

5 November 2013

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

Dear Mr Gunn

Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing

Please find below the Australasian Council of Auditors-General (ACAG) response to the proposed key changes to the ISAs. The Attachment contains our response to the specific questions in the Exposure Draft. The views expressed in this submission represent ACAG members within Australia, Papua New Guinea and Fiji. We understand the Auditor-General of New Zealand will make her own submission.

ACAG supports the Board's endeavours to enhance the auditor's report and make it more meaningful to users. ACAG substantially agrees with the proposals from a public sector perspective.

ACAG notes and supports the Board's intention to conduct a post implementation review to consider whether wider application of the proposals would be in the public interest. For this reason ACAG encourages the Board to consult with users and preparers, including those in the public sector about their information needs. This consultation should carefully consider the likely costs as well as the possible benefits. The Attachment to this letter notes a number of matters that may not be best suited to application in the public sector. In addition, ACAG suggests any future expansion of requirements arising from the post implementation review be the subject of a separate exposure draft.

With regard to the proposals relating to Key Audit Matters (KAM) ACAG:

- notes the requirements are obligatory only for audits of listed entities. ACAG expresses no view on whether the proposals are appropriate for listed entities.
- advises some members have significant concerns on a number of matters if the proposals in their present form were extended to the public sector
- requests that in ISA 700 at paragraph 46(g) the Board clarify that where the auditor of a non-listed entity has elected not to communicate KAM in the independent auditor's report, the auditor is not required to refer to KAM appearing in a separate report.

In relation to the specific matters for comment, ACAG expresses no view on whether the proposals are appropriate for listed entities.

The opportunity to comment is appreciated and I trust you will find the attached comments useful.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Simon O'Neill', with a horizontal line underneath.

Simon O'Neill

Chairman
ACAG Financial Reporting and Auditing Committee

CC Australian Auditing and Assurance Standards Board

Specific matters for comment

Question 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?

From a public sector perspective, ACAG believes the information will enhance the usefulness of the auditor’s report. ACAG encourages the Board to continue to consult with different classes of users and preparers about whether the benefit from the enhancements will outweigh the costs before extending the proposals to the audits of other entities.

Question 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?

From a public sector perspective, ACAG considers that the framework is adequate to guide the auditor’s judgement.

Question 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?

Yes, for public sector purposes. ACAG also notes that when there are several key audit matters (KAMs) the guidance only advises the auditor to consider whether all the matters are really the KAMs. ACAG believes it may be appropriate to include an option to combine one or more KAM if they share several characteristics. This has not been included as an option, and the Proposed ISA is silent on whether this would be acceptable.

Question 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 four examples are useful in enhancing user confidence in the audit process. They deal with most of the types of matters that the proposed standard intends should be addressed. In addition, ACAG believes the examples stay within the boundary of the auditor’s responsibilities.

The examples also illustrate the need for great care in drafting KAMs. ACAG has two suggestions for improving the existing text. In relation to the “valuation of financial instruments”, the final sentence may contain an apparent contradiction in that the auditor says their procedures included testing controls over development and calibration of the model “and confirming that management had determined it was not necessary to make any adjustments ...”. Presumably the auditor was satisfied adjustments were not necessary. In the example on long term contracts, the sentence that “side agreements may be inadvertently unrecorded or deliberately concealed and therefore present a risk of material misstatement” does not need to finish with the words “due to fraud”.

ACAG notes however, that an example could be added which illustrates a KAM which involves circumstances which require significant modification to the auditor’s planned audit approach, including as a result of a significant deficiency in internal control.

Illustrative examples of KAMs should also be provided for scenarios stated in the proposed ISA 701 paragraph 8(b) and 8(c). The current examples only relate to the paragraph 8(a) scenarios.

The illustrative example on the Revenue Recognition Relating to Long-Term Contracts as currently worded appears to express an audit opinion on the matter.

Question 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?

From a public sector perspective, ACAG agrees that if KAMs are communicated on a voluntary basis, proposed ISA 701 must be followed.

Question 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?**

From a public sector perspective, ACAG considers it necessary to allow for the possibility that there are no KAMs to communicate. We would prefer that the auditor’s report in such circumstances should not need to mention that there were no KAMs.

The proposals are currently limited to listed entities, where an assumption that a KAM must exist may be valid. However if the eventual standard did not make allowance for the possibility that the auditor may identify no KAMs to communicate, and the proposals were extended to other entities, problems may arise. Because of statutory obligations, Auditors-General may be required to audit agencies with few, or even nil transactions.

Question 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?

ACAG agrees with the proposals.

Question 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?

From a public sector perspective, ACAG agrees with the retention of Emphasis of Matter paragraphs and Other Matter paragraphs.

Question 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?

ACAG does not think the audit report, at least in the public sector, should expressly opine on the appropriateness of management’s use of the going concern basis.

ACAG notes mandatory audit comment on going concern exceeds the obligation on management and those charged with governance.

If comment on going concern is required, it would be useful for the Board to provide specific guidance and illustrative examples of appropriate wording for public sector applications.

(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.

ACAG does not agree with the statements in the illustrative auditor’s reports.

Based on field testing by one of our member Offices ACAG considers such reporting may be misunderstood or misinterpreted by users of the financial statements. ACAG is concerned that the required statements in paragraphs 20, 22 and 23 in proposed ISA 570 (Revised) are very

prescriptive and appear contrary to the spirit of more flexibility in reporting on issues that are of specific interest to the entity's readers. ACAG notes that proposed ISA 701.A30 encourages auditors to limit the use of highly technical auditing terms in order to enable users who do not have a reasonable knowledge of auditing to understand the description of key audit matters. ACAG considers that "users who do not have a reasonable knowledge of auditing" would also have difficulty understanding the implications of the going concern reporting as currently envisaged in proposed ISA 570.

Question 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?

ACAG substantially agrees with the proposals and considers this statement should also be required when an entity has identified and disclosed a material uncertainty, but the entity is still a going concern. Proposed ISA 570(Revised) paragraphs .22 and .23 currently do not require such a statement.

Question 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?

From a public sector perspective, ACAG agrees substantially with the proposals. However, in any jurisdiction there may be any number of laws and regulations establishing and governing the operations of the public sector entities within that jurisdiction. Each of those laws and regulations may contain specific provisions relating to independence and ethical requirements. In some Australian public sectors this would amount to at least 10 sources and listing all of them would detract from the readability of the report while adding very little of substance. ACAG believes the standard should be clarified such that a statement of compliance with the professional standards on independence and ethics should be sufficient, except where laws and/or regulations override or add to those professional standards. In such instances the primary sources of independence and other ethical requirements should also be specified in the auditor's report.

Question 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?

ACAG supports the proposal.

From a public sector perspective ACAG requests the term "engagement partner" be amended to "engagement partner or public sector equivalent".

Question 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?

From a public sector perspective, ACAG agrees substantially with the proposals. However, we note the proposals allow the auditor to remove from the auditor's report the description of the auditor's responsibilities and to instead allow the auditor to refer to a website of an appropriate authority should be dependent upon such a body committing to ensure the accuracy, completeness and continued availability of the standardised information, which is outside the control of the auditor.

ACAG suggests that the information would sit best within the auditing standards framework as it gives the information a legislative or quasi legislative status and provides for version management.

Question 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?

ACAG agrees substantially with the proposals.

ACAG requests that in ISA 700 at paragraph 46(g) the Board clarify that where the auditor of a non-listed entity has elected not to communicate KAM applies ISA 701 in the independent auditor's report, the auditor is not required to refer to KAM appearing in a separate report.