



International Organization of Securities Commissions
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13 December 2013

Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York, NY 10017 USA

Our Ref: 2013/JE/C1/IAASB/257

Subject Line: IAASB’s Exposure Draft: *Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs)*

Dear Sir:

The International Organization of Securities Commissions’ Committee on Issuer Accounting, Disclosure and Audit (Committee 1) appreciates the opportunity to comment on the International Auditing and Assurance Standards Board’s (the IAASB or the Board) Exposure Draft: *Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs)* (the Paper). As an international organization of securities regulators representing the public interest, IOSCO is committed to enhancing the integrity of international markets through the promotion of high quality accounting, auditing and professional standards, and other pronouncements and statements.

Members of Committee 1 seek to further IOSCO’s mission through thoughtful consideration of accounting, disclosure and auditing concerns, and pursuit of improved global financial reporting. Unless otherwise noted, the comments we have provided herein reflect a general consensus among the members of Committee 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

Overall Proposal

We support the IAASB’s efforts to explore ways in which the auditor’s report could become more informative and provide more relevant information to users of financial statements. We recognize the significant effort the Board has expended to move this work-stream forward and we appreciate the



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Board’s persistence to that end. Our comments are intended to address overarching points for the Board’s consideration as it crystalizes the proposal.

We believe that the current proposal progresses and improves the thinking over the Board’s previous June 2012 Invitation to Comment: *Improving the Auditor’s Report* as it provides, among other things, more specific criteria for assisting auditors in determining which matters are to be included in the auditor’s report. We continue, however, to have concerns regarding some aspects of the proposal. We think there are questions that need to be addressed by the Board as it evaluates the feedback received from various stakeholders.

We appreciate the Board’s deliberations that have led to the current proposal, including the concept of key audit matters (KAM). We have provided some overall reactions to the proposal, including concerns, in this letter; however, we need to better understand the feedback surfacing from the field-testing currently being done in order for us to provide more in-depth reactions.

Key Audit Matters

We have comments on the following four fundamental aspects of the proposed KAM reporting model:

1. Auditor Identification of KAM;
2. Auditor Reporting on a KAM – Main Elements;
3. Auditor Reporting on a KAM – Audit Specific Information; and
4. Integration of KAM with other Auditor Reporting Obligations.

We discuss each of these in greater detail below.

Auditor Identification of KAM

Relying on Considerable Auditor Judgment

The proposal will require the auditor to exercise considerable judgment in deciding which audit matters communicated to those charged with governance to include as KAM. While auditor judgment is important, we think the framework and definition the auditor uses to make these decisions could be enhanced. We believe greater specificity and guidance should be provided to promote consistency in determining which matters are to be considered “of most significance.”

Based on what the Board currently proposes in the Paper, we question whether two unrelated auditors for similar entities examining identical facts and circumstances associated with a group of potential



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KAM would be sufficiently guided to consistently identify the matters as being “of most significance” in the audit. It is unclear to us what a determination “of most significance” in the audit entails. What reference point or denominator is an auditor expected to use in evaluating matters “of most significance”? For example, are matters “of most significance” measured by the extent of firm-wide consultations? The degree of partner involvement? Total hours incurred? We believe additional guidance is needed to reach consistency. Further complicating this is the fact that the three aspects of significant auditor attention mentioned which determine a KAM differ from each other (and are not additive with each other).¹ As such, in comparing the three areas, how does an auditor decide what is determinative in evaluating “most significance”?

We note that auditors are required to document only the matters that will be communicated as key audit matters and the significant professional judgments made in reaching this determination. To further address consistency and completeness of the auditor’s considerations, in addition to enhancing the definition of KAM as noted above, we believe the documentation requirements should also be strengthened. For example, the Board could include a requirement for the auditor to document the rationale behind matters and risks that have been communicated to TCWG but not included as KAM.

Rare Circumstances of no KAM

We believe the Board should clarify under what circumstances KAM is not expected to be included in the auditor’s report as the notion of “rare” has not been clearly articulated in the proposal. More specifically, is it the Board’s intent to scope out from a requirement to include KAM “a listed entity that has very limited operations or assets” and set an expectation that, for other than these entities, it should be rare to have no KAM? Or is it the Board’s intent that reporting no KAM is expected to be

¹ Paragraph 8 of proposed ISA 701 states “The auditor shall determine which of the matters communicated with those charged with governance are the key audit matters. In making this determination, the auditor shall take into account areas of significant auditor attention in performing the audit, including: (Ref: Para. A1–A14, A24)

(a) Areas identified as significant risks in accordance with ISA 315 (Revised)¹ or involving significant auditor judgment. (Ref: Para. A15–A19)

(b) Areas in which the auditor encountered significant difficulty during the audit, including with respect to obtaining sufficient appropriate audit evidence. (Ref: Para. A20–A21)

(c) Circumstances that required significant modification of the auditor’s planned approach to the audit, including as a result of the identification of a significant deficiency in internal control. (Ref: Para. A22–A23)



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rare for all entities within the scope of the proposal? In re-addressing this area, the Board could consider including language in the requirements to indicate that an auditor of non-complex entities with limited operations or limited assets may not identify any KAM depending on the facts and circumstances of the audited entity.²

Significant Auditor Attention due to a Breach of an Independence Provision

A breach of a provision of the IESBA Code of Ethics for Professional Accountants is one type of client acceptance and continuance matter required to be discussed with those charged with governance. Does the Board expect these types of matters to be included in KAM? For example, due to the importance of the auditor maintaining his/her independence in performing the audit potential breaches of independence provisions can demand significant auditor attention to determine whether objectivity was compromised. As such, independence matters may fall within the criteria for KAM even though they may be of a different nature than KAM as envisioned by the Board. The Board should consider whether these breaches of independence meet the criteria of KAM and, if they do, whether they should be presented in a separate section of the report. More importantly, the Board should also consider if and how such independence matters can be presented in a manner that does not confuse a user as to the auditor's objectivity.

Effect of Prior Year Situations

We have observed that the Board's intent is for KAM to be limited to those matters of most significance in the audit of the financial statements of the current period. What remains unclear is how auditors in determining KAM are to consider audit work done in the current year that relates to a restatement of prior year financial statements for which there was no effect on the financial statements of the current period.

Illustrative Examples

As noted earlier, the Paper itemizes three aspects of significant auditor attention to determine which matters communicated to those charged with governance are KAM. Nonetheless, we find that the current examples in the illustrative report did not address two of the aspects of significant attention as reflected in the Paper, namely, (i) areas in which the auditor encountered significant difficulty during the audit and (ii) circumstances that required significant modification of the auditor's planned approach to the audit. An example of the latter that could be especially useful for auditors might be

² In the Paper, this matter is covered in paragraph A47 of Proposed ISA 701.



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the situation in which the auditor uncovered indications of fraud that resulted in modifications to the audit plan to address this risk.

Auditor Reporting on a KAM – Main Elements

We note that the proposal does not seek to define what information should be disclosed in relation to each KAM. We think that the proposal should, and we observe three elements of information in the illustrative report that relate to each KAM that could be considered by the Board: (i) the nature of the audit matter; (ii) the audit approach adopted with respect to the matter; and (iii) the outcome of the auditor’s work provided the language used could not be viewed as in substance altering the content of the auditor’s responsibility for the KAM or the auditor’s opinion on the financial statements. The examples included in the illustrative auditor’s report seem inconsistent in reflecting these three elements. Whereas the example KAM relating to valuation of financial instruments and revenue recognition both include all three elements, the other KAM do not. Further, the KAM relating to the acquisition of XYZ Business only refers to the nature of the matter and the KAM referring to goodwill only includes the first two elements.

Auditor Reporting on a KAM – Audit Specific Information

We believe that the proposed auditor’s report as reflected in the illustrative example would not achieve the desired outcome if boilerplate language was consistently used to describe KAM of a similar nature. We believe the minimizing of boilerplate disclosures should be a priority for the Board.

We recognize the effort the Board expended in drafting the four specific examples of KAM in the illustrative independent auditor’s report. We believe examples could play an important role in setting the expectation of what should be included in KAM. However, we see the content of the current illustrative examples as easily transferrable from one audited entity to another with only minor changes. Based on the current proposal there is substantial risk of KAM reflecting boilerplate language.

We encourage the Board to draft examples reflecting information specific to the audited entity to the greatest extent possible. For example, the KAM addressing goodwill in the illustrative auditor’s report could refer to the valuation being with respect to a retail chain operating in jurisdiction X, an emerging market that has in recent years seen volatile swings in growth. Further, detailed guidance should then be provided in the proposed standard that reflects the steps the Board envisioned the auditor perform in applying the standard to draft audit-specific KAM that avoids the use of boilerplate language particularly after considering the outcome of field testing by the firms.



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Integration of KAM with Other Auditor Reporting Obligations

We are concerned that KAM may be seen by some auditors, investors and management as providing an alternative approach of communicating matters to investors in place of Emphasis of Matter (EOM) or Other Matter (OM) paragraphs, and even modified opinions. We believe the Board should clarify when the use of KAM, EOM, OM or a modified opinion is required and what is expected of auditors particularly when the disclosure of all or more than one of these is appropriate. Perhaps a pictorial illustration in addition to clear language may be helpful to auditors in understanding the relationship between the various elements.

Going Concern

We see some incremental benefit to investors and users of financial statements with requiring the auditor to comment on its audit work associated with the audited entity’s status as a going concern. We support the Board’s efforts to actively keep abreast of the accounting standard-setting considerations with respect to going concern. We believe the resulting outcome of what management is asked to say or not say about its going concern assessment as a result of the accounting standard-setters’ work in this area should be used by the Board to determine what the auditor should or should not say about the results of the auditor’s work. In any event, our members believe that if a material uncertainty exists, then the auditor should reflect the relevant facts and circumstances in the report with similar detail as currently being proposed for KAM.

We question the wording of the second paragraph of the suggested illustrative example concerning the fact that “neither management nor the auditor can guarantee the Company’s ability to continue as a going concern.” We believe this sentence should be deleted as it only states the obvious and does not add benefit to investors.

Placement of Opinion and Auditor’s Responsibilities for the Audit

We agree that the opinion should be prominent in the report. Further, we support the option of including the supplemental description of the auditor’s responsibility in an appendix to the report or on a website of an appropriate authority.

Global Consistency among Standard-Setters

We recognize other national and regional standard-setters continue to debate the way forward regarding auditor reporting. As the Board considers feedback received to its Paper and as other standard-setters receive feedback on their proposals, we encourage the Board to minimize, as much as practical, differences in approach and final outcome in an effort to achieve global consistency. For



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example, some standard-setters are considering the inclusion of risk assessment and the assessment of materiality among the items that an auditor might cover in its report. While some of our members are comfortable with the Board's conclusion to in particular omit these matters, others would like to see the Board reconsider at least these two areas as part of its redeliberations

Next Steps

While we support robust post-implementation review by the Board, we believe it is also important for the Board to uncover potential implementation issues as it considers comments from stakeholders. To this end, we understand that the firms are performing field testing of the proposal by using recently concluded audit engagements to determine if and how KAM would have been reflected in those reports. We understand that the firms expect to complete this after the deadline for comments on the Paper. We recommend that the Board should only seek to finalize the standard when, in light of the results of this work, the Board and its stakeholders are able to see how the proposed guidance is likely to be implemented. If this takes additional deliberations we believe that such additional time and effort is worthwhile.

We also encourage the Board to conduct field testing with investors, by providing them with examples of proposed KAM as prepared in the illustrative report so that the Board can understand whether, how and why investors would benefit from this information. The Board should give as many clarifications in the standard and information about the standard as possible in order to help users understand the new concept of KAM and also better set the expectations of users.

Thank you for the opportunity to comment on the Paper. If you have any questions or would like to further discuss these matters, please contact either Nigel James or me at 202-551-5300.

Sincerely,

Julie A. Erhardt
Chair
Committee on Issuer Accounting, Disclosure and Audit
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