be seen by those users as enhancing its usefulness. However, that goal will only be achieved if the content of that section is drafted in a manner that provides genuine insight and is both meaningful and understandable to the reader, and avoids boilerplate. Ultimately it will be for users of the financial statements to judge the usefulness of the new disclosures.

We considered what we thought the reporting of key audit matters should achieve:

- *Insight that is relevant to users’ understanding of the financial statements.* Although not explicitly stated in the proposed standard, there is an underlying impression in it that the IAASB believes that most key audit matters will be rooted in the financial statements, an impression supported by the illustrative examples. We agree that a focus on why and how the audit addressed key financial statement areas is the insight from the audit that is the most meaningful and valuable to users because it is relevant to their understanding of the financial statements.
- *Focussed on the most significant matters.* We believe auditor’s reports will be the most effective when the key audit matters highlight the most significant matters in that particular audit.

Within that context, we support the direction taken by the requirements and application material in the proposed standard with respect to the selection of key audit matters and how such matters are to be described. We believe, however, that refinements can, and should, be made to help better guide auditors in making these determinations to enhance prospects for achieving the overall objective of relevant and valuable reporting. We have provided suggestions in our responses to Q2 through Q4 below that we believe support that goal, by:

- making clearer the framework that supports the judgments auditor’s will need to make in determining key audit matters, by refining the filter for their selection, and
- avoiding the reporting of matters that could risk unintended market consequences, which would not be in the public interest.

- 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?**

The need for a clear filter for determining key audit matters

As noted in our response to Q1, for the new section of the report describing key audit matters to achieve its aim of providing relevant and valuable reporting, we believe some refinement of the requirements and application material for determining key audit matters is needed. Based on internal consultation with engagement teams across a broad geographic range of territories, we received feedback that the proposed requirement and



application material do not currently provide a sufficient framework to guide the judgments that they needed to make in selecting the key audit matters.

Intuitively, our engagement teams had a strong – and consistent – sense of the types of matters that they believed would be of most relevance to users. They thought that these would always be matters that they discuss with those charged with governance (TCWG), but they applied a second filter to identify those matters that they felt were *relevant* to users. They viewed users as a different audience to TCWG, both in their roles and their interests. The key audit matters that the engagement teams identified as being most relevant in providing insight from the audit to users were related to those areas in the financial statements that involved complex financial reporting estimates and significant management judgment – the more subjective areas in the financial statements.

However, almost to a person, the engagement teams said that applying the proposed requirements and guidance in the Exposure Draft would not necessarily have led them to select those matters. Many found that the proposed requirements and application material were: (1) not sufficient to guide their judgments and, therefore, might not result in auditors making comparable judgments in similar circumstances; and (2) could lead to matters being identified that they would not have considered a key audit matter if they were telling their story of the audit.

How the filter is interpreted

Our engagement teams expressed a number of difficulties and concerns in trying to align their initial judgments with their interpretation of matters that would need to be reported in applying the requirement and guidance in proposed ISA 701.

Most of the teams felt that the focus on “*areas of significant auditor attention in performing the audit*” was relevant but not sufficient on its own to drive the necessary consistency in judgments. In addition, there was a lack of clarity in how the “factors” in the proposed requirement (parts a)-c) in paragraph 8) are intended to apply – while a majority of teams considered the factors to be areas of consideration, as many as one third interpreted them as being a form of “trigger”, requiring any matter that met the description of one of those factors to be disclosed as a key audit matter. This is a clear indication that further clarification of the requirement is needed.

The majority of teams were not looking for “rules”, which could excessively restrict the exercise of the judgments they made, but they were looking for greater clarity on the judgments that need to be made in the selection process.

Areas of clarification identified included, amongst others:

- Whether, and when, ISA presumed risks are considered key audit matters.
- Treatment of matters discussed with the audit committee that have no relationship to the financial statements.
- Whether matters such as, for example, identified misstatements should be included. Our teams felt this fell within the scope of the factors but had concerns about whether disclosing such matters was in fact appropriate.

Our suggestions to refine the filter

As noted in our covering letter, while we support the direction of the principles-based requirement and application material for determining key audit matters, based on our internal field testing we believe that the requirements need to be refined to better articulate the judgment framework to be applied and, in doing so, address a number of the concerns and questions we heard from engagement teams in practice.

We believe that the key audit matters should be anchored in the most significant financial statement areas – those that involved complex financial reporting estimates and significant management judgment – the more



subjective areas in the financial statements. Viewed this way, key audit matters would provide an auditor’s “lens” into the areas in the financial statements that were the most important from an audit perspective and why – a different dimension that may be useful to users in obtaining their understanding of the financial statements.

The application of such a filter is not intended to result in the key audit matters identified simply acting as a roadmap to those areas for users of the financial statements. It is purely a selection consideration. Key audit matters should be described in the context of the audit, that is, why they are of particular importance to the audit and, at a high level, how they were addressed (which would be highlighting significant judgments made by the auditor). We address our vision for the content of key audit matter descriptions in our response to Q3.

Such clarifications would both inform users’ understanding of the financial statements and also help eliminate concerns over the appropriateness of certain matters being defined and reported as key audit matters. We articulate further our reasoning behind these concerns, and why we feel these refinements are therefore necessary, following our proposed solutions below.

Our suggested enhancements to clarify the proposed requirement include both amending the proposed requirement so that it focusses on the most relevant matters from which key audit matters would be selected and adding a second filter to enable the auditor to select the most significant matters from that population. For the reasons we explain below, we would amend the requirement in proposed ISA 701 as follows:

ISA 701.8 The auditor shall determine the matters relating to the financial statements that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the matters communicated to those charged with governance that involved:

- (a) Areas identified as significant risks in accordance with ISA 315 (Revised) or involving significant auditor judgment.*
- (b) Areas of significant complexity in the financial statements or that involved the application of significant judgment or estimation by management.*
- (c) Significant events or transactions that occurred during the year.*

ISA 701.9 The auditor shall determine which of the matters determined in accordance with paragraph 8 were of most significance in the audit of the financial statements of the current period.

This wording is designed to achieve the following:

- 1) The proposed changes to paragraph ISA 701.8 would make more explicit the nature of matters that would form the population of matters from which those of “most significance” are to be selected. We believe those matters would be anchored in the financial statements – hence our proposed revisions to the introductory text and new part b) – and, by their nature, result in the application of a *relevance* filter (supported by relevant application material).

In our proposed amendments, we have deleted references to areas in which the auditor encountered “*significant difficulty during the audit*” and “*significant modification of the auditor’s planned approach to the audit, including as a result of a significant deficiency in internal control.*” With regard to the former, we believe our proposed revised elements b) and c) would encompass areas of difficulty in the audit but provide greater clarity as to the expected nature of those matters that would be of relevance to users. We believe removing the latter element is appropriate for the following reasons:



- A significant change in the auditor’s planned approach may arise from a variety of reasons, including any decision by the auditor that another approach, in hindsight, is more appropriate – a decision not influenced in any way by the entity or engagement circumstances. On its own, we believe this ‘factor’ risks confusion about its intended meaning and is unlikely to lead to the identification of relevant key audit matters. In our view, the more relevant factor to focus on is entity-driven events or transactions that occurred during the year, which may have given rise to new risks of material misstatement and/or that required significant audit effort – something that would be of relevance and interest to users. Hence, our suggested addition of part (c) above.
 - Similarly, we believe that a deficiency, or even a significant deficiency, in internal control does not necessarily, in and of itself, constitute a key audit matter. There may be circumstances when it may be relevant to refer to an internal control deficiency in the description of a key audit matter, but it would then be incidental to the overall context of describing that key audit matter relevant to the financial statements. Because not all audit engagements adopt a “controls-based” approach, disclosing identified deficiencies will not result in comparable reporting across entities. This would, in our view, give rise to the risk of unintended consequences arising from users drawing conclusions based on incomplete information – simply as a result of differences in the audit approach adopted. In a reporting model that requires audits to undertake reporting on internal control, such as certain US public issuers, this risk is clearly mitigated. That is not the case under an ISA audit. We provide further context on this point in our comments in Appendix 3.
- 2) The inclusion of a further requirement (as shown in illustrative paragraph ISA 701.9 above), designed solely to emphasise that key audit matters are those that were of *most significance* in the audit, and are selected from the population of matters identified through applying the preceding filter.

Other enhancements that we recommend include:

- 1) The application material to our suggested amended requirements should establish a clear expectation of the number of key audit matters that would be considered reasonable. We believe this is important to aid consistency in reporting and to further emphasise the concept of describing those matters that were of “most significance” in the audit. A “laundry list” of matters that obscured those that were truly of most significance would be unhelpful and likely to reduce the perceived usefulness of the new reporting. In our field testing with engagement teams in August and September, most teams identified 2-4 matters, while a few identified 5-6. In our view, this is a reasonable range capable of providing insight without excessive detail. We suggest that paragraph A7 be updated to include guidance that, ordinarily, most reports would include 2-4 matters and seldom any more than 5-6. Such guidance would set an appropriate expectation of what range would be considered reasonable, depending on the circumstances.
- 2) To avoid inconsistent practices arising, the Board should be explicit that the presumed significant risks in the ISAs do not automatically result in a key audit matter, and that the other elements of the filter, including our suggested refinements, need to be taken into account. In our internal consultations with engagement teams, they found the application material in paragraph A16 ambiguous in this respect, creating uncertainty over the expected treatment of such risks.
- 3) Including introductory material in the scope section of the proposed standard and/or application material to explicitly exclude from scope certain matters that could risk unintended negative market consequences, which would not be in the public interest – we explain our views further in the following section on “unintended consequences”.

Unintended consequences of changing the trigger point for reporting certain matters

As noted in our covering letter, we are concerned that the current requirement and application material could result in matters being identified for inclusion that we do not believe are appropriate for reporting *within the*



auditor's report. This is particularly the case in the areas identified below where we believe that reporting of the matter in the auditor's report could have the effect of lowering the threshold for disclosing that information to markets, in the sense of triggering reporting at an earlier point. Today's reporting models reflect established consensus, with regard to the public interest, on the nature and timing of disclosure of particular information to users and by whom. While that does not necessarily mean that those reporting models and trigger points cannot be changed, if they are to be changed, it should be after full consideration of the impacts. In each of the cases we discuss below, communicating these matters in the auditor's report would make the auditor's report the original source of information about that matter – which is a breach of an overarching principle on which there is broad consensus among stakeholders – but changing the trigger point could also have unintended market consequences.

“Significant auditor attention in performing the audit”, “significant auditor judgment”, and “areas in which the auditor encountered significant difficulty during the audit” are all sufficiently broad concepts that matters including going concern “close-calls”, identified misstatements, deficiencies in controls (as explained above), suspected illegal acts or suspected fraud could all quite easily be deemed to fall within those categories. In many cases, communicating those matters in the auditor's report would make the auditor's report the original source of information about that matter, as well as change the nature and timing of the disclosure to users of information related to those matters from that on which there is consensus in today's reporting models. We provide further rationale for why we believe each of these items should not be disclosed in Appendix 3 to this letter. We also articulate further, in our response to Q3, the importance of considering what information is disclosed by management when determining whether and what it is appropriate for the auditor to communicate as a key audit matter in the auditor's report.

As noted in our proposed solutions, we suggest that the scope paragraphs of ISA 701 and/or the application material in support of the determination requirement be explicit with regard to the nature of matters that would not be considered for inclusion as key audit matters.

For example, going concern “close calls” could easily be addressed by clarifying in the scope section of ISA 701 that the auditor's responsibilities regarding reporting going concern matters are addressed in ISA 570 and therefore are not in the scope of ISA 701. Paragraph A45 could also easily be extended to explain that when the auditor considered the possibility that a material uncertainty may exist, but ultimately concluded otherwise, such matters would not fall within the scope of ISA 701. We elaborate further on our recommendations with respect to reporting on going concern, including the issue of “close-calls”, in our response to Q9. Similar exclusions should be incorporated in relation to those other matters described above and in Appendix 3.

In addition to those matters described above that may not be appropriate for inclusion as a key audit matter, there may be restrictions placed on the auditor with regard to what can be reported as a result of law, regulation or other factor. To that end, we believe that the application material in paragraph A35 may also be useful as a cross reference from the application material related to determining key audit matters.

Consideration of audit input judgments

We recognise that our approach indirectly argues that matters regarding the audit approach or design (the “audit process”) would not be considered key audit matters.

As explained in Appendix 1, information included in the auditor's report will not be effective if it could create misconceptions, or if it is not capable of being explained or understood without broader context. In our view, reporting audit input judgments could lead to inferences regarding perceived differences in audit quality that are not warranted – it is difficult to meaningfully compare individual audit input judgments without further dialogue to explain the rationale for those judgments in the context of the overall audit plan and methodology. For these reasons, in many, if not most, jurisdictions, it may be more fruitful, and more acceptable to users, to consider audit quality in the context of the “auditor” (i.e., the audit firm) rather than the “audit” (i.e., the audit



engagement), with firms' transparency reports and audit inspection reports providing relevant information in that regard.

For these reasons, we believe that key audit matters should not include audit input judgments unless the corporate governance structure in a particular jurisdiction provides the framework for the engagement necessary to avoid unintended consequences. We note that the UK Financial Reporting Council has required the disclosures of certain audit input judgments, but it is in the context of their Effective Company Stewardship model, which provides the basis for appropriate shareholder engagement with audit committees and auditors on those matters.

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?

As noted in our covering letter, we believe that the description of a key audit matter will be most meaningful when the auditor includes an explanation of why that matter was considered of particular importance to the audit, and how, at a high level, it was addressed in the audit. We therefore strongly support the overall principle set out in the requirement in paragraph 10 of proposed ISA 701.

We also agree that the description should not merely reiterate what is disclosed in the financial statements or simply point to those disclosures without providing additional context from the auditor. In setting out why the area was considered to be one of most significance in the audit and how it was addressed, the description can explain what it was that caused it to be judged a matter that required significant audit attention. Although undoubtedly from an audit perspective, that description can provide insight into the nature of the matter and the judgments inherent in it. That insight, we believe, takes our vision of the description beyond simply being a "roadmap" to the financial statements. We believe the broad intent of the application material in paragraphs A31 through A41 is helpful in that context.

However, based on our proposals that key audit matters should be anchored to areas in the financial statements that involved complex financial reporting estimates and significant management judgment – the more subjective areas in the financial statements – we believe the application material, in particular, paragraph A31 could more explicitly make reference to significant judgments and complexity in the financial statements.

Furthermore, while we support the overall intent of the application material, we find the placement of some of the guidance in paragraphs A31-A37, which addresses "*explaining why the auditor considered the matter to be of most significance in the audit*", a little confusing. In places, as illustrated below, these paragraphs do not appear to directly address the concept of "why" the matter was one of significance, but instead deals with other concepts, detracting from the clarity of the application material. For example:

- In paragraph A31, the auditor's approach to the matter, and whether experts were used seems less relevant to *why* the matter was one of significance and more relevant to *how* the auditor addressed the matter; and
- Paragraph A35 addresses the ability of an auditor to communicate key audit matters under law, regulation or ethical standards in certain circumstances. This appears to be a much broader point than guidance on describing the "why". We suggest this may be better located following paragraph A30.

Avoiding the auditor becoming the original source of information

We reiterate in Appendix 1 our overarching principles for changes to auditor reporting, one of which being that the auditor should not be the original source of information about the entity. We therefore support the application material included within paragraph A34.



However, we did not find paragraph A36, which discusses “sensitive matters”, such as suspected fraud, which may or may not be disclosed in the financial statements, to be helpful in that context. In our view, the matters described in paragraph A36 should not be disclosed by the auditor in the absence of disclosure by management, for the reasons we set out in our response to Q2.

Where matters are disclosed, we believe it is important that the description of a key audit matter provide a cross-reference to that disclosure, where more detailed information underlying that matter can be read by the user – such as, for example, management’s detailed policies, assumptions or other disclosures on the matter. We therefore found paragraphs A42-A43 useful.

We do, however, recognise that there may be rare circumstances when there may be a key audit matter that is related to the audit of a line item in the financial statements, but for which there is no specific note disclosure that directly addresses the particular aspect of the audit of that item. In such circumstances we believe it can be appropriate for such key audit matters to be disclosed, but to an even greater degree, consideration would need to be given to the words used to describe that matter to avoid the auditor introducing “original” information. It is also likely that in such cases, the auditor would actively encourage management to provide additional disclosures to address the specific matter.

How the matter was addressed in the audit

In addition to the description of the key audit matter explaining why it was one of most significance in the audit, we also support the concept of describing at a high level the effect on the audit – how the auditor addressed that matter. We would, however, suggest that the alternative description of “how the matter was addressed in the audit” may be a more readily understandable concept for auditors and users than “the effect on the audit” currently used in the requirement in paragraph 10.

In describing how the auditor addressed the matter, we support the application material in paragraphs A39 and A40, and agree that lists of audit procedures on their own are also unlikely to be meaningful. Such information is likely to be either excessively detailed and technical, if trying to provide a complete picture, or overly simplistic and boilerplate.

However, we believe that the concept of an “outcome” or “conclusion”, addressed by application paragraphs A38 and A41, or descriptions that could be misinterpreted as being of the nature of a conclusion, are problematic. Notwithstanding the overall caveat included within the proposed introductory text to the key audit matters section of the report - that “*our opinion on the consolidated financial statements is not modified with respect to any of the key audit matters described below, and we do not express an opinion on these individual matters*”, we suggest the Board clarifies the statement in paragraph A41 to better explain what was practically envisaged by the statement “*if in explaining the effect on the audit, the auditor considers it necessary to indicate findings or a conclusion in relation to a matter, there is also a need for the auditor to avoid giving the impression that the discussion about key audit matters in the auditor’s report is intended to convey an opinion on individual matters.*”

- 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.**

We set out our overall views on the content of the descriptions of a key audit matter in response to Q3. Within that context, we broadly support the illustrative examples included within the illustrative report in the Exposure Draft.



As explained in our comments in response to Q3, we believe that one of the necessary elements of the description of an individual key audit matter is the provision of sufficient context that explains why that matter was one of most significance in the audit. Therefore, we support the inclusion of descriptions such as, for example:

“Because the valuation of the Group’s structured financial instruments is not based on quoted prices in active markets, there is significant measurement uncertainty involved in this valuation. As a result, the valuation of these instruments was significant to our audit.”

As we note in our response to Q3, we do not believe it is appropriate for the descriptions to include “conclusion” type statements. We recognise that different readers will draw different interpretations from the form of words used and would just highlight that, by way of example, the illustrative statement that *“based on the audit procedures performed, we did not find evidence of the existence of side agreements”* could be misconstrued by the reader.

As we also explain in our response to Q3, we believe that certain aspects of the illustrative examples are only appropriate where management has provided disclosure from which the auditor’s description has been drawn – the auditor’s description must not be seen as a way to “fill in gaps” in the entity’s own disclosures or of introducing new information. For example, the reference in the goodwill example to *“assumptions that are affected by expected future market or economic conditions, particularly those in [Countries X and Y]”* may not be appropriate if such facts do not form part of the disclosures given by management.

- 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 not? 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?**

We can envisage circumstances when there are entities for which voluntary reporting of key audit matters may be appropriate. In those circumstances, we agree that the auditor is required to follow ISA 701 and to signal the auditor’s intent in the audit engagement letter. For example, in the UK, many large private entities that are not required to comply with UK Corporate Governance Code disclosure requirements applicable to listed entities voluntarily do so due to their public profile. In those circumstances, some have asked if we would report on those disclosures in the same way that we are required to do for listed companies, which could include reporting of key audit matters. It is likely that similar requests may be seen across jurisdictions in similar circumstances. However, where voluntary adoption of ISA 701 is permitted, consistent reporting year on year is important. As such, we recommend that the IAASB needs to build into proposed ISA 701 safeguards to guard against entities having voluntary reporting of key audit matters by the auditors in “good” years, i.e., when an entity has strong results and few audit issues, and then electing in subsequent “bad” years to choose not to have such reporting. Unrestricted flexibility to opt in and out of ISA 701 is not desirable and could result in misleading reports over time.

- 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 believe it is appropriate for the proposed standard to remain principles based and to permit auditor judgment in making a determination that, in some limited circumstances, there are no matters to report. We therefore support the requirement as drafted and the proposed reporting that would be required in the auditor's report in such circumstances.

As noted in our response to Q2, we believe that most auditors' reports will, in practice, include at least one matter, but most will ordinarily include 2-4 matters, and seldom any more than 5-6. Based on the principle of disclosing matters of "most significance", in our view, it would be unusual for an auditor to conclude that there were no matters to report. We, therefore, also support the application material that emphasises this point.

- 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?**

Key audit matters are defined in paragraph 7 of proposed ISA 701 as those matters of most significance in the audit of the financial statements of the current period. Paragraph A8 of ISA 701 further clarifies that the auditor's determination of key audit matters "is limited to those matters of most significance in the audit of the financial statements of the current period, even when comparative financial statements are presented."

We believe there might be situations where it is appropriate to report key audit matters related to prior years. For example, the PCAOB's proposed standard similarly focuses reporting of critical audit matters on the current period; however, paragraph 10 states that "when the current period financial statements are presented on a comparative basis with those of one or more prior periods, the auditor should consider communicating critical audit matters relating to the prior periods when (1) the prior period's financial statements are made public for the first time, such as in an initial public offering, or (2) issuing an auditor's report on the prior period's financial statements because the previously issued auditor's report could no longer be relied upon."

It would appear these situations would be applicable to audits conducted in accordance with ISAs; therefore, we suggest the IAASB consider similar guidance.

- 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?**

No. We believe that an auditor's report that includes key audit matters, emphasis of matter paragraphs and other matter paragraphs potentially will be confusing to users who may have difficulty understanding why some matters are reported as key audit matters and others, for example, a litigation uncertainty or a significant related party transaction, are reported in an emphasis of matter paragraph. We believe that, for listed entities where the auditor is required to report key audit matters, the proposed requirements of emphasis of matter paragraphs and the proposed requirements on other matter paragraphs should be combined into a single new other matter section that could be used for purposes of reporting such matters as dual dating a report, stating that the prior period financial statements were audited by a predecessor auditor, or other planning and scoping matters that are unlikely to be key audit matters because of how key audit matters are defined in proposed ISA 701, as discussed in proposed ISA 706.A8. The existing definitions and guidance for emphasis of matter paragraphs and other matter paragraphs for entities that do not report key audit matters could be retained, although going forward the IAASB may wish to consider whether differentiating the reporting of emphasis of matter paragraphs and other matter paragraphs in reports of non-public companies is meaningful to users and might also be simplified.



Going concern

9. Do respondents agree with the statements included in the illustrative auditor's reports relating to:
 1. The appropriateness of management's use of the going concern basis of accounting in the preparation of the entity's financial statements?
 2. Whether the auditor has identified a material uncertainty that may cast significant doubt on the entity's ability to continue as a going 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.

We consider going concern to be an area of corporate reporting that is of fundamental importance – it is a key principle underlying the preparation of financial statements. Its significance has been underlined by the fact that a number of standard setters and other bodies have recently established projects to reconsider how solvency and liquidity risks and going concern are dealt with in corporate reporting. Many users have expressed the desire to see entities explain the basis on which the going concern assumption has been arrived at. Although a number of preparers now provide these types of explanations, many others do not make the linkage.

Our view is that there should be a requirement for all preparers of financial statements to provide an explicit explanation of the rationale for their going concern conclusion. This would help clarify the use of the going concern assumption to users. We believe the IAASB should continue to work with accounting standards setters (including the IASB) and other bodies that set the framework for financial reporting and should encourage those organisations to add such an explanation to their requirements.

We acknowledge, however, that there is undoubtedly demand from some stakeholders to hear from the auditor on going concern and for this reason we would be prepared to support the new section and statements by the auditor regarding going concern proposed in the Exposure Draft. Initial feedback from our field testing and from what we hear from some other stakeholders does, however, indicate that the proposed new section on going concern may be perceived as “boilerplate” – which does not provide the transparency around going concern judgments that users are seeking. If the Board were to go forward with its current going concern proposal, we believe further attention is needed on a number of aspects before these statements are implemented – not least the practical issue of “close call” going concern situations.

We elaborate further below on the following aspects:

- The treatment of “close call” situations which do not constitute a material uncertainty.
- Other aspects of the relationship between key audit matters and going concern.
- Related developments in accounting standards setting.

The treatment of “close call” situations which do not constitute a material uncertainty

In the Exposure Draft, the IAASB notes in paragraph 87 that a going concern material uncertainty would, by its nature, be considered a key audit matter.

The Board also included in its previous Invitation to Comment (ITC) a proposal that auditors specifically discuss “close call” situations where a potential issue regarding going concern had been identified, but where it was ultimately not considered to be a material uncertainty. This would effectively have created a “fourth category” of



situation and accompanying judgments, in addition to the “three category”² approach embodied in the current financial reporting and audit models of going concern.

The Board listened to respondents’ views and the same ITC proposal on “close calls” is not carried over explicitly in the Exposure Draft. However, as a result of the proposed construct of key audit matters, the practical issue remains. Under the IAASB key audit matters proposals (and the PCAOB’s similar critical audit matters proposals), auditors will almost certainly consider that such “close call” situations would be discussed with the audit committee and hence could constitute a key audit matter and require discussion in the auditor’s report. Our own internal field testing of the proposals for key audit matters has shown that some audit engagement teams consider that going concern issues, particularly where there is the possibility of a material uncertainty, constitute a key audit matter.

We consider this to be a practical issue that will pose very real problems on implementation, in the absence of further deliberation by the IAASB and, potentially, further guidance. It will result in imbalance in the reporting model, as there is no related concept in the IFRS financial reporting literature, and hence no compulsion on management to disclose such situations. It would also change the trigger point for public reporting on going concern as compared to the current ISA 570 model and may require a different set of judgments from those presently required under ISA 570.

Some of these practical difficulties may be mitigated by the fact that the matters giving rise to discussion with the audit committee may often be described by reference to the individual underlying facts and circumstances (for example “risks to the business model” or “borrowing facilities”) rather than using the specific “going concern” label. Nevertheless, depending on how such matters are described in the auditor’s report, they could be construed by the reader as representing similar risks to a matter that is described when the auditor has determined that there is a going concern uncertainty. There is a risk that commentary in key audit matters on such matters could be perceived as undermining the proposed auditor’s “standard” statements on going concern.

We believe this to be the most significant of a number of issues pertaining to the relationship between the key audit matters and going concern sections of the auditor’s report and urge the Board to clarify its intentions in this area. As noted elsewhere in our response, we suggest scoping out going concern matters from proposed ISA 701 and explaining that such matters will be dealt with in ISA 570 (including “close call” situations in due course). Another consideration, as we note further below, is that the Board has itself acknowledged that there may be an option to defer finalisation of the auditor reporting elements relating to going concern pending further deliberation by the IAASB and related developments by other standards setters. The difficulties posed by “close calls” could be part of that further deliberation.

Other aspects of the interrelationship between key audit matters and going concern

We welcome the fact that the Board listened to respondents’ views on the ITC by including all the going concern related elements in one place in the illustrative auditor’s report.

As mentioned above, the IAASB notes that a going concern material uncertainty would, by its nature, be a key audit matter. However the Exposure Draft also notes that the Board believes that information relating to a material uncertainty should be presented in the Going Concern section of the report to give it appropriate emphasis.

We believe there are pros and cons as to whether going concern matters could be included within key audit matters or, as proposed in the Exposure Draft, in a separate section. Some of the advantages of inclusion in key audit matters are: (i) it would help avoid the impression the auditor is reporting on going concern separately from the audit of the financial statements; (ii) where there is an issue, going concern will be a key audit matter

² Situations in which there is no material uncertainty regarding going concern; situations when there are material uncertainties; and situations when use of the going concern basis is no longer appropriate and the liquidation basis should be used.



discussed with the audit committee; and (iii) it may aid consistency in treatment where auditors judge that a “close call” situation also qualifies as a key audit matter, as discussed above.

Against this, some of the difficulties of inclusion of going concern matters in key audit matters are: (i) auditor’s reports on non-listed companies may not include a key audit matters section; (ii) where there are no issues or uncertainties regarding going concern, it is questionable as to whether the matter should be elevated as a key audit matter; and (iii) highlighting a matter as a key audit matter may have unintended consequences (for example, provoking undue concern among investors and other users of reports, particularly in the case of financial institutions).

On balance, we believe inclusion in the illustrative auditor’s report of a separate section headed going concern is appropriate. However, the IAASB, in finalising these proposals, should give further thought to the interaction between key audit matters and going concern and the impact on international convergence and should consider providing further guidance.

Related developments in accounting standards setting

The Exposure Draft notes that many ITC respondents stressed the importance of the IAASB working with others to develop a holistic and more integrated solution that considers enhanced financial reporting, corporate governance and audit responsibilities to achieve greater transparency into going concern judgments, which we continue to support.

Projects looking at financial reporting aspects of going concern are under way at the IASB and FASB, though these have differing scopes and objectives. In addition, the PCAOB has a project on auditing aspects of going concern and the UK FRC continues to deliberate on how best to implement the recommendations from the report of the *Sharman Panel of Inquiry on Going Concern and Liquidity Risks*. None of these projects is likely to be far advanced during the comment period of this Exposure Draft.

The Board notes in paragraphs 84 and 85 of the Explanatory Memorandum that further changes to ISA 570 may be required once future amendments to the underlying accounting standards are known and acknowledges that there may be an option to defer finalisation of the auditor reporting elements related to going concern.

An area of discussion by some commentators has been whether disclosure of going concern uncertainties should be before or after considering mitigating actions by management. This Exposure Draft presumes the current financial reporting model and audit work effort in ISA 570 apply (i.e., disclosure is after taking account of mitigating actions). Waiting for clarification of the financial reporting aspects and the Board’s broader ISA 570 project may allow this question to be clarified.

We therefore strongly urge the Board to continue to use its best efforts to work for enhanced understanding and international convergence on management and auditor reporting on going concern. Some of the above-mentioned financial reporting standard setting developments may lead to enhanced and expanded reporting by companies in this area, and this may mitigate some of the more challenging issues (such as the “close call” situations) outlined above.

We believe the Board should weigh carefully the merits of introducing the going concern elements of these proposals now – for which there is undoubted demand by some stakeholders – against deferring their introduction in the light of potential financial reporting changes and the knock-on impact on ISA 570, and some of the practical implications of the Exposure Draft proposals (in particular, the key audit matter “close call” situations) which do not sit well with the present ISA 570 model.



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 be required in the auditor's report whether or not a material uncertainty has been identified?

We believe a statement that the going concern basis cannot be guaranteed should be included whether a material uncertainty is identified or not. In both cases, the going concern basis of accounting is considered appropriate, and therefore it would seem logical to include the same "health warning".

However, to avoid the perception that the auditors are making a statement on behalf of management, we suggest the wording could be amended to "*However, it is not possible for any party, including the auditor, to guarantee the Group's ability to continue as a going concern*".

This is consistent with our view, emphasised in previous responses to the IAASB (including in relation to the ITC) that disclosures regarding going concern, whether made by management or the auditors, should help clarify for users that such disclosures should not be viewed as a self-standing guarantee of the entity's viability.

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 are generally supportive of including further details on the independence and other ethical requirements in the auditor's report. An explicit statement of the independence and other ethical requirements in the body of the auditor's report may clarify the auditor's responsibilities and support effective communication. However, we note that this is an area where the IAASB proposal differs from the proposed PCAOB requirement to state in the auditor's report that the auditor "*is required to be independent with respect to the company in accordance with the United States federal securities laws and the applicable rules and regulations of the SEC and PCAOB*". We believe that different statements with respect to the compliance with independence and ethical requirements across territories are potentially confusing to the users of auditor's reports. Therefore, we encourage the IAASB to work with the PCAOB in order to achieve convergence of the respective reporting requirements.

Paragraph 28(c) of proposed ISA 700 requires the auditor to identify the relevant ethical requirements or applicable law or regulation. An audit firm may be subject to mandatory ethical requirements (such as legal requirements) or voluntary requirements (such as ethical requirements within an audit firms' network). Although not explicitly stated in the proposed standard, we presume that reference in the auditor's report should be made to the mandatory ethical requirements.

It is also our understanding that in a group audit situation the proposed requirement to "*include a statement that the auditor is independent of the entity within the meaning of the [relevant ethical requirements of applicable law or regulation] and has fulfilled the auditor's other responsibilities under those ethical requirements*" (ISA 700 (revised), par. 28(c)) applies to the responsible group auditor issuing the group auditor's report. This would mean that the relevant ethical requirements that need to be stated refer to the requirements to which the group auditor is subject. We do not read the proposed standard to require the auditor to, and we do not believe it necessary or helpful to the reader to, also explicitly state ethical requirements with which component auditors need to comply (e.g., local territory requirements where they may differ). However, we believe the proposed requirement could be misunderstood and therefore recommend that, if retained, it be clarified in the final standard that, in a group audit situation, reference should be made to the ethical requirements including independence applicable to the group auditor regardless of any local ethical requirements that may exist in a component auditor's jurisdiction.



Disclosure of engagement partner name

- 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 were pleased that the IAASB's proposed requirement to include the name of the engagement partner includes an exception for circumstances when such disclosure is reasonably expected to lead to a significant security threat to the individual.

However, as we stated in our response letter on the IAASB's ITC, we are not convinced that disclosure of the audit engagement partner's name increases either accountability or audit quality, although we acknowledge that some would like this transparency. We continue to believe that such requirements are best addressed in national requirements, which can identify the appropriate vehicles and address legal implications. However, if the Board continues to include a requirement to disclose the name of the audit engagement partner for audits of financial statements of listed entities, we believe the requirement should apply only if the audit engagement partner's name is "not otherwise publicly available."

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?**

Improved description of the responsibilities of the auditor and key features of the audit (paragraphs 35-38 and related application material):

While acknowledging that the significantly expanded descriptions of the responsibilities of the auditor and the key features of the audit proposed in paragraphs 35-38 may be viewed by some as helpful, we are not convinced that the auditor's report is the best vehicle for providing a more detailed overview of the audit. A summary in the auditor's report will inevitably be incomplete in relation to the ISAs themselves. For example, the proposed summary refers to matters addressed in some standards (for example, ISAs 240 and 315), but does not mention others (for example, the auditor's consideration of illegal acts in ISA 250, or related parties in ISA 550, or the evaluation of misstatements in ISA 450). In addition, in trying to write the summary in plain English rather than use the words directly from the standards, there is a risk that the meaning is unintentionally changed. Both of these examples illustrate that the complexity of the subject does not make it readily susceptible to succinct description, and attempts to do so may increase rather than lessen the expectations gap. This may be particularly the case given that the IAASB is proposing to substantially amend the standard wording in the auditor's report in comparison to the auditor's reports of other jurisdictions.

We believe that there would be significant benefit in the standard description of the auditor's responsibilities and key features of an audit being the same in all auditor's reports. The auditor's responsibilities and key features of an audit are fundamentally the same regardless of the auditing standards being followed; therefore, having different descriptions runs the risk of confusing rather than informing users of the financial statements. We continue to encourage the IAASB to work with other standard setters such as the PCAOB, which proposed only limited changes to the standard wording in their proposed standard, to achieve consistency. In fact, for the reasons stated above, we question whether the advantages of the longer description proposed in the IAASB's Exposure Draft are worth creating a substantive difference with the PCAOB's proposed wording. There is no compelling need to change the existing standard wording as it is consistent with the extant standards, and, therefore, it could be retained in order to maintain greater alignment between the PCAOB and IAASB reports.



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, or for reference to be made to such a description on the website of an appropriate authority (paragraphs 39-40 and related application material):

Eliminating proposed changes to the descriptions of the responsibilities of the auditor and key features of the audit obviates the need to relocate expanded descriptions elsewhere. We continue to believe it is important to retain in the body of the auditor's report statements describing the respective responsibilities of the auditor, management and those charged with governance. Although these statements are "standard wording", these paragraphs communicate the fundamental roles in the corporate financial reporting model and, as such, we believe they should remain an integral part of the core content of the auditor's report.

Reference to whom in the entity is responsible for overseeing the Company's financial reporting process (paragraph 33 and related application material):

We support the requirement in paragraph 33(b) of proposed ISA 700 (Revised) to describe in the auditor's report the responsibilities of those in the organisation that are responsible for oversight of the financial reporting process, where those responsible for oversight are different from those responsible for the preparation of the financial statements.

We believe application guidance should be included in proposed ISA 700 (Revised) that illustrates report language that might be appropriate where those responsible for oversight of the financial reporting process are the same as those responsible for the preparation of the financial statements.

Other reporting responsibilities (paragraph 41 and related application material):

We support the requirement in paragraph 41 of proposed ISA 700 (Revised) that other reporting responsibilities in the auditor's report that may be required by law or regulation in addition to the auditor's responsibilities under the ISAs should be clearly differentiated from reporting required by the ISAs, but need not be included in a separate section *Report on Other Legal or Regulatory Requirements* as required by extant ISA 700.

- 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 believe the IAASB's decision not to mandate the ordering of sections of the auditor's report, but rather to use illustrative reports, as well as the order in which the requirements are presented in proposed ISA 700 (Revised), to indicate the IAASB's preferred ordering, strikes the right balance in promoting adoption of the report form preferred by the IAASB while providing flexibility in reporting to national standard setters.

We believe the requirement in paragraph 47(b) to include, at a minimum, each of the elements set out in paragraph 46(a)-(n) calls into question the ability of auditors conducting an audit in accordance with the auditing standards of a specific jurisdiction to make reference to the ISAs in the same auditor's report, even when the performance of such an audit fully complies with the ISAs. For example, it would appear that a PCAOB auditor's report could not reference the ISAs given the differences in reporting requirements with respect to independence, going concern, other information, and naming the engagement partner, as well as other report elements such as those addressed below. As a result, we believe it is important for the Board to consider flexibility in establishing what the minimum reporting requirements should be when an audit is compliant with the ISAs, because the potential of having two reports on the same set of financial statements might be more confusing to users of the financial statements.



We believe certain elements required by paragraph 46 of the proposed ISA 700 (Revised) need clarification as described below.

Paragraph 46(i) requires that the auditor's report shall include "a description of the responsibilities of those responsible for the preparation of the financial statements." We believe clarification needs to be made that only the responsibilities of those responsible for the preparation for the financial statements need be included in the auditor's report, even when those responsible for the oversight of the financial reporting process are different from those responsible for the preparation of the financial statements.

Paragraph 46(j) requires that the auditor's report shall include a description of the auditor's responsibilities for an audit of the financial statements "in a manner that is not inconsistent with paragraphs 36-38." If the description of the auditor's responsibilities omits much of the content required by paragraphs 36-38, we believe the IAASB should clarify whether such omission constitutes an "inconsistency".

Other comments not specifically addressed by the Exposure Draft questions

Other Information

Paragraph 31 of proposed ISA 700 (Revised) requires that the auditor report in accordance with proposed ISA 720 (Revised) and includes a footnote reference to the Exposure Draft, Proposed ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information in Documents Containing or Accompanying Audited Financial Statements and the Auditor's Report Thereon* (ED), which had a comment deadline of 14 March 2013.

If it appears that proposed ISA 720 (Revised) will not be available concurrent with the auditor's reporting standards when they are finalised, we believe that proposed ISA 700 (Revised) should require auditor reporting on other information that is consistent with the work effort in extant ISA 720, *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements*, until a revised standard is adopted.

As previously stated in our response letter on the IAASB's ITC, based on the auditor's extant responsibilities in ISA 720 to read other information, we support including in the auditor's report:

- a description of the auditor's responsibilities to read the other information in an entity's annual report (or equivalent). Stakeholders may not understand these responsibilities and may presume greater involvement by auditors than is the case. It is important, therefore, that the description clarify both the nature and limitations of the auditor's procedures in order to reduce rather than exacerbate this misunderstanding.
- an explicit statement as to whether, at the time of signing the auditor's report, the auditor is aware of any unresolved material inconsistencies between the other information and the audited financial statements. In doing so, certain practical issues will need to be considered: for example, situations when the other information is not available at the time the auditor's report is signed or when the auditor's report may be re-produced in a separate document containing additional or different "other information".

In our response letter on the Exposure Draft to revise ISA 720, we supported the IAASB's desire to "raise the bar" regarding the value auditors can contribute to the quality of other information reported by companies but found the Exposure Draft fundamentally flawed, moving away from the clarity of extant ISA 720 by introducing ambiguity around the meaning of terms and the auditor's work effort. We also believed the proposed communication in the auditor's report describing the auditor's responsibilities was not sufficiently clear and would likely increase the expectations gap by causing users to draw unwarranted assurance.

In moving the proposed revision of ISA 720 forward, we encourage the IAASB to avoid rushing to meet an arbitrary deadline in favor of exploring all available approaches including, for example, consideration of the responses to the PCAOB's proposed Other Information standard. In addition, we believe both the possibilities for, and the limitations of, a revised ISA 720 could be clarified by considering what else, by contrast, might be



needed at some future time to provide assurance on selected other information (for example, developing an International Standard on Assurance Engagements (ISAE) directed towards Other Information).

Key audit matters and Other Information reporting when an adverse opinion is expressed

The requirements in proposed ISA 700 (Revised) related to key audit matters and to Other Information would apply to an auditor's report expressing an adverse opinion. If the auditor expresses an adverse opinion, we believe the most important matter to investors and other financial statement users would be the reason for the adverse opinion and that communication of key audit matters and statements regarding Other Information may overshadow the importance of the matter(s) giving rise to the adverse opinion. Accordingly, we recommend that the IAASB prohibit key audit matters and Other Information reporting in an auditor's report expressing an adverse opinion. We acknowledge that with respect to a disclaimer of an opinion, in addition to excluding these items, the IAASB has also excluded the proposed auditor statements related to going concern and the description of the auditor's responsibilities; however, we believe these report elements should still be required for an auditor's report expressing an adverse opinion.



Appendix 3

Changing the trigger points for reporting

As explained in our response to Q2, we believe there are at least five areas in which we feel the current requirements and guidance for key audit matters could have the effect of triggering reporting at an earlier point, in effect “lowering the threshold” for the point at which information is communicated to the markets: suspected illegal acts, fraud, deficiencies in controls, going concern and identified misstatements.

Each of these could involve “*significant auditor attention in performing the audit*”, involve “*significant auditor judgment*”, could be “*areas in which the auditor encountered significant difficulty during the audit*”, and could require “*significant modification of the auditor’s planned approach*”. We explain below what we perceive to be the challenges, and potential for unintended market consequences, of lowering the threshold for reporting of each of these matters:

- **Illegal Acts:** Responses to the International Ethics Standards Board for Accountant’s Exposure Draft on Suspected Illegal Acts articulated well the significant negative unintended consequences for all market participants of shifting current models of reporting of suspected illegal acts. National regulations and legislation have been enacted after weighing the benefits of professional obligations of confidentiality and who should be responsible for reporting illegal activity. Auditors are not experts in law and the requirement to disclose suspicions – even if it involved significant auditor judgment and focus on the audit engagement – could create significant unwarranted harm to companies and their shareholders, which would be further compounded in litigious environments.
- **Fraud:** Similar considerations apply to suspected fraud. The auditor is responsible under ISA 240 for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error, including fraudulent financial reporting or misappropriation of assets. ISA 240 discusses the auditor’s responsibilities to respond to a suspected fraud, the implications when forming the audit opinion, considerations if the auditor is unable to continue the engagement, required communications to management and those charged with governance, and considerations regarding communicating to regulatory and enforcement authorities. These are carefully balanced responses to matters that could have serious consequences for all involved.

For both illegal acts and fraud, there is an inherent unfairness in public reporting of suspicions on matters that will ultimately require courts to judge.

- **Internal control deficiencies:** Further to our comments in response to Q2, an audit conducted in accordance with ISAs is not designed with the objective of obtaining sufficient appropriate audit evidence to be able to form an opinion on the design, implementation and operating effectiveness of the entity’s internal control. One of the overarching principles we articulate in Appendix 1 is that auditor reporting should be sufficiently similar to facilitate users’ comparison of the underlying economic reality / state of affairs of different entities. That would not be the case if the auditor were required to identify significant deficiencies in internal control. Auditors who adopted different audit approaches may or may not have tested particular internal controls and, therefore, may or may not have identified particular deficiencies. In other jurisdictions, the threshold for public reporting is “material weaknesses”, which is not a threshold embedded in ISA 265. The definition of “significant deficiencies” is, in itself, based on auditor judgment (for valid reasons given the overall context of the audit engagement). For these reasons, readers could draw unwarranted conclusions about the quality of the entity’s internal control from disclosure of only those internal control matters that came to the auditor’s attention as a result of the audit approach adopted. If users would value assurance regarding the design, implementation and operating effectiveness of internal control over financial reporting, there should be a separate engagement designed to obtain the audit evidence necessary for a complete and unbiased opinion thereon – as is the case in a number of jurisdictions.



- **Going concern “close calls”:** The current audit and financial reporting models link disclosures regarding the entity’s ability to continue as a going concern to circumstances when there is a material uncertainty. A number of standard setters and other bodies have been revisiting how solvency and liquidity risks and going concern are dealt with in corporate reporting, including whether earlier disclosure or disclosure based on different criteria would be appropriate – e.g., the Sharman Inquiry in the UK, and the FASB project in the US. To date, the discussions are ongoing and consensus not yet reached. Including “close calls” regarding going concern (i.e., circumstances when events or circumstances raise doubt, triggering additional work effort, but the auditor is ultimately able to conclude that a material uncertainty does not exist) as a key audit matter would change the trigger point for public reporting regarding going concern. A model that anticipates earlier disclosure may be entirely appropriate, but if done through the auditor’s report alone, it would result in the auditor being the source of original information, and, in the absence of a more clearly articulated framework for when such disclosures should be made, could result in a fairly significant likelihood of inconsistency in the nature and timing of disclosures for which there may be a significant market reaction. As we stated in our response to the ITC, this is an area that requires a holistic solution for auditors, management and those charged with governance collectively.
- **Identified misstatements:** The financial reporting model is premised on the financial statements communicating information that could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements (ISA 320) – in essence, there is a common understanding that materiality sets a threshold for reporting. In the audit, misstatements may be identified that are corrected, or remain uncorrected but are immaterial individually or in aggregate. The evaluation of identified misstatements and determination of whether or not the financial statements as a whole are free of material misstatement is an audit judgement that can involve significant auditor attention. However, disclosing uncorrected misstatements is inconsistent with that established and understood threshold for reporting. Unwarranted conclusions might be drawn given that it would not be a complete population of all immaterial misstatements because the audit is focussed on identifying *material* misstatements. If a matter(s) is not sufficiently material to require adjustment to the financial statements, it is difficult to see how it would be logical to consider it to be a key audit matter, even if there had been significant auditor attention focussed on the determination of whether it is material, individually or in aggregate with other uncorrected misstatements. Materiality is the appropriate threshold for reporting.