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Dear James

Exposure Draft: "Reporting on audited financial statements: Proposed new and revised International Standards on Auditing (ISAs)"

Thank you for the opportunity to comment on the IAASB's auditor reporting proposals. Our main concerns and the responses to the specific questions raised by the IAASB in their Exposure Draft are detailed below.

Main concerns

- ***Artificial differences*** – Despite all the consultation to date we are extremely disappointed to still see what many would regard as artificial differences between the IAASB's definition of "Key Audit Matters", the PCAOB's "Critical Audit Matters" and the UK FRC's risks of material misstatement which had the greatest effect on the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. In our opinion, it is likely that audit reports produced under the three different approaches will be very similar as auditors will seek to apply the requirements in a sensible and consistent manner but, at a time when international consistency is increasingly important and is expected by global clients, it is unhelpful to have respected standard setters introduce these artificial inconsistencies and we urge the IAASB to work with the other standard setters to provide the consistency that everybody wants.

- ***Inclusion of going concern*** - In our view, going concern is primarily a financial reporting matter that is the responsibility of the directors not an audit reporting point, and the IAASB should not, at this time when accounting standard setters are looking at this issue, make changes to the auditor reporting requirements to include what is just boiler-plate wording regarding going concern that adds little or no value. Lengthening the audit report wording in relation to going concern may have the unintended effect of diluting the message conveyed rather than drawing attention to what is an important matter. We do not agree with the inclusion of an explicit statement that neither management nor auditors can guarantee the entity's ability to continue as a going concern and if the IAASB were to insist on including such a statement we request that the reference to "management" is deleted. Management are responsible for the running of the company and through the directors for the preparation of the financial statements on a going concern basis and therefore do have a great deal of control over the future of the company whereas auditors do not and it is wrong to give this impression.

Response to specific questions asked by the IAASB

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?

As noted in our previous responses to the IAASB on auditor's reports we do not consider that the unqualified auditor's report is an appropriate place for original auditor reporting on the financial statements particularly where this merely acts as a cover for inadequate financial statement disclosure. We do not know what users of financial statements believe, the IAASB and national standards setters have consulted with investors who say there is a demand for change but we see little evidence of this from our clients. In our opinion 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 has the potential to enhance the usefulness of the auditor's report but only if it is applied properly and does not degenerate into standard boiler-plate wording that in our opinion does not help anyone. It remains to be seen whether investors will find the audit report useful, particularly if they have two or three years of seeing the same risks being reported.

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?

YES

Paragraph 8 of ISA 701 proposes that the auditor takes into account areas of significant auditor attention in performing the audit, including significant risks identified in accordance with ISA 315, significant difficulties encountered during the audit and circumstances that required a significant modification to the auditor's planned approach. We believe that, although there is some overlap between these categories, 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" (KAMs).

In addition to these points the IAASB should also consider the recent PCAOB consultation which highlighted the importance of including in their "Critical Audit Matters" (CAMs) matters that posed the most difficulty to the auditor in forming the opinion on the financial statements. ISA 701.11 states that a matter giving rise to a qualified or adverse opinion or the existence of a going concern material uncertainty is by its nature a KAM but does not deal with matters that posed the most difficulty in forming the opinion but did not ultimately lead to a qualified or modified opinion or emphasis of matter. In our view a reader of the auditor's report would be very interested to know where the auditor was close to issuing a qualified or modified opinion or including an emphasis of matter and the reasons why they did not.

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?

YES

Despite all the consultation that has taken place and discussions with investors we are extremely disappointed to still see what many would regard as artificial differences between the IAASB's definition of "Key Audit Matters" and the criteria for identifying them, the PCAOB's "Critical Audit Matters" and related criteria and the UK FRC's risks of material misstatement which had the greatest effect on the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. All of these standards setters have had the opportunity to consult with each other and have been speaking to investors, who presumably have been saying the same things when asked what they want, but despite that the standard setters have come out with proposals that are similar enough to make no difference to a reader of the financial statements but different enough that they can be challenged by regulators and attacked by lawyers. In our opinion, it is likely that audit reports produced under the three different approaches will be very similar as auditors will seek to apply the requirements in a sensible and consistent manner but, at a time when international consistency is increasingly important and is expected by global clients, it is unhelpful to have the leading standard setters introduce these artificial inconsistencies and we urge the IAASB to work with the other regulators to provide consistency.

One of the main concerns from a UK perspective is the interaction of the auditor reporting of risk with the UK corporate governance requirements for audit committees to make disclosure of matters that the auditor has brought to their attention and the potential repetition that could take place as a result of this dual requirement. There is already evidence in some of the early reporters under the FRC's new ISA (UK and Ireland) 700 that risks have been repeated in the auditor and audit committee reports with little value or insight added by either and we question how useful this is to investors. ISA (UK and Ireland) 700.19B states that matters set out in the auditor's report are required to "be reported in a manner that complements the description of significant issues relating to the financial statements, required to be set out in the separate section of the annual report describing the work of the audit committee in discharging its responsibilities" and goes on to say that the auditor seeks to "avoid duplication of reporting". This point seems to have been overlooked by some of the early reporters and we have drawn this to the attention of the FRC. We recommend that the IAASB include some guidance to try and avoid unnecessary duplication between auditor reporting of risks and the risks already reported by the audit committee in the front section of the annual report and the critical accounting estimates and judgements that the directors are required by IAS 1 to disclose in the financial statements..

In earlier consultations we were concerned about the number of risks that might be reported and the fact that investors and regulators would demand all risks to be included in the audit report. The European Securities and Markets Authority (ESMA) has recently published a set of priority issues to be used by EU national competent authorities in their assessment of listed companies and regulators in EU countries might focus on whether those priority issues have been dealt with in the auditor's reporting of risks and if not ask why. There is some good guidance in ISA 701.A1 suggesting that a relatively smaller number of matters should be reported compared to the matters communicated with those charged with governance, and in ISA 701.A7 which says that the greater the number of key audit matters, the less useful the auditor's communication of key audit matters may be. ISA 701.A16 says that in determining whether significant risks are key audit matters it is likely that the auditor will give greater consideration to significant risks that have been specifically identified in the context of the entity, rather than to those that are identified only because they are presumed by the ISAs to be significant risks. In our view, the guidance about the number of KAMs and inclusion of presumed risks is very important but it is lost in the guidance notes to the standard. We consider that this guidance should be given greater prominence otherwise the auditor is likely to include overly long lists of KAMs, including the presumed risks of management override of controls and risk of fraud in revenue recognition, because they are fearful that they might leave out something important and be challenged by their regulators or other users of the accounts.

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?

NO

ISA 701.38 states that the description of the KAM would include a brief overview of the procedures performed, or the auditor's approach to the matter, or may include an indication of the outcome of the auditor's procedures. In our view this does not provide the auditor with much guidance and we would expect the ISA to be more specific and as a minimum we would expect the description to refer to the relevant financial statement accounts and disclosures that relate to the KAM as envisaged by the draft PCAOB guidance.

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.

We found the illustrative examples useful in informing our comment on the exposure draft but the inclusion of examples such as these in an auditing standard is likely to encourage boiler-plate wording and in our opinion the examples should not be included in the final standard.

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?

YES

We agree with the approach taken by the IAASB in relation to KAMs for entities where the auditor is not required to provide such communication but does so on a voluntary basis. In these circumstances we agree that the proposed ISA 701 must be followed and the auditor must signal this intent in the audit engagement letter.

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?

This is a difficult area and it would be better if the IAASB maintained a clear cut-off between where an auditor is required to report KAMs and where the auditor is not. Voluntary reporting is by definition the decision of the auditor who will need to have good reasons for doing so and the IAASB is in danger of undermining its decision to limit reporting of KAMs to listed entities by seeming to encourage reporting of KAMs in other situations. In our view, the requirement for KAMs in relation to listed entities does provide the clear cut-off needed. We acknowledge that the definition of listed entities varies between countries and may require guidance from national standard setters as has already been required for the adoption of IFRS.

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?

YES

It is appropriate for proposed ISA 701.13 to allow for the possibility that the auditor determines that there are no KAMs to communicate.

(a) If so, do respondents agree with the proposed requirements addressing such circumstances?

YES

We agree that where the auditor has identified no KAMs they should discuss it with the engagement quality control reviewer, communicate it with those charged with governance and explain it in the auditor's report.

(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?

N/A

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?

YES

We agree that when comparative information is presented the auditor's description of the KAMs should be limited to the audit of the most recent period's financial statements.

If not, how do respondents suggest these issues could be effectively addressed?

N/A

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?

YES

We agree with the IAASB's decision to retain the concepts of Emphasis of Matter (EOM) paragraphs and Other Matter (OM) paragraphs. This is going to be necessary in the UK where the FRC's requirement for the auditor's report to include a measure of materiality for the financial statements as a whole will mean that this is regarded under IAASB standards as an OM rather than a KAM.

We anticipate difficulties in the interaction between KAM's and EOMs which is likely to lead to repetition where the KAM and EOM address the same point. It is very unlikely that an EOM will not also be KAM and the IAASB guidance should address this but it is much more likely that there will be situations where a KAM is not reflected in an EOM and this situation needs to be acknowledged by the IAASB and guidance provided otherwise it may be challenged by regulators.

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.

NO

Although the statements about going concern really only just confirm what the auditor was doing already we question whether the auditor should be making statements about going concern when it is the directors' responsibility to prepare the accounts on a going concern basis and make sufficient disclosures about this. In our view going concern is primarily a financial reporting matter not an audit reporting point and the IAASB should not, at this time when accounting standard setters are looking at this issue, make changes to the auditor reporting requirements regarding going concern.

Our main concern with the requirement is how the interaction between going concern KAMs, EOMs and the mandatory statements when going concern issues do arise and the need to avoid repetition of going concern problems in three places in the auditor's report.

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 our opinion, the lack of guidance about the interaction between going concern KAMs, EOMs and the mandatory statements and the confusion generated by potentially having going concern paragraphs in three different places within the audit report could mean that the going concern disclosures are misunderstood or misinterpreted by users of the financial statements. In our view the directors are responsible for the preparation of the accounts on a going concern basis and the directors should make sufficient disclosures in the financial statements to support that going concern basis with auditors only commenting if they disagree with the directors' view or want to draw attention, by way of emphasis, to the directors' disclosures when there is a material uncertainty that may cast significant doubt about the company's ability to continue as a going concern. There is a danger that any concerns the auditor may have about going concern will be lost in the increased boiler-plate disclosure made about going concern and either the message conveyed is diluted or the user may miss the warning signs entirely.

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 agree with the inclusion of an explicit statement that neither management nor auditors can guarantee the entity's ability to continue as a going concern. It is a statement of the obvious and adds nothing by including it in the auditor's report. If the IAASB were to insist on including the statement we request that the reference to "management" is deleted because management are responsible for the running of the company and through the directors for the preparation of the financial statements on a going concern basis and therefore have some control over the future of the company whereas auditors do not. A statement that neither management nor the auditor can guarantee the entity's ability to continue as a going concern gives the impression that management and the auditor have an equal responsibility for the entity's ability to continue as a going concern which is clearly not the case.

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 believe there are benefits to be gained from the proposed requirement to disclose the sources of independence and other relevant ethical requirements in the auditor's report. Users of financial statements should have access to the standards that the preparers of auditor's reports have to comply with so they can better understand the independence and ethical requirements faced by auditors.

In our view this is more complex in a group situation where auditors of different components could follow different national independence and ethical standards to the group auditor. We recommend that the IAASB considers the extent of disclosure required and whether in a group situation this should include the highest sources of independence and ethical requirements or the minimum level that is met by the group whilst still complying with IFAC requirements. .

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 agree with 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. The name of the engagement partner is already included in UK for auditor's reports issued under the Companies Act 2006 and the UK does not appear to have experienced any problems implementing this requirement. We recommend that if the name of the engagement partner is included that this is typed rather than a live signature included in a set of publicly available financial statements.

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 have no comments on the changes to the nature of and manner in which auditor and management responsibilities are disclosed in the auditor's report. In our view this type of boiler-plate material is best dealt with by including a link to a website rather than the inclusion in the auditor's report of lengthy standard paragraphs which will