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Steven Leonard  
Project Director – Audit and Assurance Team  
Codes and Standards Division, Financial Reporting Council  
Floor 5, Aldwych House  
71-91 Aldwych  
LONDON WC2B 4HN

Dear Steven

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

ICAEW welcomes the opportunity to comment on the FRC's Invitation to Comment on IAASB Exposure Draft (July 2013): *Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs)* published by the FRC in July 2013, a copy of which is available from this [link](#).

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 140,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

The Audit and Assurance Faculty is a leading authority on external audit and other assurance activities and is recognised internationally as a source of expertise on audit issues. It is responsible for technical audit and assurance submissions on behalf of ICAEW as a whole. The faculty membership consists of nearly 8,000 members drawn from practising firms and organisations of all sizes from both the private and public sectors. Members receive a range of services including the monthly Audit & Beyond newsletter.

As already indicated to you, neither we nor our members are able to consolidate our position on the IAASB's proposals in advance of the comment deadline. Nevertheless, we address in this letter those issues in the FRC's Invitation to Comment (ITC) that relate to whether, and if so how, the FRC should adopt the proposed changes to the ISAs (assuming they were to be issued as final standards by the IAASB) through amendments to the ISAs (UK and Ireland).

You will be aware of how ICAEW's response to IAASB on its proposals develops through the FRC's participation with observer status in ICAEW's ISA Implementation Sub-group.

## General points

1. We observe with interest the first few audit reports produced under the new UK regime and we are hopeful that the objectives of enhanced transparency and improved communications between audit committees and investors will be achieved.

### **The FRC should consider carefully the implications of its recent decisions to act before an international consensus emerged**

2. The FRC has chosen to act ahead of IAASB which, together with other recent actions, particularly in respect of ISA 720, clearly indicate its intention going forward to set standards for UK practitioners without waiting for an international and European consensus to emerge.
3. We understand the FRC's need to satisfy its stakeholders, particularly investors, and we hear the voices of those who argue that the UK should lead the debate by acting first. There are indeed benefits in going first, but there are also problems. In future, we recommend that the FRC bring investors, auditors and companies together in a Financial Reporting Lab type environment before making changes of this magnitude. Experimenting with new reporting mechanisms might have reduced uncertainties, managed stakeholder expectations better and enabled the FRC to defend its position even more vigorously when arguing its case internationally.
4. The questions the FRC asks in this ITC demonstrate all too clearly some of the problems associated with acting before a consensus emerges. Auditors are now considering whether they can prepare comprehensible audit reports that meet both UK and IAASB requirements and it seems likely that such reports will be cumbersome and repetitive.
5. New requirements for audit reports are also expected from the proposed EU legislation on audit. While the precise nature of these new requirements and the timing of their implementation are still uncertain, UK auditors will have to comply with them. The fact that this will represent a further change to audit reports might compound the difficulties UK auditors face in implementing the new requirements and perhaps more importantly, create potential confusion for investors in trying to understand them.
6. Unlike other auditing standards, the effects of the auditor reporting standard are highly visible. Outsiders surveying the sequence of events, in which the FRC acted just a few months before the IAASB issued what will appear to many to be a very similar paper, might be forgiven for thinking that the UK no longer has regard for international standards.
7. Our main concern in all of this is that we do not think that, even when they become clear, the differences between reports prepared under the UK, IAASB (or indeed PCAOB) regimes will demonstrate the inherent superiority of one reporting standard over others. Materiality and going concern issues aside, by and large, the matters reported under the different regimes will be very similar. They will just be reported in slightly different ways. This is because the nature, depth and quality of auditor reporting will be driven largely by stakeholder demands, the approach taken within global firms, the regulatory approach to monitoring auditors, the economic climate and common practices within and across industry sectors in the next 2-3 years, rather than the detailed wording of different standards. Auditors and investors have to operate on a global basis, and we would not wish to see the valuable contribution of national standard-setting marginalised because it failed to reflect these realities.
8. The IAASB is listening to investors just as much as the FRC and despite the fact that different investors have different 'takes' on these matters, as we noted in ICAEW Rep 12/134<sup>1</sup>, we believe that the messages investors are conveying to the IAASB and the FRC are likely to be basically the

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<sup>1</sup> ICAEW's May 2014 response to the FRC on the Invitation to Comment that preceded the implementation of the revised ISA (UK and Ireland) 700

same. We suspect that the largely technical differences between reports prepared under the different regimes will ultimately be of little interest to investors.

9. We noted in ICAEW Rep 12/134 our belief that the FRC should lead the international debate by example and by using its powers of persuasion, and that ICAEW has long supported International Standards on Auditing (ISAs). Having UK add-ons which have a negligible if any effect on audit quality is simply an additional cost, ultimately borne by UK businesses. In particular, we continue to have serious doubts about the value of reporting on materiality, the one area which the FRC clearly requires 'more' than the IAASB. Anecdotally, we understand auditors are finding it difficult to explain and justify the inclusion in the audit report of either a single materiality figure for the financial statements as a whole or various different materiality figures, and we fear that boilerplate will rapidly become the norm in this area.
10. Many of our member firms have operated on an international basis for over a decade and their methodologies are firmly based on international standards, not UK standards. We reiterate our consistently held view that in general, there are many good pragmatic reasons for waiting for an international consensus to emerge. Even in the short term, acting alone is likely to weaken the UK's influence internationally. This we regret. There are well-resourced bodies within and outside the UK who are fully committed in word and deed to international standards on auditing and they will, quite naturally, be more clearly heard at the top table than jurisdictions which choose to go their own way.

### **The FRC should perform impact assessments**

11. ICAEW Rep 12/134 also emphasised our strong belief that the FRC should develop a regulatory impact assessment framework to analyse proposals *prior* to exposure, in order for assertions regarding their impact on audit quality to have any credibility. We noted the fact that we do not believe that IAASB can legitimately continue to ask questions about impact unless it too makes some effort to include some sort of analysis, absent which, any 'belief' that benefits will exceed costs amounts to uninformed speculation, which is not enough to support major changes. We urged the FRC to develop a framework to describe and measure the costs, benefits and impacts of all of its proposals.
12. This is not the first time we have made this point to the FRC. We have made the same point to the IAASB in our responses to a number of their recent consultations and we re-iterate it here because in the absence of properly structured impact assessments, it is difficult to form a view as to the likely effect of the new UK requirements or the IAASB's proposals, both of which are radical, and it is even more difficult to assess the relative merits of different sets of proposals. This is pertinent to the first of the FRC's specific questions, below.
13. Firms reporting under the new UK regime tell us that it is costing money. While this may be a relatively small percentage increase in total costs for larger listed entities, it can represent a significant additional burden for smaller entities which needs to be justified in terms of real, long-term benefits to investors. We are aware that some academics are taking a keen interest in these changes and any past research and current and proposed projects would be a starting point for an impact assessment. We encourage the FRC to perform an assessment retrospectively and to engage with academics if necessary.

### **The FRC should take a holistic approach**

14. ICAEW Rep 12/134 also emphasised the fact that the regulatory approach will determine the value of enhanced auditor reporting and that developments in financial reporting need to be tied into auditor reporting. We trust that the FRC is dealing with these issues on a holistic basis.

## Specific points

The FRC specifically asks about:

The consistency or otherwise of the likely communications that will be made under the combined audit committee and auditor reporting requirements introduced by the FRC in October 2012 (see paragraph 4 above) with those likely to be made under the requirements for the determination and description of key audit matters in accordance with proposed ISA 701; and

Whether the additional auditor reporting requirements introduced in June 2013 (see paragraph 5 above) would not by their nature be consistent with the concept of key audit matters as in ISA 701 but would rather be consistent with the concept of an 'Other Matter' paragraph under ISA 706, as suggested in paragraph 79 of the exposure draft

15. We note in our general points above our belief that public consultations on the likely effect of new requirements and proposed changes are severely hampered by the absence of detailed impact assessments performed in advance of the proposals.
16. There are two obvious differences between the FRC's requirements and the IAASB's proposals. The IAASB's proposals would require in all cases certain statements to be made on going concern which the FRC's requirements do not, and the FRC's requirement to report on the application of materiality would be dealt with as an 'other matter' rather than a 'key audit matter' under the IAASB's proposals. The going concern statements are not classified as a key audit matter by the IAASB and we see no reason why IAASB should classify the application of materiality as a key audit matter in all cases either, as it does not meet the IAASB's definition of a key audit matter. We note above concerns that disclosures about materiality will create confusion and boilerplate, and we re-iterate our point made in ICAEW Rep 12/134 that the disclosure of materiality levels will have a novelty value for a year or so but, absent a discussion of the judgements and thought processes that led to the figures reported, the disclosures will be largely meaningless. Audit reports are simply not the right place for a detailed or nuanced discussion of judgements and thought processes.
17. The important parallels are between the IAASB's *key audit matters* and the FRC's *risks having greatest effect on audit strategy, resources, and effort, and the response thereto*. All we can say at present is that we hope that the differences between these two sets of requirements will not result in significant differences. This is because it will be in everyone's interests to be able to assert compliance with UK and IAASB requirements within the same audit report, without too much repetition resulting from minor, overlapping differences. We note above that we think it very unlikely that it will become clear that reporting under the IAASB's requirements is superior to reporting under the FRC's requirements (or those of the PCAOB for that matter), or vice versa, because the quality of auditor reporting will be driven largely by stakeholder demands, the approach taken by reporting firms, the regulatory approach, the economic climate and common industry practices.
18. We call on the FRC, given its role in the development of the IAASB ED, to state what in *its* view any differences will be.

Whether the FRC should seek, as far as possible, to implement proposed ISAs 700 and 701 and the other proposed amendments to the ISAs, by adopting a new ISA (UK and Ireland) 701 and implementing changes to ISA (UK and Ireland) 700 and the other relevant ISAs (UK and Ireland) to achieve a direct basis of adoption (as has been used for all the current ISAs (UK and Ireland) other than ISA (UK and Ireland) 700); and

Whether any of the current differences between the ISAs and the ISAs (UK and Ireland) (the de facto differences in the case of ISA (UK and Ireland) 700) should be eliminated in adopting the proposed ISAs;

19. As noted in our general points above, ICAEW remains firmly committed to ISAs. The challenges experienced with applying IFRS in the UK and elsewhere are not paralleled in auditing standards and there is little justification for the UK going its own way in this area. Indeed, were the FRC to signal its commitment to a level playing field globally by committing to ISAs, its observations on IFRS might carry more weight.
20. We do not really understand why the FRC is asking whether it should seek to implement the IAASB's proposals in place of its own at this stage, when it has already made it clear by its actions that it does not intend to do so. The FRC is well aware that now it has started the ball rolling, and UK firms have taken the first steps down this route, they and the entities they audit are unlikely to want to backtrack. In any case, as noted elsewhere in this response, going concern and materiality issues aside, reports prepared under the different regimes are unlikely to be very different. There are some legitimate UK pluses that are needed to deal with the UK Corporate Governance Code but apart from these, the likely lack of differentiation between reports prepared under the UK and IAASB regimes will, unfortunately, only serve to demonstrate how irrelevant some of the debates in this area have been.
21. We are concerned that the FRC's actions indicate that it may no longer be committed to ISAs. We challenge the FRC to clearly signal its intentions going forward, either to wait for an international consensus to emerge before making further changes and to make essential changes only for the UK regulatory environment once that consensus has emerged, or to consider eliminating the use of the term 'ISAs' in the title of UK and Ireland auditing standards. If UK auditing standards continue to diverge from ISAs, the FRC's use of the term 'ISAs' in the title will be called into question.

**Whether any new differences between the ISAs and the ISAs (UK and Ireland) should be introduced in adopting the proposed ISAs.**

22. We are concerned that this question demonstrates the lack of commitment to ISAs on auditing noted above, and we are in any case very disappointed that the FRC should be suggesting that any new differences should be introduced.

Yours sincerely

**Katharine Bagshaw FCA**  
**Technical Manager**

T +44 (0) 207 920 8708

E [kbagshaw@icaew.com](mailto:kbagshaw@icaew.com)