EY supports efforts by standard setters to examine the adequacy of the auditor's reporting model and consider meaningful changes to increase the usefulness and informational value of the auditor's report. We believe enhancing the auditor's report will contribute to the ongoing relevance of the financial statement audit and to serving the public interest.

Both the International Auditing and Assurance Standards Board (IAASB) and the US Public Company Accounting Oversight Board (PCAOB) have issued exposure drafts proposing significant changes to the standard auditor's report. These proposals were informed by prior consultations and reflect stakeholder feedback. This Point of view summarizes EY's views, as set forth in our comment letters responding to the IAASB and PCAOB.1

Context

Issued in July 2013, the IAASB's proposal is the next important stage of the IAASB's project to enhance the relevance of the auditor's report in the public interest. The PCAOB issued its proposed standard to enhance the auditor's report in August 2013. The comment periods for each proposal have closed, and the standard setters are in the process of reviewing comments received. The IAASB intends to finalize its standards in 2014. The timing of the PCAOB initiative is less certain, although the PCAOB has indicated it will hold a public roundtable in the spring.

While there are differences between the IAASB and PCAOB proposals, they are aligned at a high level. Importantly, both proposals would retain the ultimate “pass/fail” conclusion in the auditor’s opinion, but add further context and requirements as described below. Both would require the auditor to identify and include in the auditor’s report matters the auditor considers to be “key” (KAM – the IAASB proposal) or “critical” (CAM – the PCAOB proposal) to the audit. While the criteria proposed by the IAASB and PCAOB to identify key and critical audit matters are not identical, they are intended, broadly speaking, to represent the areas in the audit of the financial statements of most significant auditor attention (KAM) or difficulty (CAM).

1 Other regulators and policy makers, including the European Commission, are exploring and proposing changes to auditor reporting, and some, such as the UK Financial Reporting Council (FRC), have already issued final standards. The FRC revised its auditor reporting standard in June 2013, effective for audits of financial statements for periods commencing on or after 1 October 2012. The new FRC standard is broadly consistent with the IAASB proposal.
In addition, both proposals would require additional discussion in the auditor’s report regarding the auditor’s responsibilities relating to various matters, including risk of material misstatement due to fraud and the footnotes to the financial statements, as well as independence. The PCAOB also proposes a revised standard for new reporting on the auditor’s evaluation of “other information” that accompanies the audited financial statements in an annual report (e.g., MD&A), while the IAASB is deliberating the specifics of such reporting as part of a separate standard-setting initiative. The PCAOB also proposes including a statement about auditor tenure in the auditor’s report.

Another key point of differentiation is that the IAASB proposes to include required statements in the auditor’s report related to going concern and the identification of the engagement partner’s name (for listed entities only). Both of these topics will be addressed by the PCAOB in separate standard-setting initiatives. On the identification of the engagement partner, the PCAOB re-proposed a standard on 4 December 2013, and its comment period closes on 17 March 2014.

Key points

- We support meaningful enhancements to the auditor’s report that respond to requests by stakeholders for more information and insights, which we believe will contribute to the ongoing relevance of the financial statement audit and the public interest.

We believe that, in general, the direction and types of changes contemplated by both the IAASB and PCAOB proposals would improve the auditor’s report. In particular, the communication of KAMs or CAMs in the auditor’s report should contribute to enhancing its informational value to all users. Communicating such matters will highlight areas of the entity’s financial statements that the auditor may have found to be challenging during the audit and draw users’ attention to management’s disclosures of those matters. In addition, we believe the proposed clarifications of the auditor’s responsibilities will help users of the financial statements better understand the auditor’s obligations for the audit of the financial statements.

Certain aspects of the proposals will be challenging to implement and could give rise to financial statement user misunderstanding. In our comment letters to the IAASB and PCAOB we have made a number of constructive suggestions aimed at addressing such challenges and making the ultimate standards in this area more workable in practice. We also encouraged both standard setters to continue to engage with stakeholders and draw on lessons learned from field testing to ensure that the proposals can be implemented in a practical way and are both valuable and understandable. The proposed changes are significant, and we believe communication and education will be important elements in the success and acceptance of the enhanced auditor’s report. We also believe that, due to the significance of these standard-setting initiatives, both would benefit from a post-implementation review, as the IAASB has planned.

- We support the introduction of a new section in the auditor’s report describing the matters the auditor determined to be of most significance to the audit of the financial statements.

We believe the introduction of a new section in the auditor’s report describing KAMs or CAMs will help investors and others focus on those matters that were of most significance to the audit of the financial statements.

We support a principles-based approach to the identification and disclosure of KAMs or CAMs, because we do not believe that it is feasible for an auditing standard to prescribe the number, subject or contents of such matters, which will, by design, address the relevant facts and circumstances that arise in a given audit. In identifying a KAM or a CAM, we believe that matters that were the subject of the most interaction with the audit committee would be an important filter, since auditors and audit committees tend to spend the most time focusing on matters that have the characteristics generally contemplated by both proposals. This would have the added value of responding to investor requests for further
insights into auditor/audit committee communications. We believe this specific filter should be built into the PCAOB proposal to help appropriately narrow the inventory of potential matters that otherwise might appear to be a CAM.

We also believe the auditor should describe why the matter was determined to be a KAM or a CAM, in addition to identifying where the matter is disclosed in the financial statements. We do not believe it is appropriate, however, for the auditor to disclose original information about the entity in the auditor’s report. Such disclosure should continue to be the responsibility of the entity’s management. Given that KAMs and CAMs are intended to highlight matters of significance in the audit, we would generally expect such matters would also be material to, and be disclosed in, the entity’s financial statements. We believe that, in most circumstances, KAMs or CAMs should not contain an overview of the audit procedures performed by the auditor, or an indication of the outcome of the auditor’s procedures.

We are concerned that a description of the auditor’s procedures might be misunderstood without proper context and that conclusions might be perceived as separate opinions on parts of the financial statements. In our letter to the PCAOB, we suggested that the PCAOB provide more flexibility regarding the content of the CAM descriptions rather than requiring the audit report to include all the factors outlined in its proposal that relate to a particular matter. However, we noted that there may be some circumstances where a description of a CAM’s effect on the audit may be necessary to explain why the matter was a CAM.

We believe that the issue of going concern should be addressed holistically with enhanced disclosures by both management and the auditor, and therefore recommend that the IAASB collaborate with the International Accounting Standards Board (IASB) and other accounting standard setters.

The IAASB has proposed that the auditor’s report include a statement on (i) the appropriateness of management’s use of the going concern basis of accounting in the preparation of the entity’s financial statements and (ii) 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 further disclosures when such an uncertainty has been identified.

We support additional disclosures about going concern in the auditor’s report because we share the IAASB’s view that an appreciation of going concern is of great importance to users of the financial statements. However, we believe a holistic approach, which requires collaboration between the IAASB and the IASB, should be considered in order to clearly align the auditor’s report and the financial statements prepared by management (upon which the auditor is reporting) and to address the lack of clarity about the meaning of certain terminology, such as “material uncertainty,” “significant doubt” or “ability to continue as a going concern.”

In addition, we believe the IAASB needs to address the interaction between proposed ISA 701 Communicating Key Audit Matters in the Independent Auditor’s Report (which sets out the requirements for disclosing KAMs) and ISA 570 Going Concern (which describes the requirements for reporting on going concern), and clarify when the disclosures in proposed ISA 701 would be required for going concern, including whether a KAM about going concern should be included in the auditor’s report when the auditor has devoted significant attention to going concern but ultimately concludes that no material uncertainty exists.

For its part, the PCAOB is continuing to seek to align its standard-setting initiative with the FASB’s related standard-setting project. The FASB is considering whether management should be required to disclose potential uncertainties related to its ability to continue as a going concern, including whether substantial doubt exists, as part of its preparation of financial statements. It issued a proposed accounting standard in January 2013 and recently announced that it will re-deliberate several aspects of that proposal, including the definition of “substantial doubt” and the time horizon over which management would have to evaluate events and conditions for disclosure. PCAOB staff has publicly indicated they will continue to delay their initiative to revise the existing going concern audit standard until there is more clarity from the FASB on the direction of the project.
We support describing in the auditor’s report the auditor’s performance responsibilities related to “other information.” We believe this would be responsive to requests from investors and others to obtain a better understanding of the auditor’s responsibilities in this area.

The PCAOB proposal includes a revised standard for new reporting on the auditor’s evaluation of “other information” that accompanies the audited financial statements in an annual report (e.g., MD&A). As noted above, the IAASB is deliberating the specifics of such reporting as part of a separate standard-setting initiative. We have significant concerns with certain changes contemplated in the PCAOB proposal. In particular, we believe the proposal will expand the auditor’s existing responsibilities for “other information” although the PCAOB has not clearly stated whether this is its intent. In addition, we believe the proposed concluding statement surrounding the auditor’s work on other information should be revised to avoid potential financial statement user misunderstanding and unnecessary increased legal liability for auditors. In our comment letter to the PCAOB, we outlined an approach that we believe will address these concerns while at the same time meeting the Board’s objective of increasing transparency in this area.

We believe that the disclosure of the name of the engagement partner in the auditor’s report does not add to the quality of the audit and may result in unintended or negative consequences.

We do not support a requirement for disclosure of the engagement partner’s name in the auditor’s report as we do not believe it adds to the quality of the audit or improves investors’ decision-making ability. We acknowledge that a requirement for that disclosure has existed in many jurisdictions for some time and is a function of the local legal and regulatory environment. For that reason, we suggested in our letter to the IAASB that a decision to require the disclosure of the name of the engagement partner be left to national standard setters or to local law or regulation. With regard to the PCAOB’s proposal, disclosing the identity of the engagement partner (as well as information on other parties involved in the audit) within the auditor’s report, and the related need to obtain consents from such parties, will give rise to a variety of complications in practice. We have suggested that if the PCAOB continues to proceed with this project, it should look at alternatives for making such disclosure outside of the auditor’s report, perhaps in a periodic public filing with the PCAOB.

We support global consistency in the auditor’s report across entities and jurisdictions.

While recognizing that legal, regulatory and reporting frameworks vary across jurisdictions, we continue to believe that comparability is important for global investors and global markets and that the auditor’s report should be as consistent as possible across jurisdictions. Therefore, we encourage the IAASB and the PCAOB to work together and with other standard setters and regulators to align reporting models where feasible and minimize complexity for users of financial statements.
For more information

For more information on this issue and our views, please speak to a member of the EY public policy team:

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