Investment Management Association

3 December 2013

J. Gunn
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IAASB
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Dear James

EXPOSURE DRAFT: REPORTING ON AUDITED FINANCIAL STATEMENTS: PROPOSED NEW AND REVISED INTERNATIONAL STANDARDS ON AUDITING (ISAs)

IMA represents the asset management industry operating in the UK. Our members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of £4.5 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, the Annual IMA Asset Management Survey shows that IMA members managed holdings amounting to 30% of the domestic equity market.

In managing assets for both retail and institutional investors, IMA members are major investors in companies whose securities are traded on regulated markets. Therefore, they have an interest in the requirements governing the audit of these companies' accounts and the auditor's report to them as users. We welcome the IAASB's initiative to expand audit reports to make them more informative by sharing insight into the audit - investors want an audit report that is more informative with more entity specific information. Whilst the changes proposed would help reaffirm the relevance and value of the audit to users, we set out below our main observations and in the attached Annex our comments on the specific questions raised.

- The introduction of 'key audit matters' is a significant step towards increasing the transparency of the audit process and improving the usefulness of the audit report for investors. We support 'key audit matters' replacing earlier proposals for an 'auditor commentary' which would have required the audit report to highlight matters 'likely to be most important to users' understanding of the audited financial statements or the audit'. This would have required the auditor to take responsibility for determining what is important to a user's understanding and potentially blur the roles of management,

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those charged with governance and the auditor. The revised proposals for the 'key audit matters' section responds to these concerns by linking it with the dialogue with those charged with governance.

- The 'key audit matters' section should describe the significant matters for a particular audit and focus on complex financial reporting estimates and areas of judgment – the more subjective areas. This should help investors better understand key areas in so far as they are a focus for the audit and provide them with a basis to engage with management. Investors want a concise explanation of why the matter was considered important, an indication of the auditor's response and importantly, the outcome. In this latter respect, we do not consider that the text "may include an indication of the outcome" in A38 of ISA 701 or the illustrative examples on pages 13 to 16 are sufficiently clear. Indeed, some investors would go further than just requiring that the outcome of the audit process is disclosed and would like auditors to disclose information around the sensitivity of management's judgments and valuations.

- Audit reports should be bespoke, meaningful and tailored to a company's changing circumstances. A concern is that the significant risks might not change much from year to year - auditors need to guard against boilerplate reporting from one year to another which would diminish the usefulness of the proposals over time. It would be helpful if the regulators kept this under review.

- We would also emphasise the usefulness for investors of including the auditor's assessment on materiality, as is currently required in the UK. This information can be an important element in assessing the quality of the audit and provides useful comparative information year on year.

- Several standard setters are looking at proposals to change the audit report. The US Public Company Accounting Oversight Board, the European Commission, the UK's FRC as well as the IAASB. Investors invest internationally - around 63 % of all equities managed by our members are held internationally - and ideally would welcome harmonised international standards for auditing. Whist we recognise that there is a high level of consistency in the proposed requirements, there is room for further convergence in that differing models could be confusing for the capital markets. Given that corporate governance frameworks can differ internationally, this may take time to achieve but unnecessary differences should be avoided where possible.

Please contact me if you would like clarification on any of the points in this letter or if you would like to discuss any issues further.

Yours sincerely

Liz Murrall
Director, Corporate Governance and Reporting

ANNEX

IMA's ANSWERS TO THE DETAILED QUESTIONS RAISED

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?

Investors have had concerns about auditor's accountability to investors and the transparency of the audit for some time. Many of these concerns are a product of the fact that investors feel excluded from the audit process and real findings - they are largely invisible. The usefulness of the key communication auditors have with investors - the audit report - is undermined by the binary opinion, pass or fail, and the fact it tends to include more details of what the auditor did not do rather than what it did.

The introduction of 'key audit matters' is a real step towards improving transparency and is welcomed by investors. We support this replacing the 'auditor commentary' which would have highlighted matters 'likely to be most important to users' understanding of the audited financial statements or the audit'. This would have required the auditor to decide what is important to a user's understanding and could potentially blur the roles of management, those charged with governance and the auditor. We do not want to see dual reporting by companies and auditors – the accounts are the responsibility of the board. But we do need better transparency on audit matters. The revised proposals for the 'key audit matters' section responds to these concerns by linking it with the dialogue with those charged with governance.

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 material provides a good framework to determine 'key audit matters'. What is important is that the 'key audit matters' section describes the significant matters for a particular audit and focuses on complex financial reporting estimates and areas of judgment – the more subjective areas.

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 additional direction could be included about what needs to be described. Investors want a concise explanation of why the matter was considered important, an indication of the auditor's response and importantly, the outcome. In this latter respect, we do not consider that the text "may include an indication of the outcome" in A38 of ISA 701 or the illustrative examples on pages 13 to 16 are sufficiently clear. Indeed, some investors would go further than just requiring that the outcome of the audit process is disclosed and would like auditors to disclose information around the sensitivity of management's judgments and valuations.

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IMA's ANSWERS TO THE DETAILED QUESTIONS RAISED

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.

Subject to our comments under question 3 in that the examples do not give sufficient details of the "outcome", the illustrative example is otherwise clear.

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?

We support key audit matters only being required to be discussed for listed companies. We also agree with the IAASB's approach that unlisted companies may disclose the information on a voluntary basis. Unlisted entities can often seek a listing in the near future and in the interests of ensuring transparency, it is helpful if they have a history of such information disclosed.

6. Do respondents believe it is appropriate for proposed ISA 701 to allow for the possibility that the auditor may determine that there are no key audit matters to communicate? (a) If so, do respondents agree with the proposed requirements addressing such circumstances? (b) If not, do respondents believe that auditors would be required to always communicate at least one key audit matter, or are there other actions that could be taken to ensure users of the financial statements are aware of the auditor's responsibilities under proposed ISA 701 and the determination, in the auditor's professional judgment, that there are no key audit matters to communicate?

We agree with the proposed ISA 701 allowing for the possibility that there are no key audit matters and auditors being required to state expressly that there are no key audit matters to report. However, as well as this when describing the key audit matters, a number of investors believe it would be helpful if the auditors also positively confirmed that there are no other matters that they wish to report.

7. Do respondents agree that, when comparative financial information is presented, the auditor's communication of key audit matters should be limited to the audit of the most recent financial period in light of the practical challenges explained in paragraph 65? If not, how do respondents suggest these issues could be effectively addressed?

The purpose of the key audit matters report is to increase the transparency of the audit and investors' understanding of it. In the interests of clarity, this report should be concise and focus on the most recent financial period. In particular, recently we have seen an increase in auditor rotation between firms and it may be difficult for an incoming auditor to comment on comparative information when it was not the auditor at the time.

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 believe the Emphasis of Matter and Other Matter paragraphs should be retained. Key Audit Matters are only required in respect of listed entities and even then Emphasis of Matter and Other Matter paragraphs give an additional vehicle for auditors to disclose information that may not fall under Key Audit Matters such as a significant subsequent event. In this context, it would be helpful if more explicit guidance was given on how these should be differentiated.

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 would welcome preparers explaining the basis for their going concern conclusion and note that a number of bodies are currently looking at this. We would encourage the IAASB to work with the IASB on this. Investors would also like to hear from auditors on the matter and consider the statements in the illustrative reports relating to the appropriateness of management's use of the going concern basis in the preparation of report satisfactory. Investors would also welcome auditors reporting on any material uncertainty 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 welcome retention of the disclosures in the illustrative example and in particular a statement that: "management has not identified a material uncertainty that may cast significant doubt on the Group's ability to continue as a going concern, and accordingly none is disclosed in the consolidated financial statements of the Group". Moreover, the fact that the auditor has not identified any material uncertainly is clearly in the context of the audit. For this reason, some investors, but not all, do not believe the disclosure: "However, neither management nor the auditor can guarantee the Group's ability to continue as a going concern" needs to be retained. To do so could imply a lack of accountability from both management and the auditor in the event that the Group does fail to continue as a going concern.

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?

IMA agrees that it is important to signify the auditor's compliance with independence and other relevant ethical requirements. A reference to international or national codes of ethics would be useful.

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 believe that the name of the engagement partner should be disclosed in that it makes the partner more accountable. As such, we welcome the proposal to make this disclosure a requirement for audits of listed companies.

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 welcome the description of the auditor's responsibilities in the revised ISA 700. We are in favour of stating these separate from the main body of the auditor's report (e.g. as an Appendix or on the website) as long as they are referenced in the report. This will strengthen investors' focus on the main auditing issues and if any additional clarification on the auditor's responsibilities is needed, provides access to the information. We consider that a reference as to whom in the entity is responsible for overseeing financial reporting is valuable for investors, particularly given the different governance frameworks internationally.

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?

In the interests of clarity, we welcome the ED proposing but not mandating that the report should be structured with the more valuable information and the audit opinion appearing first followed by the entity specific information and the more standardised elements at the end.

In this context, several standard setters are looking at proposals to change the audit report. The US Public Company Accounting Oversight Board, the European Commission, the UK's FRC as well as the IAASB. Investors invest internationally – around 63 % of all equities managed by our members are held internationally - and ideally would welcome harmonised international standards for auditing. Whist we recognise that there is a high level of consistency in the proposed requirements, there is room for further convergence in that differing models could be confusing for the capital markets. Given that corporate governance frameworks can differ internationally, this may take time to achieve but unnecessary differences should be avoided where possible.