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Dear Sir

Exposure Draft ISA (UK and Ireland) 700 (Revised)

We appreciate the opportunity to comment on the Auditing Practices Board's Exposure Draft on ISA (UK&I) 700 (Revised), *The Auditor's Report on Financial Statements*. We set out our comments on the key issues below. Detailed responses to the specific questions raised in the Exposure Draft are set out in the Appendix to this letter.

We remain strongly of the view that the APB should, at this time, make only the minimum changes needed to comply with the requirements of the Companies Act 2006. Further amendments should be considered as part of the APB's consideration of the adoption of Clarity ISAs in the UK.

As noted in our response to the Discussion Paper *The Auditor's Report: A Time for Change?* in March 2008, there remains uncertainty as to whether the EC will adopt ISA 700 (Redrafted) for use in the EU or whether it will develop its own audit report applicable in all European countries, including the UK.

However, overall there is strong international support for ISAs, as issued by the IAASB, as the appropriate standards for ensuring the international harmonisation of auditing standards, in much the same way as IAS has taken root internationally in relation to accounting standards.

We note the view that the APB regards its proposed changes to ISA (UK&I) 700 as an opportunity to influence international decisions by implementing a concise audit report in the UK. We agree that the APB needs to play its full part in influencing the debate at the IAASB, but we do not believe that it is appropriate for the UK APB to act independently of the IAASB. Once the international debate has been concluded, we believe that the APB should then focus on implementing ISAs in the UK, with a minimum number of UK "plusses".

Consequently, we are concerned that implementing a new standard at this time:

- is separate from the IAASB's ISA process - ISA 700 (Redrafted) was recently approved for publication by the IAASB and takes account of the 8th Directive requirement for a degree of consistency of wording in audit reports across Europe;
- appears to be somewhat at odds with APB's stated objective of convergence through adoption of ISAs, particularly at a time when APB has issued a consultation paper on the adoption and implementation date of the entire suite of Clarity ISAs in the UK;
- is not a precondition to commencing research to better understand what can be done to make auditors' reports more informative and to influencing the international discussion on this subject; and
- could have a significant impact on auditors and users of financial statements at a time when further significant changes to the audit report are likely to occur in the relatively near future.

We are aware that IAASB has agreed to consider, in early 2009, recent research and developments with regard to the auditor's report and to determine what action should be taken in relation to ISA 700 (Redrafted) to increase its acceptance, and/or whether more radical changes may be warranted in auditor communications in the longer term. This could lead to further revisions to ISA 700 being issued in 2011. As noted by the APB, there is an opportunity to influence international debate on whether a more fundamental change is required to close the expectation gap between auditors and users of financial statements, and we support the APB taking a thought leadership role in this regard, but do not believe that this should be done by implementing a concise audit report in the UK at this time.

We would be happy to discuss our views further with you. If you have any questions regarding this letter, please contact Deian Tecwyn on 020 7212 3695.

Yours faithfully



PricewaterhouseCoopers LLP

Appendix

Question 1 (a): Comments on the proposed ISA (UK&I) 700 (Revised)

As noted in our covering letter, we are strongly of the view that changes to ISA (UK&I) 700, at this time, should be limited to those required by changes in law.

However, we set out specific comments on the exposure draft below.

References to "properly prepared"

Paragraph 5(c)(i) requires the auditor to evaluate whether the financial statements "have been properly prepared and presented in all material respects in accordance with the relevant financial reporting framework, including the requirements of applicable law." However, the Companies Act 2006, Section 495 states that: The report must state clearly whether, in the auditor's opinion, the annual accounts... *have been properly prepared* in accordance with the relevant financial reporting framework; and *have been prepared* in accordance with the requirements of this Act (and, where applicable, Article 4 of the IAS Regulation). There is not a requirement to evaluate whether they have been *properly* prepared with the requirements of applicable law. Whilst we appreciate that this paragraph may be intended to apply to law other than the Companies Act, the wording as it stands could be misleading. This paragraph should reflect the requirements of Companies Act 2006, as should paragraphs 18 and 39.

Identification of UK "plusses"

Whilst, previously, it was clear which paragraphs were UK "plusses", this is no longer the case, making it more difficult to distinguish ISA requirements from UK additions – for example paragraphs 4, 11 and 33-35 were previously shaded grey. This may be because the proposed (UK&I) 700 now departs significantly from extant ISA 700 (Revised) and Clarity ISA 700 (Redrafted) such that the identification of UK "plusses" is not easily achieved. However, this, in itself, is of concern as further departure from the ISAs does not accord with APB's stated intention of moving towards convergence with ISAs.

Compliance with ISA 700

In the invitation to comment, APB explains that, in framing its proposals to revise ISA (UK&I) 700, it has sought to ensure that compliance with it would not preclude auditors from asserting, in their auditor's reports, that the ISAs have been complied with.

However, as drafted, proposed ISA (UK&I) 700 does not appear to cover explicitly all the requirements of either extant ISA 700 (Revised) or Clarity ISA 700 (Redrafted). For example:

- the black letter requirements of paragraph 12 of proposed ISA (UK&I) do not cover all the matters required by extant ISA 700 (Revised) paragraph 22 or those that will be required by Clarity ISA 700 (Redrafted) paragraph 23.
- the black letter requirement of paragraph 13 of proposed ISA 700 (UK&I) relating to the responsibilities of those charged with governance does not appear to fully address those matters covered in paragraph 28 of extant ISA 700 (Revised) or those in paragraph 26 of Clarity ISA 700 (Redrafted).

Extant ISA 700 (Revised) does provide for derogation from its requirements where national law obliges the auditor to use a form of report different from that required by the ISA. However, the variations from extant ISA 700 (Revised) do not result from conflicts between that ISA and the Companies Act 2006, so it is unclear whether compliance with proposed ISA (UK&I) 700 would, in fact, preclude auditors from asserting that the ISAs have been complied with.

Description of auditors' responsibilities

Paragraph 16 (b) of proposed ISA (UK&I) 700 requires the auditor's report to include a description of the auditor's responsibilities and the work the auditor typically performs. Paragraphs 12–16 of extant ISA (UK&I) 700 set out the matters that should be covered by such a description. The proposed ISA (UK&I) 700 provides less clarity, because if auditors choose not to refer to the APB's

website, it is not clear what needs to be included in the audit report, and in particular whether the statement that is proposed to appear on the APB's web site, which is much longer than the extant scope paragraph in the auditor's report, needs to be included in full in the auditor's report.

Paragraph 7(d) (iii) allows some flexibility by permitting "a cross reference to a suitable description". However, paragraph 16 prescribes that the "suitable description" is that set out on the APB's web site. It is not clear whether the intention is to allow only cross reference to the statement on the APB's web site or whether, if they desired, auditors could cross refer to information on the auditor's own web site. If auditors are not permitted to cross refer to their own web sites, for those audits not covered by statements on the APB's web site, this would require lengthy descriptions in the audit report itself. For smaller entities, this could make the auditor's report disproportionately long compared to the financial statements.

Question 1 (b): Comments on the proposed "Statement of the scope of an audit and the auditor's responsibilities in respect of a publicly traded company incorporated in the United Kingdom" which it is intended would be posted to the APB's web site

We believe the statement to be a useful explanation of the scope of an audit and the auditor's reporting responsibility, subject to the following:

- Section 3 correctly describes the auditor's responsibility to report certain matters by exception. If the APB adopts the example audit report in proposed ISA (UK&I) 700, this will be overridden by the professional responsibility to report that there are no matters, and this responsibility should therefore be referred to.
- We question whether the proposed statement meets the requirement of extant ISA 700 (Revised) to include a description of the work an auditor typically performs. Whilst it is, to an extent, implicit in Section 2 of the proposed statement, the explicit matters referred to in paragraph 14 of extant ISA 700 (Revised) are not covered.
- In respect of section 2 of the proposed statement, we believe that the list of ISAs (UK and Ireland) that establish requirements in relation to those areas of the auditor's work where it is particularly important that the views of auditors and users of financial statements are aligned should be expanded to include the standards on accounting estimates and fair values.

Question 1(c): Comments on the example auditor's reports

We do not support the inclusion of either a reference to the auditor's responsibility to comply with the APB's Ethical Standards or a statement that the auditor has nothing to report in respect of those responsibilities where the auditor is required to report by exception.

ISA (UK&I) 200 already requires compliance with the APB's Ethical Standards. We do not believe it is necessary to include reference to ethical standards in the audit report.

The Companies Act does not require auditors to include a statement on those matters on which the auditor is required to report by exception. There was an opportunity during the Companies Act consultation process for this to be included had there been a perceived benefit to users. However, no change was made to the Companies Act 2006, and we do not believe it is appropriate now for the APB to change this reporting responsibility. By implication, if auditors have not reported, then there is nothing to report.

As noted in our response to Question 1(a) above, the proposal of describing the auditor's responsibilities and the work an auditor typically performs by either cross referring to standard paragraphs maintained by the APB on its web site or including a description in the auditor's report itself potentially gives rise to greater confusion as it is not clear whether the two responsibilities statements should be the same or, if different, whether they should be as they are set out in extant ISA (UK&I) 700 or extant ISA 700 (Revised).

In respect of the report on other legal and regulatory requirements, we are of the view that the reference to auditors' responsibilities to report, under the Companies Act, whether adequate accounting records have not been kept should be amended to read "Adequate accounting records

have not been kept by the parent company" to align with the specific responsibility in the Companies Act.

Question 2 - Do commentators support APB's proposal of describing the auditor's responsibilities and the work an auditor typically performs by either:
(a) cross referring to standard paragraphs maintained by the APB on its web site; or
(b) including a description in the auditors report itself?

In principle, we support a shorter audit report, provided that information removed from the audit report is accessible to users. However, we are not in favour of a proposal to cross refer to a description of the auditor's responsibilities on the APB's web site.

This proposal may address investors' concerns that there should be a reduction in the boilerplate content of auditors' reports in order to make them clearer and remove wording which appears to be designed to minimise prospective liability. However, whilst the proposals change the descriptions of auditor's responsibilities and where they are disclosed, they do not, rightly, change those responsibilities. We are not convinced that there is any real benefit in moving the description to the APB's web site, as it makes the description less accessible, particularly for those users who do not have ready access to the internet. There is also a danger of creating an increased expectation gap as between investors' perceptions of an audit and the reality if this wording is relatively invisible.

Further, the proposed requirement to either cross refer to the statement on the APB's web site, or include a description within the auditor's report could result in inconsistency in audit reports, depending on which option the auditor selects. The proposed statement of responsibility to be included on the web site is significantly longer than the paragraphs in the current auditor's report, and it is not clear what will need to be included in the auditor's report itself, should that option be selected.

As noted in our response to the APB's Discussion Paper *The Auditor's Report: A Time for Change?*, we strongly support the continued inclusion of the Bannerman disclaimer wording in all UK audit reports. This wording will continue to be included in the auditor's report, with the result that, should the option to cross refer to the proposed statement of responsibility on the APB's web site be selected, only the Bannerman wording would remain in the description of auditor's responsibilities in the audit report itself. This could exacerbate the perception that the auditor's report contains wording designed to minimise prospective liability.

Question 3 – On pages 41 and 42 the APB sets out a schedule of the range of example statements that it presently intends to post to its web site. Are there any other examples that you believe it is imperative the APB should post to its web-site?

As noted in our response to Question 2, we do not support the option of cross referring to statement of responsibilities posted onto the APB's web site. However, we are of the view that if this approach is adopted, there should be examples for, at least, those audits covered by the Audit Regulations and by APB's Practice Notes. Therefore, for example, limited liability partnerships, qualifying partnerships, banks and insurance companies should also be included.

Question 4 – In addition to the need for the APB to develop and maintain current examples relating to a number of different types of entity what other practical difficulties do you think might arise from the APB's proposed approach?

The maintenance of different versions of the statement over time would also need to be ensured. As auditors are required to retain their audit files for a prescribed period, the version of the statement to which the auditor's report cross referred would need to be retained for the same period, and would need to be accessible. If multiple versions were retained on the APB's web site, obtaining access could be a cumbersome exercise and result in a web site that was not 'user-friendly'.

A further consideration is that, if the content of the statement were to be developed and maintained by the APB, it is not clear whether the responsibility for the content would rest with the APB, or whether auditors' responsibilities for that part of the content of the audit report would remain unchanged.

Question 5 – Is the wording of paragraph 18 in the Exposure Draft of the proposed ISA (UK and Ireland) 700 (Revised) sufficiently generic to apply to all entities that are required to be audited? (In this regard more detail concerning the legal framework applicable to a particular type of entity will be provided in the applicable example “Statement of the scope of an audit and the auditor’s responsibilities”). If not please describe any concerns.

We do not consider the wording to be sufficiently generic to apply to all entities that require an audit. We are concerned that this paragraph does not address situations where auditors provide reports which do not require a true and fair opinion. If the APB does not intend adopting ISA 800 on special purpose audit engagements, we are of the view that proposed ISA (UK&I) 700 should allow for situations where, for example, a “properly prepared in accordance with ...” opinion is provided. Whilst paragraph 2 of proposed ISA (UK&I) 700 permits the adaptation of the proposed standard, as necessary in the circumstances, to compliance audits where the auditor is not required to report on whether the financial statements give a true and fair view, it is not clear how the standard should be adapted in such circumstances.

Question 6 – Do you agree that it is logical for the reference to the “true and fair view” to be the final element in the auditor’s opinion on the financial statements? If you disagree what would be your preference for ordering the elements?

On balance we are comfortable with the proposed order of the elements, because we accept that “true and fair view” is ultimately the key element of the opinion. However, we question whether it is appropriate to depart from the order of the elements of the auditor’s opinion as set out in the Companies Act 2006. Further, there could be a drawback to having the ‘true and fair view’ as the last element as its impact and importance could be perceived as less than if it is placed first.

We believe the more important point is that, whichever order is decided upon, it should be prescribed so as to ensure consistency of auditors’ opinions.

Question 7 – Please provide any comments that you may have on the steps set out concerning the APB’s proposed course of action and the proposed timing of those steps. Are there any other actions that you believe the APB should be taking?

As set out in the body of our letter, we do not believe that the APB should, at this time, be making changes to ISA (UK&I) 700 other than those required for changes to the Companies Act 2006. For the reasons set out in response to Question 2 we do not support the posting of “Statements of the scope of an audit and the auditor’s responsibilities” to the APB web site to allow cross reference from the auditor’s report.

We support the APB undertaking further research to better understand what can realistically be done to make auditor’s reports more informative and to take a lead in influencing international decisions that will affect auditors’ reports in the longer term.

We believe the development of clear guidance on what constitutes “adequate accounting records” is essential if directors, auditors and users of financial statements are to have clarity on, and a common understanding of: what constitutes “adequate accounting records”, in whose judgement they are “adequate”, and for what purpose they are “adequate”. We strongly support the development of this guidance.