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Our ref SS/288
Contact Sylvia Smith

22 November 2013

Dear Sirs

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

We are pleased to have the opportunity to respond to Exposure Draft, *Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs)* (the exposure draft) issued by the International Auditing and Assurance Standards Board (IAASB). We have consulted with, and this letter represents the views of, the KPMG network.

Overarching comments

We are in agreement with the IAASB that there has been a clear message from users that the auditor’s report needs to become more informative and transparent. We also believe that the proposals set out in the exposure draft are responsive to the feedback received from stakeholders by the IAASB on the Invitation to Comment: *Improving the Auditor’s Report*. We are therefore supportive of the thrust of the current proposals in the exposure draft.

The proposals when implemented will represent a significant change to the information provided in today’s auditor’s report. We therefore believe that the proposed and revised standards, especially proposed ISA 701 *Communicating Key Audit Matters in the Independent Auditor’s Report* (ISA 701), will be an important first step towards meeting the needs of users who want more insights from auditors than is provided under today’s model.

It is important that the IAASB evaluates user reaction to the expanded auditor’s report. We therefore support the IAASB’s planned post-implementation review. A critical part of such a review will be to understand if the information reported in the expanded auditor’s report meets the expectations of users and whether further enhancements are needed, for example, by broadening the key audit matters reported by auditors and/or the information included in the report regarding the auditor’s response to such matters. While we recognize that the IAASB is not able to require changes to auditors’ reporting responsibilities on its own within existing ISAs, it is nevertheless important that the IAASB’s post-implementation review includes consideration of whether users' expectations may be better met by having the auditor provide assurance on company information beyond the annual financial statements. Examples of such information may include earnings announcements; certain financial and non-financial information presented outside the financial statements such as information included in management discussion and analysis; company disclosures of key performance indicators or other operational or risk disclosures. We believe such additional assurance would contribute to narrowing of the significant expectation gap that exists today between what the audit is and what many in the market place believe or would like the audit to include.

The implementation of change works best when there is alignment of the goals of all stakeholders. Whilst the IAASB does not set rules that govern reporting by management and those charged with governance, we believe it is important that the IAASB encourages jurisdictions that adopt ISAs to also consider implementing requirements for management and those charged with governance to report on matters that were of most significance in the discharging of their responsibilities with respect to the preparation of the financial statements and oversight thereof. This will help to better align the reporting responsibilities of management/those charged with governance with those of the auditor in respect of reporting key audit matters.

Key audit matters

While we agree that the proposed requirements and related application material provide an appropriate framework to guide the auditor's judgment in determining key audit matters, we have the following observations.

- We are not supportive of including original information about an entity in the auditor's description of a key audit matter because it is the role of management and those charged with governance to provide information about the entity to users. However, we acknowledge that in rare cases it may be necessary when the description of a key audit matter would be incomplete without disclosing original information about the entity.

- It is important that the IAASB clarify that an auditor is not required to communicate a matter as a key audit matter when the auditor is precluded from reporting the matter by laws, regulations or other professional standards.

- It is important that the description of a key audit matter in the auditor's report does not undermine the opinion on the financial statements as a whole. For this reason, we are not supportive of the illustrative examples in the exposure draft that include a conclusion in the description of a key audit matter.

- We are supportive of having the auditor include a description of the auditor's response to each key audit matter in the report. Including this information in the report is consistent with the objective of providing more transparency into the audit.

In preparing our response to the IAASB, we compared the criteria in proposed ISA 701 to those provided by the Public Company Accounting Oversight Board (PCAOB) in its proposal on critical audit matters[1]. We note the two sets of proposals are similar, but not identical. This could lead to different matters being reported under each standard. We are concerned that users of financial statements for entities listed in the US and in other jurisdictions where ISAs apply may not understand why the same auditor is reporting different matters for the same set of financial statements. We recommend that the IAASB seek to work with the PCAOB to ensure that the criteria for identifying key or critical audit matters result in similar reporting of such matters under both standards, because we do not believe that differences in this area will be meaningful or helpful to users of the financial statements.

Going Concern

ISA 570 (Revised) *Going Concern* (ISA 570 (Revised)) requires the auditor to evaluate events or conditions that may cast doubt about an entity's ability to continue as a going concern and to determine whether or not such events or conditions represent a material uncertainty regarding an entity's ability to continue as a going concern. We agree with the proposal in the exposure draft that, when the auditor concludes a material uncertainty exists, this should be addressed in a separate section of the auditor's report in accordance with the requirements of ISA 570 (Revised). However, proposed ISA 701 is silent regarding the auditor's reporting responsibilities when the auditor identifies an event or condition that may cast significant doubt about an entity's ability to continue as a going concern but concludes that a material uncertainty does not exist. We recommend that the final standard clarifies that such a conclusion may represent a key audit matter because it often requires significant estimates by management, poses challenges in obtaining sufficient appropriate audit evidence and generally requires the application of significant auditor judgment.

Further, requiring the auditor to include statements relating to use of the going concern basis of accounting when no material uncertainties exist is, in our view, of limited informational value primarily because such statements would be included in all reports where going concern is not an issue.

Effective date for the new and revised ISAs

Assuming the final standards are issued in the second half of 2014, we would be supportive of the requirements being effective for annual reporting periods commencing on or after 15 December 2015. Given the significance of the changes, this would give firms sufficient time to develop internal guidance and training and to implement appropriate quality control procedures. However, we believe that early adoption should be permitted so as to allow those auditors who are in a position to apply the new requirements before this date to do so.

[1] PCAOB Release No. 2013-005, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*

Appendix 1 to this letter includes our response to the questions posed in the exposure draft. It also elaborates on the issues discussed above.

Please contact Sylvia Smith at +44 (0)20 7694 8871 if you wish to discuss any of the issues raised in this letter.

Yours faithfully

KPMG IFRG Limited

KPMG IFRG Limited

cc: Jean Blascos

Appendix 1

Key audit matters

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?

As auditors, we believe that including key audit matters in the auditor's report is an important first step towards better meeting the needs of users who want more insight into the audit that was performed than is possible under the current model.

We believe it is important that the IAASB evaluates user reaction to the expanded auditor's report. We therefore support the IAASB's planned post-implementation review. A critical part of such a review will be to understand if the information reported as key audit matters meets the expectations of users and whether further enhancements are needed, for example, by broadening the key audit matters reported by auditors and/or the information included in the report regarding the auditor's response to such matters.

While we recognize that the IAASB is not able to require changes to auditors' reporting responsibilities on its own within existing ISAs, it is nevertheless important that the IAASB's post-implementation review include consideration of whether users' expectations may be better met by having the auditor provide assurance on company information beyond the annual financial statements. Examples of such information may include earnings announcements, certain financial and non-financial information presented outside the financial statements such as information included in management discussion and analysis, company disclosures of key performance indicators or other operational or risk disclosures. We believe such additional assurance would contribute to narrowing the significant expectations gap that exists today between what the audit is and what many in the market place believe or would like the audit to include.

The implementation of change works best when there is alignment of the goals of all stakeholders. Whilst the IAASB does not set rules that govern reporting by management and those charged with governance, we believe it is important the IAASB encourages global and national organizations that establish governance standards and reporting for management and those charged with governance to report on matters that were of most significance in the discharging of their responsibilities with respect to the preparation of the financial statements and oversight thereof. This will help to better align the reporting responsibilities of management/those charged with governance with those of the auditor in respect of reporting key audit matters. For example, the UK Financial Reporting Council simultaneously introduced new requirements for auditors, directors and audit committees to report on the significant matters related to the financial statements and how these were addressed.

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?

We believe the proposed requirements and related application material provide an appropriate framework to guide the auditor's judgment in determining key audit matters. We also believe that proposed ISA 701 provides a reasonable basis for consistent auditor judgments about what matters are determined to be key audit matters. These conclusions were supported by the results of a field test performed by KPMG engagement partners from a number of countries. The partners participating in the field test agreed that matters communicated to those charged with governance that require significant auditor attention as described in paragraph 8 of proposed ISA 701 is an appropriate starting point for determining key audit matters. Having said this, our field test also identified the following areas requiring clarification.

- Application of requirements to separate financial statements of listed entities.

  Paragraph 4 of proposed ISA 701 indicates that this ISA applies to audits of complete sets of general purpose financial statements of listed entities. In some jurisdictions, entities are required to prepare and publish separate financial statements, such as parent company only financial statements, in addition to consolidated financial statements. We recommend that paragraph 4 of proposed ISA 701 clarify that the requirements of proposed ISA 701 apply only to the consolidated financial statements of the listed entity and not the separate financial statements of the parent company or other entities within the consolidated group.

- Clarification of the concept of significant auditor attention.

  We agree, as described in paragraph A12 of proposed ISA 701, that the concept of "significant auditor attention" should focus on areas of higher assessed risks of material misstatement, including significant risks. This is consistent with the risk-based approach to an audit. However, the last sentence of paragraph A12 of proposed ISA 701 appears to be inconsistent with this concept. It appears to be suggesting that a significant number of hours by the auditor or the auditor's expert may, on its own, be a trigger for a key audit matter. We recommend deleting this sentence to avoid this type of potential misunderstanding.

- Reporting key audit matters that conflict with requirements of laws, regulations or other standards.

  During the course of the audit, the auditor may address a matter that appears to meet the definition of a key audit matter, which the auditor is precluded from reporting by laws, regulations or other professional standards. For example, paragraph A19 of ISA 250 *Consideration of Laws and Regulations in an Audit of Financial Statements* notes that "the auditor's professional duty to maintain confidentiality of client information may preclude reporting of identified or suspected non-compliance with laws and regulations to a party outside the entity." Paragraph A65 of ISA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* makes the same observation with respect to suspected fraud. We therefore recommend that paragraph 9 of proposed ISA 701 clarify that the auditor is not required to communicate as a key audit matter a matter that the auditor is precluded from reporting by laws, regulations or other professional standards.

- Differences between IAASB and PCAOB proposed requirements.

  In preparing our response to the IAASB, we compared the criteria in proposed ISA 701 to those provided by the PCAOB in its proposal on critical audit matters[2]. We note the two sets of proposals are similar, but not identical. We believe that different matters could be reported under each standard and the descriptions of the same matter in the auditor's report may also differ. We are concerned that users of financial statement for entities listed in the US and in other jurisdictions where ISAs apply will not understand why the same auditor is reporting different matters for the same set of financial statements. We are also concerned that auditors reporting under both IAASB and PCAOB requirements may expend considerable effort trying to reconcile any differences between the two standards. We recommend that the IAASB seek to work with the PCAOB to ensure that the criteria for identifying key or critical audit matters result in similar reporting of matters under both standards because we do not believe that differences in this area will be meaningful or helpful to users of the financial statements.

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?

Generally, we believe that sufficient direction is provided with respect to what should be included in the description of a key audit matter. However, our field test did identify the following areas that could be improved.

- Including original information in descriptions of key audit matters.

  In describing key audit matters we do not believe it is appropriate for the auditor to include original information about an entity in the descriptions, but we acknowledge that there may be rare circumstances where the description of a key audit matter would be incomplete without disclosing original information about the entity. For example, a matter may be determined to be a key audit matter because there was a change to the planned audit approach as a result of a significant internal control deficiency. In this circumstance, the auditor may be reporting original information about the entity if it is determined that

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[2] PCAOB Release No. 2013-005, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*

describing an internal control deficiency, which is not normally disclosed by the entity, is necessary to the users' understanding of the key audit matter. We expect that in most cases entity information relevant to the description of a key audit matter will be disclosed in the financial statements. However, in some cases the relevant information may be disclosed in information accompanying the financial statements, such as the annual report. We believe it is appropriate for the auditor to consider information included in documents such as the annual report as part of the information set that has already been made available to users in assessing whether the description of a key audit matter would constitute providing original information about an entity. However, we do not believe the auditor should go as far as referencing information outside the financial statements in the auditor's report.

- Description of what constitutes key audit matters in the auditor's report.

  It is important that the descriptions of key audit matters in the auditor's report do not undermine the opinion on the financial statements as a whole, and that users understand that the matters described were addressed as part of the audit of the financial statements as a whole. For this reason, we are not supportive of the illustrative examples in the exposure draft that include a conclusion in the description of a key audit matters. Further, to clarify that audit matters are matters identified and addressed as part of the audit of the financial statements as a whole, we suggest that the introductory wording for key audit matters to the auditor's report be revised as follows:

  > *Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements <u>of [insert period]. The description is intended to provide a succinct explanation on why we determined the matter was one of most significance in the audit and how this matter was addressed during the audit.</u> Key audit matters are selected from the matters communicated with [those charged with governance], but are not intended to represent all matters that were discussed with them. Our audit procedures relating to these matters were designed in the context of our audit of the consolidated financial statements <u>taken</u> as a whole. Our opinion on the financial statements is not modified with respect to any of the key audit matters described below, and we do not express an opinion on these individual matters.*

- Describing the effect on the audit.

  The proposed requirements for communicating key audit matters set out in paragraph 10 of proposed ISA 701 suggest that the auditor may consider it necessary to include the effect of the matter on the audit in the explanation of why a matter was one of most significance in the audit. Our view is that the effect of a key audit matter on the audit would be of interest to users, and describing it would be consistent with the objective of providing more transparency into the audit. We therefore recommend that the proposed requirement for the auditor to provide a description of the effect of a key audit matter on the audit, to the extent they judge it necessary, be rephrased as a separate requirement of paragraph 10 that requires the auditor to include a description of the auditor's response to each key audit matter included in the auditor's report. We have included a possible version of the revised requirement below.

The auditor shall describe each key audit matter in the Key Audit Matters section using an appropriate subheading, except in the circumstances explained in paragraph 11. The description of each key audit matter shall include:

a) *An explanation of why the auditor considered the matter to be one of most significance in the audit; ~~and, to the extent the auditor considers it necessary as part of this explanation, its effect on the audit; and~~*
b) *A description of the auditor's response to the matter during the audit; and*
c) *A reference to the related disclosure(s), if any, in the financial statements.*

We also recommend that application material clarify that a high level overview of the auditor's approach to the matter would meet the objective of describing the response rather than providing details of audit procedures. Our revised introductory paragraph for key audit matters included above also provides recommended conforming changes.

- Ordering of key audit matters.

  We also believe that the second sentence of paragraph A29 of proposed ISA 701 that notes 'the ordering of key audit matters is a matter of professional judgment, but such matters may be best organized in order of relative importance' should be removed. There is no objective criteria for ordering and we do not believe ordering is relevant to a matter that has been reported as a key audit matter. In addition, this guidance may lead some users to give bias to key audit matters based on the ordering, which may not be properly informed.

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.

We acknowledge that the illustrative examples included in the exposure draft were designed to provide alternate presentations and prompt feedback from respondents, but overall they are very generic and without context. It is also unclear how they were developed in accordance with the description requirements of proposed ISA 701. We suggest that any illustrative examples included in the final standard are presented in a consistent format and that they address the following points.

- The illustrative examples of key audit matters should include:
  - background information to enable a reader to understand how the description aligns with the requirements of proposed ISA 701. The background information should be as specific as possible so as to avoid the illustrative examples being used as boilerplate descriptions for similar types of matters;
  - the related financial statement disclosures so that each example can be considered in the context of the financial statements; and
  - alternate wording for each key audit matter illustrated to demonstrate that there is more than one way to meet the description requirements. This would also help to reduce the chances of any illustrative disclosure being used as the boilerplate response for that type of key audit matter. Further, alternative wording for certain key audit matter illustrations should also show how changes to the related financial statement disclosures may affect the nature and extent of the description of the key audit matter in the auditor's report.

- The illustrative examples of key audit matters should not include:
  - a conclusion on the matter so as not to undermine the opinion on the financial statements taken as whole – see our response to Question 3; and
  - unnecessary adjectives that make the auditor's response to a matter unclear. For example, the illustrative key audit matter on 'Revenue Recognition Relating to Long-Term Contracts' has the following wording – We identified revenue recognition of long-term contracts as a significant risk requiring 'special' audit consideration. As 'special' is not a word that is defined in audit literature – e.g. the ISAs, it is unclear what meaning it is intended to convey.

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?

We agree that the inclusion of key audit matters should be mandated only in auditors' reports of listed entities. For all other entities, we agree that the auditor's report could include key audit matters when the intention to do so is communicated with management of the entity. In such situations, the auditor would be required to determine and communicate matters in the same manner as for listed entities – i.e. in compliance with all of the requirements of proposed ISA

701. There may also be some jurisdictions where the description of key audit matters will be required by law or regulation for entities other than listed entities.

We also believe that the value of providing key audit matters for entities other than listed entities should continue to be monitored and reconsidered as part of any post-implementation review of proposed ISA 701. If there is perceived value in mandating key audit matters for other types of entities, e.g. public interest entities, then the requirement to provide key audit matters could be extended to other types of entities in the future.

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?

We believe that it is appropriate to allow for the possibility that the auditor may determine that there are no key audit matters to communicate. We also agree with the proposed requirements for addressing such circumstances. However, we think that it will be rare that an auditor will determine there are no key audit matters to communicate in respect of a listed entity.

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?

We agree with the proposal that the requirements should be limited to the audit of the most recent financial period and that the lead-in paragraph should clearly state what period the key audit matters pertain to– see revised introductory paragraph for key audit matters included under Question 3.

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?

We agree with the decision to retain the concepts of emphasis of matter and other matter paragraphs, even when the auditor is required to communicate key audit matters. Retaining the concepts allows the auditor the ability to include additional matters that may not meet the definition of a key audit matter but may still be either in the auditor's judgement fundamental to the understanding of the financial statements or relevant to users' understanding of the audit. For example, an emphasis of matter paragraph may be required when an entity early adopts a new accounting standard or changes its accounting policy and an other matter paragraph may be required when there is a change in auditor.

Going Concern

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?

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.

We recognize that the enhanced reporting requirements being proposed by the IAASB are intended to be responsive to users and regulators who have asked for clarification of the roles and responsibilities of management and the auditor within existing requirements. Given this objective, we are supportive of enhancing current reporting requirements around the going concern basis of accounting. In our view, reporting on going concern and material uncertainties is most relevant when either:

- a material uncertainty has been identified, in which case it is included in the auditor's report in accordance with the requirements in ISA 570 (Revised); or

- an event or condition that may cast significant doubt about an entity's ability to continue as a going concern is identified, but it is concluded that a material uncertainty does not exist, in which case the matter is disclosed as a key audit matter (see discussion below).

We believe that statements relating to the use of the going concern basis of accounting and material uncertainties would be more informative to users if they were only included when an issue with respect to going concern has arisen. This would also be consistent with the requirements introduced by the UK Financial Reporting Council which does not require statements in the auditor's report when the use of the going concern basis of accounting is appropriate and no material uncertainties are identified. However, if the current proposals are retained, we recommend the wording in paragraph A22 of ISA 570 (Revised) and corresponding paragraphs in the illustrative examples in the proposals be revised as set out below. We believe this revised wording better reflects the principle that management is responsible for preparing the financial statements, which includes assessing if material uncertainties exist, and it is the auditor's responsibility to determine if they concur with this assessment.

> *…Based on our audit of the financial statements <u>of the Company</u> <u>taken as whole</u>, we <u>concur with management's conclusion that disclosure of a material uncertainty is not necessary.</u> ~~also have not identified such a material uncertainty~~*

Recommendations for improving information included in the auditor's report when a going concern issue has arisen

When it is determined that management's use of the going concern basis of accounting is appropriate there are four broad conclusions that can be reached by the auditor on management's assessment of whether material uncertainties exist:

1) no uncertainty exists;
2) an event or condition that may cast significant doubt about an entity's ability to continue as a going concern was identified but it is concluded that a material uncertainty does not exist;
3) a material uncertainty exists and is appropriately disclosed in the financial statements; or
4) a material uncertainty exists and the disclosure in the financial statements is inadequate.

The proposals indicate that scenarios 1, 3, and 4 are matters dealt with under ISA 570 (Revised) and would be discussed in the going concern section of the auditor's report (and in the basis of opinion, in certain circumstances). However, we believe that the second scenario may represent a key audit matter, but it is not clear from ISA 570 (Revised) and proposed ISA 701 if such a matter could be considered a key audit matter. For example, when an auditor identifies an event or condition that may cast significant doubt on the entity's ability to continue as a going concern, ISA 570 (Revised).16 requires the auditor to perform additional procedures, including consideration of mitigating factors to determine whether or not a material uncertainty exists. The additional procedures may involve difficult and subjective judgments, challenges in obtaining sufficient appropriate audit evidence, would likely be undertaken by senior audit engagement team members and, in some cases, involve consultations with specialists, the engagement quality control reviewer and others outside the engagement team. This may lead to the conclusion that a material uncertainty does not exist and therefore, under certain financial reporting frameworks, no disclosure in the financial statements would be required by management or by the auditor under the proposed requirements of ISA 570 (Revised). However, the treatment of such matters as a key audit matter under proposed ISA 701 is not clear.

To clarify and improve the value of the auditor's report, we recommend that the proposals specifically acknowledge that scenario 2 above may represent a key audit matter.

An inherent issue with our recommendation is that under IFRS, an entity is not specifically required to make going concern disclosures when a material uncertainty has not been identified. Practice today relating to the nature and extent of disclosures by entities in such a situation varies significantly. Therefore, including guidance that such circumstances may meet the criteria of a key audit matter may result in having the auditor include original information about the entity's operations, liquidity, business risks and future plans. Our view is that this issue could be overcome if the IASB were to introduce specific disclosure requirements that address the scenario described above. Absent a corresponding change by the IASB, we believe that indicating that going concern related matters could be a key audit matter may improve financial statement disclosures in these situations since management may be reluctant to have the auditor as primary provider of such information.

Addressing the expectations gap

While the inclusion of the explicit statements on going concern and material uncertainties is responsive to user and regulator concerns, we continue to believe that requiring the auditor to make explicit statements on management's use of the going concern basis of accounting and management's assessment of whether material uncertainties exist will not, on its own, reduce the expectations gap. We believe that the IAASB should also consider the following issues that will in some circumstances require the IAASB to work with other bodies such as the IASB and regulators to address.

- Circumstances in which preparers are required to undertake a going concern assessment.
- Consistency and clarity as to the key terms relating to the going concern assessment.
- Disclosures that should be provided in the financial statements relating to the assessment.
- Additional information that should be provided outside the financial statements.
- How the above should be applied to financial institutions, in particular, banks.

We have included a discussion on each of the issues noted above in Appendix 2 to this letter.

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?

For reasons explained in our response to Question 9, we are not supportive of the proposal to require the auditor to state that management's use of the going concern basis of accounting is appropriate and that the auditor has not identified a material uncertainty that may cast significant doubt on the entity/Group's ability to continue as a going concern. However, should the proposal be implemented, we believe that it is important to always include the explicit statement that neither management nor the auditor can guarantee the entity's ability to continue as a going concern to minimize the potential for misunderstanding by users of the financial statements. We would also suggest clarifying the wording in paragraph A22 of ISA 570 (Revised) and corresponding paragraphs in the illustrative examples in the proposals to make it clear that the statement refers to the fact that the assessment of going concern may change due to future events or conditions that arise after the assessment has been completed. To make this point clear we suggest revising the wording as set out below.

> *However, because future events or conditions cannot be predicted, neither management nor the auditor can guarantee the Company's ability to continue as a going concern.*

The illustrative example in paragraph A22 of ISA 570 (Revised) includes the explicit statement above regarding the inability of management or the auditor to guarantee an entity's ability to continue as a going concern. However, Illustrations 1, 2 and 3 to ISA 570 (Revised) do not include such statement. We believe it is appropriate to include such a statement in the Going Concern Basis of Accounting section in each of the situations being illustrated as the auditor has concluded that management's use of the going concern basis of accounting is appropriate.

Other matter

We recommend that paragraph 20(b) and the illustrative language in A22 of ISA 570 (Revised) and in other illustrative examples be revised to emphasize that the auditor's assessment of going concern is within the audit taken as a whole. One possible version of the revision to paragraph 20(b) of ISA 570 (Revised) is illustrated below.

> *A statement that, as part of the audit of the financial statements taken as a whole, the auditor has concluded that management's use of the going concern basis of accounting in the preparation of the entity's financial statements is appropriate.*

Also, the language in the first sentence of the "Going Concern Basis of Accounting" paragraph included in the illustrative reports where a material uncertainty is identified includes a double negative which may be difficult for users to understand especially if English is not their first language. We recommend that the sentence be revised to remove the double negative. One possible version is illustrated below.

> '~~The material uncertainty identified above *does not indicate that the going concern basis of accounting is inappropriate.*~~ *Despite the material uncertainty identified above, management has determined the use of the going concern basis of accounting is appropriate. The Company's financial statements have therefore been prepared using the going concern basis of accounting...'*

Compliance with Independence and Other Relevant Ethical Requirements

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?

We are supportive of disclosing in the auditor's report the source(s) of independence and other relevant ethical requirements the auditor complies with when undertaking the audit on the basis that it will improve the transparency of the auditor's report. However, as noted below it is unclear as to how the proposed requirement would apply in a group audit situation where the parent entity and its components are spread across multiple jurisdictions.

- The guidance in paragraph A29 of ISA 700 (Revised) appears to suggest that the independence requirements of the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) may be the appropriate ethical code to which auditors conducting a group audit engagement across jurisdictions would comply.

- A29 acknowledges that independence requirements in a group audit situation is complex and it refers to ISA 600 *Special Considerations-Audits of Group Financial Statements (Including the Work of Component Auditors* (ISA 600), but neither A29 of ISA 700 (Revised) nor ISA 600 provide clarity on what ethical code would be appropriate and how best to communicate specific source(s) of independence in a group audit situation where the group spreads across multiple jurisdictions.

To avoid potentially disclosing a long list of independence and ethical standards in the auditor's report upon implementation of ISA 700 (Revised), we recommend that ISA 700 (Revised) clarify that as far as communicating the source(s) of independence and ethical requirements is concerned, in a multi-jurisdictional group, it would be sufficient to disclose only those requirements that are applicable in the jurisdiction or jurisdictions where the auditor's report of the group is filed.

Disclosure of the Name of the Engagement Partner

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?

We recognize that communicating the name of the engagement partner in the auditor's report is already required by law in some jurisdictions and that it is not required in others.

In considering the value of such communications, we believe that including the engagement partner's name in the audit report will not enhance an engagement partner's sense of personal accountability. Engagement partners understand the potentially significant consequences to them personally (and their families) as well as to their partners and firms of failing to perform audits with integrity and in accordance with professional standards. In addition, they are also subject to internal inspection reviews and inspection by audit oversight regulators.

We are also concerned that in some jurisdictions communicating the name of the engagement partner may lead to an increase in engagement partner liability and a misunderstanding of the role and responsibility of the firm and network affiliates in the performance of an audit. There may also be some jurisdictions where this requirement could not be implemented under existing securities laws or possibly even under the existing legal framework.

Given these jurisdictional differences, we recommend that this requirement be left to the discretion of local law or regulation.

Other improvement to Proposed ISA 700 (Revised)

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?

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?

In terms of questions 13 and 14, we recognize that in many jurisdictions the format of the report is required by legislation and that there are practical difficulties to getting changes to such legislation. Accordingly, we support the IAASB allowing flexibility to accommodate requirements of local legislation provided the report includes the key elements set out in ISA 700 (Revised). However, global consistency in the content and order of the auditor's report is our preference as it enables users to quickly identify matters of importance in auditor's reports across multiple jurisdictions. To meet this goal, except where another ordering is required by local laws, we support mandating that the auditor's opinion, basis of opinion and when applicable key audit matters sections be presented at the beginning of the auditor's report, in that order, so as to give appropriate prominence to matters that are entity specific and most important to users.

Content and location of responsibility descriptions

Standardized wording for the sections of the auditor's report describing the responsibilities of the auditor, management and those charged with governance, gives consistency to such statements. Further, in jurisdictions where these responsibilities are not well established and understood by users, such descriptions may help reduce the expectations gap. Accordingly, we recommend that the proposed standard enable the descriptions of responsibilities to be relocated to an appendix or to a website only in countries where the respective roles are well established and understood. This may be evidenced by the fact that national laws, regulations or auditing standards permit such descriptions to be included in an appendix or a dedicated website. We recommend that paragraph 40 of ISA 700 (Revised) be revised to also only permit the descriptions to be included in an appendix when permitted by national laws, regulations or auditing standards.

Appendix 2

Going concern issues

As discussed in our response to Question 9, we believe that there are a number of issues, not within the direct purview of the IAASB, that still need to be addressed in order to narrow the expectations gap with respect to going concern. We recommend that the IAASB considers addressing the following issues in conjunction with other bodies such as the IASB and major international regulators.

- Circumstances in which preparers are required to undertake a going concern assessment.

  Both IAS 1 and ISA 570 acknowledge that entities with a history of profitable operations and ready access to financial resources may not need a detailed analysis to support the going concern assumption. Recent and continued difficult economic and market conditions have shown that a good track record is no protection from rapidly changing market conditions for credit, liquidity and profitability, particularly for financial institutions – see further discussions below.

  We believe it would be of benefit to all stakeholders if preparers had a requirement to perform a going concern assessment in all circumstances and to make an explicit statement on the results of their assessment (including relevant uncertainties identified – material or otherwise) in the context of the preparation of financial statements. This would provide a basis for the auditor's going concern assessment and reporting.

- Consistency and clarity as to the key terms relating to going concern assessment.

  Current accounting and auditing literature do not have clear definitions of key terms such as 'significant doubt', 'material uncertainties' and 'going concern' (when it is not related to the going concern basis of accounting). We would encourage the IAASB to focus on agreeing with the IASB common definitions of these terms so that users and stakeholders would have a clear understanding of the concept of 'material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern'. We believe that such clarity is important and would contribute to reducing the expectations gap.

- Disclosures that should be provided in the financial statements relating to the assessment.

  It would be of benefit to all stakeholders if preparers had a requirement to disclose an event or condition that may cast significant doubt on an entity's ability to continue as a going concern even though it was determined not to represent a material uncertainty to support their explicit statement that no material uncertainties exist.

In some cases, management's plans for future actions are important to firstly assessing whether an entity's use of the going concern basis of accounting is appropriate and secondly whether or not a material uncertainty exists. Therefore, consideration should be given to whether disclosure of such plans should be specifically required in the financial statements when such plans are a significant part of the judgments made with respect to going concern.

- Additional information that should be provided outside the financial statements.

  While we agree with the principles underlying the going concern basis for purposes of preparing the financial statements, we also believe that preparers should be required to provide additional disclosures, that go beyond those that are relevant to applying the going concern basis of accounting, on their consideration of operational and business risks, their potential impact on the economic and financial viability of the entity and their potential impact on going concern. As such information is beyond the scope of the financial statements, we believe that it should be disclosed in information accompanying the financial statements. The auditor could then, if there is stakeholder demand, provide assurance on such disclosures. We therefore recommend that regulators, users and the IAASB assess the benefits and costs of having auditors add credibility to all or part of this information. If it is concluded that there would be benefits from providing such information, we recognize the IAASB alone would not have the ability to effect the required changes.

- How the above should be applied to financial institutions, in particular, banks.

  Explicit statements on going concern are particularly relevant to financial institutions in an economic environment where the financial health of a financial institution can change in a very short time.

  For example, banks are different from other entities when evaluating the use of the going concern basis of accounting. The banking business model may inherently provide a challenge; a bank's principal operations and assets include long term loans, but their debt is typically short term – deposits and borrowings from central banks and others. Further, confidence in a bank's liquidity is what sustains the business model – any fear about the future viability and liquidity of a bank can give rise to a "run on the bank" and immediate liquidity concerns. In addition, an analysis of going concern by a bank is affected by the financial stability and regulatory regime of the country in which the bank is domiciled. There is a correlation between sovereign debt issues and the ability of that country's banks to sustain their ability to use the going concern basis of accounting because of both explicit and implicit support that a national government may provide to its banking sector. As a regulated industry, the extent of oversight and the powers of national banking regulators to identify bank liquidity issues, influence capital requirements and seize bank operations to protect depositors and other stakeholders vary significantly around the globe. Any requirement to disclose going concern uncertainties by preparers and auditors needs to be carefully considered in conjunction with the factors summarized above and input from banking regulators given the wider systemic contagion risks that can ensue. It would also be of assistance to auditors if the IAASB in conjunction with relevant regulators provided some guidance on how the extent of oversight and powers of national banking regulators should be incorporated into the going concern assessment of a bank.