October 8, 2012

Re: Invitation to Comment: Improving the Auditor’s Report

Dear Sir or Madam,

The Chinese Institute of Certified Public Accountants (CICPA) welcomes the opportunity to comment on Invitation to Comment: Improving the Auditor’s Report. We commend the International Auditing and Assurance Standards Board (IAASB) on its work to enhance the relevance and informational value of the auditor’s report.

In general, we believed that the proposed improvements in the ITC will make the auditor’s report more informative, relevant and transparent, and contribute to meeting the increasing needs of report users.

The appendix to this letter provides our responses to the questions presented in the ITC.

We would be pleased to discuss in further detail our comments and any other matters with respect to this ITC.

Yours sincerely,

Yugui Chen
Secretary General
CICPA
Appendix

Responses to Questions in the Invitation to Comment: Improving Auditor’s Report

Overall Considerations

1. Overall, do you believe the IAASB’s suggested improvements sufficiently enhance the relevance and informational value of the auditor’s report, in view of possible impediments (including costs)? Why or why not?

Yes. In principle we believe that the IAASB’s suggested improvements will sufficiently enhance the relevance and informational value of the auditor’s report. The proposed improvements will make the auditor’s report more informative, relevant and transparent which should substantially address the “expectation gap” and “information gap” between the users and auditors.

We would like to explore “enhancement to auditor’s report” from wider perspectives:

(1) It may be the right time to reassess the role of auditors and auditor’s report in today’s economic life. Many users expressed their view that they are no longer satisfied with a standardized “pass or fail” auditor’s report and they would like to know more from the auditors. It may not necessarily be about the auditor’s report but may be about what an auditor’s role should be and what an auditor can do for stakeholders. Consequently changes to the auditor’s report alone may not be sufficient to address the expectations of stakeholders.

The demands for Auditor Commentary may indicate that the users would like to further differentiate the quality of financial reporting on top of “pass or fail”, and the expectation for subjective comments from the auditor is conflicting with the concept “an audit is an audit”, where auditors are expected to express more views which is more close to what a consultant does.

(2) Users of auditor’s report may also need to make improvements to enhance the value of auditor’s report. It would be reasonable for the auditor to assume that users of audit report have reasonable knowledge of auditing, understand the audited financial statements and make appropriate use of auditor’s report. For examples, it was observed by IAASB that the demands for Auditor Commentary have come primarily from institutional investors and analysts. It is questionable whether they have reasonable knowledge about auditing to support a proper use of auditor’s report (and auditor commentary, if the proposal is put into revised ISAs). How about the large population of individual investors?

(3) Users are using auditor’s report to obtain assurance on the entities’ financial statements therefore to make more informed decisions. Auditor’s report is an add-on to the financial statements. Questions could be asked if the financial reporting framework should be improved to make the financial statements themselves more relevant and have more informative value to the users, rather than achieving that from asking more of the auditor’s report. It also leads to the matter of accounting and auditing responsibility.

To conclude, demands for improved auditor’s report may not only be about the auditor’s report, and auditors may not be the only party to make movements.
2. Are there other alternatives to improve the auditor’s report, or auditor reporting more broadly, that should be further considered by the IAASB, either alone or in coordination with others? Please explain your answer.

Yes. Please refer to Q1. The response could include:
- Assess the stakeholders’ needs and look out for other solutions to address the needs.
- Outreach to IASB for improvement of IFRS.
- Provide information and channels for users to acquire better understanding of an audit.

Auditor Commentary

3. Do you believe the concept of Auditor Commentary is an appropriate response to the call for auditors to provide more information to users through the auditor’s report? Why or why not? (See paragraphs 35–64.)

Yes. Auditor Commentary would be an appropriate response to the users’ demands for more information provided that:
- It does not overturn the basic concept of an audit and the objectives of an audit.
- It is not misinterpreted by users as providing additional assurance on individual items, especially when the commentary includes a description of audit procedures and the related results.

4. Do you agree that the matters to be addressed in Auditor Commentary should be left to the judgment of the auditor, with guidance in the standards to inform the auditor’s judgment? Why or why not? If not, what do you believe should be done to further facilitate the auditor’s decision-making process in selecting the matters to include in Auditor Commentary? (See paragraphs 43–50.)

No. A combination of required content and recommended content for auditor commentary may be better than having the auditor to make the judgment and take all the risk and pressure associated with such judgment.

The primary question would be to determine:
- Whether the inclusion of Auditor Commentary (for listed entities or PIEs as discussed in the ITC) will be an ISA “Requirement” or an ISA “Guidance”; and
- How the Auditor Commentary will affect the evaluation of audit quality by regulators and other stakeholders, i.e. whether the auditor will be penalized for not including certain matters in Auditor Commentary where regulators or other informed party believe they should have.

The ITC states that the IAASB does not intend to specify a minimum number of matters to be addressed in Auditor Commentary, which allows auditors to go for “zero”. For cost and relationship considerations, auditors may tend to include as few matters as possible if there are no “hard rules”.

The examples provided in ITC do not clearly illustrate how auditor commentary extends beyond the current Emphasis of Matter (EOM) and Other Matter (OM) in ISAs. If Auditor Commentary will replace the traditional EOM and OM, the matters required by ISA 706 to be included as EOM and OM should at least be required for Auditor Commentary.
We suggest that matters to be included in auditor commentary are based on/extracted from auditor’s written communication with Those Charged With Governance (TCWG), that are in the auditor’s opinion, to be most important to users’ understanding of the audited financial statements or audit.

In addition, there are certain matters that may be of audit significance and could be mandated for Auditor Commentary, such as:

- Information about the matters leading to a modified opinion.
- Significant audit adjustments, and auditor’s evaluation of unadjusted misstatements.
- Material weakness in internal control which is relevant to the financial reporting.
- Key scoping decisions in a group audit.

Besides, “close calls” may be considered “matters of audit significance”, though there is the risk that such matters may dilute the overall audit opinion. However, this might be what the users really want – they would like to know if the “pass” result (overall audit opinion) is a good “pass” or a marginal “pass”. It relates to the issue discussed in the response to Q1 – what are the real needs of stakeholders?

5. Do the illustrative examples of Auditor Commentary have the informational or decision-making value users seek? Why or why not? If not, what aspects are not valuable, or what is missing? Specifically, what are your views about including a description of audit procedures and related results in Auditor Commentary? (See paragraphs 58–61.)

A description of audit procedures and related results is meaningful and valuable for users who possess reasonable understand of audit. Otherwise it may enlarge the expectation gap – users having misconception about audit may get more confused and want to know more.

Regarding the illustrative examples of Auditor Commentary, we have the following observations:

Example 2 – Goodwill
It draws users’ attention to Management Commentary which is not part of the financial statement but other information. It may be conflicting with auditor’s responsibility relating to other information.

Example 3 - Valuation of Financial Instruments
It starts with explaining a “high risk of material misstatement” and then discusses audit procedures and results “Management’s recorded amount fell within our range” – readers who do not know ISA 540 well may be questioning what the implication is if management’s recorded amount fell within auditor’s range – does it mean that the auditor concludes there is no material misstatement? Should the auditor further explain the precision of the range and the estimate uncertainty?

Example 4 – Audit Strategy
We have doubts about if the information of the change of information system is valuable for users. It was an area that the auditor put audit effort to but it is not clear if it is a significant risk which would be more relevant.
6. What are the implications for the financial reporting process of including Auditor Commentary in the auditor’s report, including implications for the roles of management and those charged with governance (TCWG), the timing of financial statements, and costs? (See paragraphs 38 and 62–64.)

The inclusion of Auditor Commentary in the auditor's report may significantly increase the communication and potential conflict among the management, TCWG and auditor. Auditor Commentary will need to be discussed and agreed with TCWG. The communication process could be costly and lengthy.

7. Do you agree that providing Auditor Commentary for certain audits (e.g., audits of public interest entities (PIEs)), and leaving its inclusion to the discretion of the auditor for other audits is appropriate? Why or why not? If not, what other criteria might be used for determining the audits for which Auditor Commentary should be provided? (See paragraphs 51–56.)

Yes. We agree that Auditor Commentary should only be required for certain audits. Listed entities may be a more appropriate population to be defined in ISA due to the reason discussed in the ITC – PIE definitions are not consistent around the world. The inclusion of Auditor Commentary in auditor's report will certainly increase the cost to auditor. However, we cannot see any other reason to support such inconsistency between PIE and non-PIE.

Going Concern/Other Information

8. What are your views on the value and impediments of the suggested auditor statements related to going concern, which address the appropriateness of management’s use of the going concern assumption and whether material uncertainties have been identified? Do you believe these statements provide useful information and are appropriate? Why or why not? (See paragraphs 24–34.)

We understand the proposal is driven by demands of certain groups of users as a result of the financial crisis, in particular European users. We suggest that the statement and conclusion of going concern not be made a required part of the auditor’s report, but an optional part if required by laws and regulations. It could be incorporated into the “Other Reporting Requirements by Law and Regulation” discussed in ISA 700.

For territories where going concern is considered a widely shared concern and mandated in auditor’s report, the form and placement of the going concern content need to be more thoroughly explored.

The proposed statement and conclusion in the illustrative report appears to be a “second” opinion in an auditor’s report in addition to the opinion at the beginning of the report. ISA 570 discusses different types of audit opinions relating to going concern considerations. How could the auditor’s “modified” statement and conclusion relating to going concern be reconciled with the overall audit opinion in a consistent way?

Paragraph 29 of the ITC mentioned that the auditor will need to draw users’ attention if material uncertainty is identified. This creates an inconsistency with other “draw attention” matters which are supposed to be in Auditor Commentary.
A possible solution is to make going concern a mandated matter in Auditor Commentary. The auditor shall either make the statement if the conclusion is “clean” or provide more insights into the issue if the conclusion is “modified”.

We agree that more guidance needs to be provided by IAASB and IASB from auditing and accounting perspective regarding the judgment of “significant uncertainty”.

9. What are your views on the value and impediments of including additional information in the auditor’s report about the auditor’s judgments and processes to support the auditor’s statement that no material uncertainties have been identified? (See paragraphs 30–31.)

We agree with the principle that auditors should not be the first one to disclose information about the entity which is not disclosed by management or TCWG.

Since IFRS is not clear about the disclosure requirements for situations where there are negative indicators but management concludes that no significant uncertainty exist, such additional information in the auditor’s report will likely lead to the undesired results of “auditor disclosing more than management”.

Therefore, unless the value is recognized by all parties including IASB (and the National Accounting Standards setters) who shall then require for such disclosure in the financial statements, we do not think it is appropriate for auditors to include such information in the auditor’s report.

10. What are your views on the value and impediments of the suggested auditor statement in relation to other information? (See paragraphs 65–71.)

We agree with the proposal to clarify auditor’s responsibility in relation to other information and to include the conclusion as well as a disclaimer. But in practice, the other information sometimes may not be or only draft version is available for auditors reading before the auditor’s report date. Therefore, it is not appropriate that auditor’s report make an expression on whether other information is consistent with the audited financial statement. We suggest that IAASB consider this practice issue when updating the ISA 720.

Clarification and Transparency

11. Do you believe the enhanced descriptions of the responsibilities of management, TCWG, and the auditor in the illustrative auditor’s report are helpful to users’ understanding of the nature and scope of an audit? Why or why not? Do you have suggestions for other improvements to the description of the auditor’s responsibilities? (See paragraphs 81–86.)

Yes. We are supportive of initiatives aimed at enhancing users understanding of the role/responsibilities of the auditor. The differentiated responsibilities of the three parties are fundamental to an audit and worth being made more transparent in the auditor’s report.

One of the barriers to introduce the enhanced description is related to the TCWG as TCWG responsibilities vary among territories, even within one territory for different forms of entities.
It would be difficult to use consistent wording to describe TCWG’s responsibility in relation to financial reporting and auditing.

In addition, the changes proposed by IAASB do not go far enough because they do not explain enough what an audit is not. Significant events such as the financial crisis have highlighted that users still do not have a clear understanding of the auditor’s responsibilities, e.g. that the auditor’s opinion does not extend to concluding on matters such as the appropriateness of an entity’s business decisions or risk management controls.

12. What are your views on the value and impediments of disclosing the name of the engagement partner? (See paragraphs 72–73.)

We support the disclosure of engagement partner’s name which has been implemented in China for many years.

13. What are your views on the value and impediments of the suggested disclosure regarding the involvement of other auditors? Do you believe that such a disclosure should be included in all relevant circumstances, or left to the auditor’s judgment as part of Auditor Commentary? (See paragraphs 77–80.)

If the principal auditor will take all responsibility, what’s the purpose of making such disclosure in the audit report?

We believe that the inclusion of the involvement of other auditors risks undermining the principle of ISA 600 that there is no divided responsibility and that the group auditor is solely responsible for their report on the group financial statements.

And there is also lack of an appropriate, understandable and transparent approach to measuring the involvement of other auditors in an audit.

In addition, such disclosure may mislead users to believe that a higher level of network involvement leads to better audit quality.

14. What are your views on explicitly allowing the standardized material describing the auditor’s responsibilities to be relocated to a website of the appropriate authority, or to an appendix to the auditor’s report? (See paragraphs 83–84.)

We do not support relocating the description of the auditor’s responsibilities to a website or to an appendix to the auditor’s report because such information is extremely important for the users to understand an audit and should be kept in body of the auditor’s report.

Form and Structure

15. What are your views on whether the IAASB’s suggested structure of the illustrative report, including placement of the auditor’s opinion and the Auditor Commentary section towards the beginning of the report, gives appropriate emphasis to matters of most importance to users? (See paragraphs 17–20.)
We suppose all users will read audit report in detail. And we think the current form and structure in ISA 700 seems more logical. It would be more logical to place the responsibilities of management and auditor before the auditor’s opinion.

16. What are your views regarding the need for global consistency in auditors’ reports when ISAs, or national auditing standards that incorporate or are otherwise based on ISAs, are used? (See paragraphs 21–23 and 87–90.)

We agree that consistency in auditors’ reports, when the audit has been conducted in accordance with ISAs, or national auditing standards that incorporate or are otherwise based on ISAs:
- Making more readily identifiable those audits that have been conducted in accordance with globally recognized auditing standards.
- Facilitating users’ understanding of auditors’ reports.
- Facilitating users’ ability to identify unusual circumstances when they occur.

17. What are your views as to whether the IAASB should mandate the ordering of items in a manner similar to that shown in the illustrative report, unless law or regulation require otherwise? Would this provide sufficient flexibility to accommodate national reporting requirements or practices? (See paragraph 17 and Appendix 4.)

Yes. We believe the IAASB should mandate the ordering of items, maintaining the consistency and readability, unless law and regulations required otherwise. Flexibility could be achieved in the content of the auditor’s report.

18. In your view, are the IAASB’s suggested improvements appropriate for entities of all sizes and in both the public and private sectors? What considerations specific to audits of small- and medium-sized entities (SMEs) and public sector entities should the IAASB further take into account in approaching its standard-setting proposals? (See paragraphs 91–95.)

As mentioned above, significant additional cost will be required if non-PIEs are included in the scope. But it may need to ascertain whether the users of the SME auditor’s report will be satisfied if the IAASB’s suggested improvements are not applied to such audit.