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November 29, 2013

Mr. James Gunn
Technical Director
International Auditing and Assurance Standards
Board
529 Fifth Avenue, 6th Floor
New York NY 10017
USA

by electronic submission

Dear James,

Re.: Exposure Draft: Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs)

We would like to thank you for the opportunity to provide the International Auditing and Assurance Standards Board (IAASB) with our comments on the Exposure Draft: Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs) (hereinafter referred to as "the draft").

As we mentioned in our comment letter to the IAASB dated October 8, 2012 on the Invitation to Comment, "Improving the Auditor's Report" (hereinafter referred to as our "ITC comment letter"), because the auditor's report is often the only product of the audit that external users see, auditor reporting is closely linked by users to the value of audits. If the value of an audit and perceptions thereof can be increased within the context of the related costs and risks by including more information in auditors' reports, then this should be attempted. For this reason, and the discussions about the content of the auditor's report in the EU and at the PCAOB, we consider this exposure draft to be both necessary and timely.

We would like to refer to the principles that we identified in our ITC comment letter, which form the basis for our response in this comment letter. In this context, we would like to emphasize that our comment letter is restricted to matters that relate to improving auditor reporting only, without consideration of matters in connection with the modernization of the audit or expansions of audit

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
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scope. These latter issues are important too, but may need to be considered by the IAASB in future. However, as we pointed out in our ITC comment letter, while the IAASB has a political role in discussions about expansions of audit scope, having the audit of the financial statements cover information other than the financial statements is a matter that can only be determined by legislators, regulators and terms of engagement. For this reason, we are convinced that changes to ISA 720 that go beyond reporting on what is currently required in extant ISA 720 is not a matter for the auditor reporting project, but is in fact a broader issue relating to the scope of the audit that needs separate treatment.

Since comment letters on this exposure draft are not likely to have been analysed prior to March 2014, we expect the IAASB not to be in a position to make the results of its public consultation on this exposure draft known until after the March 2014 IAASB meeting. However, we are aware that the discussions of the European Commission, the European Parliament and the Council of Ministers on matters of audit policy, including on the content of the auditor's report, are due to be finalized soon, and indeed, may have been completed by early next year. We therefore urge the IAASB to maintain an intense dialogue with the European Commission, the European Parliament, and the Presidency of the Council of Ministers so as to help minimize the risk that the final European legislation is at variance with the IAASB's proposals.

We also note that the PCAOB issued proposed auditing standards, that were released on August 13, 2013, on auditor reporting with proposals that are in many ways similar to those of the IAASB, but that also contain differences. We encourage the IAASB to engage with the PCAOB to seek to minimize differences for audits of financial statements of listed entities.

We have responded in Appendix 1 to this letter to the questions posed by the IAASB in the exposure draft.

In summary, we would like to take issue with the following matters.

We are not convinced that the proposals for including key audit matters (KAM) will necessarily alleviate all investor concerns about more informative auditors' reports, but we also note that KAM may serve to reduce user expectation gap with respect to the nature of the audit opinion when the financial statements contain matters requiring considerable auditor judgment. We therefore believe that the inclusion of key audit matters in auditors' reports is to be welcomed. However, we are not convinced that the IAASB has developed a sufficiently clear definition or robust criteria for the identification of KAM. In particular, we believe that the definition should be based on the decision usefulness of KAM for users and that the starting point for the criteria that filter out KAM from other matters ought to be the concepts of significant risks of material misstatement and matters requiring considerable auditor judgment. While, as a matter of principle, we would prefer that KAM be required for all audits of complete sets of general purpose financial statements – not just for listed entities – we recognize that at this stage KAM has been designed with investors in listed entities in mind, that the introduction of KAM is somewhat experimental, and that its introduction would engender considerable audit costs for non-listed entities. For these reasons, we accept limiting the requirement for KAM to audits of complete sets of general purpose financial statements of listed entities. However, if the requirement for KAM is limited in this way, ISA 701 ought to emphasize more clearly that law, regulation, national standards or the terms of engagement cannot prohibit KAM for other audits without such audits ceasing to be ISA audits. In this respect, ISA 210 ought to require that the terms of engagement clarify this matter. In addition to noting when KAM may not be appropriate in certain instances, for example, due to law, regulation or ethical requirements, ISA 701 also ought to provide for consistent application of KAM over time by auditors when KAM is not required, rather, than having auditors include KAM in one year and not the next. We also believe that KAM should be permitted – but not required – for ISA 800 and 805 audits.

We largely support the IAASB's proposals on going concern, but we are not convinced that listing, in the auditor's report, the sources of ethical requirements is practicable: the statement should be limited to an assertion of compliance with relevant ethical requirements. We also believe that it is not in the interests of preparers or users at an international level to include such a high degree of flexibility in the structure of ISA 700 beyond that needed to comply with law, regulation or national standards (when the auditor refers to both ISAs and national standards).

We hope that our views will be helpful to the IAASB in its deliberations on the form and content of the auditor's report. If you have any questions relating to our comments in this letter, we would be pleased to be of further assistance.

Yours truly,

Klaus-Peter Feld
Executive Director

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494/584

APPENDIX 1:
Responses to the Questions Posed In the Framework

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?**

   As we mentioned in our ITC comment letter, as a matter of principle we welcome the idea that the auditor's report provide more relevant information to users (note: when we speak of users in our comment letter, we mean "intended users", which may be narrower than "users", depending upon the jurisdiction and financial reporting framework, and are referring to "external users" – that is, neither management nor those charged with governance, who have additional access to information about the audit) of financial statements because it would increase the value of audits to users. However, it seems to us that based on our roundtable of users, regulators, and preparers for the ITC and from our consultation with members of our profession, not enough research has been done to determine which information is really of interest to users and what they would do with that information if it were available through the auditor's report.

   For this reason, we do not believe that we are able to conclude as to whether the introduction of Key Audit Matters (KAM) into the auditor's report will in fact enhance the usefulness of the auditor's report for audits of complete sets of general purpose financial statements. In particular, we expect a continuing danger of boilerplate and user misunderstanding of the nature of KAM (with the resulting increase in the expectations gap) in this respect to remain. On the other hand, we note that the inclusion of KAM may provide users with additional information about matters in the financial statements involving auditor judgment and that therefore the expectations gap may also be reduced with respect the nature of the audit opinion. For these reasons, overall we believe that the arguments for including some form of KAM in such auditors' reports outweigh the arguments against. It is therefore important that the IAASB use the Implementation Monitoring Project to review the application of KAM in practice after a few years of experience in practice.

We welcome the fact that KAM is focused on having the auditor report on matters that are important to the audit, and that therefore KAM no longer serves the purpose of having the auditor help users "navigate" through the financial statements, which we believe is the role of management – not the auditor.

However, in this context, we believe that the IAASB has not emphasized the purpose of KAM in relation to user needs enough. Ultimately, like the content of the financial statements depends on the financial information needs of users, the contents of auditors' reports must be driven by the information needs of users with respect to the audit. It is inconsistent to claim, on the one hand, that auditors must use their judgment to determine materiality for the financial statements and consider materiality for the fair presentation of the financial statements based on the financial information needs of users, but at the same time claim that auditors are not able to determine what the contents of KAM ought to be based upon the auditor's judgment of the information needs of users with respect to the audit. We note that the application material (paragraphs A2, A4 and A5) does address user information needs, but we believe that this issue needs to be central to the decision of what ought to be KAM.

It is the lack of a connection to user information needs with respect to the audit that we believe causes some weaknesses in the proposed requirements and guidance in the draft for the determination of when audit matters ought to be KAM. We address these issues further in our response to Question 2 below.

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

We believe that the requirements and related application material in proposed ISA 701 provide the basis for an appropriate framework to guide auditor judgment in determining KAM, but we believe that there is room for further improvement. We have been informed that field tests undertaken in the firms appear to suggest that auditors intuitively identify those matters that they believe ought to be KAM. However, we do have some concerns that the factors as currently conceived may not lead to reasonably consistent auditor judgments about which matters ought to be KAM across firms and jurisdictions, and therefore may be difficult to enforce because regulators may have different views as to what is KAM: therefore the intuitive process applied by auditors needs to be reflected in a clear "filter".

As we note in our response to Question 1 above, basis for the determination of KAM must be user information needs with respect to the audit: the objective of KAM ought to be to increase the value to users of the auditor's report. Consequently, the filter gleaning matters of interest to users of the auditor's report that ought to be KAM needs to be based on the decision-usefulness of the information about the audit to users, which in turn depends upon the use to which auditors expect users to put that information.

However, in our view, KAM should not serve the objective of enabling users to ascertain the quality of the audit or to compare the quality between audits based on auditors' reports – KAM is solely a "value to users" proposition, not an "audit quality" evaluation instrument. This implies that the criteria for KAM need to be directed at enhancing the information about the audit for decision-making by users, rather than seeking to convey or differentiate audit quality.

The lack of a connection to the decision-usefulness to users of information provided in KAM leads to the requirements and guidance in proposed ISA 701 not including clear criteria that need to be applied in determining what matters ought to be KAM. We are not suggesting that the inclusion of clear criteria would alleviate the need for considerable auditor judgment in the determination of KAM, but we do believe that clear criteria would assist auditors in applying their judgment in a more decision-useful and consistent manner.

In summary, the main general weaknesses that we have identified with the approach in proposed ISA 701 for the determination of KAM are:

- The lack of a connection between the determination of KAM and the information needs of users in relation to the audit as well as the decision-usefulness of that information for those users, the lack of which leads to a definition of KAM that restricts KAM to those matters communicated to those charged with governance.

- Given the selection of KAM from those matters communicated with those charged with governance, lack of clarity in the requirements that failure by the auditor to communicate matters with those charged with governance that would otherwise be KAM (which, we recognize, would contravene ISA 260, but nevertheless is not an unreasonable scenario) does not relieve the auditor to communicate in the auditor's report such matters as KAM, we note a certain circularity in defining KAM as a subset of those matters communicated with those charged with governance, but then requiring in ISA 701.12 that all KAM be communicated to those charged with governance.
- The lack of a clear requirement (rather than just application material) that prohibits auditors from using KAM as a substitute for modifications of the auditor's opinion.
- The use of a relative test (matters of "most" significance in the audit), rather than an absolute test (e.g., "critical audit matters", which aligns with PCAOB nomenclature, but admittedly not approach), the former of which implies that the number of matters identified as KAM must always be similar across all audits and that, in contravention of the requirement in paragraph 13 of proposed ISA 701, there can never be no KAM.
- The lack of clear criteria that act as an effective filter for the determination of KAM from those matters communicated with those charged with governance (the current matters listed in paragraph 8 (a) to (c) are just "areas of significant auditor attention to take into account").

With respect to the factors identified in paragraph 8 of proposed ISA 710, we are not convinced that the factors mentioned in (b) and (c) on their own are relevant to the determination of whether matters ought to be KAM. For example, in relation to (b) an auditor may encounter a significant difficulty during the audit, including in obtaining sufficient appropriate evidence, but the difficulty is 1. not especially significant for decision-making by users because, though material, the matter is not critical to the financial statements, or 2. even though sufficient appropriate evidence may have been difficult to obtain, such evidence may have been conclusive once obtained, which would really not interest users.

Likewise, the fact that auditors may need to have significantly modified their audit approach as described in 8 (c) does not imply that this is necessarily of interest to users – particularly if the evidence obtained as a result is conclusive or the matters addressed are just material to the financial statements but not critical. This also applies to situations in which a significant internal control deficiency is identified. For example, if the auditor initially expects control risk to be low for a particular assertion, but determines, due to a significant deficiency in internal control, that such expectation is not appropriate and therefore changes the audit approach to substantive testing and thereby manages to obtain conclusive evidence for that assertion, this matter would not be of interest to users.

We also believe that matters involving significant auditor judgment as described in the second half of 8 (a) alone may not be necessarily of interest to users because, as ISA 230.08 (c) intimates, significant judgments may not necessarily relate to significant matters.

For these reasons, in accordance with our comment letter to the ITC, we continue to believe that unless the matter in question relates to a significant risk of material misstatement, the matter is not likely to be a matter that ought to be KAM. This means that the starting point for the determination of KAM ought to be whether a matter has been identified as a significant risk (or perhaps a high risk of material misstatement for which substantive procedures alone do not provide sufficient appropriate evidence and for which a significant deficiency in internal control is relevant). We note that the concept of significant risks of material misstatement is more than just an audit planning or risk assessment concept because under ISA 330.25 an auditor is required to evaluate before the conclusion of the audit whether the risks of material misstatement at the assertion level remain appropriate (which implies determining whether the identification of significant risks remains appropriate).

However, this does not imply that all such significant risks of material misstatement ought to be KAM. In particular, those risks that are always significant risks or are presumed to be significant risks under the ISAs (e.g., fraud risk, revenue recognition, management override of controls) need not be KAM unless the nature of such risks of material misstatement are of critical importance to the audit of the financial statements due to their being peculiar to the entity, the information about which would therefore also be decision-useful to users. This means that only those significant risks ought to be regarded as KAM that involve significant auditor judgment in relation to significant matters. Such auditor judgment would occur when the matter relates to significant management judgment as to the appropriateness of accounting treatment of recognition, measurement, presentation or disclosure issues, the use of grooming transactions, or in relation to auditor judgment that sufficient appropriate evidence has been obtained.

This approach would provide a clear set of criteria, directly related to items in the financial statements, to which auditors can apply professional judgment to filter out those matters that ought to be KAM.

For all of the reasons noted above, we believe that the definition of key audit matters (or, the nomenclature is brought in line with the definition and the suggested PCAOB term, "critical audit matters") in paragraph 7 of proposed ISA 701 ought to be as follows:

> "Those matters critical to the audit that the auditor judges are reasonably expected to influence decisions of intended users."

Application material would note that under ISA 260, matters critical to the audit would by definition be included as a subset of those matters required to be communicated to those charged with governance and that it is an absolute test – that is, depending upon the audit, there can be very few (or rarely, no) such matters, but that it is not generally expected that in any one audit more than several matters can be matters critical to the audit that are reasonably expected to influence decisions of intended users.

In relation to the criteria for the determination of KAM, we suggest that paragraph 8 be reworded as follows:

> "The auditor shall determine those matters that are key audit matters by:
>
> (a) Identifying those matters that have been identified as significant risks of material misstatement;
> (b) Excluding those risks of material misstatement that are always required to be treated as significant risks of material misstatement in an audit (the risk of material misstatement due to fraud[1], including the risk of management override of

[1] ISA 240, paragraph 27

controls[2]) or are always presumed to be a significant risks of material misstatement due to fraud (revenue recognition[3]), unless the nature of such risks of material misstatement are of critical importance to the audit of the financial statements due to their being peculiar to the entity, the information about which would therefore also be decision-useful to users.

(c) Excluding those significant risks of material misstatement not relating to significant management judgments about recognition, measurement, presentation or disclosure issues in the financial statements or grooming transactions, or not relating to significant auditor judgment that sufficient appropriate evidence has been obtained."

This approach would help clarify the filtering process that auditors intuitively use to identify KAM and would aid documentation and enforceability. In addition to the clear requirement in ISA 701.12 that those matters identified as KAM by the auditor shall be communicated to those charged with governance under ISA 260, another clear requirement is needed that KAM cannot be used as a substitute for modified opinions. The approach noted above would alleviate the need for a requirement that even if not communicated to those charged with governance, matters that would otherwise be KAM still need to be included as KAM, and would otherwise ameliorate the weaknesses we have identified in the approach proposed in the draft.

The draft also needs to clarify when KAM may not be appropriate. Generally speaking, KAM should not be used as a substitute for information about the entity that should normally be provided by management, but this would not preclude the provision of information about the entity needed to describe a matter from an audit perspective. More importantly, there may be circumstances when law, regulation or ethical requirements effectively prohibit the dissemination of information by the auditor. In these cases, the draft needs to recognize that there may be legitimate limitations on what can be included in KAM. For example, ISA 250.A19 notes that the duty of confidentiality may preclude the reporting of identified or suspected fraud or non-compliance with law or regulation.

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[2] ISA 240, paragraph 31
[3] ISA 240, paragraph 26

We note that the criteria proposed by the PCAOB for "critical audit matters" are not identical to the requirements and guidance in the draft, which means that what would be included in the auditor's report under each of these sets of standards might be different. Since there are many dual-listed entities, users might be confused as to why some matters are identified in one auditor's report and not in another, or if they are included in both, why they are described differently. We believe that the IAASB and the PCAOB need to cooperate to reduce the remaining differences to those required by U.S. securities laws and existing PCAOB standards to help reduce confusion among users and thereby improve the comparability of audit information in capital markets.

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?**

We believe that the proposed requirements and related application material in the draft 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. However, we believe that the reference to "to the extent the auditor considers it necessary as part of this explanation, its effect on the audit" to be a matter that would be expected to be necessary exceptional circumstances. This could be explained further in the application material.

Overall we consider it important to avoid the provision of audit conclusions that convey the impression that piecemeal opinions are being expressed.

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.**

Overall, we believe that the IAASB should focus its time and effort on getting the requirements and related guidance on the content of KAM right in the first instance before considering the content of the illustrative examples of key audit matters that ought to reflect those requirements and guidance. On the whole, we regard the illustrative examples as helpful. However, we do believe that the illustrative examples should be worded in a manner that is consistent with the requirements – in particular, that no audit conclusions that convey the impression that piecemeal opinions are being expressed are included in KAM.

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

As we noted in our ITC comment letter, having KAM in some auditors' reports and not others will leave the impression that auditors' reports without KAM are of lesser quality. Consequently, as a matter of principle, we would prefer that KAM be required for all audits of complete sets of general purpose financial statements – not just for listed entities. However, we recognize that at this stage KAM has been designed investors in listed entities in mind, that the introduction of KAM is somewhat experimental, and that its introduction would engender considerable audit costs for other audits. For these reasons, we accept limiting the requirement for KAM to audits of complete sets of general purpose financial statements of listed entities. However, if the requirement for KAM is limited in this way and KAM is not required by law, regulation, national auditing standards or the terms of engagement, then ISA 701 ought to emphasize more clearly that the inclusion of KAM is at the sole discretion of the auditor – that is, that the inclusion of KAM cannot be prohibited (by law, regulation, national auditing standards or the terms of engagement) for an audit to be an ISA audit. In this respect, ISA 210 ought to include a requirement that clarifies this matter in the terms of engagement.

However, if law, regulation, or the terms of engagement require the use of KAM, or KAM is included voluntarily by the auditor, then we agree that ISA 701 must be followed when KAM is included in the auditor’s report.

Furthermore, if an auditor is not required to include KAM in an auditor’s report under ISA 701 or law or regulation, but the auditor voluntarily chooses to include KAM, we believe that an additional requirement is necessary in ISA 701 to require the auditor to thereafter include KAM in the auditor’s report for the corresponding financial statements of subsequent periods so maintain consistency between periods. This would prevent auditors from including KAM in one period, but not the next given the nature of the KAM identified – particularly for similar matters across periods.

With respect to the applicability of KAM to ISAs 800 and 805, we suspect that the inclusion of KAM to be decision-useful to users only in exceptional circumstances. For this reason we would not support extending the requirement to include KAM to audits performed using ISAs 800 or 805. However, we do not believe it to be appropriate to prohibit the use of KAM either. We therefore believe that the auditor’s ability to include KAM for audits under ISAs 800 and 805 ought to be the same as audits of other than audits of general purpose financial statements of listed entities.

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 that there may be rare circumstances in which there are no KAM for audits of complete sets of general purpose financial statements of listed entities. Consequently, we agree that it is appropriate for proposed ISA 701 to allow for this possibility. However, as we point out in our response to question 2 above, the use of a relative test in the definition of key audit matters ("…matters of <u>most</u> significance in the audit…") means that, by definition, there can never be no KAM. Consequently, the requirement in paragraph 13 is logically inconsistent with the definition of KAM. In our response to question 2, we propose changes to the definition and requirements that we believe would alleviate this inconsistency.

We agree with the proposed requirements addressing the situation when the auditor determines that there are no KAM to report. In particular, we believe that the explanations in the auditor's report proposed in ISA 701.13 (c) are adequate. We do not believe it to be appropriate for auditors to explain in the auditor's report or document in the audit working papers as to why certain matters considered for inclusion as KAM are not KAM because there can be a large number of such matters and it violates the principle that auditors report and document matters included, not excluded, from consideration.

It is unclear how the requirement in paragraph 13 applies to situations in which the audit does not relate to complete sets of general purpose financial statements of listed entities. Does this paragraph also apply when KAM is required by law or regulation or the terms of engagement?

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?**

   We agree that when comparative financial information is presented that 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.

8. **Do respondents agree with the IAASB's decision to retain the concepts of Emphasis of Matter paragraphs and Other Matter paragraphs, even when the auditor is required to communicate key**

audit matters, and how such concepts have been differentiated in the Proposed ISAs? If not, why?

We agree with the IAASB'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. The reason that we agree is that the definition (whether that proposed in the draft or our proposed definition) will not cover all of the circumstances for which emphasis of matter and other matter paragraphs can be used. It is therefore entirely appropriate that both concepts be retained.

However, we disagree with the following changes (or lack of changes) proposed to ISA 706:

- The auditor's report under ISA 700 is now divided into "sections" rather than "paragraphs". It is unclear to us why continued reference is made to emphasis of matter and other matter "paragraphs". In which sections would these paragraphs reside? We believe that when an emphasis of matter or other matter is included in the auditor's report, it requires a separate section.
- We disagree with the deletion of the second sentence of paragraph 8 (a) "Such a paragraph shall refer only to the information presented or disclosed in the financial statements". This sentence is a key requirement distinguishing emphasis of matter paragraphs from modifications and other matter paragraphs. We therefore believe that this sentence (and its related application material in the second sentence of A5) needs to be retained.

We also strongly disagree with the inclusion of the example in paragraph A8 referring to "the application of materiality in the context of the audit". This would encourage auditors to consider the inclusion of a treatment of materiality in the auditor's report, and may in fact encourage the disclosure of quantitative materiality levels. Although we are aware that one jurisdiction has required this, we believe this to be ill-conceived because it ignores the qualitative aspects of materiality – both in terms of ISA 320 and especially in relation to ISA 450 – which cannot be described in any meaningful way in a short-form audit report. We note that the deletion of this example would not prohibit any jurisdiction from making ISA-compliant requirements in this regard, and therefore strongly recommend its deletion.

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.

We recognize that ISA 570 currently requires the auditor to obtain sufficient appropriate evidence [i.e., obtain reasonable assurance] regarding the appropriateness of management's use of the going concern assumption [i.e., the going concern basis of accounting] in the preparation of the financial statements (see extant ISA 570.9 (a) and .18). We also recognize that, because a conclusion on the appropriateness of the going concern basis of accounting applies to the financial statements as a whole since it reflects an assertion at financial statement level that permeates the financial statements, such a conclusion does not represent a "piecemeal opinion". The political imperative posed by the proposals of the European Commission and the European Parliament in this respect is also an important factor to consider.

However, we do not believe that users really understand what the "going concern basis of accounting" means, when it applies, and what the responsibilities of management and the auditor are in this respect. In particular, most users believe the statement is some form of "early warning" – when in fact it is not because it applies when liquidation is imminent or probable, depending upon the applicable financial reporting framework. Consequently, some have expressed considerable unease at expressing a conclusion in the auditor's report on the appropriateness of management's use of the going concern basis of accounting in the preparation of the entity's financial statements when management is not required to make an explicit assertion in the financial statements or elsewhere about its use of the going concern basis of accounting even though this is, in the first instance, management's responsibility. It is clear to us that an auditing standard cannot require management to make such an assertion, and that at this stage, accounting standards do not yet require such assertions (whether IFRS, US GAAP or the requirements of the EU Accounting Directive).

However, we note that by using the going concern basis of accounting in the preparation of the financial statements, management is implicitly acknowledging that it has concluded that its use is appropriate. For this reason, we believe that the inclusion of a conclusion by the auditor on the appropriateness of management's use of the going concern basis of accounting is acceptable.

Overall we agree with the statement included in the illustrative auditor's reports relating to 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.

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?**

We believe that to combat the expectations gap to which users are subject, it is absolutely essential to include an explicit statement in the auditor's report that neither management nor the auditor can guarantee the entity's ability to continue as a going concern. Indeed, if this statement were to be removed, we would no longer support any going concern reporting (except when material uncertainty has been identified or the auditor concludes that the use of the going concern basis of accounting is not appropriate) in the auditor's report. We appreciate that when a material uncertainty is identified and addressed in the going concern section of the auditor's report, such identification suggests that no such guarantee is being given. However, to be clear and help reduce the expectations gap, we believe that the noted statement on no guarantee being given should also be required when a material uncertainty has been identified.

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 support the introduction of a generic requirement to disclose in the auditor's report that an auditor is independent and that the auditor has fulfilled the auditor's other ethical responsibilities under relevant ethical requirements. However, we are not convinced that, even for an audit conducted within a single jurisdiction, it is practicable to refer to all of the sources of the relevant ethical requirements. In addition, it is not clear to us what benefit users of the auditor's report would have from such disclosures in terms of decision-usefulness.

For example, in Germany a reference to such sources for an audit performed entirely within Germany would need to include the Wirtschaftsprüferordnung [Public Auditor Law], the independence requirements in the Handelsgesetzbuch [German Commercial Code], and the requirements of the Berufssatzung [Professional Statute]. For firms in the Forum of Firms, an additional reference to the IESBA Code of Ethics may also be required. We are not convinced that these disclosures are helpful to users, particularly since there is considerable overlap between these requirements.

We therefore suggest that the requirement in paragraph 28 (c) be phrased in generic terms such as the following:

> "Includes a statement that the auditor is independent and has fulfilled the auditor's other responsibilities under relevant ethical requirements".

We note that paragraph 28 (c) in the draft uses the phrase "independent of the entity". The term "independence" relates not only to the entity, but to parties and other conditions that are connected with the entity as defined by the Code. In addition, the auditor is required to be independent of the financial statements prepared by management to avoid the self-review threat. For this reason, we believe the words "of entity" are both misleading and technically incorrect and therefore ought to be deleted.

Disclosure of the Name of the Engagement Partner

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

We agree with the proposal to require the disclosure of the name of the engagement partner and the inclusion of a harm's way exemption, which would be in line with EU law. However, we do not see a good reason for limiting the proposal to audits of the financial statements of listed entities: the proposal ought to apply to the audit of financial statements of all entities.

Other Improvements to Proposed ISA 700 (Revised)

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

We agree with the improved description of the responsibilities of the auditor and key features of the audit as required in paragraphs 35 to 38 ISA 700 in the draft with the following exceptions:

We note that the statement that material misstatements may arise due to fraud and error is included in both paragraphs 36 (a) (i) and 36 (c) and that these statements are close to one another in the illustrative auditor's report. This is repetitive and redundant: we suggest that the reference to "whether fraud or error" be deleted from paragraph 36 (a) (i) to eliminate this redundancy. This would have the added benefit of not appearing to claim in the auditor's report that reasonable assurance in relation fraud is the same as reasonable assurance in relation to error, which was the reason that the IAASB did not include the phrase in this sentence of the auditor's report in the clarification of ISA 700 in 2008. Our proposed change would also be consistent with the statement in paragraph 37 (b) (i), which points out that the risks are different.

We note the provisions in paragraphs 39 and 40 of ISA 700 of the draft to relocate the material in paragraphs 37 and 38 to an appendix or to a website of an appropriate authority. We welcome the opportunity to move such material in future, but believe that the application material ought to note that in each jurisdiction clarification will be needed as to whether the movement of this material to an appendix or to a website means that this material is still legally a part of the auditor's report and that an auditor's decision in this respect may need to address the legal implications of such a movement. We believe that under current EU and German law, the movement of material from the auditor's report is not permitted. We also believe that for cases in which material is moved to a website of an appropriate authority, the requirement in paragraph 40 needs to clarify that such an authority is officially authorized to act in this capacity. We therefore suggest that the words "with official authorization to act in this capacity" be inserted after the word "authority" in the first sentence of paragraph 40.

We are not in favor of the provision in paragraph 49 (a) that permits greater flexibility with respect to the description of an auditor's responsibility when such description is placed on a website than if it is included in the auditor's report or an appendix thereto. In our view, this will tend to further disconnect the material on the website from what is considered to be an official part of the auditor's report. We are not against such websites providing additional material on an auditor's responsibilities – only that the words "description is not inconsistent" means that the description required in paragraphs 37 and 38 on a website can be at variance with that otherwise required for the body of the auditor's report or an appendix.

We appreciate that it may appear logical, as proposed in paragraph 41 of the draft, to permit both reporting responsibilities under the ISAs and other reporting responsibilities in relation to the same matters within the same section of the auditor's report as long as these are clearly distinguished from one another. However, despite the difficulties it causes us in the design of the German auditor's report, based on the input from our practitioners and their views on what both preparers and users desire at a global level, we have come to the conclusion that it is essential for worldwide comparability and transparency of auditors' reports and advantageous for both efficiency and quality control reasons to clearly separate reporting responsibilities under the ISAs from other national reporting responsibilities. It is also unclear to us how "clear differentiation" is supposed to function when such responsibilities are mixed within the same section. We therefore do not agree with the proposed change in the draft to permit the placement reporting requirements under the ISAs and other national reporting requirements within the same section of the auditor's report. We note that when national law or regulation prescribes including both reporting responsibilities within the same section, paragraph 46 provides for the needed exception (as does paragraph 47 for auditors referring to both ISAs and national standards).

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?**

As a general comment, we note that in the extant ISAs, the ordering of paragraphs in the auditor's report is not mandated with the following important exceptions:

- The requirement in ISA 700.23 for an introductory paragraph (we have received informal legal advice, both nationally and internationally, that a required introductory paragraph must be placed before anything it introduces)
- The placement of the "basis for modifications paragraph" prior to the modified opinion paragraph (ISA 705.16)
- The placement of emphasis of matter paragraphs and other matter paragraphs after the opinion paragraph, and the second after the first (ISA 706.7(a) and ISA 706.8).
- The placement of the section dealing with other reporting responsibilities after the section dealing with the reporting responsibilities under the ISAs (ISA 700.39).

Consequently, extant ISA 700 provides flexibility in terms of ordering of paragraphs only for:

- The paragraph dealing with management's responsibilities
- The two or three paragraphs on the auditor's responsibilities
- The opinion paragraph

in between the introductory paragraph and the section on other reporting responsibilities. The limited number of paragraphs not already required to be placed in a certain way implies that there was little need for additional requirements relating to structure: there was little incentive to place the remaining few paragraphs not subject to mandated ordering in a manner different from that proposed in the illustrative report.

In contrast, there are at least seven sections (and about a dozen standard paragraphs) in the auditor's report proposed by the draft without any requirements with respect to ordering of those sections (or the paragraphs within them). It seems to us to be incongruous that as the need for a mandated structure increases to safeguard international comparability given the increasing number of sections and paragraphs in the report, the IAASB is decreasing the degree to which it mandates ordering. In our discussion with practitioners and the needs of the entities whose financial statements are subject to audit – in particular those entities that operate internationally – and based on information we have obtained from users, we do not believe that permitting individual auditors or national standards setters to design auditors' reports that are completely at variance from one another in terms of structure to be appropriate. In this respect, we believe that the IAASB is not meeting its international standards setting responsibilities.

For these reasons, we believe that it has become appropriate for the IAASB to mandate the ordering of the section in the auditor's report.

The addition of such requirements in relation to structure, along with the treatment of other reporting responsibilities in a separate section of the auditor's report as we propose in our response to question 13, would provide some comparability of ISA auditor's report on a worldwide basis while providing a high degree of flexibility otherwise. We note that paragraphs 46 and 47 still provide additional flexibility when national law or regulation regulates the layout or wording of the auditor's report or when an auditor refers to both national standards and ISAs in the report, respectively, and that therefore the flexibility needed to deal with national circumstances is still maintained under our proposals.

We note one change to paragraph 46 (g) in ISA 700 of the draft which appears to us to be inconsistent with the requirements of ISA 701. We believe that reference to a separate report (either of the auditor or those charged with governance) of the matters required in ISA 701 is not consistent with the requirement to include these matters in ISA 701. Furthermore, all of the other requirements in paragraph 46 deal solely with placement and wording of matters *within* the auditor's report – not placement outside of the auditor's report. We therefore believe that second sentence of paragraph 46 is incompatible with the purpose of paragraph 46 and should therefore be deleted.

We also note that the requirement in paragraph 33 of ISA 700 in the draft with respect to the description of management's responsibilities has been considerably weakened compared to paragraph 26 in extant ISA 700. In particular, paragraph 26 in extant ISA 700 requires the specific descriptions of management responsibilities for the financial statements and internal control, whereas, through the wording "that are responsible for", paragraph 33 of ISA 700 suggests that the descriptions in (a) and (b) are not required. We therefore recommend that the wording be revised to require the descriptions in (a) or (b) as applicable. We also note that the rather specific requirement in paragraph 34 of the draft relating to paragraph 33 is inconsistent with such an unspecific requirement in paragraph 33.

In relation to this requirement, the application material in the last sentence of paragraph A34 in ISA 700 suggests that, where not prohibited by law or regulation, the auditor may "elect" to refer to a more detailed description of management responsibilities by way of reference to another source outside of the auditor's report (e.g., the annual report of the entity or a website of an appropriate authority). This suggests that the auditor's report itself need not include *any* description of management responsibilities other than the reference. This is a clear weakening of the requirement because it means that no description of management responsibilities is required in the auditor's report. We therefore suggest that the wording should be changed to clarify that, *in addition* to the wording required in the auditor's report, the auditor may *also* elect to refer to the other sources outside of the auditor's report containing a more detailed description.

APPENDIX 2:
Additional Comments By Standard And Paragraph

We have not repeated our comments in our responses in Appendix 1 to particular questions posed in the draft when those comments affect the paragraphs below, nor have we proposed changes to the application material that would result from our proposed changes to the requirements.

Proposed ISA 700

24. We believe that to clarify the content of the ellipses within the square brackets in both (a) and (b), the words "the matters presented in the financial statements" ought to be inserted within the square brackets.

27. In (d), it appears to us that the phrase "including the summary of significant accounting policies" is inconsistent with the definition of "financial statements" in ISA 200.13(f), since the notes are defined as ordinarily (but not necessarily) including the summary of significant accounting policies – it depends on the nature and requirements of the financial reporting framework. For these reasons, the phrase should be deleted.

30. In line with our response to question 4 above on the applicability of KAM to ISA 800 and 805 audits, the wording in the second sentence should be changed to read "When the auditor of other than a complete set of general purpose financial statements of a listed entity…".

42. The "'s" should be deleted from the word "partner's".

44. It appears rather strange that only the location, but not the jurisdiction in which the location is, is required to be named. We therefore suggest that the word "in" be replaced with "and".

46. For both paragraph 46 and 47 we note that if law or regulation, or national auditing standards, specify only one matter in terms of layout or wording, then even though an auditor is able to otherwise comply with paragraphs 20 to 45, the auditor need not do so. We believe that, to the extent that law or regulation, or national standards permit, auditors making reference to compliance with the ISAs should follow the requirements in paragraphs 20 to 45. We suggest that the following words be inserted at the end of

paragraph 46: "The auditor shall comply with the requirements in paragraphs 20 to 45 to the extent that law or regulation do not require the use of a specific layout or wording of the auditor's report." Likewise, the following sentence should be inserted at the end of paragraph 47 (b): "The auditor shall comply with the requirements in paragraph 20 to 45 to the extent that national auditing standards do not require the use of a specific layout or wording of the auditor's report".

47. We refer to our comments in paragraph 46. To take into account the addition of KAM in ISA 701 and the requirement in the ISAs to use other matter paragraphs in some circumstances, paragraph 47 (a) (ii) should read "…not include key audit matters, an emphasis of matter paragraph, or other matters paragraph, that are required in the particular circumstances by the ISAs".

A4. The word "evaluates" in the second sentence intimates a requirement, when in fact it just reflects a requirement in the requirements section. We therefore suggest that "evaluates" be replaced with "is required to evaluate" to signify that the requirement is just being repeated.

A16. We believe that the second sentence should clarify that, depending upon the jurisdiction and applicable law and regulation, auditors' reports are ordinarily addressed to the engaging (e.g., management or those charged with governance) or appointing party (the owners or shareholders) of the entity whose financial statements are being audited, or to the entity itself.

A34. The same square brackets containing an ellipsis used in paragraph 24 (a) and (b) ought to be inserted after the words "material respects".

A29. We suggest that the word "rules" at the end of the last sentence be replaced with "requirements", since not all requirements are rules.

A44. When a separate title is required for the section of the auditor's report for the audit under the ISAs, then the title needs to be more descriptive by recognizing that other legal or regulatory audit requirements may also pertain to the financial statements. We therefore suggest that the title be renamed: "Report on the Audit of the Financial Statements Under the ISAs".

Appendix, Illustration 2

We are concerned about the reference to "subsidiaries" in the report because there may be at equity interests or proportionate consolidation (which is still permitted by some financial reporting frameworks, particularly for undivided interests in assets and liabilities) involved. We suggest that the circumstances and the report delete the reference to subsidiaries.

Appendix, Illustration 3

In line with the requirement in paragraph 40, the final bullet point in the description of circumstances should make reference to the fact that law and regulation explicitly permit the auditor to refer to a website.

Proposed ISA 701

11. To clarify that the reference to the different kinds of opinions depends upon that used, we suggest inserting the term “as applicable” between the words “section(s)” and “in the introductory”.

A30. Since the ISAs use the term “sufficient and appropriate” only in relation to audit evidence, we suggest that the reference to “sufficiency and appropriateness” in relation to the description of key audit matters be changed to “adequacy”.

A47. To be consistent with the scope of ISA 701, the words “complete sets of general purpose” need to be inserted in between the words “the auditor of “and “financial statements” in the second line.

Proposed ISA 260

A9. The word “audit” in the fourth line should be changed to “engagement”.

A15. The present tense construction intimates a requirement. We suggest changing the wording to “It may be necessary to exercise care when…”.

Proposed ISA 570

Appendix, Illustrations 1 and 2

To clarify the relationship between material uncertainties and the going concern basis of accounting, we suggest that the words “per se” be inserted in between the words “indicate” and “that” in the first line of the paragraph on the going concern basis of accounting.

Illustration 3

In the last sentence of the paragraph on inadequate disclosures about a material uncertainty identified, we suggest inserting the words “on the financial statements” after the words “adverse opinion” to clarify that the adverse opinion is on the financial statements.

Proposed ISA 705

5. There seems to be some confusion among practitioners about whether a disclaimer of opinion is an audit opinion. The definition in paragraph 5 (b) clarifies that it is a form of modified opinion, but this appears not to have completely eliminated the confusion. We believe that a disclaimer of opinion is an opinion, but, unlike the other forms of modified and unmodified opinions, it is not an opinion on the financial statements: rather it is an audit opinion that, due to a lack of sufficient appropriate audit evidence, an opinion cannot be expressed on the financial statements. In other words, the auditor is “disclaiming an opinion” on the financial statements.

   To clarify this, we suggest that the words “on the financial statements” be added to the definition in paragraph 5 (b). The IAASB may also wish to consider whether it would be helpful to add these words in ISA 701 whenever an opinion is mentioned.

15. The word “contradict” is too binary for the thought being expressed in the second sentence. We suggest that it be replaced with “undermine”. The same applies to paragraph A16.

19. The phrase that begins with “that indicates that” and ends with “ISA 700 (Revised)” needs to be set off in commas to clarify that the following word “to” relates to the word “statement” at the beginning of the sentence.