



National Audit Office

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Dear Mr Gunn,

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

The National Audit Office (NAO) is pleased to comment on the above exposure draft. The NAO, on behalf of the Comptroller and Auditor General, carries out the external audit of all UK central government departments and a wide range of other UK and international public bodies.

The National Audit Office applies ISAs (UK and Ireland) issued by the UK Financial Reporting Council and therefore would be affected by any changes to ISAs that are adopted in the UK.

Our responses to the detailed questions set out in the exposure draft can be found in the enclosed annex.

If you have any queries in relation to the content of this submission, please feel free to contact me.

Yours sincerely

Maggie McGhee
Director General, Quality Assurance

Annex: Detailed responses to questions in exposure draft

Key audit matters

1. Do users of the audited financial statements believe that the introduction of a new section in the auditor's report describing the matters the auditor believed to be of most significance in the audit will enhance the usefulness of the auditor's report? If not, why?

Yes, we believe that users will find a key audit matters section (KAM) or similar commentary useful in providing insight to the audit process, improving understanding, transparency and accountability.

We support the requirement being for listed entities only. However this means the KAM would not be a requirement of public sector audits in the UK, despite the size, complexity and public interest in some of those audits being potentially similar to the audits of listed entities. We note that proposed ISA 701 allows for voluntary adoption of the requirements (which could be applied in the public sector).

2. Do respondents believe the proposed requirements and related application material in proposed ISA 701 provide an appropriate framework to guide the auditor's judgement in determining key audit matters? If not, why? Do respondents believe the application of proposed ISA 701 will result in reasonably consistent auditor judgements about what matters are determined to be the key audit matters? If not, why?

Broadly speaking, we believe these provide an adequate framework. We consider that there is a risk of inconsistent application of the guidance in respect of determining which matters are key audit matters, but this will probably diminish over time as more reports become publicly available.

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, although significant judgement will be involved in determining precisely what should be included for each key audit matter.

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.

In general, we find these examples to be helpful in illustrating explanations of risk, cross-referring to the financial statement disclosures and (where appropriate) the audit approach. However the examples given only appear to address the first of the circumstances outlined in proposed ISA 701 paragraph 8, rather than illustrating how the auditor might also communicate either:

- areas in which the auditor encountered significant difficulty during the audit, including with respect to obtaining sufficient appropriate audit evidence; or
- circumstances that required significant modification of the auditor's planned approach to the audit, including as a result of the identification of a significant deficiency in internal control.

If the IAASB intends to finalise proposed ISA 701 in its current form, we believe it should provide illustrative examples of these other types of key audit matter and how they might be reflected in the auditor's report. Such illustrations need not be included in the standard itself.

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 with the approach the IAASB has taken.

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 judgement, that there are no key audit matters to communicate?

We do 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. Although this would be rare for listed entities, auditors in the public sector may be required by legislation or their mandate to apply ISA 701 on all audits. This may cover the audit of fairly simple and non-complex entities where there may be no matters to report that would be of value to users of financial statements.

If no key audit matters are to be included, we are ambivalent as to whether a statement within the audit report confirms that this is the case. It lengthens the audit report without adding much value however we recognise that it confirms to users that, had any such matters existed, they would have been reported.

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?

Yes, we agree that key audit matters should be limited to the audit of the most recent financial period where comparative financial information is presented.

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 that Emphasis of Matter and Other Matter paragraphs should be retained for all audits, including those reporting KAMs, although there is the risk that users will be confused between the different headings in the auditor's report. The guidance in proposed ISA 706 differentiates adequately between the matters that should be included in KAM (where

proposed ISA 701 is applied) and those that should be included in Emphasis of Matter or Other Matter paragraphs.

Going Concern

9. Do respondents agree with the statements included in the illustrative auditor's reports relating to:

a) The appropriateness of management's use of the going concern basis of accounting in the preparation of the entity's financial statements?

b) Whether the auditor has identified a material uncertainty that may cast significant doubt on the entity's ability to 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 by users of the financial statements.

Although going concern considerations can be different in the public sector to those in the private sector, and dependent on the financial reporting framework in place, we can see how the illustrative statements could be adapted for this context. The statements do not appear to be problematic for auditors, although we do not believe they add the value that investors probably seek.

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?

This statement helps to reduce the scope for misunderstanding the going concern section of the report. However we would question whether the auditor's report is the right place to assert that management cannot guarantee the entity's ability to continue as a going concern - management has more influence over going concern than the auditors and the relative responsibilities could be confused by the current illustrative wording.

Compliance with Independence and Other Relevant Ethical Requirements

11. What are respondents' views as to the benefits and practical implications of the proposed requirement to disclose the source(s) of independence and other relevant ethical requirements in the auditor's report?

Our view is that it is helpful for the auditor's report to refer to the primary source of independence and other ethical requirements. However we believe this should be restricted to the primary source(s) of requirements. In the public sector, auditors are often subject to a range of requirements which may include legislation determining independence, professional ethical standards for auditors, requirements of professional accountancy bodies, codes of conduct and standards/principles for public sector workers. In some cases it could be very difficult to identify all of the sources of requirements that have a bearing on independence and ethics, and it would therefore be less easy for users to identify and refer to the most relevant requirements.

Disclosure of the name of the Engagement Partner

12. What are respondents' views as to the proposal to require disclosure of the name of the engagement partner for audits of financial statements of listed entities and include a "harm's way exemption"? What difficulties, if any, may arise at the national level as a

result of this requirement?

In the UK, the name of the auditor is required to be included in the auditor's report. We see no problem with this requirement being introduced for listed entities.

In the case of auditors appointed by statute (as is often the case within the public sector) the terminology "Engagement Partner" may not be the right description for the individual who signs the auditor's report. We request that this is amended to "Engagement Partner or public sector equivalent who signs the auditor's report".

Other improvements to Proposed ISA 700 (Revised)

13. What are respondents' views as to the appropriateness of the changes to ISA 700 described in paragraph 102 and how the proposed requirements have been articulated?

Our only observation is that cross-referring to a description of management's and the auditor's responsibilities that exists on a website has worked well in the UK.

14. What are respondents' views on the proposal not to mandate the ordering of sections of the auditor's report in any way, even when law, regulation or national auditing standards do not require a specific order? Do respondents believe the level of prescription within proposed ISA 700 (Revised) (both within the requirements in paragraphs 20-45 and the circumstances addressed in paragraphs 46-48 of the proposed ISA) reflects an appropriate balance between consistency in auditor reporting globally when reference is made to the ISAs in the auditor's report, and the need for flexibility to accommodate national reporting circumstances?

We agree with the proposal not to mandate the ordering of sections. In the absence of national laws, regulations or auditing standards we believe auditors are likely to follow the ordering given in the IAASB's illustrative auditor's reports, providing a degree of consistency.