

# CONSULTATIONS

## IAASB EXPOSURE DRAFT - REPORTING ON AUDITED FINANCIAL STATEMENTS

### ABOUT AIA

The Association of International Accountants (AIA) was founded in the UK in 1928 as a professional accountancy body and from conception has promoted the concept of 'international accounting' to create a global network of accountants in over 85 countries worldwide.

AIA is recognised by the UK government as a recognised qualifying body for statutory auditors under the companies act 2006, across the European Union under the mutual recognition of professional qualifications directive and as a prescribed body under the companies (auditing and accounting) act 2003 in the Republic of Ireland. AIA also has supervisory status for its members in the UK under the money laundering regulations 2007.

AIA promotes and supports the advancement of the accountancy profession both in the UK and internationally. The AIA exams are based on international financial reporting and international auditing standards and are complimented by a range of variant papers applicable to local tax and company law in key jurisdictions together with an optional paper in Islamic accounting.

AIA members are fully professionally qualified to undertake accountancy employment in the public and private sectors.

## AIA RESPONSE

The AIA welcomes the opportunity to comment on this exposure draft. The IAASB provided a detailed set of questions and the AIA's responses are provided below.

### KEY AUDIT MATTERS

1. DO USERS OF THE AUDITED FINANCIAL STATEMENTS BELIEVE THAT THE INTRODUCTION OF A NEW SECTION IN THE AUDITOR'S REPORT DESCRIBING THE MATTERS THE AUDITOR DETERMINED TO BE OF MOST SIGNIFICANCE IN THE AUDIT WILL ENHANCE THE USEFULNESS OF THE AUDITOR'S REPORT? IF NOT, WHY?

The AIA believes that the usefulness of this section will depend upon the information that is actually disclosed. The answer to this question is effectively implicit in the answers to the other questions in this section.

In principle, this proposal may allow for some "fine tuning" of the audit report. Users will be able to identify areas in which the auditor has had to apply professional judgement and may, therefore, be better informed as to which figures are at greater risk of misstatement.

The AIA's concern is that the inclusion of matters in the statement of key matters may be viewed as an alternative to modifying the audit report in certain circumstances. The auditor's independence may be compromised if preparers of financial statements attempt to persuade the auditor to issue an unmodified report with a contentious item described in the key audit matters rather than modifying the audit report with respect to that item.

The AIA notes that users have expressed a desire to be informed of matters involving audit judgement and so the IAASB will appear to be responsive to users' wishes.

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?

Notwithstanding the reservations expressed with respect to point 1 above, the AIA believes that the guidance offered on the identification of key audit matters is sound.

The proposals clearly require the comprehensive reporting of matters that have involved significant judgement, not just those for which reservations remain after that judgement has been exercised and discussed. This will require some education of users of audited financial statements. It will have to be made clear that key audit matters are not necessarily subject to doubt or challenge.

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?

The AIA believes that sufficient guidance has been provided in this regard.

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.

To an extent, the illustrative examples could almost become boilerplate because they deal with matters that are likely to involve audit judgement whenever they arise. The AIA believes that it would be unfortunate if this became the norm because informed users are likely to be able to identify such problem areas for themselves.

5. DO RESPONDENTS AGREE WITH THE APPROACH THE IAASB HAS TAKEN IN RELATION TO KEY AUDIT MATTERS FOR ENTITIES FOR WHICH THE AUDITOR IS NOT REQUIRED TO PROVIDE SUCH COMMUNICATION – THAT IS, KEY AUDIT MATTERS MAY BE COMMUNICATED ON A VOLUNTARY BASIS BUT, IF SO, PROPOSED ISA 701 MUST BE FOLLOWED AND THE AUDITOR MUST SIGNAL THIS INTENT IN THE AUDIT ENGAGEMENT LETTER? IF NOT, WHY? ARE THERE OTHER PRACTICAL CONSIDERATIONS THAT MAY AFFECT THE AUDITOR’S ABILITY TO DECIDE TO COMMUNICATE KEY AUDIT MATTERS WHEN NOT OTHERWISE REQUIRED TO DO SO THAT SHOULD BE ACKNOWLEDGED BY THE IAASB IN THE PROPOSED STANDARDS?

The AIA believes that it may be preferable to avoid the potential inconsistencies that may arise from permitting voluntary reporting. For example, what are the implications for the auditor’s liability in the event that no voluntary disclosures are offered and it is subsequently alleged that a user of the audited financial statements has been misled by the decision to refrain from providing such information?

The AIA believes that any voluntary disclosure should be in accordance with the requirements of ISA 701.

The decision to offer voluntary disclosures should be discussed with management at the earliest possible stage, ideally before the appointment has been accepted. Management may feel that it is inappropriate for the auditor to modify the terms of the engagement by extending the audit report to include a voluntary disclosure of key audit matters.

One concern is how the lack of a report will be interpreted. It may not be clear to users whether the auditor has not reported on key audit matters because no such matters were identified or because the auditor’s policy is not to report on such matters on a voluntary basis.

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?

The AIA agrees with the suggestion that there ought to be the possibility of a nil return in the event that there are no matters requiring disclosure. Forcing the identification of disclosures when none are truly warranted may simply confuse users by drawing undue attention to insignificant matters.

Given the fairly generic nature of the illustrative examples offered, the AIA believes that it is unlikely that there will be many audits for which a nil return is justifiable.

The AIA supports the proposed requirements in this area.

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?

The AIA agrees that these disclosures should be limited to the period under review.

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?

The AIA agrees with the retention of emphasis of matter paragraphs and other matter paragraphs. The AIA believes that these paragraphs fulfil a very different purpose to the proposal concerning key audit matters and that auditors should retain the ability to provide these disclosures.

#### GOING CONCERN

9. DO RESPONDENTS AGREE WITH THE STATEMENTS INCLUDED IN THE ILLUSTRATIVE AUDITOR'S REPORTS RELATING TO:

(A) THE APPROPRIATENESS OF MANAGEMENT'S USE OF THE GOING CONCERN BASIS OF ACCOUNTING IN THE PREPARATION OF THE ENTITY'S FINANCIAL STATEMENTS?

(B) WHETHER THE AUDITOR HAS IDENTIFIED A MATERIAL UNCERTAINTY THAT MAY CAST SIGNIFICANT DOUBT ON THE ENTITY'S ABILITY TO CONCERN, INCLUDING WHEN SUCH AN UNCERTAINTY HAS BEEN IDENTIFIED (SEE THE APPENDIX OF PROPOSED ISA 570 (REVISED))?

IN THIS REGARD, THE IAASB IS PARTICULARLY INTERESTED IN VIEWS AS TO WHETHER SUCH REPORTING, AND THE POTENTIAL IMPLICATIONS THEREOF, WILL BE MISUNDERSTOOD OR MISINTERPRETED BY USERS OF THE FINANCIAL STATEMENTS.

The AIA is concerned that the wording of the illustrative material may prove unhelpful. For example, will a lay reader fully appreciate that the going concern assumption may have a dramatic effect on reported profit or on the valuation of assets?

The final sentence is also potentially misleading. Some readers may misread the word “guarantee” in this context to mean that neither management nor the auditor can promise to make good any losses in the event that the entity fails. It may be clearer to rephrase that sentence. Replacing “guarantee” with “be certain of” would eliminate this ambiguity.

10. WHAT ARE RESPONDENTS’ VIEWS AS TO WHETHER AN EXPLICIT STATEMENT THAT NEITHER MANAGEMENT NOR THE AUDITOR CAN GUARANTEE THE ENTITY’S ABILITY TO CONTINUE AS A GOING CONCERN SHOULD BE REQUIRED IN THE AUDITOR’S REPORT WHETHER OR NOT A MATERIAL UNCERTAINTY HAS BEEN IDENTIFIED?

The AIA is concerned that such a boilerplate statement may do little to inform readers and it may also do very little to protect auditors from criticism in the event that a company does fail after receiving a clean audit report.

In some respects it would be potentially more useful to encourage auditors to use the key audit matters paragraphs to highlight specific cases where going concern was raised as an issue during the audit.

#### 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?

The AIA does not believe that there is great benefit in making such disclosures. Informed users will be aware of the safeguards in place to maintain auditor independence. Less informed users may draw comfort from such reassurance, but it is unlikely to deepen users’ understanding of the relationships or of the safeguards in place to maintain independence.

#### DISCLOSURE OF THE NAME OF THE ENGAGEMENT PARTNER

12. WHAT ARE RESPONDENTS’ VIEWS AS TO THE PROPOSAL TO REQUIRE DISCLOSURE OF THE NAME OF THE ENGAGEMENT PARTNER FOR AUDITS OF FINANCIAL STATEMENTS OF LISTED ENTITIES AND INCLUDE A “HARM’S WAY EXEMPTION”? WHAT DIFFICULTIES, IF ANY, MAY ARISE AT THE NATIONAL LEVEL AS A RESULT OF THIS REQUIREMENT?

The AIA does not support this proposal. Audit firms do not give engagement partners unfettered freedom to resolve matters of professional judgement and so the naming of the partner may actually undermine transparency rather than enhancing it. The final decision to express a particular audit opinion will almost certainly involve collaboration and consultation within the audit firm and a corporate signature may highlight that fact.

#### 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?

The AIA supports any proposal that may enhance the clarity and usefulness of the audit report.

The AIA does not believe that it is practical to ensure that the precise wording of an audit report can ever be totally free of ambiguity when read by a lay person.

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?

The AIA believes that a consistent ordering of the sections is desirable in order to enable users of audited financial statements to identify concerns quickly and easily. Having said that, a mandatory format may be impractical given that different legal or other regulatory systems may impose their own structure.

## FURTHER INFORMATION

The above replies represent our comments upon this consultation document. We hope that our comments will be helpful and seen as constructive. AIA will be pleased to learn of feedback, and to assist further in this discussion process if requested.

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