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Dear Sirs

Re: BVCA response to FRC invitation to comment on IAASB Exposure Draft (July 2013): Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs)

The British Private Equity and Venture Capital Association (“BVCA”) is the industry body for the private equity and venture capital industry in the UK. With a membership of over 500 firms, the BVCA represents the vast majority of all UK based private equity and venture capital firms, as well as their professional 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 £33 billion in over 4,500 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 2012 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 in more widely held companies. As such, the level of communication between these parties tends to be high, and to a level that covers the areas investors require.

Previous response on the FRC Consultation Paper: Revision to ISA (UK & Ireland) 700

The BVCA submitted a response to the consultation on ISA (UK and Ireland) 700 on 26 April 2013.

The amendments made subsequently to ISA (UK and Ireland) 700 apply to those companies that are required to (or who voluntarily chose to) report on how they have applied the UK Corporate Governance Code. Therefore, generally the new auditor’s report requirements will apply to listed companies and since most of our members are concerned with investing in unlisted private companies, via their limited partnership funds, then in the main there is no impact on financial reporting requirements of such investee entities.

However, we continue to be concerned that any wider application and adoption of a more detailed format of audit report for the purposes of reporting on unlisted private entities will add to audit costs without any commensurate benefit. This is because in many unlisted private entities the stakeholders are often the same as management or if they are not, there is informal communication between the private entity board and the stakeholders. Generally, private unlisted entities do not have a wide pool of investors. This contrasts to listed entities where the number of stakeholders is



normally greater and there is a reliance on financial reports, regulated announcements and press releases to formally communicate with stakeholders. We note that the IAASB state they will consider wider application in their post implementation review.

IAASB Exposure Draft

With regard to the IAASB Exposure Draft, we can see no reason why the FRC would not implement the proposed ISAs 700 and 701 into ISAs (UK and Ireland) and amend other relevant ISAs (UK and Ireland) in accordance with the proposed amendments by the IAASB. As far as possible, and within the confines of national law and regulations, the FRC should aim to achieve a direct basis of adoption.

Similarly, we can see no reason why the FRC should require additional auditor's reporting requirements over and above those set out in the proposed ISA 700 and 701. We do not believe that it is necessary or helpful to have differences in the (UK & Ireland) audit reports for listed companies compared to ISA audit reports for listed companies domiciled in other countries. This particularly applies to the current requirement (introduced through the June 2013 changes) to include commentary on materiality, audit scope, audit strategy and the allocation of audit resources. We recommend that the FRC remove these requirements from ISA 700 (UK and Ireland) so there is better consistency of audit report format across the different territories using ISAs.

We have included in Appendix I and Appendix II answers to the specific questions requested in in the ITC document.

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

Yours faithfully

A handwritten signature in black ink, which appears to read 'S. Witney', is positioned below the 'Yours faithfully' text.

Simon Witney
Chairman – BVCA Legal and Technical Committee

APPENDIX I

We have provided answers to the 14 questions posed by the IAASB below.

IAASB Exposure Draft (July 2013) Specific Questions

1. *Do users of the audited financial statements believe that the introduction of a new section in the auditor's report describing the matters the auditor determined to be of most significance in the audit will enhance the usefulness of the auditor's report? If not, why?*

The introduction of a section on key audit matters for audit reports of listed entities has already been introduced by the FRC in the UK. We continue to be concerned about the overall cost effect this will have on the annual audit, especially as the drafting of such additional paragraphs will need to be completed by senior staff.

We also continue to believe that for unlisted companies the less formal nature of the relationship between auditors and stakeholders enables such matters to be adequately communicated to those charged with governance.

We welcome the fact that the extended reporting is not being applied to unlisted entities. However, we note that the IAASB intends to conduct a post implementation review of the proposed ISAs, one part of which will be whether wider application would be in the public interest. We consider that applying the same principles and guidance for the audit reports of unlisted entities would inevitably add significantly to audit costs. We are concerned that there will be little benefit to the stakeholders because of the more direct relationship that already exists between shareholders and the auditors.

2. *Do respondents believe the proposed requirements and related application material in proposed ISA 701 provide an appropriate framework to guide the auditor's judgment in determining the key audit matters? If not, why? Do respondents believe the application of proposed ISA 701 will result in reasonably consistent auditor judgments about what matters are determined to be the key audit matters? If not, why?*

Inevitably, the facts and circumstances of each audit of a listed entity will be different and therefore it is important that the auditor both has the flexibility and the ability to determine what is a key audit matter and how to describe it. The application material in ISA 701 is sufficient guidance.

3. *Do respondents believe the proposed requirements and related application material in proposed ISA 701 provide sufficient direction to enable the auditor to appropriately consider what should be included in the descriptions of individual key audit matters to be communicated in the auditor's report? If not, why?*

Covered in the answer above.

4. *Which of the illustrative examples of key audit matters, or features of them, did respondents find most useful or informative, and why? Which examples, or features of them, were seen as less useful or lacking in informational value, and why? Respondents are invited to provide any additional feedback on the usefulness of the individual examples of key audit matters, including areas for improvement.*

The examples of key audit matters act as a reasonable guide to the nature and description of a key audit matter. We do not think more examples are necessary. To do otherwise carries

the risk that disclosures will become boilerplate or standardised rather than specific to individual entities.

5. *Do respondents agree with the approach the IAASB has taken in relation to key audit matters for entities for which the auditor is not required to provide such communication – that is, key audit matters may be communicated on a voluntary basis but, if so, proposed ISA 701 must be followed and the auditor must signal this intent in the audit engagement letter? If not, why? Are there other practical considerations that may affect the auditor's ability to decide to communicate key audit matters when not otherwise required to do so that should be acknowledged by the IAASB in the proposed standards?*

Certainly any voluntary disclosure of key audit matters in the auditor's report should be specifically referred to in the auditor's letter of engagement.

6. *Do respondents believe it is appropriate for proposed ISA 701 to allow for the possibility that the auditor may determine that there are no key audit matters to communicate?*
(a) If so, do respondents agree with the proposed requirements addressing such circumstances?
(b) If not, do respondents believe that auditors would be required to always communicate at least one key audit matter, or are there other actions that could be taken to ensure users of the financial statements are aware of the auditor's responsibilities under proposed ISA 701 and the determination, in the auditor's professional judgment, that there are no key audit matters to communicate?

It seems unlikely that an audit would not have at least one key audit matter since the determination of the key audit matters is a "relative" exercise and involves judgement over a number of areas of audit focus. Every audit has at least one area of audit focus and this should be the key audit matter.

7. *Do respondents agree that, when comparative financial information is presented, the auditor's communication of key audit matters should be limited to the audit of the most recent financial period in light of the practical challenges explained in paragraph 65? If not, how do respondents suggest these issues could be effectively addressed?*

Key audit matters should relate to the current financial period. If prior year key audit matters are still relevant then obviously they should be updated. To make this clearer the IAASB could consider amending the title in the illustrative audit report to "Key Audit Matters in the Current Period"

8. *Do respondents agree with the IAASB's decision to retain the concepts of Emphasis of Matter paragraphs and Other Matter paragraphs, even when the auditor is required to communicate key audit matters, and how such concepts have been differentiated in the Proposed ISAs? If not, why?*

Yes. It is important that the audit report can contain an emphasis of matter in relation to the financial statements and there is a clear differentiation from key audit matters.

9. *Do respondents agree with the statements included in the illustrative auditor's reports relating to:*
- (a) *The appropriateness of management's use of the going concern basis of accounting in the preparation of the entity's financial statements?*
 - (b) *Whether the auditor has identified a material uncertainty that may cast significant doubt on the entity's ability to concern, including when such an uncertainty has been identified (see the Appendix of proposed ISA 570 (Revised)? In this regard, the IAASB is particularly interested in views as to whether such reporting, and the potential implications thereof, will be misunderstood or misinterpreted by users of the financial statements.*

We agree with the suggested format and disclosures in relation to the going concern basis of accounting. We think it will be important to publicise and educate users of financial statements on the distinction between preparing historical results on a going concern basis compared to guaranteeing an entity's ability to continue as a going concern; there remains much confusion by users of financial statements over this point.

10. *What are respondents' views as to whether an explicit statement that neither management nor the auditor can guarantee the entity's ability to continue as a going concern should be required in the auditor's report whether or not a material uncertainty has been identified? Compliance with Independence and Other Relevant Ethical Requirements*

See answer to the previous question. We think it is essential that this language is incorporated in the auditor's report.

11. *What are respondents' views as to the benefits and practical implications of the proposed requirement to disclose the source(s) of independence and other relevant ethical requirements in the auditor's report? Disclosure of the Name of the Engagement Partner*

We agree with the proposals.

12. *What are respondents' views as to the proposal to require disclosure of the name of the engagement partner for audits of financial statements of listed entities and include a "harm's way exemption"? What difficulties, if any, may arise at the national level as a result of this requirement? Other Improvements to Proposed ISA 700 (Revised)*

Partner name disclosure is already in place in the UK, so we support the disclosure.

13. *What are respondents' views as to the appropriateness of the changes to ISA 700 described in paragraph 102 and how the proposed requirements have been articulated?*

We agree with the proposals.

14. *What are respondents' views on the proposal not to mandate the ordering of sections of the auditor's report in any way, even when law, regulation or national auditing standards do not require a specific order? Do respondents believe the level of prescription within proposed ISA 700 (Revised) (both within the requirements in paragraphs 20–45 and the circumstances addressed in paragraphs 46–48 of the proposed ISA) reflects an appropriate balance between consistency in auditor reporting globally when reference is made to the ISAs in the auditor's report, and the need for flexibility to accommodate national reporting circumstances?*

There needs to be flexibility for national laws and regulations but where there is no prescription in national law and regulations, the ordering of sections should be mandated so, as far as possible, there is recognised consistency between different countries when applying the ISA audit report standards. It will make it easier for users of financial statements to identify particularly relevant points in the audit report.

We agree that the mandating of specific headings in the audit report, where national law and regulations precludes the preferred format, helps with consistency.

APPENDIX II

Response requested by FRC in paragraph 9 of the FRC Invitation to Comment on IAASB Exposure Draft (July 2013)

9. *In addition, the FRC would welcome any comments that you may have about 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), having regard to the inter-relationship of the IAASB's proposals and the changes already made by the FRC in 2012/13, as described above, including:*
- (a) 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;*
 - (b) 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;*
 - (c) 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) 7001;*
 - (d) 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; and*
 - (e) Whether any new differences between the ISAs and the ISAs (UK and Ireland) should be introduced in adopting the proposed ISAs.*

We consider that, as far as possible within the confines of national law and regulations, ISAs (UK and Ireland) should implement the proposed ISAs 700 and 701 and the other resulting amendments to other ISAs so as to achieve a direct basis of adoption.

With regard to the June 2013 changes introduced by the FRC (summarised in paragraph 5 of the ITC document), we do not believe that it is necessary to have differences in the (UK & Ireland) audit reports of listed companies compared to ISA audit reports of listed companies domiciled in other countries. This particularly applies to the current requirement to include commentary on materiality, audit scope, audit strategy and the allocation of resources. We recommend that the FRC remove these requirements from ISA 700 (UK and Ireland) so there is better consistency of audit report format across the different territories using ISAs.

We note that if the current requirements remain and are included in the "other matter" paragraph of the audit report, this paragraph will be placed after the key audit matters which does not help the reader understand the relevance or context of these inputs (scope, materiality, etc.) to the audit process when considering the key audit matters.