



22 November 2013

Our Ref.: C/AASC

International Auditing and Assurance Standards Board
529 Fifth Avenue, 6th Floor
New York, 10017
USA

Dear Sirs,

IAASB's Exposure Draft on Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs)

The Hong Kong Institute of Certified Public Accountants is the only statutory licensing body of accountants in Hong Kong responsible for the professional training, development and regulation of the accountancy profession. The HKICPA sets auditing and assurance standards, ethical standards and financial reporting standards in Hong Kong.

We welcome the opportunity to provide you with our comments on the IAASB's ED. We support the IAASB's continuing efforts to clarify the role of auditors as expressed through reporting requirements and welcome this ED.

In principle, we are supportive of the proposed changes to the auditor's report to provide more information to stakeholders to meet their needs. However, we have concerns as to the extent of additional information provided particularly under key audit matters. HKICPA and stakeholders in Hong Kong that have commented on the ED believe that both management and auditors should have the responsibility to provide useful information – management and those charged with governance having the primary responsibility and the auditors providing their perspective in the auditor's report. The extent and nature of information provided by the auditor should be balanced in the context of the responsibilities of respective parties – i.e. to provide useful comments in a concise and understandable form, while not being the provider of original information on the company.

In addition, given that other standard setters such as the US PCAOB and the UK FRC have also proposed changes to the auditor's report in their respective jurisdictions; we would encourage the IAASB to liaise with them when finalizing the ISAs. This would be helpful in ensuring the proposed changes for auditor's reporting are well understood and implemented consistently. We note that there are different terminologies being used e.g. "key audit matters" by IAASB, "critical audit matters" by PCAOB and "description of assessed risks of material misstatement identified" by UK FRC and nature of proposed improvements and concepts may differ.

We have received comment letters on the ED from local stakeholders, namely the banking and financial analysts associations. The comment letters are available on our website at <http://www.hkicpa.org.hk/en/standards-and-regulations/standards/auditing-assurance/auditing-assurance-submissions/2013/cl-reiaasb/> and we would encourage the IAASB to consider their comments in finalising the ED.



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Responses to the specific questions in the ED are included in the attachment.

We trust that our comments are of assistance to you. If you require any clarification on our comments, please contact me at simonriley@hkiipa.org.hk.

Yours faithfully,

Simon Riley
Director, Standard Setting

SR/al

Encl.



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ATTACHMENT

HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS' COMMENTS ON THE IAASB'S EXPOSURE DRAFT ON REPORTING ON AUDITED FINANCIAL STATEMENTS: PROPOSED NEW AND REVISED INTERNATIONAL STANDARDS ON AUDITING (ISAs)

Key Audit Matters

Question 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?

In principle, we are supportive of the proposal to provide useful information in the auditor's report to enable users to better understand the audit process.

As highlighted in our covering letter, management and those charged with governance have the primary responsibility of providing insights and additional information to users (e.g. on methods and judgements made in valuing assets and liabilities; key business and operational risks). Auditors could then provide their perspective in the auditor's report. The extent and nature of information provided by the auditor should be balanced in the context of the responsibilities of respective parties – i.e. to provide useful comments in a concise and understandable form, while not being the provider of original information on the company. Some scenarios could be judgemental e.g. where key audit matters are identified because of the matter was one that required a lot of audit effort (for instance in the area of potential fraud risk, potential illegal act or significant breakdown in controls) but such information would not be reflected on the financial statements.

There is some value for auditors pointing out important information dealing with matters of significant judgment or highly unusual or material items; a roadmap to the important matters, if those matters have already been disclosed and explained by management or by those charged with governance.

We have concerns that without additional clarification and guidance the "key audit matters" section may result in a boilerplate approach to auditor reporting and, in substance, may not provide useful information to users. In addition, there is a possibility of different approaches being taken in different markets. Local stakeholders have emphasised that there should be clear guidance on what should be "key audit matters" to ensure consistency. We would encourage the IAASB to consider the comments posted on our website.



Question 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?

In general, we support that there should be a framework in determining the key audit matters. The framework should allow the profession to develop its own practice using the principles in ISA 701. It should be emphasized in ISA 701 that the focus of the example paragraphs on key audit matters should not be on the example wording used but rather the thought process of identifying the subject matter as a key audit matter.

We believe that the framework to be used in the thought process for identifying key audit matters could be more clearly described. Such clarification would be helpful in order to ensure consistency in the selection (in particular, the number of key audit matters, and the nature of those matters) of matters to be reported.

Question 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?

We note that there is little guidance in the proposed ISA 700 or ISA 701 on what needs to be included in the key audit matters paragraphs (e.g. description of matter, management's assertion, description of audit work performed and auditor's conclusion).

Even though at the opening paragraph of the "Key Audit Matters" section states that the auditors do not express an opinion on these individual matters, we note that within the individual examples, there is wording indicating the auditor's "conclusion" on the matter, e.g. "we concluded the use of such a model was appropriate", "we did not find evidence of the existence of side agreements". We would recommend the IAASB to further clarify whether such "conclusions" would be required.

Similarly for the description of audit work performed, it is not clear under what circumstances this needs to be included in the auditor's report. Users may become confused about why they sometimes see procedures being described and in other cases they do not. Also when we refer to audit testing, there is the possibility for users to misinterpret the level of assurance provided as many such procedures are only on a limited sample basis. The audit conclusion is an outcome of the evaluation of the financial statements as a whole. We would recommend the IAASB considers developing standard wording explaining the inherent limitations in any such procedures in the event that it is necessary to include such descriptions in the auditor's report.

As referred to in our covering letter, we would encourage the IAASB to read the comments received from our local stakeholders.



Question 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.

Please see our comments on Question 3.

We note that most of the examples of key audit matters have respective disclosure in the notes to the financial statements, which is useful. As previously mentioned in our comments on the IAASB's Invitation to Comment: Improving the Auditor's Report, we believe that it may not be appropriate for auditors to provide information directly to users on methods and judgments made in valuing assets and liabilities; key business and operational risks; and quality and effectiveness of the governance structure and risk management. We consider that management is in a better position to convey such information to users. Therefore, we recommend that IAASB liaises with the accounting standards standard setters e.g. IASB, FASB and regulators to enhance disclosure requirements in the financial statements and ensure that auditor's disclosure of key audit matters is not used as a substitute for inadequate financial statement disclosure.

The example on fraud risk is useful. In addition, as highlighted in our comments to Question 3, we note that in the examples provided, some refer to audit procedures (e.g. use of an expert to test goodwill) while others do not (e.g. testing of the business combination). We would encourage the IAASB to clarify the principles and circumstances where audit procedures should be included.

Question 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?

We agree with the proposed approach that ISA 701 must be followed where key audit matters are communicated on a voluntary basis. Such an approach should be agreed in advance with the entity and included in the engagement letter to avoid any practical difficulties that may arise in deciding to report key audit matters during the audit.



Question 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?**

We are of the view that it is unlikely that there would be no key audit matters to communicate. However, we are supportive of the proposed guidance on addressing such a scenario.

In addition, it may be useful to include some guidance on the implications of such a presentation in the auditor's report e.g. auditors may be questioned and therefore should be prepared to explain further their rationale at a listed entity's Annual General Meeting.

Question 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?

We agree with the proposal that the key audit matters should be limited to the audit of the most recent financial period.

Question 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?

We agree with the IAASB's proposal to retain Emphasis of Matter paragraphs and Other Matter paragraphs, even when the auditor is required to communicate key audit matters. In such circumstances, the Emphasis of Matter paragraphs should only relate to the requirements set out in other ISAs or law or regulation and refer to matters covered by/disclosed in the financial statements.

It is useful to retain the mechanism for entities where there is no requirement to communicate key audit matters.



Given that the proposed auditor's report will now have different sections – "key audit matters", "emphasis of matter", "other matter", it may be difficult for users to fully understand the context of the information provided under the respective sections. We would recommend the IAASB to consider inserting the definitions of "key audit matters", "emphasis of matter" and "other matter" in the auditor's report to clarify and distinguish the nature of information provided. The additional information provided may not be useful if the users, in particular, the general public do not understand the technical jargon.

Going Concern

Question 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 are of the view that the requirements under the extant ISA 570, *Going Concern*, are sufficient for the assessment of the entity's ability to continue as a going concern. The extant ISA 570 allows for the auditor to disclose information in the auditor's report (e.g. Emphasis of Matter, adverse opinion) where the auditor has concerns with going concern. We believe the existing mechanism is appropriate.

There should not be any further requirements on the auditor to provide comments on going concern over and above the existing requirements in ISA 570 without corresponding disclosure by management in the financial statements.

Therefore, we would request the IAASB to liaise with the relevant accounting standards standard setters e.g. IASB, FASB to align the respective disclosure requirements on going concern before finalizing the proposal.

In addition, there are concerns as to the technical jargon being used in the auditor's report such as "going concern" and "material uncertainty". With the use of technical jargon, there is a risk that readers, in particular, the general public, may misunderstand what these technical jargon mean and interpret the message differently.

As referred to in our covering letter, we also encourage the IAASB to read the comments from our local banking association available on our website.



Question 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?

We are of the view that such a statement is not helpful. Comments from our local financial analysts association indicate that there is limited benefit to be gained from making such a statement as most users should implicitly understand this already.

Compliance with Independence and Other Relevant Ethical Requirements

Question 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?

As the HKICPA's Code of Ethics for Professional Accountants has converged with the IESBA's Code of Ethics for Professional Accountants since 2005, in Hong Kong there is requirement for auditors to be independent with respect to their audit clients. We have no particular concern for disclosing the source of independence and other relevant ethical requirements in the auditor's report.

However, we question the value of such disclosure to readers and whether readers would be interested in receiving such information. In addition, we note that there may be implications for group audits where there are various jurisdictions involved, potentially resulting in a lengthy list of disclosure.

Disclosure of the Name of the Engagement Partner

Question 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?

In general, we are supportive of disclosing the name of the engagement partner, as currently required under the ISAs and ISQC 1, i.e. the engagement partner being responsible for the conduct and performance of the audit.

We would note, however, that in Hong Kong, the auditor's report is normally signed in the name of the firm because the firm as a whole assumes responsibility for the audit. For a corporate practice, the auditor's report is signed by a director of the practice, who must be a professional accountant holding a current practising certificate. The auditor's report states the name of the corporate practice and the location of its office and is signed in the name of the corporate practice. The auditor's report also identifies the director responsible for the performance of the audit engagement contemplated by such



report, and states his/her full name as appearing in his/her practising certificate and the practising certificate number.

We would suggest that some flexibility be adopted for this proposed requirement in order for national standard setters to consider any local regulatory requirements.

Other Improvements to Proposed ISA 700 (Revised)

Question 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?

In general, we agree with the proposed requirements for:

- the description of the responsibilities of the auditor and key features of the audit
- provision for the descriptions of the responsibilities of the auditor and key features of the audit to be relocated to an appendix in the auditor's report, or for reference to be made to such a description on the website of an appropriate authority
- reference to whom in the entity is responsible for overseeing the entity's financial reporting process
- other reporting responsibilities

We are of the view that there should be consistency as to the form and content of the auditor's report unless a law or regulation prohibits such consistency. This would enable users to make comparison across entities.

We would also encourage the IAASB to liaise with other regulators such as the PCAOB and UK FRC when finalizing the standards in order to ensure consistency.

Question 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 should be consistency in the form and contents of the auditor's report. We believe that national standard setters should adopt the IAASB's proposed ordering of the paragraphs unless there is a law or regulation prohibiting as such.

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