The Chartered Institute of Public Finance & Accountancy

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

response to exposure draft

25 November 2013

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. Our 14,000 members work throughout the public services, in national audit agencies, in major accountancy firms, and in other bodies where public money needs to be effectively and efficiently managed.

As the world's only professional accountancy body to specialise in public services, CIPFA's portfolio of qualifications are the foundation for a career in public finance. They include the benchmark professional qualification for public sector accountants as well as a postgraduate diploma for people already working in leadership positions. They are taught by our in-house CIPFA Education and Training Centre as well as other places of learning around the world.

We also champion high performance in public services, translating our experience and insight into clear advice and practical services. They include information and guidance, courses and conferences, property and asset management solutions, consultancy and interim people for a range of public sector clients.

Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance. We work with donors, partner governments, accountancy bodies and the public sector around the world to advance public finance and support better public services.

Our ref: Responses/ 131125 SC0203

James Gunn
Technical Director
International Auditing and Assurance Standards Board
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November 2013

Submitted electronically via www.iaasb.org

Dear Mr Gunn

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

CIPFA is pleased to present its response to this Exposure Draft, which has been reviewed by CIPFA's Accounting and Auditing Standards Panel.

Comments

CIPFA welcomes this IAASB work in this difficult but important area, which further develops ideas explored in the 2011 paper *Enhancing the Value of Auditor Reporting: Exploring Options for Change*, and the 2012 *Invitation to Comment, Improving Auditor Reporting*.

General comment - Key Audit Matters

We note that the proposals to require discussion of Key Audit Matters (KAM) in the auditor's report are mandated only for audits of listed entities. We agree with this scoping, and in particular that this reporting is not mandated for auditors of public sector entities.

Public sector comments – Going Concern

Viewed from the public sector perspective, the nature and relevance of going concern assessments and the effect of such assessments on financial reporting and on auditor reporting differ significantly from similar considerations in most of the private sector audits to which ISAs will be applied.

In the light of these differences, we suggest that the proposals for additional reporting on going concern do not work well for most audits of public sector entities which are not, and in the worst case scenario may be irrelevant and inappropriate.

Given this, we suggest that the proposals for reporting on going concern should be scoped out of auditor reporting for most audits of public sector entities. Even for those audits where this reporting is retained it may be necessary to use very different text to the text in the illustrative example.

Comments on specific questions

CIPFA comments on the specific questions raised in the Exposure Draft are attached at Annex A.

We would also note that in reviewing the ED proposals in respect of going concern, we noted some issues in respect of extant ISA 570 *Going Concern.* In particular, the material in paragraph 4 of the ISA appears to be grounded in a view of company financial statements, and may not generalise to all financial reporting frameworks. We attach further information on this at Annex B.

I hope this is a helpful contribution to the development of the Board's guidance in this area. If you have any questions about this response, please contact Steven Cain (e:steven.cain@cipfa.org, t:+44(0)20 7543 5794).

Yours sincerely

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ANNEX A

Responses to 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? If not, why?
CIPFA believes that the proposed key audit matters (KAM) section is an improvement on the proposals for Auditor Commentary outlined in the 2012 ITC. Users may find this useful in providing insight to the audit process, although it will necessarily increase the length of the auditor's report and increase the effort required from readers. We support the requirement being for listed entities only, noting that proposed ISA 701 allows for voluntary adoption of the requirements.
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?
CIPFA believes these probably provide an adequate framework. Inasmuch as there is a risk of inconsistent application, we would expect this to 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 what should be included for each KAM.
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.
CIPFA has no comment to make on this proposed requirement for listed entities.

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?
CIPFA agrees 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 judgment, that there are no key audit matters to communicate?
(a) CIPFA considers that 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. This would be particularly important for audits where ISA 701 has been followed voluntarily or is required under jurisdiction specific legislation, which may be the case for some public sector entities. While the audits of listed entities may tend to be more complex and give rise to KAM in most reporting periods, this might not be true of wider classes of entities being reported upon. (b) Reporting on the absence of KAM lengthens the audit report without adding much value, although we do recognise that it will reassure users that the auditor has considered whether there are any Key Audit Matters to communicate.
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?
CIPFA agrees with this proposal.
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?
CIPFA agrees with this decision.

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 or misinterpreted by users of the financial statements.
CIPFA suggests that the proposals for additional reporting on going concern for all audits do not work well for many audits of public sector entities. If this reporting requirement is retained it would be necessary to use very different text to that in the illustrative example, and the reporting may still add little value. Viewed from the public sector perspective, the nature and relevance of going concern assessments and the effect of such assessments on financial reporting and on auditor reporting differ significantly from similar considerations in most of the private sector audits to which ISAs will be applied. There is a class of public sector entity for which the ED's proposals would be more relevant, which is to say entities which operate like businesses inasmuch as they - Generate income which they are expected to use to fund their expenditure, and produce financial statements which include their income, expenditure, and related assets and liabilities; - Are expected to break even or make a surplus on an ongoing basis, or risk the discontinuation of the entity. For these entities, the going concern basis is important, and is linked to the information provided in the financial statements. Consideration of whether the entity is a going concern may affect the value attributed to assets in the financial statements, and is relevant to reader's consideration of whether surpluses are real, and whether losses can be sustained on a temporary basis. CIPFA would also be less concerned about the application of the ED proposals to audits of public sector financial statements prepared under reporting frameworks designed to provide a true and fair view of the financial position of the reporting entity, such as IFRS, the accrual IPSAS suite of standards, and some other nationally developed frameworks which require comprehensive reporting on income, expenditure, assets and liabilities. Even though these entities might not be required to break even or make a surplus, information on the planned discontinuation of the entity might affect information in the financial statements such as asset valuation, and is also important context to the readers of the financial statements. Having said this, these public sector entities are often supported by an overarching government entity (such as a national or regional government) with tax raising powers, and it is the overall financial health of the tax raising entity which is more relevant to citizens and other stakeholders reading the financial statements. In the light of this we still do not consider that the proposals add significant value to auditor reporting on most public sector entities supported through taxation, for which the current requirements of ISA 570 seem adequate.

Furthermore, it is important to realise that many public sector entities worldwide report on a cash basis and do not report using accrual frameworks, and the financial statements may provide such limited information that going concern considerations are essentially irrelevant, and the financial statements would not be affected by firm information that the entity was to be closed down. This would apply, for example, to public sector financial statements prepared under the required accounting and disclosures of the IPSASB standard on *Financial Reporting Under The Cash Basis Of Accounting*. The matters reported in cash based financial statements are historical information with no pretension to predictive value. Except where disclosures are provided which go beyond the requirements of the Cash Basis IPSAS, for the readers of these financial statements, readers are generally wholly reliant on information on the financial health of a national or regional government. This information is frequently not available in financial statements, although it may be accessible through Government Financial Statistics (GFS) produced by government economists, or through assessments by external parties such as the IMF or the World Bank. CIPFA considers that it would be difficult to produce a worthwhile form of auditor reporting to comment on the position where the auditor has no observations to make on the very limited financial reporting described above.
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 it is not clear that 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?
This disclosure seems reasonable, although it may be appropriate to restrict this to the primary sources of requirements. In the public sector, auditors are often subject to a range of requirements which may include requirements derived from legislation, national or international standard setters, professional accountancy bodies, public sector codes of conduct and other sources of guidance or 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?
We agree. This is a standard requirement under UK law. Recognising that this standard may be applied voluntarily or under jurisdiction specific legislation to audits carried out by public sector audit agencies, it would be helpful if explanation could be provided that 'Engagement Partner' should be deemed to apply to persons carrying out an equivalent role in public sector audits, in line with similar explanation provided in ISQC 1.
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?
CIPFA generally agrees with these proposals. As noted in our response to the 2012 ITC, cross referencing to web-based material is used for the audits of private sector entities in the UK. However, given that the users of public sector financial statements potentially include all citizens, this approach is not used in the UK public sector.
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?
CIPFA agrees with the proposal not to mandate the ordering of sections of the auditor's report.

ANNEX B

Issues for ISA 570 in relation to General Purpose and Special Purpose Financial Statements

The current text of ISA 570 paragraph 2 states that:

> *2… General purpose financial statements are prepared on a going concern basis, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so. Special purpose financial statements may or may not be prepared in accordance with a financial reporting framework for which the going concern basis is relevant (for example, <u>the going concern basis is not relevant for some financial statements</u> prepared on a tax basis in particular jurisdictions)…*

while subsequently ISA 570 paragraph 3 and 4 explain that:

> *3. Some financial reporting frameworks contain an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern, and standards regarding matters to be considered and disclosures to be made in connection with going concern. …*
>
> *4. In other financial reporting frameworks, there may be no explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern. Nevertheless, <u>since the going concern assumption is a fundamental principle</u> in the preparation of financial statements as discussed in paragraph 2, the preparation of the financial statements requires management to assess the entity's ability to continue as a going concern even if the financial reporting framework does not include an explicit requirement to do so.*

We agree that, for those financial statements where the going concern is a fundamental principle in the preparation of financial statements, it is desirable that the entity's ability to continue is assessed, and if management do not do this, then the auditor needs either to prompt such an assessment, or to confirm that the assessment is essentially trivial.

However, we do not agree with the assertion in paragraph 4 that paragraph 2 demonstrates that the going concern is always a fundamental principle in the preparation of financial statements. We would suggest that, to the contrary, paragraph 2 explicitly notes that there are some special purpose financial statements for which the going concern basis is not relevant. Furthermore, while paragraph 2 characterises these exceptions in terms of tax reporting, there are other significant categories of financial statements which might be considered to be prepared under special purpose frameworks where the going concern basis is not relevant. This would include, for example, some public sector financial statements prepared on a cash basis.

Also, some caution needs to be exercised in connection with the assertion at paragraph 2 of ISA 570 that general purpose financial statements are prepared on a going concern basis. This may be true when the term 'general purpose financial statement' is used in a particular way, and this may encompass most or many frameworks and local GAAPs under which companies listed on capital markets prepare their financial statements, especially where the framework asserts that the financial statements present fairly the financial position of the entity. However, it is not clear that it is true for all financial statements which are described as 'general purpose'.

In particular, we would note that while the IPSASB standard on *Financial Reporting Under The Cash Basis Of Accounting* describes itself as applying to 'general purpose financial statements', it does not require these to be prepared on a going concern basis. The requirements of the Cash Basis IPSAS are designed only to 'present fairly the entity's cash receipts, cash payments and cash balances'. Assessment of whether the entity is a going concern is included in *Part 2: Encouraged Additional Disclosures*, but would make no difference to the accounting under *Part 1: Requirements*.