

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

An Exposure Draft issued by the International Auditing and Assurance
Standards Board

Comments from ACCA
19 November 2013

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ACCA welcomes the opportunity to comment on the Exposure Draft *Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs)* issued by the International Auditing and Assurance Standards Board (IAASB). The ACCA Global Forum for Audit and Assurance¹ has considered the matters raised in the Exposure Draft and the views of its members are represented in the following.

Our comments draw upon our world-wide membership, which includes significant numbers of members working in all aspects of the financial reporting supply chain in a wide range of industries, the public sector and small and medium-sized entities.

GENERAL COMMENTS

Audit has a very important place in society. It provides public value through increasing confidence in financial reporting. For global capital markets this facilitates the efficient allocation and use of capital. The benefits of audit are also strongly felt in the public and not for profit sectors.

The report of the auditor is the most visible output of the audit process and we welcome this initiative of the IAASB to improve its usefulness and relevance to shareholders and other interested parties. The project will also promote financial reporting of the highest quality.

This important project is not codifying existing best practice but is setting standards that drive innovation. Such standards cannot be overly prescriptive but must allow scope for auditor judgement to tailor reports to individual client circumstances so that best practice can emerge.

The project has involved a considerable amount of work to an ambitious timetable set against a background where the European Commission and the US PCAOB have similar proposals under discussion. We are impressed with the extent to which the resulting proposals have been developed on the basis of research and views expressed in response to an earlier consultation and outreach activities. It is important that the IAASB maintains its outreach efforts on the current Exposure Draft and ACCA has organised events and a survey to assist in this.

¹ <http://www.accaglobal.com/en/research-insights/global-forums/audit-assurance.html>

As a global body, ACCA appreciates the inclusion of flexibility in the proposals so as to allow appropriate interaction with national laws or regulations.

We commend the IAASB for the informative package of documents making up the Exposure Draft and the accompanying staff papers showing changes in mark up from extant standards.

We welcome the announcement of a field test of the proposals in ISA 701 *Communicating Key Audit Matters in the Independent Auditor's Report* and the continuing IAASB stakeholder engagement. The experience of auditors reporting under changed circumstances should be taken into account when finalising the pronouncements. This can include not just those involved in the field test but also auditors, such as those in the United Kingdom, that have reported under standards that share some of the characteristics of those proposed by the IAASB. Within a few years, a post-implementation review should be carried out to identify whether auditor reporting is better meeting user needs.

ACCA has carried out an online global survey on the IAASB proposals for auditor reporting. Because we believe that education is an important ingredient in the successful implementation of change, we used the accompanying material for the survey to brief those wanting to complete it.

The survey was issued in conjunction with a survey carried out in Europe, in four languages, by the European Federation of Accountants and Auditors for SMEs ('EFAA') which is an umbrella organisation for national accountants and auditors' organisations whose members provide services to SMEs. Our response has been informed by the general themes arising from the survey. ACCA and EFAA are cooperating to analyse the survey data. The detailed survey results will be shared with the IAASB when analysis is complete.

SPECIFIC COMMENTS

KEY AUDIT MATTERS

Question 1 Do users of audited financial statements believe 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?

We agree that the inclusion of a new section in the auditor's report, as specified in proposed ISA 701 *Communicating Key Audit Matters in the Independent Auditor's Report* (ISA 701), will be beneficial for users. As we said in our response to an earlier consultation *Improving the auditor's report*², we support the concept because it is a focused and timely response to meet the diverse demands of stakeholders, particularly institutional investors and financial analysts.

There is, by now, a reasonable body of evidence that users value such information and, no doubt, the current consultation will provide further insights³.

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 that ultimately, the contents of key audit matters (KAM) should be determined by auditor judgement. It is important, therefore, that the requirements and related application material implement a principles-based approach. The proposals strike a good balance between the flexibility necessary to allow auditors to report matters that they judge are appropriate to report and the structure necessary to encourage consistency and comparability in approach.

² <http://www.accaglobal.org.uk/en/technical-activities/technical-policy/archive-policy/auditing-submissions/cdr1134.html>

³ For example, refer to *The Value of Audit: Views from Retail (Private) Investors*, a report prepared by ACCA for the Singapore regulator ACRA
<http://www2.accaglobal.com/pdfs/international/singapore/VOAPAC>

The benefits of a principles-based approach are significant. We would not wish to see any changes to the proposed ISA 701 that would take it away from a principles-based approach to one where the auditor is provided with a list of individual KAM that must be reported if they exist.

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?

Just as the determination of the constituents of KAM should be a matter of auditor judgement, the individual descriptions should also be determined by auditor judgement.

We agree that it is appropriate for the standard to give direction to enable the auditor to give appropriate consideration to the individual descriptions of circumstances that will differ between audited entities and over time. It would be a mistake, however, to prescribe how KAM should be reported. Prescription would undermine innovation in what should be an evolving area.

The overall success of ISA 701 will also depend on the mechanisms to 'test' the usefulness of individual items of KAM. Such mechanisms will include intra-firm procedures as well as examination of reporting by other auditors, particularly in the same industry as the audited entity.

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 recognise that the IAASB's examples were intended to demonstrate different approaches to the description of individual matters. Of the four examples, we preferred the second (*Valuation of Financial Instruments*) and fourth (*Revenue Recognition Relating to Long-Term Contracts*). We feel that these provide more value for users because they fully resolve all issues about the matters reported.

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 with the mechanism proposed for voluntary communication of KAM. It is important that an appropriate process is followed, and that is best achieved by the application of the whole of ISA 701.

In rare circumstances, if the auditor determines at a late stage that communication of KAM is in the best interests of users, there should be no insurmountable barrier to amending the terms of the engagement to provide such reporting.

In relation to practical considerations that may affect the auditor’s ability to communicate KAM; it is possible that the client may refuse, at a late stage, to accept an audit on that basis or refuse to pay an increased fee. A client may suggest that disclosure in such circumstances would amount to a breach of auditor confidentiality (adequately dealt with in paragraph A35 of proposed ISA 701) but that may not always be the case. The likelihood of such an event may be sufficiently low, however, to justify omission from ISA 701 of wording to deal with it.

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 agree that ISA 701 should allow for the possibility that the auditor may determine that there is no KAM. We are aware, for example, of listed companies where activities are minimal and users would derive little or no value from KAM. The use of such a declaration should only be expected in rare circumstances.

Accordingly, we agree that the proposed requirements addressing such circumstances (paragraph 13) are necessary to ensure an appropriate process and communication where the expectation of users for disclosure of KAM is not met.

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 believe that users will naturally focus on the most recent financial period so that it is unlikely that KAM of a prior period would continue to be of most significance in the audit. That possibility ought to be allowed for, however, as there would otherwise be no mechanism for its inclusion.

Accordingly, there should be no prohibition on disclosing a KAM relating to a prior period matter. Having said that, a matter in a prior period should be reconsidered in the current audit (as part of the determination of KAM) and if disclosed it is not disclosed as a simple copy of a prior period KAM but as a matter re-evaluated as a KAM in the course of the current audit.

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. It is important to retain the concepts as these are necessary where KAM is not disclosed. The concepts remain important where KAM is disclosed.

It is inevitable that users will form views on the relative importance of individual items disclosed as KAM. The likelihood is that the first disclosed is the one of most importance. The Emphasis of Matter has a threshold of 'fundamental importance' and it ought therefore to be positioned 'above' KAM in all cases. Theoretically, Emphasis of Matter throws a spotlight onto something in the financial statements whereas KAM is primarily illuminating the audit.

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 in 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 agree with the statements included in the illustrative auditor's reports relating to the going concern basis and the identification of a material uncertainty. Such statements make explicit what the auditor concludes and so add value to the audit.

There is potential for user misunderstanding and this will be higher in the first year of disclosure, or where KAM is not also presented and there are relatively unsophisticated users. Nevertheless, this does not amount to a reason why the disclosures should not be made. User misunderstanding is not an insurmountable problem. It should be addressed by education of, and communication with, users. The IAASB should be prepared to take a lead in such matters.

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?

We are not convinced of the need for an explicit statement about inability to foresee the future, as users understand that the future is an unknown. The value of such a statement as a disclaimer is also questionable as it would not remove the possibility of litigation against the auditor.

We are also uncomfortable about the statement being made in the report of the auditor, as management should disclose its own position. We can indeed envision circumstances where management would be prepared to issue such a guarantee, for example where resources are provided to a subsidiary by its holding company.

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 believe that increased transparency, through the disclosure of the publically available sources of independence and other relevant ethical requirements will be beneficial for users. Through appreciation of the ethical qualities to which auditors subscribe, users are more likely to value their work and report. This is particularly important where it is a voluntary audit as there may be no statutory requirements on the qualification and professional standing of the auditor.

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 support the proposed disclosure of the name of the engagement partner. Through increased transparency the report is more informative for users, especially investors. Although there is no strong research evidence that links naming of the engagement partner positively with audit quality; anecdotally, engagement partners find that the association of their own name with a report is motivating.

We support the inclusion of a 'harm's way exemption'. We would stress, however, that there should be an expectation that the use of such an exemption would be rare.

OTHER IMPROVEMENTS 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?

We support the improved description of the responsibilities of the auditor and the key features of the audit, as users will be better informed. The limitation on what may be communicated in a simple report should be recognised, however, as should the continuing need for user education.

We agree that there should be a provision for the material to be relocated to an appendix or referenced through a website of an appropriate authority. Such relocation will remove length from the auditor's report, improving its overall readability. This flexibility of presentation is important to allow appropriate tailoring in particular jurisdictions or circumstances.

We agree with making reference to those in the entity who are responsible for the oversight of the company's financial reporting process. This is informative for users and the approach has sufficient flexibility to allow for tailoring in particular jurisdictions or circumstances.

We are comfortable with the relaxation under which other reporting responsibilities need not be dealt with in a separate section, so long as they are clearly differentiated from the rest of the report. We accept the reason for this advanced by the IAASB ('the proposed new sections in the auditor's report relate to areas for which there may be additional reporting responsibilities . . . it is appropriate to allow additional flexibility for national standard setters to determine . . .')

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?

We agree that flexibility must be maintained to allow for appropriate tailoring in particular jurisdictions or circumstances. We expect that the needs of those who look for compatibility between reports internationally will be met by the increased use of standardised headings. Experience has shown that auditors rapidly conform to national approaches whether driven by more prescriptive standards or simply as a result of the publication of example reports. It is through such mechanisms that national standard setters can encourage consistency.

TECH-CDR-1224