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Stellungnahme zum IAASB Exposure Draft – Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing

Die Wirtschaftsprüferkammer hat mit Schreiben vom **25. Oktober 2013** gegenüber dem IAASB zum *Exposure Draft – Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing* wie nachfolgend wiedergegeben Stellung genommen:

We are pleased to take this opportunity to comment on the Exposure Draft: Reporting on Audited Financial Statements. WPK supports the work of the IAASB to enhance the usefulness of the auditor's report.

Comparing the previous 'Invitation to Comment: Improving the Auditor's Report' with the current Exposure Draft, we welcome the progress made. The requirements are much more clear and manageable; the responsibilities between auditor and management of the audit client as to providing information to the public are distributed more properly.

Even though we welcome the improvement in the current Exposure Draft, some weaknesses especially relating to the 'key audit matters' (please see our answers below) remain. Below we would like to start with some general remarks on the Exposure Draft before we answer the specific questions raised by the IAASB.

General Remarks

The current revision of the auditor's report provides – from our point of view – an excellent opportunity for the IAASB to further reduce the expectation gap, i.e. the difference between the expectations of the general public in the work of an auditor in contrast to the actual task of the audit. Therefore we would appreciate, if the IAASB were stressing the legal obligations and limitations of a statutory audit even more.

According to ED ISA 700.35 and .36 the auditor shall state its responsibilities in relation to the statutory audit in a separate section of the auditor's report. Ideally this section should be supplemented by a specific statement especially about what is not the objective of a statutory audit, for instance:

- No evaluation of the quality of the business model;
- No assessment of the efficiency and effectiveness of the Board;
- No assessment of the earnings prospects of the company (beyond the assessment of the appropriateness of management's use of the going concern basis of accounting).

Specific Questions

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 determined to be of most significance in the audit will enhance the usefulness of the auditor's report?*

The IAASB stated that many users of the auditor's report asked for more relevant information about the audit that had been performed. In this context, the proposed requirements on key audit matters in general may result in a higher transparency about and an increase in the understanding of the audit process and the auditor's report. Furthermore the engagement of the auditor and those charged with governance on key audit matter issues will lead to a more intense dialogue between these two parties.

The usefulness of the key audit matter communication in the auditor's report depends on the form and design of this communication. Decisive factors are the definition of key audit matters, scope and extent of key audit matter communication. In this context we refer to our answers to the following questions.

In general we welcome the concept of key audit matters and think that the introduction of a respective new section in the auditor's report may enhance the usefulness of the auditor's report.

However chances are that – depending upon the implementation of the key audit matter communication on an individual basis – the auditor's opinion on the financial statements as a whole may seem to be diluted by listing various deficiencies of the underlying accounting principles as key audit matters (e.g. management and auditor discretion, actual and factual accounting choices, assumptions and premises to valuation models etc.). Thereby creating the impression of reducing the auditor's responsibility due to impaired auditability of these issues.

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?*

Compared to the “auditor commentary” requirements in the previous discussion paper “improving the auditor's report”, we consider the current proposal on key audit matter as a good improvement. Under the new proposals the auditor is neither regarded as a navigator through the financial statements, nor does the auditor have to give information that belongs to management's responsibility. The currently proposed criteria to determine key audit matters are also better manageable and understandable compared to the former draft.

In this context we welcome the proposal of the IAASB to focus on significant risks as a (the) decisive criterion for the determination of key audit matters (ED ISA 701.8(a)). We think, that the other criteria in ED ISA.701.8(b) – (c) stem from the risk based audit approach and are in essence just another form of occurrence of the “significant risk” criterion.

Basically the combination of “matters communicated with those charged with governance” and “areas identified as significant risks” in ED ISA 701 should provide sufficient guidance for the auditor to determine the possible range of key audit matters. Unclear so far is the question, if all “significant risk issues” from the “matters communicated with those charged with governance” are to be reported as key audit matters, or just a selection. And in the latter case, what are the relevant selection criteria?

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?*

Unfortunately, we do not think that the proposed requirements in ED ISA 701.10 and the related application material provide sufficient direction. We suspect that the extent of the description of individual key audit matters is not sufficiently determined and therefore may vary considerably between different auditor's reports:

- The required contents are not clearly determined (see also question 4).
 - The key audit matter communication is "...intended to provide succinct explanation to enable users of the financial statements..." – what level of proficiency can be expected from the addressees?
 - What level of scalability is adequate?
 - Confidentiality aspects also impact the key audit matter communication, especially when internal control weaknesses or fraud issues are concerned.
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 think that all illustrative examples should be structured in a consistent way. That is

- Short description of the issue,
- Explanation, why this issue is considered a key audit matter,
- Audit procedure applied to the issue, and
- Reference to related disclosure (if applicable).

We do not think, that a conclusion/result should be added. This could be misinterpreted as a piecemeal opinion.

Against this background, we find example 1 (goodwill) as most useful. Unfortunately none of the examples illustrate the scalability aspects of the key audit matter communication.

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?*

Contrary to our previous view, we welcome the approach that key audit matters are obligatory only for listed companies. Compared to listed companies, non-listed companies in general have a much smaller amount of stakeholders interested in the entity’s auditor’s report. The differentiation between listed and non-listed entities is a decent way to take account of the scalability thinking.

In order to foster consistency in auditor’s reports we support the approach of the IAASB. If key audit matters are communicated on a voluntary basis, proposed ISA 701 must be followed. Contrary to the IAASB we think that the decision about the voluntary application of key audit matter communication should not be left to the auditor’s discretion alone. In fact, this decision should be part of the audit contract negotiation between entity and auditor.

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?*

Admittedly we do not have an extensive overview of the different kinds of business models and activities of listed companies on a global basis, but we find it hard to imagine situations in which no key audit matters can be identified for **listed companies**.

Even if a company does not represent much more than a mere shell, the auditor will – according to the risk based audit approach of ISA 315 and 330 – identify key aspects for its

audit approach (e.g. understanding of the entity and its internal control, risk assessment, funding), which serve as key audit matters.

Solely the existence of ED ISA 701.13 may lead to discussions between management, auditor and competent authority as to the appropriateness of the application of this rule in this or that situation. Accordingly efforts to prevent reporting on key audit matters may be made with the consequence that ED ISA 701.13 might be interpreted and applied differently nationally and globally.

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 IAASB's view that the auditor's communication of key audit matters should be limited to the most recent financial period. Nonetheless prior period key audit matters may also be key audit matters in the current period - as correctly stated in ED ISA 710.A9.

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 IAASB's decision to retain the concept of Emphasis of Matter paragraphs and Other Matter paragraphs. The auditor may find it necessary to communicate issues (either in relation to the financial statement or the audit) to the public that do not meet the definition of key audit matters. ED ISA 706 provides adequate rules for the auditor to report such issues in a consistent and clear way.

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 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.

and

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 consider a going concern statement of the auditor as a positive improvement to the auditor's report. Even when no doubt or uncertainty as to the going concern ability of the entity exists, such a statement is a useful extension for the user of an auditor's report. In the latter case, an explicit statement that neither management nor the auditor can guarantee the entity's ability to continue as a going concern (ED ISA 570.20(d)) is essential in order to limit the auditor's potential risk of liability connected to such a statement.

The illustrative examples of going concern statements do not explicitly give information about the "foreseeable future", to which the management's and the auditor's assessment on going concern relate. This information might improve the reporting value of such a statement even more and should be discussed.

The wording in the reworked ED ISA 570.16 may be misunderstood. If events or conditions have been identified that cast significant doubt on the entity's going concern ability, the auditor has to obtain sufficient appropriate evidence for what purpose? To determine (a) whether or not a material uncertainty as to the *entity's going concern ability* exists, or (b) whether or not a material uncertainty as to the *identified events or conditions* exists? In case of (b) a conclusion about the entity's ability to continue as a going concern cannot be reached in every case. Furthermore, the going concern statement in the illustrative example on page 15 refers to significant doubt on the entities going concern ability.

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?*

The compliance with independence and other professional requirements is a matter of course and should not be repeated explicitly in the auditor's report as required in ED ISA 700.28(c). We do not see a benefit from such a general statement.

A listing of all different sources of ethical requirements (particularly individual national sources – in Germany at least three different sources; depending on the line of business of the client possibly more) seems useless in an international context, unless the international users of the auditor's report have an understanding of the different national sources. Perhaps a general statement like "...in accordance with German ethical requirements..." or "...the IESBA Code of Ethics and German ethical requirements..." should be considered.

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?*

We appreciate the disclosure of the name of the engagement partner. In Germany, this proposal has been a legal obligation for years and relates to the auditor report of both, listed and non-listed entities. A non-disclosure of the individual's name will be considered as a breach of German professional requirements.

We do not see situations in which the disclosure of the name of the engagement partner can lead to a significant security threat to the individual. Guidance may be needed to describe these exceptional cases.

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?*

The statements on the responsibilities of the auditor are rather long and detailed, but we consider the shifting of this information to other media - such as a website - as negative, since the information belong to the particular audit report, should be fixed permanently to it and must not be changeable.

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?*

The proposed requirements about key audit matters may lead to a high fluctuation in the volume of the related reporting of the auditor. This reporting on key audit matters may range from just a couple of lines up to several pages – depending on the estimation of the respective auditor. Furthermore, cross-references within the auditor's report (ED 700.28 (b)) and to a website (ED ISA 700.40) or an appendix to the auditor's report (ED ISA 700.39) further reduce consistency, clarity and comprehensibility of the auditor's report.

In order to foster consistency, clarity and comprehensibility of the auditor's report nationally and internationally, we prefer an obligatory ordering of sections within the auditor's report. Otherwise we think that the current level of prescription within ED ISA 700 does not lead to a sufficiently high level of consistency, clarity and comprehensibility nationally and globally.

Furthermore we suggest the following two changes as to the assignment of certain paragraphs within the "Audit Opinion" and the "Basis for Opinion Section":

- Since ED ISA 700.27 ("We have audited the consolidated financial statements of the Group, which...") describes the underlying of the audit, it should be the first paragraph under the headline "Basis for Opinion" and should not be included within the "Opinion".

- In case of a modified opinion, the description of the matter(s) giving rise to the modification (ED ISA 705.20(b) - .27) should be included in the “Modified Opinion” section. From our point of view, the immediate linkage of modified opinion and explanation of modification under one headline improves the understandability of this section.

In this context we encourage the IAASB to discuss the requirement in ED ISA 705.23(c). We are of the opinion, that it is not the auditor’s task to disclose information that are within the responsibility of the entity’s management.