Mr. James Gunn
Technical Director
International Auditing and Assurance
Standards Board
545 Fifth Avenue, 14th Floor
New York, New York 10017, USA

Stockholm 22 November 2013

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

FAR, the Institute for the Accountancy Profession in Sweden is responding to the Exposure Draft: *Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs).*

FAR's general comments

FAR is in general positive to the IAASB's initiative to improve auditor reporting, and is pleased to provide you with FAR's comments to the exposure draft. FAR understands that there is a call for the auditor's report to be more informative and agrees with the overall approach taken by the IAASB.

FAR's main concerns are related to the section of Key Audit Matters (KAM) in ED ISA 701. Firstly, FAR believes that the standard requires too much information in a KAM. In FAR's opinion the information should be limited to a description of the issue. The KAM should not contain information over the audit approach to the specific KAM or how it was resolved in the audit. This concern is further discussed in the response to question 3. Secondly, FAR believes that the standard in too little extent deals with implications that reporting of sensitive KAMs may have on the audited entity and on the auditor's risk and future relation to the entities management. This concern is further discussed in the response to question 2.

Please see attached appendix 1 for FAR's detailed response to the specific questions in the exposure draft.

FAR

Bo Hjalmarsson
Chairman FAR Auditing Policy Group

Appendix 1

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?

FAR welcomes the fact that the IAASB, in the ED, introduces a Key Audit matter (KAM) section, instead of the Auditor Commentary section which was presented in the Invitation to Comment (ITC) document published in June 2012. FAR believes it is more relevant that the auditor enlightens the users of his/her most significant communication with "Those charged with Governance" (TCWG) in the KAM section, rather than highlighting matters that are the most important to users' understanding of the financial statements in an Auditor Commentary section, as was suggested in the ITC-document.

As stated in FAR's response to the ITC-document, FAR believes that KAM information may be helpful to analysts and investors in listed entities, provided that the information is truly entity specific and enhances the users' understanding of the entity and of the audit of the financial statements. In FAR's opinion, information communicated to TCWG in accordance with ISA 260 and ISA 265, would by definition always be significant and entity specific, and a selection of the most important matters from that communication, would therefore be expected to be helpful to the users.

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?

One should be aware that some KAMs communicated to TCWG may be very sensitive and that the auditor may hesitate in disclosing them in the auditor's report. The IAASB has commented (in ED ISA 701 A36) situations when KAM information may be viewed as sensitive. However, the IAASB only seems to urge the auditor to reconsider the appropriate wording of the KAM and re-challenge whether the matter really is a KAM. FAR believes that ED ISA 701 should provide further guidance on possible implications when the auditor chooses to disclose sensitive information about management's behaviour. For example, what are the implications when difficulties are encountered in the audit, due to significant delays from the management to provide information and management's unwillingness to make corrections of misstatements in the financial statements? FAR recommends the IAASB to introduce guidance in the Application and Other Explanatory Material of ISA 701 over possible implications from KAMs in sensitive situations.

In appendix 2, FAR presents two other examples of situations when it may be very sensitive and potentially risky for the auditor to disclose information as KAMs. FAR is concerned over whether it is in the stakeholders' interest that all KAMs always should be included in the auditor's report when they may cause serious harm.

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?*

FAR has strong concerns about the content in a KAM as described in ED 701 paragraph 10 (a); "The description….shall include: (a) …….., its effect on the audit". The meaning of describing "its effect on the audit" is further explained in paragraphs A38-A41 who are suggesting that the audit approach to the KAM is explained and that the auditor addresses the outcome in the audit regarding that matter. FAR agrees with the IAASB that a KAM shall not give the impression of conveying an opinion on individual matters. However, FAR believes that the difference between a description of whether a matter has been satisfactorily resolved and an opinion on an individual matter is very subtle. FAR believes that such a difference may not even be recognizable to the users. In FAR's opinion, a KAM should therefore include neither a description of the audit approach nor any kind of information with resemblance to a conclusion over the individual KAM. It is quite sufficient that the auditor in the introduction to the KAM section generally states that the auditor's opinion on the financial statements is not modified with respect to any of the KAMs as required by ED 701 paragraph 9 (d).

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.

FAR believes that the examples meet the criteria to be selected as a KAM and that they are adequately presented. However, please observe the response to question three about not including a description of audit procedures and conclusions.

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?

FAR agrees with the approach in ED ISA 700 paragraph 30 that an auditor may communicate KAMs in the auditor's report on a voluntary basis, provided that the auditor has acknowledged this intent in the engagement letter and that both management and TCWG are thereby properly informed. FAR appreciates that paragraph 30 specifically requires that if an auditor voluntarily chooses to include KAMs in the auditor's report, ISA 701 must be applied. In case of voluntary KAM-reporting and the auditor determines that there are no KAMs to report, the auditor may need to be reminded that ISA 701 paragraph 13 8(c) requires a statement in the auditor's report that there are no KAMs to report.

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?

FAR has noted that the IAASB, in paragraph 59 of the explanatory memorandum, has stated that KAMs as being matters "of most significance" in the audit is a relative concept, meaning that, relative to other matters, there will always be one or more matters that are more significant than others. FAR agrees that KAM is a relative concept, but also agrees with the IAASB in paragraph 60 of the explanatory memorandum that there may nevertheless, in rare situations, be no matters significant enough to qualify in the KAM-section.

In the response to the ITC document, FAR stated that if no KAMs should be identified, the auditor explicitly should report that fact in the auditor's report. FAR therefore welcomes that ED 701 in paragraph 13 requires the auditor to include an explanation in the auditor's report that no KAMs were identified by the auditor.

(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?

Not applicable.

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?

FAR anticipates that users of the auditor's report, especially investors and analysts, will compare KAMs over time, to determine how significant changes in KAMs in different years affect their understanding of the entity or the audit. Even though users therefore might find it helpful if KAMs from prior financial periods were presented, FAR agrees with the IAASB that there should be no such requirement. Another issue may be whether the auditor should provide an explanation in the auditor's report when KAMs are significantly changed from one financial period to another. FAR believes that no such explanations should be made. For example, in cases when a new auditor has been appointed, the new auditor can often not explain what triggered the previous auditor's choice of KAMs.

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?

FAR is concerned that even though the KAMs and EoMs are differentiated reasonably well by their definitions in ED ISA 701 and ISA 706 respectively, FAR believes that users of the auditor's report will in practice have difficulties in differentiating them from each other. However, as the IAASBs reasons in the Explanatory memorandum in paragraphs 74-79, EoMs are currently mostly used to emphasise going concerns matters, matters that in accordance with ED ISA 700 will now be reported under the separate going concern section. In practice therefore, and under the condition that a separate going concern section will be introduced, the problems to differentiate the concepts may not cause any significant problems. FAR also refers to the response to question 9 below, and about FAR's concerns regarding the going concern section.

Since there is a concern about the differentiation, FAR recommends the IAASB to carry out a post-implementation review of the KAM-section rather soon after the standards have been made effective, to discover any practical problems for the users to differentiate KAMs from EoMs.

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?

As already stated in FAR's response to the ITC document, FAR believes that more transparency could be provided over going concern issues but FAR does not believe that a separate going concern section is the appropriate solution. FAR suggested in the response to the ITC document that going concern issues, when there are issues, should continue to be reported under the heading Emphasis of Matters. FAR also suggested that when there are no going concern issues, it would be sufficient to provide information under the heading Auditor's responsibilities for the Audit of the Financial Statements stating that the auditor's responsibilities include an evaluation of the management's assessment that a going concern basis of accounting is appropriate and an evaluation of management's assessment of the entity's ability to continue as a going concern. FAR strongly recommends the IAASB to consider this alternative way to deal with going concern in the auditor's report. Especially in a situation, as currently, when management is not required to disclose its assessments over going concern in the financial statements and the concept of going concern is inconsistent between different accounting frame works, it is extremely significant that the auditor's communication does not increase the auditor's risk unproportionally.

(b) Whether the auditor has identified a material uncertainty that may cast significant doubt on the entity's ability to continue as a going concern, including when such an uncertainty has been identified (see the Appendix of proposed ISA 570 (Revised)?

In this regard, the IAASB is particularly interested in views as to whether such reporting, and the potential implications thereof, will be misunderstood or misinterpreted by users of the financial statements.

See FAR's response to question 9 (a).

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?

If going concern shall be addressed in the auditor's report regardless of whether any issues have been identified or not, FAR agrees with the IAASB that an explicit statement should be made that the auditor cannot guarantee that the assessments regarding going concern are correct. The reference to management in this paragraph should in FAR's opinion be deleted since the auditor shall not speak for the management. However, referring to FAR's response to question 9 (a), information over going concern should rather be placed under the heading of Emphasis of matters when there are going concern issues, or under the heading Auditor's responsibilities for the Audit of the Financial Statements when no issues are 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?

In FAR's opinion, a detailed list of all sources that constitute the complete ethical requirements in a jurisdiction is not useful to the users of the auditor's report. FAR believes that a reference to ethical requirements for auditors in the relevant jurisdiction is sufficient.

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?

Sweden has, for a long time, had a requirement that the engagement partner must sign the auditor's report, and FAR is not aware of any difficulties in connection with that requirement. Generally, FAR is therefore positive to a requirement in ISA that the name of the engagement partner must be included in the auditor's report and that the report is signed by the engagement partner.

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?

FAR's comments to the various subjects in paragraph 102;

- *Improved description of the responsibilities of the auditor and key features of the audit*: FAR has no objections to the new description of the audit, and agrees that it is an improvement to the wording in the current auditor's report.

- *Relocation of the description of the responsibilities of the auditor and key features of the audit to an attachment or to a website*; FAR welcomes that some of the standard information regarding the audit is placed in an attachment to the auditor's report or on a website. However FAR is concerned about the proposal in ED 700 paragraph 40, admitting that the information about the audit when placed on a website need not be identical to the information when it is placed in the auditor's report or in an attachment (i.e. in accordance with ED 700 paragraph 37-38). Even though the auditor is required to determine that the information when placed on a website is not inconsistent with paragraphs 37-38 in ED 700, differences in the wording and length can affect how the user understands the responsibility. FAR believes that when information about the audit is published on a website and not identical to the wording in paragraphs 37-38, the auditor should consider not referring to the website but placing the information in the auditor's report or in an attachment.

- *Reference to who in the entity is responsible for overseeing the Entity's financial reporting process*: FAR believes it is an improvement to include a reference, when relevant, to who is responsible for overseeing the financial reporting process.

- *Other reporting responsibilities*; FAR welcomes the more flexible approach the IAASB introduces by not prescribing that other reporting responsibilities must always be placed in the separate section Reports from Other Legal and Regulatory Requirements.

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?

FAR notes that one reason for the IAASB to allow for full flexibility in the order of the various elements is that respondents have claimed that cultural reasons make flexibility necessary. Full flexibility means that entities from a certain jurisdiction may provide users from a certain culture with an auditor's report with the elements presented in an order that suits that certain culture. However, full flexibility also means that entities with international stakeholders or entities operating in jurisdictions with inhabitants from more than one culture can only meet the preferences of one user group. However, FAR accepts the IAASB's decision to allow flexibility, but recommends the IAASB to encourage national standard setters and auditor's to apply the same order of the elements as in ISA 700, when the users of the auditor's reports are multi-cultural.

Appendix 2

(Refers to FAR's response to the IAASB's question 2)

Example 1
The new proposed ISA 701 states in paragraph 8 c that circumstances that require significant modification of the auditor's planned approach to the audit, for example caused by the identification of a significant deficiency in internal control, should be considered when determining KAMs to report.

Further, ISA 701 A23 states the following:

"ISA 265 requires the auditor to communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis. The auditor is not required by the ISAs to report externally on significant deficiencies in internal control identified during the audit. However, the identification of a significant deficiency may be an indicator of a KAM relating to the area(s) of the financial statements affected by the significant deficiency."

In applying ISA 701, the quote above states that, on the one hand, the auditor should not report externally on significant deficiencies in internal control, but on the other hand the same deficiency may be identified as a KAM. This is illustrated by the following example:

> Client B is a public bank where we have identified credit risk in the loan portfolio as a KAM. Our initial audit approach is control based. When we performed audit procedures for General IT controls to verify access rights in the loan system we noted that there are a number of super user access rights and that a number of access rights still remain for employees that have left the company. The company has not implemented any compensating controls to reduce the risk of unauthorized access to the loan system. However, we are able to reduce the risk of material misstatement to an acceptable level by using data analytics for the whole transaction loan base, as a substantive audit measure, to ensure that no significant unauthorized adjustments have been made. The company also immediately initiates a project to rectify the deficiencies in access rights but this has not been finalized at the time of the auditor's report.

FAR assumes that an auditor normally would consider the described significant modification of the planned audit approach to be a KAM in accordance with paragraph 8 in ISA 701 and hence included in the auditor's report.

The auditor concludes that he or she has no problem in providing an unmodified opinion on the financial statements, but by including the problem with access right as a KAM the auditor will probably harm the bank, as this type of business is very sensitive to indications that they do not have full control over its IT systems. It is stated in paragraph A36 that the auditor should consider how to best describe the KAM which is viewed as being sensitive, e.g. a significant deficiency in internal control. However, as explained in this example, it will be almost impossible to describe this matter without the risk of harming the company. On the other hand, if the auditor has determined that this matter is a KAM (which FAR believes normally would be the case), the auditor has no alternative but to include this as a KAM in the auditor's report to comply with ISA, and by doing so harm the company. FAR realizes that sensitive KAMs must also have a place in the auditor's report, but is concerned that there is no option to omit KAMs that seriously may harm the company. In FAR's opinion, it is very doubtful whether it is in any stakeholders' interest that a financial statement audit should harm the company when there is no modification in the audit opinion.

Example 2

The practical implications in Sweden of the new auditor's report have been considered. FAR will, with this second example, describe how the introduction of KAM affects a Swedish audit. The following background information is considered appropriate to understand the scope of an audit in Sweden in relation to an ISA-audit:

1. In addition to auditing the financial statements in accordance with ISA, a Swedish auditor also audits the administration report. The latter audit is regulated by a Swedish auditing standard.

2. An audit of the president's and the board of directors' management of the company. This audit is also regulated by a Swedish auditing standard. The objective with this audit is to assess whether the president and/or individual directors by acting intentionally or negligently have harmed the company (which could result in liability for damages versus the company) or otherwise acted in violence of the Companies Act, the applicable Accounting Act or the company statutes.

3. An audit of the board of director's proposal regarding the disposition of the accumulated profit or loss of the company.

A statutory auditor in Sweden also has a number of reporting requirements in accordance with law. The most important are:

1. An annual auditor's report to the shareholders which covers the three components discussed above.

2. A requirement to communicate with management and the board to report the observations from the audit.

3. A requirement to issue a formal objection to the board if the auditor has made observations in the audit which are severe and requires actions to be taken by the board. The formal objection can be seen as a red flag for future potential remarks in the auditor's report.

In FAR's analysis of the proposed new ISA 700 and ISA 701, FAR has assumed that the concept of KAM in Sweden will not only relate to the audit of the financial statements but also to the audits of the administration report as well as the presidents and the board of directors' management of the company. FAR wants to make the IAASB aware that there probably will be a need for special considerations by a Swedish auditor regarding KAM-reporting when it comes to the auditing and reporting areas in addition to ISA. Regarding the national reporting requirement 3 above (formal objection) let us illustrate it with the following example:

NN is auditor in a small public company. The audit of the annual report went well and resulted in few and small observations. However, NN observed that the board of directors had not organized its work in a manner which NN believes is appropriate for a public company. For example, the documentation of decision material is lacking or very thin and the board has not ensured a proper reporting flow to ensure that information can be provided to the market in accordance with the rules of the stock exchange. As NN believes that the observations are severe and requires immediate action by the board, he issues a formal objection in relation to Swedish law. The auditor also identifies the situation as a KAM in accordance with ISA 701 and consequently reports it in the auditor's report. However, as described above the legislator's purpose with the formal objection is that it should not be discussed in the auditor's report but only reported to the board, as a red flag and warning for potential future remarks in the auditor's report. Hence, it may be regarded as some kind of conflict between ISA 701 and Swedish law which a Swedish auditor must handle. NN has two alternatives which, due to legal uncertainties around KAM-reporting, may both cause him/her problems:

1. He/she includes the matter as a KAM which potentially results in that the stock exchange starts an investigation and/or a delisting. NN might be sued by the shareholders for the damage that the reporting in excess of the law has caused.

2. He/she does not include the matter as a KAM as he/she concludes that the information could damage the company. In the following year, the company encounters problems, partly due to lack of proper handling by the board. In the resulting investigation by the stock exchange and others, it becomes public that NN had issued a formal objection but not reported the matter in the auditor's report in accordance with ISA 701. NN might be sued by the shareholders for the damage caused by not reporting the KAM and NN is criticized by the Audit oversight body.