ASSIREVI
Associazione Italiana Revisori Contabili

Il Presidente

IAASB
International Auditing and Assurance Standards Board
529 Fifth Avenue, 6th Floor
New York, NY 10017
USA

22 November 2013

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

Dear Sirs,

Assirevi is pleased to have the opportunity to comment on the Exposure Draft – *Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs)* – issued by the International Auditing and Assurance Standards Board (IAASB) in July 2013.

Assirevi is the association of Italian audit firms. Its member firms represent the majority of the audit firms under the oversight of CONSOB (*Commissione Nazionale per le Società e la Borsa*) and are responsible for the audit of almost all of the companies listed on the Italian stock exchange. Assirevi promotes technical research in the field of auditing and accounting and publishes technical guidelines for its members. It collaborates with Governmental bodies, CONSOB, the Italian accounting profession and other bodies in the development of auditing and accounting standards.

Our detailed comments to the questions included in the Explanatory Memorandum are set out in the attached document.

Should you wish to discuss our comments please do not hesitate to contact us.

Yours faithfully,

Mario Boella
Chairman of Assirevi

20123 Milano - Via Vincenzo Monti, 16 - Tel. 02.436950 - Fax 02.437326
e-mail: info@assirevi.it - www.assirevi.it

RESPONSE TO THE IAASB EXPOSURE DRAFT:

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

(July 2013)

Introduction

Assirevi agrees with the IAASB's proposals to improve the auditor's report, but notes that they entail the following issues, especially those related to the Key Audit Matters ("KAM"):

- Increasing time pressure at the end of the audit when the identification of KAM is finalized, draft disclosures are prepared and discussed with management and those charged with governance ("TCWG") – will impact management, the audit committee and auditors
- Potential for these disclosures to become boilerplate over time – risk that the objectives of providing unique information to stakeholders over time will not be achieved
- Initial inconsistency in number and extent of detail of KAMs across similar industries, entities, etc.. Over time though, likely that users may help "shape" expectation for disclosure

In addition, as outlined in the responses below, Assirevi believes that the proposed changes of the auditor's report with the inclusion of the specific section of going concern should be reconsidered within a comprehensive reassessment of the requirements for reporting on going concern by both preparers and auditors.

Finally we draw to your attention that auditors and preparers' costs associated with applying the requirements should be considered.

<u>Responses to questions:</u>

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?

Although Assirevi is not a "user", we feel that our comments may be useful.

Generally speaking, presentation of KAM in a specific section of the auditor's report should effectively contribute to increasing its usefulness and value, providing users with information to better understand the entity, its financial statements and areas/captions subject to "significant judgement" and/or management's estimation procedures that the auditor has considered most significant as part of their audit, although responsibility remains with management and TCWG to provide adequate disclosures. We believe it may be useful for users to understand what financial statements areas have been identified by the auditor as having significant risks in accordance with ISA 315 (revised) or involving significant auditor judgement. We refer to the type of KAM defined in paragraph 8.(a) of ISA 701.

We have doubts about the usefulness for users of including the KAM identified in letters (b) and (c) of paragraph 8, i.e., the presentation of areas in which the auditor encountered significant difficulty during the audit (including with respect to obtaining sufficient appropriate audit evidence) and the circumstances that required substantial modification to the initially planned audit approach, including as a result of the identification of a significant deficiency in internal control. Inclusion of this information in the separate section of the auditor's report may not be fully and properly understood in the context of an audit performed to express an opinion on the financial statements. If the auditor overcomes the difficulties or performs alternative audit procedures to those initially planned, thus being able to express an opinion, Assirevi believes that users would not be aided by and/or interested in knowing about the matter[1]. Moreover, should the difficulties encountered or the change to the initially planned audit approach have a significant impact on the audit conclusions, the auditor may have to modify the audit opinion accordingly, not using the KAM section as specifically provided for by ISA 701.11.

Assirevi believes that the example KAM presented in the Illustrative Auditor's Report of the Explanatory Memorandum and in Illustrations 1 and 2 of the Appendix to the Proposed ISA 700 (revised) all refer exclusively to the type of KAM set out in paragraph 8.(a) of proposed ISA 701. Therefore we believe that, they do not provide information useful to understand the nature and scope of the information to be provided as KAM in the cases in letters (b) and (c). In fact in our opinion the "Acquisition of XYZ Business" example presented as a description of KAM in point 51 of the Explanatory Memorandum related to an area in which the auditor has encountered significant difficulty during the audit actually refers to a significant risk without providing any details or explanations about the difficulties encountered.

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?

Within the context set out in the reply to question 1 and with special reference to the KAM referred to in paragraph 8.(a) of the proposed ISA 701, we believe that the guidance in the Application and Other Explanatory Material is adequate in order to allow the auditor to identify the audit areas and aspects that could be qualified as KAM and that should be disclosed as such in the separate section of the auditor's report. In this case and without prejudice to the auditor's professional judgement in deciding what KAM to include, the risk of inconsistency and non-comparability of the auditor's reports, which continues to exist, should be modest.

Given our doubts as stated above about the actual usefulness for most users in including the KAM referred to in paragraph 8.(b) and (c) of the proposed ISA 701, we do not believe the guidance set out in paragraphs A20 to A23 of the Application and Other Explanatory Material to be particularly useful.

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?

See above.

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1 This information may be of interest to TGWG and regulators but different modalities are required, or could be appropriate, for these communications.

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?

Additional guidance should be provided about the nature and scope of the description and illustration of KAM as paragraph 10 of the proposed ISA 701 and paragraph A30 of the Application and Other Explanatory Material are too brief. The subsequent paragraphs, which provide more details, are not always sufficiently clear. We refer specifically to paragraph A36 which states that the auditor should decide how best to describe a matter classified (or classifiable?) as a KAM but which, due to, for example, its nature (e.g., a fraud risk specifically identified in the context of the entity or a significant deficiency in internal control) may not have been disclosed in the financial statements. In this case, we believe that the Standard should clearly indicate that the KAM section should not include information that is not disclosed in the financial statements (such as information related to areas of suspected fraud or potential illegal acts involving ongoing investigations and the reporting thereof may result in the auditor having to provide original information not included in financial statements). As we reiterate later, we do not agree with the inclusion of original information about an entity in the KAM section and it would be useful if ISA 701 included guidance on how descriptions could be developed to avoid the inclusion of original information.

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.

All the illustrative examples of KAM presented in the Illustrative Auditor's Report of the Explanatory Memorandum and Illustrations 1 and 2 of the Appendix to the Proposed ISA 700 (revised) include information useful to users in the context described in the reply to question 1. However, and especially as regards the "Valuation of Financial Instruments" and "Revenue Recognition Relating to Long-Term Contracts" examples, contrary to that set out in paragraph 9.(d) of ISA 701 whereby: "... the auditor does not express an opinion on these individual matters." and paragraph A25, the illustration seems to include the auditor's conclusions about the specific matter treated therein, which is inconsistent with the general principle that audit procedures are defined as part of the audit of the financial statements as a whole and performed solely to express an opinion thereon.
The content of paragraph A41 of the Application and Other Explanatory Material also seems inconsistent when it states that, in order to avoid creating uncertainty for the user of the financial statements and the auditor's report as to whether the KAM was satisfactorily resolved, the auditor may also consider it necessary to address the specific outcome of the auditor's response and the conclusions of the procedures performed and a need for the auditor to avoid giving the impression that the discussion about KAM in the auditor's report is intended to convey an opinion on individual matters.

In short, we believe that inclusion of conclusions on individual financial statements areas, significant risks identified or specific audit procedures performed does not meet the requirements to provide users with transparent information. Moreover, it may be misleading with respect to the audit scope. Accordingly, we feel that the Standard should expressly preclude to include conclusions about individual KAM or outcomes of audit procedures, which would imply a piecemeal opinion.

We recommend that the examples be included in ISA 701, either in the actual Standard or the appendix or at least in the Application and Other Explanatory Material, as they describe how the auditor should present the KAM. The examples should be adjusted to address our comments above about the unsuitability of the conclusions contained therein. They should be presented in accordance with point 51 of the Explanatory Memorandum (also to be revised to reflect the above considerations and our reply to question 1 about the “Acquisition of XYZ Business” example). The reason why some examples include a description of the audit procedures while others do not should also be explained better. If the illustrative examples had more complete background information, this would help the auditor to avoid the use of these examples as “boilerplate descriptions” for similar matters.

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?

In principle, Assirevi believes that any change aiming to reduce the information gap, such as providing the KAM in the Auditor’s Report, needs to be adopted only for listed entities, given the large number of stakeholders involved and the special need for reliable information, especially considering the objective of correct working of markets.

With respect to the possibility to include the KAM voluntarily when agreed by the parties as per paragraph 30 of the Proposed ISA 700, we feel that this would lead to an undue different levels of information being provided to users.

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 position indicated in the proposed ISA 701 according to which the auditor may determine that there are no KAM to be communicated in the auditor’s report. We believe that this could occur in limited circumstances, especially for small and medium size listed entities.
We agree with the specific procedures that the auditor should carry out in these situations, based on paragraph 61 of the Explanatory Memorandum, and the inclusion of a statement in the auditor’s report that there are no KAM 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?

We agree with the proposal made in the ED that, when comparative financial information is presented, the auditor's communication of KAM should be limited to the audit of the most recent financial period and the reasons supporting this position illustrated in paragraph 65 of the Explanatory Memorandum.

In addition to weighing down the auditor's report, the description of the KAM of the prior period leads to the risk that users may find it more difficult to understand. Moreover, it could not be provided in countries whose legislation provides that comparative information is provided through corresponding figures when the auditor's opinion only refers to the financial statements of the current period. It would be unusual for an auditor to only express an opinion on the current period financial statements while describing matters related to the prior period audit.

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 KAM, and how such concepts have been differentiated in the Proposed ISAs, although in practice we foresee a limited use of Emphasis of Matter and Other Matter paragraphs.

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.

In general terms, we believe that the auditors should not be the primary source of information about going concern and accordingly they cannot disclose information in their reports that have not already been presented in the financial statements, unless there is a disagreement with management about the going concern assumption or the adequacy of the management's disclosures.

At present IFRS require management to disclose material uncertainty that could cast doubt on the entity's ability to continue as a going concern., but they do not require a disclosure about the absence of material uncertainties.
The extant Italian financial reporting framework does not require to management specific disclosures on material uncertainties on going concern. Also, where material uncertainties exist about the going concern assumption, as already stated in our reply to Invitation To Comments, the current guidance in the accounting framework for financial statements prepared under Italian GAAP is very brief and does not provide for either specific definitions about the going concern assumption or what information should be disclosed in the various circumstances. Therefore, as disclosure requirements similar to those of the IFRS for management (IAS 1.25) do not exist, a paragraph on management's responsibilities about the use of the going concern assumption as proposed by Proposed ISA 570 (revised) would not be appropriate.

In such context, Assirevi believes that the inclusion of the subject subparagraph in the auditor's report would require amendment in the IFRS and talian regulations in order to provide that management states in the notes to the financial statements that the financial statements have been prepared on a going concern basis and also specifically that there are no material uncertanties that may cast significant doubt about the entity's ability to continue as a going concern. Accordingly, as already specified in our reply to previous IAASB Invitation to Comments, we believe that a more "holistic" approach to a comprehensive re-assessment of the requirements for reporting on going concern by both preparers and auditors to resolve potential conflicts between auditing standards and reporting standards would be more appropriate.

Consequently, we support that the IAASB and IASB take steps to promote consistency between the requirements of auditing standards and those of reporting standards, before revising ISA 700 and ISA 570.

We note that there are a number of initiatives in place around the world intended to explore enhancements to reporting about going concern aimed at providing better and timelier information to users regarding potential going concern issues. We note that:

- There appears to be a lack of clarity about the meaning of certain terminology used in current reporting, such as whether a conclusion on the "appropriateness of the use of the going concern assumption" is the same as the "ability to continue as going concern."
- The concepts of "material uncertainty" and "significant doubt" are not well understood by users, and can be subject to differing interpretations by both preparers and auditors.
- There appears to be an expectations gap between what users think auditors should warn of in respect of going concern, and what auditors are required to do under ISA 570.

The proposed revisions to ISA 570 relate primarily to the disclosures and do not comprise the "holistic approach" mentioned above. In absence of the "holistic approach", we believe that there is increased risk of inconsistencies in the reader's understanding of the financial statements about the going concern assessment and the responsibilities of the management and the auditor. Accordingly, we would not view favourably an approach different than the "holistic approach".

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 do not object to the 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. However, this requirements could be reconsidered as part of said "holistic" approach to a comprehensive re-assessment of the requirements for reporting on going concern by both preparers and auditors.

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 agree with the position presented. However, considering the complexity of independence requirements it could be difficult for the reader to fully appreciate the statement. We think that the ethical requirements should be limited to the local jurisdiction and/or IFAC rules, disclosing both, or whichever is more stringent.

With Group Audit scenarios, we think only the requirements of the Group Auditor should be disclosed, for clarity and length of report.

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?

Indication of the engagement partner's name in the audit report is consistent with Italian legislation about auditors' responsibilities for audits of financial statements of all entities, listed and unlisted.

Therefore, the content of paragraph 42 of the Proposed ISA 700 (revised) would not impact preparation of auditor's reports under Italian law and auditing standards.

However, we believe that the compromise suggested by the IAASB in said paragraph 42 (indication of the engagement partner's name only for listed entities, except in rare circumstances) is adequate to account for the different legislative and juridical frameworks.

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?

Improved description of the responsibilities of the auditor and key features of the audit

No critical issues identified.

Provision for the descriptions of responsibilities of the auditor and key features of the audit to be relocated to an appendix in the auditor's report, or for reference to be made to such a description on the web site of an appropriate authority

We believe that descriptions of responsibilities of the auditor are important and help limit the expectation gap. Therefore, they should be maintained in the report body and not relocated to an appendix in the auditor's report or to the web site of an appropriate authority.

Reference to whom in the entity is responsible for overseeing the Company's financial reporting process

We approve any initiative aimed at improving users' understanding of the responsibilities of management and TCWG. Therefore, we agree with the wording of paragraphs 32 and 33 of the Proposed ISA 700 (revised). Moreover, the current content of these paragraphs and the related guidance paragraphs allows mention of the location, which is necessary to account for the different national jurisdictions.

Other reporting responsibilities

The wide variety of circumstances that could arise in the various national legislations (for example, the Italian legislative framework requires expression of an opinion on the consistency of the directors' report with the financial statements) may lead to the inclusion of information in excess of that which the Proposed ISA 700 (revised) requires be included in Other information. As a result, the flexibility envisaged by the Proposed ISA 700 (revised) could assist eliminating confusion about what work was actually performed by the auditor.

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?

We believe that global consistency is of fundamental importance, especially with respect to the auditor's report as it is the "external" evidence of the audit. The use of a auditor's report model which is similar from country to country improves the comparability of financial statements of entities active internationally as it allows the easy identification of important issues, independently of whether the ISAs are used or other auditing standards that are consistent with the ISAs. Therefore, we believe it would be better to recommend a mandatory ordering of sections for all those countries whose legislation or regulations do not specify the reporting formats.
Based on what indicated above we do not agree with the IAASB's proposal not to mandate the ordering of sections of the auditor's report.

Milan, 22 November 2013