



Steven Leonard
Project Director, Audit & Assurance
Codes & Standards Division
The Financial Reporting Council
5th Floor, Aldwych House
71-91 Aldwych
London WC2B 4HN

26 April 2013

Dear Sirs,

I am writing on behalf of the Legal and Technical Committee of the British Private Equity and Venture Capital Association ('BVCA') in response to the revision to ISA 700.

The BVCA is the industry body for the UK private equity and venture capital industry. With a membership of over 500 firms, the BVCA represents the vast majority of all UK based private equity firms and their advisers. This submission has been prepared by the BVCA's Legal & Technical committee, which represents the interests of BVCA members in legal, accounting and technical matters relevant to the private equity and venture capital industry.

Our members have invested £40 billion in over 5,000 UK companies over the last five years. Companies backed by UK-based private equity and venture capital firms employ over half a million people and 90% of UK investments in 2011 were directed at small and medium-sized businesses. As major investors in private companies, and some public companies, our members have an interest in financial reporting matters, the conduct and information presented by such companies, and the burdens placed on the management of such companies.

Private equity ownership involves the close alignment of interests between investors and the management of a company, and this leads to closer and often more informal relationships than between comparable forms of ownership. As such, the level of communication between these parties tends to be high, and to a level that covers the areas investors require.

Public Companies

Public companies and private companies deal with their stakeholders in very different ways. Because public companies' shares are mainly listed, communication to stakeholders on financial matters is concentrated on financial reports and regulated announcements and press releases. It is therefore important that such material has 'sufficient information for stakeholders to make financial decisions. However, we are not convinced that the additional audit report disclosure suggested is worthwhile given that we would expect this information to be made available to the Audit Committee who are able to act on behalf of shareholders. We are concerned that such information would be difficult to compile in a meaningful way for shareholders to understand it without significant pressure for an increase in audit costs. It is reasonable to expect audit committees to access auditing standards and therefore for auditors to refer to these in their internal reports and to go into greater detail. However, this will not be practicable in reports for the public so that we have concerns over the ability of the user to be able to reach meaningful conclusions on the statements in the context in which they are made.



As investors, acquiring companies, we would expect to get the information we need on the audit through the due diligence rather than the audit report.

Private Companies

Private companies are not so restricted and tend to have a more informal relationship with their stakeholders so the benefit of requiring additional disclosure in audit reports is likely to be less than the cost of having it provided.

We consider that, for both private and public companies, each disclosure proposal needs to be considered on a cost benefit basis and that, for private companies, the better answer on matters relating of the audit and liquidity is to encourage informal dialogue with stakeholders through the Board or Audit Committee if there is one, rather than mandating additional reporting requirements.

Questions

The answers to your questions are included as an Appendix to this letter.

The BVCA would of course be willing to discuss further this submission and if you wish you should contact Gurpreet Manku.

Yours faithfully

A handwritten signature in black ink, which appears to read 'S. Witney', is positioned above the typed name.

Simon Witney
Chairman – BVCA Legal and Technical Committee

Consultation Questions

Overall View

In answer to your questions:

Question 1: *Do you agree that the auditor's report should include a description of the auditor's assessed risks of material misstatement, materiality and the audit scope? If not, why not?*

We do not agree with the proposal for the reasons set out above and because we believe that the auditors should be accountable for their opinion as to whether the financial statements show a true and fair view and that their work has been done in accordance with auditing standards. We believe that further additional disclosure potentially could allow the auditor to qualify the above by disclosing their planning assessments and resulting execution to move their conclusion from one that is 'black and white' to one that is 'grey'. We do not consider this to be a forward step.

Question 2: *Do you agree that these proposals should be limited to entities that explain how they comply with the Code? If not, why not?*

If these proposals were to be applied they should be limited to entities that explain how they comply with the Code.

Question 3:

- (a) *Do you consider that the provision of such information by the auditor will be of benefit to shareholders and other users of the financial statements and, if so, can you explain what those benefits would be and how they would arise?*
- (b) *Do you believe such information would provide an effective "hook" for investors and other users to start a dialogue with the company about the audit?*

Although we accept that there might be some benefit to some shareholders, we are concerned about the cost to the companies concerned. We consider that, particularly with private companies, there is already good incentive to start a dialogue with the company about the audit.

Question 4: *Do you believe that directors are likely to disclose information about the audit (of the type that would be required in accordance with these proposals) under the September 2012 changes to the Code? Is it more appropriate for such information to be provided in the auditor's report or by the board in the section of the annual report addressing the work of the audit committee, and why?*

We consider that it might be difficult for the directors to disclose information about the audit, but if practicable and for public companies, we would prefer such information to be provided in the section of the directors' report addressing the work of the audit committee, rather than in the audit report as we consider that the audit committee is best placed to comment on the audit in the context of the company's overall governance and direction.

Assessed risks of material misstatement

Question 5: *What do you believe would be, if any, the benefits, costs and other impacts of the proposed requirement to describe in the auditor's report certain risks of material misstatement that were identified by the auditor?*

As investors, we rely on the auditors' report as it currently stands to provide us with assurance that risks of material misstatement have been identified and dealt with. We consider that additional information is a matter for the auditor and audit committee and should be included in the processes that they establish internally. We would be concerned that additional disclosure by the auditor would lead to additional cost to the company.

Question 6: *Do you agree that the basis for determining the risks of material misstatement to be described in the auditor's report (see proposed paragraph 16A(a) of ISA (UK&I) 700 is appropriate?*

We consider that the basis of determining such risk is adequate for reporting to the Audit Committee.

Question 7: *The risks disclosed by the auditor in complying with proposed paragraph 16A(a) of ISA (UK&I) 700 may well differ from the principal risks disclosed by the directors in the business review in the annual report. What are your views about this possibility?*

The risks to the business may be very different from the risks of material misstatement. We consider disclosure by the auditors' to be, at best, secondary and, at worst, confusing and better done with the Audit Committee who are in a better position to interpret and assess the implications of the disclosure.

Question 8: *Do you believe that the omission from the auditor's report of a particular risk of material misstatement would pose a threat of significant loss or damage to the auditor if, after the event, it became evident that the risk has given rise to significant damage to the company?*

We believe that the auditors' may consider this to be a possibility which we would expect to lead an attempt to increase the price of an audit, and to 'play safe' with the disclosure, rather than disclose useful information. We consider that disclosure with respect to the workings of the audit committee in public companies would not have the same constraints.

Materiality

Question 9: *How do you assess the benefits, costs and other impacts of the proposed requirement to provide in the auditor's report an explanation of how the auditor applied the concept of materiality in planning and performing the audit, including specifying the threshold used by the auditor as being materiality for the financial statements as a whole, and the balance between them?*

Our answer is the same as expressed relating to Question 5.

Summary of audit scope

Question 10: *How do you assess the benefits, costs and other impacts of the proposed requirement to provide in the auditor's report a summary of the audit scope, and the balance between them? Does the illustrative disclosure in Section 3 provide a sufficient*

explanation of how the audit scope was responsive to the auditor's assessment of risks and materiality?

We would expect the auditors' to have audited in accordance with Auditing Standards and have disclosed items that were relevant to the Audit Committee. Indeed we would have expected such internal disclosure to be more detailed and perhaps cover additional matters.

We would prefer to rely on this process, the directors' disclosure in the financial statements in accordance with accounting standards and other regulation and any dialogue that we had with the Board or our due diligence process in the case of an acquisition, than a statement such as that made in Section 3.

Avoiding standardised language

Question 11: *Do you believe that the wording in paragraph 16A and paragraphs A9A to A9C is sufficiently principle-based so as to avoid standardised language?*

We consider that auditors will be tempted to use standardised language by adopting wording from both accounting and auditing standards to indicate they have followed normal and expected practice. We consider that this is already covered by their existing general opinion and does not add significantly to existing disclosure requirements.

Effective date

Question 12: *Do you foresee any difficulty if the effective date is periods commencing on or after 1 October 2012?*

If adopted, Boards and Audit Committees would also have to prepare as well as auditors and we therefore consider that the effective date should commence after the finalisation of the amendment.