



Federation of European Accountants

Office of the Secretary  
PCAOB

Sent by email:  
[comments@pcaobus.org](mailto:comments@pcaobus.org)

Brussels, 26 July 2016

**Subject: Reproposal of the standard “The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion”**

Dear Sir or Madam,

The Federation of European Accountants (the Federation) is pleased to provide you with its comments on the Public Company Accounting Oversight Board's ("PCAOB") reproposal of the standard *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*.

- (1) The Federation welcomes the reproposed auditing standard and fully supports an auditor's report that is more informative, user friendly and easy to understand.
- (2) It is encouraging that the IAASB and the PCAOB are engaged in a similar approach to improving the auditor's report. This is particularly helpful for investors who are interested in an entity that is required to issue an auditor's report both under IAASB and PCAOB standards. In particular, we note that the PCAOB's concept of Critical Audit Matters (CAM) has now been more closely aligned to the IAASB's concept of Key Audit Matters (KAM), as set out in ISA 701 *Communicating Key Audit Matters in the Independent Auditor's Report* than originally proposed. We advocate for alignment of auditing standards globally to the maximum extent possible. In general, there should be no differences between CAM and KAM except where jurisdictional particulars dictate the necessity for specific clearly identifiable differences. This enhances both quality of audits and acceptance of audit reports beyond home jurisdictions, whereas differences between CAM and KAM reporting for a particular entity would likely impinge on users' perceptions as to the decision usefulness of the new auditor reporting model.

- (3) The constructive relationship between the PCAOB and the IAASB also provides further transparency to informed users about audit related matters and enhances the dialogue of users with those charged with governance (TCWG) (e.g. audit committee). As the PCAOB will be aware, the new European audit legislation comprises updated European Union (EU) provisions regarding the improvement of the quality of statutory audit across the EU. Key measures comprise strengthening the independence of statutory auditors and making the audit report more explanatory. Member States were required to adopt, publish and apply the measures necessary to comply with the Directive 2014/56/EU<sup>1</sup> from 17 June 2016. Most provisions of the Regulation<sup>2</sup> also came into force from 17 June 2016. The main impact on auditor reporting in Europe will come from the Regulation and not the Directive. ISAs have not yet been adopted by the EU Commission and it currently seems unlikely that this will happen in the near future.
- (4) Moreover, we support the reproposal in that it addresses the needs of users to receive information that is entity-specific. For the new auditor's report to bring the maximum added value to users, technical or standardised language needs to be avoided.
- (5) The main threat to enhanced transparency is that CAM disclosed will be irrelevant to investor needs, or will degenerate into boilerplate. Extended auditor reporting should be seen as a journey; behavioural changes are needed among all stakeholders, and the PCAOB should not lose sight of the fact that to make CAM effective, investors, audit committees and auditors need to step up their level of engagement with each other.
- (6) We do not comment on all the questions raised in the reproposal. In particular, we have not responded to:
- Questions 3, 12 and 14 to 20 on Section IV. Discussion of the Reproposal
  - Question 26 on Section V. Other Amendments to PCAOB Standards;
  - Questions 37 to 40 on section VII. Exclusions from Critical Audit Matter Requirements;
  - Questions 41 to 43 on section VIII. Considerations for Audits of Emerging Growth Companies;
  - Question 44 on section IX. Considerations Related to Effective Date.

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<sup>1</sup> <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0056&from=EN>

<sup>2</sup> <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0537&from=EN>

Our detailed responses to the questions included in the Proposal are set out in the Annex below. For further information on the Federation's letter, please contact Hilde Blomme on +32 (0)2 893 33 77 or via email at [hilde.blomme@fee.be](mailto:hilde.blomme@fee.be) or Eleni Ashioti on +32 (0)2 893 33 87 or via email at [eleni.ashioti@fee.be](mailto:eleni.ashioti@fee.be) from the Federation's team.

Kind regards,

On behalf of the Federation of European Accountants,



Petr Kriz  
President



Olivier Boutellis-Taft  
Chief Executive

#### **About the Federation of European Accountants**

The Federation of European Accountants represents 50 professional institutes of accountants and auditors from 37 European countries, with a combined membership of over 875,000 professional accountants working in different capacities. As the voice of the European profession, the Federation recognises the public interest.

The Federation is in the EU Transparency Register (No 4713568401-18).

# Annex 1

## IV. Discussion of the Reproposal

### Auditor Communication of Critical Audit Matters - Questions 1-12

1. *Is the definition of "critical audit matter" appropriate for purposes of achieving the Board's objective of providing relevant and useful information in the auditor's report for investors and other financial statement users? Is the definition sufficiently clear to enable auditors to apply it consistently? If not, describe why the definition may not be clear, including examples demonstrating your concern.*
  - a. *Are matters communicated or required to be communicated to the audit committee the appropriate source for critical audit matters? Why or why not?*
  - b. *Are there any audit committee communications that should be specifically excluded from consideration as a source of potential critical audit matters? If so, identify and explain the reason for the exclusion.*
  - c. *Is the "relates to accounts or disclosures that are material to the financial statements" component of the definition of a critical audit matter appropriate and clear? Why or why not?*
  - d. *Is the "involved especially challenging, subjective, or complex auditor judgment" component of the definition of a critical audit matter appropriate and clear? Why or why not?*

- (1) The reproposal to the definition of CAM is achieving the PCAOB's objective. Whilst it is also quite closely aligned to the IAASB'S terminology, we question the need to use different terminology without good reason and unless differences are genuine and significant.
- (2) The auditor's communication of CAM will be relevant and useful to investors and other financial statement users if:
  - investors continue to engage with the audit committees' and auditors' communities, and are clear about what they want as pieces of information;
  - auditors avoid boilerplate where possible; and
  - regulators, companies and investors do not drive auditors into the defensive reporting of boilerplate with threats of sanctions and litigation.
- (3) We agree that the matters communicated or required to be communicated to the audit committee are the appropriate source for CAMs.
- (4) We have not identified any audit committee communications that should be specifically excluded from consideration as a source of potential CAMs.
- (5) The component "relates to accounts or disclosures that are material to the financial statements" of the definition is appropriate and clear. The requirement is similar to the one included in ISA 701; despite the fact that this component is not included in the definition of KAM in ISA 701, the standard considers materiality in paragraph A29 as one of the relevant considerations to determine a KAM, i.e. "The importance of the matter to intended users' understanding of the financial statements as a whole, in particular, its materiality to the financial statements."
- (6) We consider that the following component of the CAM definition "[...] involved especially challenging, subjective, or complex auditor judgment" is appropriate and clear.

2. *Are factors helpful in assisting the auditor in determining which matters involved especially challenging, subjective, or complex auditor judgment? Why or why not?*

(7) We welcome the reproposal listing a number of factors to determine CAMs, considering matters involved in areas which require judgement, or are challenging and subjective, such as the auditor's assessment of the risks of material misstatement, including significant risks.

(8) The fact that the PCAOB reproposal is, in general, now more aligned to the IAASB's approach than was the original proposal should limit the confusion to auditors who may need to apply both sets of standards and to investors receiving both auditor's reports under the IAASB standards and the PCAOB standards for the same entity.

(9) The PCAOB could go further to allow for and encourage the use of judgement in this area as well.

4. *Are there specific circumstances in which the auditor should be required to communicate critical audit matters for each period presented, rather than only the current period? For example, should communication be required in an IPO or in a reaudit? Why or why not?*

(10) The auditor should first and foremost concentrate on those CAMs arising from the audit of the current period, even in the case of comparative financial statements, when the auditor is required to report on both the current period financial statements and the prior period financial statements in connection with the current year's audit.

(11) We agree with the PCAOB's Reproposal indicating that the auditor might communicate CAM with regard to a prior period in particular situations. There may be circumstances, in the situation of an IPO for instance, where it might be relevant to include CAMs on other periods. The normal usage should be to report on the current year only. IPOs could be given as an example whereas re-audits are rare and should therefore not be used as an example.

5. *Are the reproposed requirements regarding the description of critical audit matters in the auditor's report, including the principal considerations and how the matter was addressed in the audit, sufficiently clear for consistent implementation by auditors? Why or why not? If not, how could the requirements be clarified?*

(12) Notwithstanding our remarks as to the importance of global consistency, the reproposed requirements in relation to the description of CAMs in the auditor's report, including the principal considerations and how the matter was addressed in the audit are sufficiently clear for consistent implementation by auditors.

(13) The reproposal narrows the auditor to describe only the principal considerations. This should result in providing more useful information to investors and other users and avoid boilerplate language in this section of the auditor's report as well as potential overload with insignificant information.

(14) We welcome the fact that the PCAOB allows for flexibility on the level of detail in the description of each CAM. This should encourage the development of tailor-made reports. The guidance on page 31, which provides some examples that the auditor could use to describe how CAMs were addressed in the audit, will certainly benefit auditors in preparing the auditor's report and will help financial statement users better understand these matters.

6. *Do the repropoed communication requirements appropriately address commenter concerns regarding auditor communication of critical audit matters, such as:*

a) *The auditor providing original information in describing the principal considerations for the determination that the matter is a critical audit matter or describing how the matter was addressed in the audit, and*

b) *Investors and other financial statement users misinterpreting critical audit matters as undermining the auditor's pass/fail opinion or providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate?*

*Are there other steps the Board could take to address these concerns? If so, what are they?*

(15) Yes, the repropoed communication requirements appropriately address the above mentioned commenter concerns. It is beneficial that the proposed requirements are very likely to enhance the way in which auditors and audit committees work together.

(16) The repropoed standard specifies that the auditor's communication of CAMs does not change by any means the auditor's opinion on the financial statements, taken as a whole. We consider this repropoal to respond to commenter concerns on the misinterpretations indicated in the question 6 (b).

7. *In addition to referring to the relevant financial statement accounts and disclosures, would it be appropriate for the auditor to refer to relevant disclosures outside the financial statements when communicating a critical audit matter? Why or why not?*

(17) No, we do not consider it appropriate for the auditor to refer to relevant disclosures outside the financial statements when communicating CAM. The CAM definition refers to information that is included in the financial statements.

(18) Also, our concern with referencing information outside of the financial statements is that the reader may infer that such information has been subject to audit, which will not be the case. This could lead to an expectation gap between what the reader thinks is done by the auditor and what the auditor has actually done.

8. *Is it appropriate for the repropoed standard to retain the possibility of the auditor determining that there are no critical audit matters and, if so, require a statement to that effect in the auditor's report? Why or why not?*

(19) Yes, it would be appropriate to retain the possibility for the auditor to determine that there are no CAMs, and require a statement to that effect in the auditor's report.

(20) We agree with the PCAOB approach that while it is anticipated that at least one CAM will be communicated in the auditor's report, there are still cases where the auditor may identify a matter but not consider it so important as to merit disclosure in the auditor's report. Requiring such a statement is also consistent with the IAASB approach.

9. *Is the repropoed documentation requirement clear and appropriate? Why or why not? If not, how should the documentation requirement be formulated?*

(21) We support the repropoal of narrowing the source of CAMs to matters communicated or required to be communicated to the audit committee and also in adding a materiality component.

(22) The IAASB's requirements for documentation focus on why a KAM is a KAM, with an option to describe why other potential KAMs were not reported as KAMs. The PCAOB's requirements have more focus on documenting why possible CAMs are not considered to be CAMs, which seems to be more about preparing audit files for inspection purposes than communicating useful information to investors. The requirements are clear, but do not go in the right direction.

10. *What effect, if any, could the auditor's communication of critical audit matters under the repropoed standard have on private litigation? Would this communication lead to an unwarranted increase in private liability?*

(23) The legal framework and litigation culture in many EU member states often still differ from the situation in the USA and the extent of private litigation is not necessarily a phenomenon of the same magnitude as it is in the US and some other jurisdictions.

11. *Do the changes from the 2013 proposal address concerns that have been raised about private liability? If not, what additional changes would you suggest should be made?*

(24) We recognise the PCAOB's effort to address the concerns that have been raised from the 2013 proposal about private liability. This is evident from various aspects of the reproposal such as changing the source of CAMs, adding a materiality component, redefining the factors and modifying the communication requirement.

### **Additional Improvements to the Auditor's Report – Questions 13-20**

13. *Is the repropoed requirement relating to auditor independence clear? Would this information improve investors' and other financial statement users' understanding of the auditor's independence responsibilities? Why or why not?*

(25) The fact that the word "independent" already appears in the audit report means that the bold statement to the effect that auditors are independent, a little further down in the report, manages to say very little and looks repetitive at the same time. The statement does not add much to the word in the title and we have doubts as to whether it will in fact improve confidence in auditor independence. Merely stating that auditors are required to be independent does not make them so. The auditors' report should not be cluttered with poor quality information, particularly if it is repetitive. Requiring auditors to include a statement on their independence will not result in any significant changes to their behaviour. Confidence in the independence of auditors is important and a statement in the auditors' report to this effect is unobjectionable, if superfluous.

### **Explanatory Language and Emphasis of a Matter – Questions 21-24**

21. *Is the interaction between the communication of critical audit matters and required explanatory paragraphs clear and appropriate? Why or why not?*

(26) Yes, the interaction between the communication of CAMs and required explanatory paragraphs is clear and appropriate. Clarifying that a CAM is not a substitute for required explanatory paragraphs as well as considering that "there could be situations in which a matter meets the definition of a critical matter and also requires an explanatory paragraph, such as going concern" could be very useful in the preparation of the auditor's report, and ultimately may increase the confidence that investors and other users have in the audit and in the financial statements.

(27) Furthermore, we acknowledge that the PCAOB requires auditors in AS 2415 to include an explanatory paragraph in the auditor's report when there is substantial doubt about the company's ability to continue as going concern. Further clarification is needed to explain the linkage between CAMs and the going concern basis of accounting in the auditor reporting standard. We would very much welcome a clear requirement that going concern issues should be included as a CAM if the definition is met. A similar requirement is included in ISA 701.

(28) We very much welcome the fact that the next action under consideration in the PCAOB's agenda relates to a project on 'Going Concern'.

22. *Should auditors be permitted to include the critical audit matter communications in the required explanatory paragraph? Would integrating explanatory paragraphs and critical audit matters be helpful to investors? Alternatively, would it decrease the impact of the explanatory paragraph? Why or why not?*

(29) Yes, the auditors should be permitted to include the CAM communications in the required explanatory paragraph. It would be helpful to investors since they will have access to additional information such as how the matter was addressed in the audit.

23. *Should the Board's requirement to include an explanatory paragraph in the auditor's report when the auditor did not perform an audit of ICFR apply not only if company's management is required to report on ICFR, but also if management is not required to report, such as for investment companies?*

(30) We support transparency as to the scope of the audit. Such requirement should be included in all audit reports where an audit of ICFR was not performed to avoid any potential misunderstanding.

24. *Is the interaction between the communication of critical audit matters and emphasis paragraphs clear and appropriate? Why or why not?*

(31) Yes. The interaction between the communication of CAMs and emphasis paragraphs is clear and appropriate. We recognise the PCAOB's effort to do so by clarifying that emphasis paragraphs are not a substitute for required CAMs. We also find useful for the auditor the list of examples provided of matters that may be emphasized in relation to the financial statements.

(32) We agree that an emphasis paragraph would not be included in the auditor's report concerning a matter that meets the definition of a CAM, as in this case that matter should be communicated as CAM.

#### **Form of the Auditor's Report – Question 25**

25. *Would the repropoed requirements for a specific order of certain sections in the auditor's report and for section titles make the auditor's report easier to use? Should the standard allow more or less flexibility in the presentation of the auditor's report?*

(33) We support requiring the report to include obligatory subheadings and also to require the ordering of paragraphs to mirror the auditor's reporting model under ISAs. The 'global standardisation' of the auditor's report would help:

- Direct users to specific areas of interest such as CAM within the auditor's report; and
- Facilitate a comparison between auditor's reports.

(34) We note, however, that flexibility might be needed in some jurisdictions and/or in the circumstances of a particular engagement. To this end, even if the paragraph order differs between jurisdictions, as a result of national laws or regulations, the reader can use those subheadings to navigate the report more easily. It would be most helpful if the PCAOB report uses the same headings as the ISA equivalent, the comparison between auditor's reports will then be more straightforward.

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#### **VI. Economic Considerations - Questions 27-36**

(35) It is worth noting that the CAM proposals should initially be viewed as an experiment, and that time will be needed to adapt and develop best practice. The definitions and requirements included in the proposals cannot currently respond to all possible questions which are bound to arise upon application of this new form of auditor reporting.