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21 November 2013

Dear Mr Leonard,

Financial Reporting Council Invitation to Comment on IAASB Exposure Draft (July 2013): Reporting on Audited Financial Statements: Proposed new and Revised International Standards on Auditing (ISAs)

Introduction

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance is a founder member of EuropeanIssuers, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Financial Reporting Expert Group has examined your proposals and advised on this response. A list of members of the Expert Group is at Appendix A.

Response

We set out below our comments on the IAASB's proposals for new and revised International Standards on Auditing 700 and 701.

We particularly urge the Financial Reporting Council (FRC) to highlight and suggest to the IAASB the possibility of applying any standards for enhanced auditor reporting only to the largest listed companies (consistently with the FRC itself including only the audit reports on companies that comply with the UK Corporate Governance Code within the scope of some of its requirements.)

Should the IAASB nevertheless complete ISA 701 on the basis of applicability to all listed companies, we would encourage the FRC to consider implementing it only for larger listed companies, at least until the value of this reporting has been evaluated.

While we understand and applaud the FRC in its efforts to improve financial reporting and auditing in the UK, in accordance with its remit, and that the FRC is more nimble than the international standard setter, we

The Quoted Companies Alliance is the independent membership organisation that champions the interests of small to mid-size quoted companies.

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trust that the FRC will be reluctant to create the problem of integrating national and international developments that are otherwise similar in aim.

That said, we do prefer the FRC's more objective descriptions of the matters that should be the subject of enhanced auditor or reporting.

Should ISA 701 be completed broadly as is, or in accordance with our more radical suggestion of separating the report on the financial statements from the description of and report on the audit process, we would suggest that FRC's enhanced (auditor) reporting requirements be moved to ISA 701 (UK and Ireland).

Below we have commented on the IAASB questions, referenced accordingly:

1. Usefulness of Key Audit Matters (KAM) disclosure

Although we recognise that a direction of travel towards more extensive reporting by auditors has been established, it is not clear to us that disclosures of key audit matters, as described in proposed ISA 701, will materially enhance the usefulness of the auditor's report. Our concerns rest upon the following points:

- There remains some risk that what the investor community is really hoping for is greater insight into the subject company. KAM disclosure clearly is no substitute for more extensive or more detailed financial reporting, nor is it within the power of the IAASB to mandate that more extensive financial reporting or management discussion and analysis, so we believe there is some possibility that KAM reporting will of itself create a fresh expectation gap.
- Notwithstanding the IAASB's highlighting of this risk, there is a likelihood of boilerplate reporting, particularly given the subjectivity of the KAM requirements.
- We are also not a little concerned that the impact of these proposals will be diluted by the sheer length of the audit report now proposed. That said, we do have a suggestion set out against question 14 below which would address this point.
- There is also the possibility that there will be rather more "no matters" reports than the IAASB might have envisaged.

For these reasons we would urge that the IAASB makes KAM reporting obligatory only for the largest listed companies. Consequently, the consideration of any wider application of KAM reporting becomes a two-step process, asking first whether what has been produced is successful and, if so, whether it should be extended to small and mid-size quoted companies, and only then considering whether there might be a wider market for enhanced reporting by auditors of private companies.

2 – 4. Proposed ISA 701

We do not agree with the implied approach of requiring an approximate handful of the most significant matters being disclosed. Significance is of itself already a subjective decision and yet greater subjectivity is introduced by requiring the auditor to determine a ranking of significant items.

We do agree that an auditor beginning with a long list might be well advised to assess the significance of each one, but we consider that it would be better to require disclosure of all significant matters and to acknowledge that there will more often be audits where there are no significant matters.

Paragraphs A36 and 37 of proposed ISA 701 are masterly in their understatement. Some matters will indeed be viewed as highly sensitive by the entity's management and if that is the case it is highly unlikely that management will facilitate KAM reporting. In the absence of any financial reporting by management it is not clear to us that ISA 701 #A37 can override a duty of confidentiality owed by an auditor to its client.

Paragraph 8B has the effect of requiring the auditor to discuss any aspect of the audit which came close to causing a scope limitation; it is difficult to envisage an audit firm being able to willingly give such disclosures given the potential commercial consequences of making such statements publicly.

We would encourage the IAASB to reflect upon whether its aims can be met by the more objective requirements, such as those set out in the FRC ISA (UK and Ireland) 700 paragraph 19A. We further note with approval that the FRC also permits an auditor to instead explain its non-compliance with these requirements.

5. Voluntary adoption

We agree that there should be only one standard for extended auditor reporting and accordingly that ISA 701 should make clear that it must be applied in any circumstance where such disclosure is being made voluntarily.

6. No circumstances

As noted above we believe that the absence of key audit matters will be a more frequent event than the IAASB envisages. That said, we believe that it is appropriate for the auditor to make clear that in their opinion there are no key audit matters to communicate.

7. Comparative financial information

We agree that reporting should be restricted to the current financial period.

8. Emphasis of matter and other matter paragraphs

We are completely in agreement with the retention of these paragraphs since they are integral to clear reporting on underlying subject matters, and quite distinct from ISA 701's objective.

9 – 10. Going concern

It is important to remember that the threshold test for adopting the going concern basis is low indeed (that the entity has a realistic alternative to ceasing to trade). Any audit comment will be taken as underwriting that the company concerned has some stronger justification than that for using the going concern basis.

The reporting proposed by the IAASB is pure boilerplate; in our view, this will simply reinforce the particular expectation gap, notwithstanding the efforts of proposed ISA 570 #20(d).

It is particularly important that any opinion on going concern is based upon a subject matter that has been prepared by management. This is an area where the auditor should not run ahead of the financial reporter.

11 – 12. Descriptions of ethical standards, naming of the engagement partner

From a UK standpoint, these are not controversial.

13 – 14. ISA 700

In the sense that not mandating the ordering of the audit report allows any party to do what it thinks best, it might be said that ISA 700 leaves no ground for meaningful criticism.

However, we believe that the proposed audit report is now unduly long and loses focus and clarity by containing such a mixture of elements.

We recommend that ISA 700 prescribes a concise audit report on the financial statements (and on other subject matter that falls under the purview of the auditor in accordance with national law or regulation).

We then recommend that the introduction of ISA 701 should prompt the IAASB to fully separate the description of the audit process from the audit opinion. We think that the distinction should be more substantial than is achieved by subheadings and that a report prepared in accordance with a further enhanced ISA 701 should capture:

- Any independence statement;
- The responsibilities of the auditor as distinct from those of the preparers of the financial statements; and
- Key audit matters, or that there are none.

ISA 701 would then repeat the formatting flexibility of ISA 700 and allow this “701 report” to be positioned separately from the opinion on the financial statements, for example alongside any report by an audit committee.

If you would like to discuss any of these matters in more detail, we would be happy to attend a meeting.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'TW', is positioned above the typed name of the signatory.

Tim Ward
Chief Executive

Quoted Companies Alliance Financial Reporting Expert Group

Matthew Stallabross (Chairman)	Crowe Clark Whitehill LLP
Anthony Appleton (Deputy Chairman)	BDO LLP
Joseph Archer	Crowe Clark Whitehill LLP
Edward Beale	Western Selection Plc
Anthony Carey	Mazars LLP
Jack Easton	UHY Hacker Young
Bill Farren/Ian Smith	Deloitte LLP
David Gray	DHG Management
Matthew Howells	Smith & Williamson Limited
Shalini Kashyap	EY
Paul Watts/Jonathan Lowe/ Nick Winters	Baker Tilly
Niraj Patel	Saffery Champness
Nigel Smethers	One Media IP Group plc
Chris Smith	Grant Thornton UK LLP