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Dear Mr Leonard

Exposure Draft ISA (UK and Ireland) 700 (Revised) “The Auditor’s Report on Financial Statements”

Thank you for the opportunity to comment on the APB’s exposure draft on audit reports.

Our responses to the specific questions raised by the APB are included below together with some more detailed comments on the document.

In summary, although the exposure draft includes some innovative suggestions and we agree with the concept of a shorter two-part ISA 700 audit report we have reservations about the approach adopted by the APB which has resulted in the APB developing its own version of an unclarified ISA 700 that is not consistent with the suite of clarified ISAs issued by the IAASB.

There is still significant uncertainty over the EU position with respect to audit reports and any decision by the EU may have an impact on the future wording of audit reports. In our opinion when updating ISA (UK&I) 700 the APB should be more consistent with the IAASB clarified ISA 700, updating this for changes required by the Companies Act 2006 and other UK pluses, and should adopt the structure for modified and emphasis of matter reports introduced by IAASB ISAs 705 and 706 rather than seeking to make changes outside of the established ISA adoption process.

We believe that if the APB seeks to adopt its own unclarified version of ISA 700, making what could be interpreted as significant changes to the IAASB standard, this might undermine the ISA adoption process in the EU and lead to lack of international consistency.

General invitation to comment

Question 1 – The APB invites comments on:

(a) the proposed ISA (UK and Ireland) 700 (Revised) on pages 15 to 31;

We have the following concerns with the proposed ISA (UK&I) 700:

- Consistency with ISA 700 - as noted above the exposure draft does not conform to the wording used in the IAASB's revised and redrafted ISA 700 and the APB appears to have developed its own version of ISA 700 rather than one based on the IAASB ISA. In our opinion, the APB should be seeking to promote International consistency by using the clarified ISA 700 as a base and amending ISA 700 by adding UK pluses in accordance with the approach agreed in the consultation before the APB issued the original ISAs (UK&I) in December 2004 rather than appearing to drop this tried and trusted approach and develop a new standard without using ISA 700 as a base.
- Clarity approach – the exposure draft is structured following the old ISA format rather than the clarified ISA format that will be adopted for periods commencing on or after 15 December 2009. In our view, because the APB has already issued example auditor's reports compliant with the Companies Act 2006 in Bulletin 2008/8, the APB does not need to issue an updated unclarified ISA (UK&I) 700 and to the APB should aim to issue an updated clarified Companies Act 2006 compliant ISA (UK&I) 700 to be effective at the same time as the other suite of clarified ISAs (UK&I).
- ISA 700 and ISA 705/706 split – we are concerned that the exposure draft does not adopt the IAASB structure for audit reports splitting ISA 700 into
 - ISA 700 for unmodified reports
 - New ISA 705 for modified audit reports
 - New ISA 706 for reports with emphasis of matter paragraphs.

In our opinion rather than continuing with a single ISA (UK&I) 700, the APB should be promoting International consistency by seeking to replicate the IAASB structure in its revision to ISA (UK&I) 700 and develop exposure drafts dealing with unmodified, modified and reports with emphasis of matter paragraphs.

- Source of material – because of the way the exposure draft has been presented in an unmarked up state it is difficult to tell which is new APB drafted ISA material, old APB ISA plus material that has been previously agreed and what is IAASB ISA material. Paragraphs 27 onwards seem to have been based on the extant ISA (UK&I) 700 but the paragraphs at the start of the exposure draft are largely new and unrelated to the previous ISA (UK&I) 700 or the clarified ISA 700 and so demand more attention. It would help a commentator to understand the changes more if APB presented a marked up version of either the old ISA (UK&I) 700 or the IAASB version and showed the changes made.

- UK pluses – linked to the comment above on the confusion about the source of the material in the exposure draft is a concern that the exposure draft does not identify those additional paragraphs the APB has added to comply with UK law or regulation, the “UK pluses”. This was a cornerstone of the consultation in 2004 about the adoption of the IAASB ISAs – the ISAs (UK&I) were clearly based on the IAASB ISAs and any UK additions were kept to a minimum and identified clearly. This approach has not been followed in the exposure draft with the result that it is impossible to tell what is part of the IAASB standard and what are the additional UK requirements or guidance. We recommend that in finalising ISA (UK&I) 700 and in future any other ISAs (UK&I) the APB continues to adopt their previous approach with regard to the identification of UK pluses.
- Overall consistency with suite of clarified ISAs – as part of the clarity project the IAASB is working very hard to ensure consistency of approach and wording between the various revised and clarified ISAs and in order to achieve this aim has issued an 80 page issues paper detailing precise wording changes that it intends to make to ensure that the suite of ISAs are internally consistent. The APB exposure draft has not gone through this same process and there is a risk that the wording used in the APB ISA will be inconsistent with the clarified ISAs.

(b) 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”, on pages 33 to 39, which it is intended would be posted to the APB’s web site; and

We have two main concerns over the approach that the APB is proposing to adopt in relation to the location of the statement of scope and the auditors’ responsibilities:

- Potential widening of the expectation gap – the previous versions of the auditor’s report referred to the statement of scope and the auditors’ responsibilities in some detail and this was seen as necessary in order to address the widely acknowledged expectations gap in auditing and help prevent misinterpretation by readers. Although the APB’s approach for such information to be held on the APB website is innovative we believe that clarity regarding the scope of an audit and the responsibilities of auditors is enhanced if these are included in a prominent position within the audit report rather than in a remote location (in this case on the APB website) and that it is this clear articulation of the scope and responsibilities that helps to prevent misinterpretation by readers. In our opinion removing this information from the auditor’s report would only serve to widen the expectations gap and in the current economic environment when readers of financial statements are more than ever interested in the work performed by the auditor it would be inappropriate to make such a change. We also consider that moving such material to the APB website could potentially make it less accessible particularly for those readers of financial statements who do not have access to the internet and could again serve to widen the expectations gap.

- Practical difficulties - We also envisage practical difficulties for the APB in maintaining up to date information on their website for all the relevant entities that exist and have covered this further in our response to question 4 below.

(c) the example auditor's reports on pages 11 to 14.

Our concerns about the removal of the descriptions of the scope of an audit and the auditors responsibilities and the ordering of the bullets in the opinion paragraph are addressed in our responses to questions 1(b) above and questions 2 and 4 below (scope and responsibilities) and question 6 below (order of bullets). We have also included some detailed comments on the audit report example in our detailed comments section at the end of this letter.

In addition to these points we have the following concerns about the example auditor's reports on pages 11 to 14:

- Inconsistency between treatment of responsibilities in parts 1 and 2 of the report - we consider that there is some inconsistency in the way that the APB has dealt with the responsibilities in the two parts of the auditor's report. The first part of the auditor's report relating to the financial statements includes a brief description of the directors and auditors responsibilities with a cross reference to the more detailed statement of the scope of an audit and auditor's responsibilities located on the APB website. In part two of the report that relates to the other legal and regulatory requirements there are two opinion expressed, in relation to the directors' remuneration report and the directors' report, for which no description of responsibilities is given and then a detailed description is given of a number of specific reporting and review responsibilities even though there is only a requirement to report by exception on those areas. In our opinion, either the report should include a description of the auditor's responsibilities (our preferred option) or those responsibilities should be available elsewhere rather than a combination of the two which only serves to complicate the report and potential confuse the reader
- Additional confirmation of nothing to report - with regard to the reporting and review responsibilities included in part 2 of the auditor's report we do not consider it necessary to include the sentence "We have nothing to report to you in respect of these responsibilities". This is not required by either the Companies Act 2006 or the Listing Rules and is inconsistent with the previous approach adopted by the APB and should be deleted.

Specific issues on which the APB invites responses

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 auditor's report itself?***

NO.

In our opinion the APB should continue with the approach outlined in option (b) above and include a description of the scope of an audit and the auditor's reporting responsibilities in the auditor's report itself rather than on the APB website or elsewhere.

The fact that firms will have the choice, may result in inconsistency in audit reports and including the information elsewhere rather than in the auditor's report will only serve to increase the expectations gap as users of auditor's reports may misunderstand or misinterpret the role and responsibilities of auditors. We do not consider that such a proposal is in the public interest in a time when auditor's reports are subject to tougher scrutiny and readers are more and more interested in the scope of the audit and responsibilities of the auditors.

The APB's proposed approach also gives rise to the practical difficulty that the APB will face because of the need to develop and maintain a comprehensive suite of statements of the auditor's reporting responsibilities addressing the auditor's responsibilities with respect to different types of entities. APB will be required to maintain these examples up to date across a wide range of industries and to maintain a library of these going back over many years. We do not consider that the time and expertise of the APB is best spent in this manner.

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 stated above we do not agree with the approach proposed by the APB and have not suggested any further examples because we are not in a position to say whether such a list is comprehensive or not. If the APB is taking responsibility to draft examples it is also taking responsibility for ensuring that the list is comprehensive and up to date and we do not feel it is appropriate for the APB to take on this responsibility..

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?

In our opinion, there are a number of practical difficulties that might arise from the APB's proposed approach, some points to consider include:

- How will the APB ensure that the information is comprehensive, covering all types of entity?
- How will the APB ensure that the information is kept up to date?
- What consultation process would be required for any changes?
- How would updates be communicated?
- Would the APB maintain libraries of superseded responsibilities statements?
- For how many years would the APB retain the information on their website?

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?

YES.

In our opinion, the wording used in paragraph 18 of the exposure draft is generic enough to apply to all entities that are required to be audited.

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?”

NO.

In our opinion, the logical layout for the opinions given on the financial statements would be to follow the order given in the Companies Act 2006 with the true and fair opinion coming first as follows, ...the financial statements:

- give a true and fair view . .
- have been properly prepared in accordance with IFRSs
- have been properly prepared in accordance with the Companies Act 2006

We disagree with the view expressed by the APB that placing the reference to the true and fair view as the final bullet point results in the most logical sequence and do not think that it emphasises the importance of the auditor in making this final judgment. Apart from being consistent with the order in the Companies Act the previous order was logical starting with in our opinion the most important and all encompassing of the opinions expressed on the financial statements.

There is a danger that the revised order with truth and fairness last only serves to downgrade the importance of the true and fair opinion. In placing the financial statement compliance with IFRS and Companies Act opinions before the true and fair opinion it leads to the impression that an audit is primarily about checking financial statement compliance when, as evidenced by the ISAs, there is a lot more to it than that.

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 (see pages 5 and 6)?

In relation to the timetable for Spring 2009 we do not consider that it is necessary for the proposed ISA (UK&I) 700 to be effective for periods commencing on or after 5 April 2009. The APB has already issued in Bulletin 2008/8 example reports taking into account the changes in the Companies Act 2006 and in our opinion the effective

date of ISA (UK&I) 700 should be in line with the effective date of the IAASB clarified ISAs ie for periods commencing on or after 15 December 2009.

The timetable does not allow for another consultation on ISA (UK&I) 700 and in our opinion because of the concerns we have expressed in our response about the lack of consistency with the IAASB clarified ISAs we consider that the APB should aim to issue another exposure draft of ISA (UK&I) 700 rather than progressing to a final standard.

Furthermore, as highlighted in our comments above, the APB has not adopted the IAASB structure of ISA 700 for unmodified reports and ISAs 705 and 706 for modified and reports with emphasis of matter paragraphs. In order to maintain International consistency we recommend that the APB adopt the IAASB structure and build consultation on these ISAs (UK&I) into the timetable.

Are there any other actions that you believe the APB should be taking?

As set out in our response to question 2 above we are not supportive of the APB’s proposal to move the descriptions of the scope of an audit and the auditor’s responsibilities to the APB web site and to allow cross reference from the auditor’s report. If the APB proposes to go ahead with this proposal we would request that they consult further specifically getting feedback from users of financial statements.

Further detailed comments

Page	Comment
11	<p>Example auditor’s report, Para 1</p> <ul style="list-style-type: none"> • the reference to “and Parent” in paragraph 1 and the last bullet of the opinion paragraph should be in square brackets because there will be instances where the parent takes the Companies Act exemption not to present the parent company income statement. • in addition to the Group and Parent Statements of Changes in Equity the example should refer to “/Group and Parent Statement of Recognised Income and Expense”. • the second sentence “The financial statements have been prepared in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union” should be deleted because it is a statement by the auditors and, apart from the absence of “properly” repeats what the auditor then reports in the opinion paragraph. • the example takes no account of the wording changes introduced by IAS revised which with effect for accounting periods beginning on or after 1 January 2009 introduces the following names for primary statements: <ul style="list-style-type: none"> ○ a statement of financial position at the end of the period, ○ a statement of comprehensive income for the period, ○ a statement of changes in equity for the period

Page	Comment
	<ul style="list-style-type: none"> o statement of cash flows for the period.
23	The extant ISA (UK&I) 700 states that the date of the auditor's is the date that the auditor signs (in manuscript) the auditor's report. Whilst we agree with the deletion of "in manuscript" in paragraph 33 we consider that the APB should provide some guidance as to what is meant by "signs".
33	The sentence in paragraph 24-6 of the extant ISA (UK&I) about signing printed copies of the audit report for identification purposes has been deleted and we consider that it is helpful if this is retained.
24	In paragraph 37 where the ISA refers to the "name of the auditor" we consider that this should refer to the "audit firm, the personal name of the auditor or both".
27	<p>In paragraph 54 the redrafting seems to have increased the likelihood of departures from accounting standards resulting in qualified auditor's reports from "In normal cases .." used in the extant ISA (UK&I) 700 to "In almost all cases ..." and we do not feel that this increase is necessary.</p> <p>Furthermore, in the extant ISA (UK&I) 700 para 36.1 the auditor was asked to consider whether there are sound reasons for the departure and this has been deleted from the exposure draft.</p>
29	Paragraph 67 of the exposure draft does not contain the sentence "The requirements of APB ethical standards concerning the response to enquiries from any proposed successor auditor seeking information which could affect the decision whether or not they may properly accept appointment" which was included in paragraph 41.5(b) of the extant ISA (UK&I) 700. We recommend that this is included as it is helpful guidance.
30	As stated above we recommend that the APB adopt the IAASB effective date of periods commencing on or after 15 December 2009.

Please contact me should you wish to discuss any of the points raised in this response.

Yours sincerely

John Hudson
Baker Tilly UK Audit LLP