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20 September 2011

Our Ref.: C/AASC

Technical Director  
International Auditing and Assurance Standards Board  
545 Fifth Avenue, 14th Floor  
New York, 10017  
USA

Dear Sir,

**IAASB Consultation Paper on Enhancing the Value of Auditor Reporting:  
Exploring Options for Change**

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 captioned IAASB Consultation Paper.

The HKICPA supports continuing efforts to encourage debate to clarify the role of auditors and stakeholders expectations and welcomes this Consultation Paper. Feedback from the consultation should provide much useful material for the International Auditing and Assurance Standards Board (IAASB) when considering possible future standard-setting projects on auditor reporting. In view of the amount of discussion and consultation that have been generated around various aspects of audits and auditors over the last few years it is very useful to have a more fundamental review of auditor reporting that brings together many of these matters.

Responses to the specific questions in the Consultation Paper are included in our attachment. The following comments set out the Institute's views on matters of principle to establish the context in which detailed responses have been given.

The Institute believes that the reality of the current situation is that there are both "expectations" and "information" gaps and that action will have to be taken to address some of the perceptions of auditor reporting. It is particularly important to address the "information gap" as mentioned in the Consultation Paper as this has implications for the efficiency of capital markets and the cost of capital. If actions taken in this respect result in changes in the scope of audit then consideration must be given to potential implications for auditor liability and particularly to ensure that scope amendments do not result in excessive liability burdens. We are also of the firm view that audit quality is paramount and that any proposed changes to the scope of an audit or the form of auditor reporting should only be implemented if they do not have a negative effect on audit quality.



In relation to the expectations gap, we agree that there continues to be a difference between what users expect from the auditor and the financial statement audit, and the reality of what an audit is. Accordingly, clarification of auditor and management responsibilities should be better communicated and understood. To achieve this there is a need for education of all parties, which should be more than just an "IAASB outreach" to its usual stakeholders. Education of users should also cover the auditors' responsibilities relating to fraud under existing professional standards, and that the current audit model is not designed to provide comfort on the financial health of a company but rather it results in an auditor's opinion as to whether the financial statements prepared by management show a true and fair view in accordance with a relevant financial reporting framework.

Stakeholders who consider that there would be benefits in extending the scope of audit should clearly understand that extending the scope of audit may result in additional costs to be borne by the company, especially when auditors are required to perform extended services which require additional knowledge and expertise. In this regard, we are of the view that any resultant changes in audit scope and audit reporting should be restricted to audits of listed entities and public interest entities. Investors or other users of private companies' financial statements typically have access to additional information from the entity and therefore changes to audit of private companies' financial statements may result in costs that exceed the derived benefits.

The Institute has set up a working group on this important project and welcomes further dialogue and contribution to this IAASB project. We have communicated with stakeholders in our jurisdiction, including practitioners, regulatory authorities and financial statements preparers. This letter contains the Institute's comments on the topic which include observations that have been contributed by other stakeholders. The Stock Exchange of Hong Kong Limited and the Hong Kong Institute of Directors have expressed interest in commenting on the topic and will provide you with their comment letters directly.

If you require any clarifications on our comments, please do not hesitate to contact me at [chris@hki CPA.org.hk](mailto:chris@hki CPA.org.hk).

Yours faithfully,

Chris Joy  
Executive Director

SO/AW/jn

Encl.



## ATTACHMENT

### **HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS' COMMENTS ON THE IAASB CONSULTATION PAPER ON ENHANCING THE VALUE OF AUDITOR REPORTING: EXPLORING OPTIONS FOR CHANGE**

#### **ISSUES IDENTIFIED**

##### **Question 1:**

**Do respondents have any comments about the issues identified in Section II regarding the perceptions of auditor reporting today?**

The HKICPA supports continuing efforts to encourage debate to clarify the role of auditors and stakeholders expectations. The reality of the current situation is that there are both "expectations" and "information" gaps and that action will have to be taken to address some of the perceptions of auditor reporting. It is particularly important to address the "information gap" as mentioned in the Consultation Paper as this has implications for the efficiency of capital markets and the cost of capital. If actions taken in this respect result in changes in the scope of audit then consideration must be given to potential implications for auditor liability and particularly to ensure that scope amendments do not result in excessive liability burdens. We are also of the firm view that audit quality is paramount and that any proposed changes to the scope of audit or the form of auditor reporting should only be implemented if they do not have a negative effect on audit quality.

##### **Question 2:**

**If respondents believe changes in auditor reporting are needed, what are the most critical issues to be addressed to narrow the information gap perceived by users or to improve the communicative value of auditor reporting?**

We consider the critical issue to be addressed is to improve the value of communication to users in respect of both understanding what the role of audit is. Accordingly, clarification of auditor and management responsibilities should be better communicated and understood. To achieve this there is a need for education of all parties, which should be more than just an "IAASB outreach" to its usual stakeholders. Education of users should also cover the auditors' responsibilities relating to fraud under existing professional standards, and that the current audit model is not designed to provide comfort on the financial health of a company but rather it results in an auditor's opinion as to whether the financial statements prepared by management show a true and fair view in accordance with a relevant financial reporting framework.

There have been discussions on what information should be included in the annual report where we believe further clarification from users is needed for an effective resolution of this matter. Auditors generally consider it may not be appropriate for them 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. It is generally believed that management is in a better position to convey such information to users.



In the respect of narrowing the information gap and to improve the communicative value of auditor reporting, we would encourage the IAASB to explore the following suggestions within the extant auditing framework:

- **Emphasis of matter paragraph**

We agree with the view set out in sections 60 and 61 of the paper that the auditor can play a greater role in helping users navigate increasingly complex corporate financial reports by drawing attention to information within the financial statements, such as important disclosures, that the auditor believes is significant to users' understanding of the audited financial statements. This could be achieved by increased use of the existing "emphasis of matter" paragraphs in audit reports. However, such paragraphs should be limited to information that is disclosed in the financial statements. We suggest that the IAASB could provide additional guidance on expanded use of the "emphasis of matter" paragraph to facilitate auditors' contribution to enhanced financial reporting.

- **Clarification on auditors' responsibility on fraud detection**

We believe that the general expectation to auditors on detection of fraud by auditors form an important part of the expectation gap between auditors and financial statement users. Even though it is already stated in the auditor's report that an audit is not designed primarily to detect fraudulent financial reporting by management, there may still be a general expectation by stakeholders that the financial statements with "clean opinion" rendered by auditors should be free from fraud. We believe that expanded explanation on what specific procedures the auditors have performed would help to enhance the stakeholders' understanding of auditors' responsibilities to fraud and hence reducing the expectation gap.

- **Internal control over financial reporting**

It is our observation that different jurisdictions already have different requirements on companies' reporting on internal control over financial reporting. We believe that this is an important area and consideration should be given to introducing comparable reporting requirements in all significant jurisdictions. Development and implementation of standardized guidance and practice on reporting on internal control over financial reporting would help to lower the information gap. Any proposed engagement arising from this proposal should be treated as a separate engagement.

**Which classes of users are, in the view of respondents, most affected by these issues?**

Users of financial statements of listed companies and public interest entities are most affected by the above issues.

**Are there any classes of users that respondents believe are unaffected by these issues?**

This will ultimately depend on whether changes are brought in for all audits or only for audits of specific entities. Please refer to our response to Question 3.



### **Question 3:**

**Do respondents believe that changes are needed for audits of all types of entities, or only for audits of listed entities?**

We believe that any resultant changes in audit scope and audit reporting should be restricted to audits of listed entities and public interest entities. Investors or other users of private companies' financial statements typically have access to additional information from the entity and therefore changes to audit of private companies' financial statements may result in costs that exceed the derived benefits.

## **EXPLORING OPTIONS FOR CHANGE**

### **A. FORMAT AND STRUCTURE OF THE STANDARD AUDITOR'S REPORT**

#### **Question 4:**

**Respondents are asked for their reactions to the options for change regarding the format and structure of the standard auditor's report described in Part A. Do respondents have comments about how the options might be reflected in the standard auditor's report in the way outlined in Appendix 1 of this Consultation Paper?**

We are supportive of proposals to change the format and structure of the standard auditor's report subject to the caveat about quality given in the answer to Question 1. In particular we support the call for wording used in the auditor's report to be less technical. As highlighted words like "fair presentation" appear to mean different things for auditors and for readers of the report.

Having said the above, we are of the view that it is importance to educate users that the current audit model is not designed to provide comfort on the financial health of companies but results in an opinion on the truth and fairness of a set of financial statements. If the objective is to narrow the "expectations gap" this cannot be achieved solely by amending the format and structure of the auditor's report.

#### **Question 5:**

**If the paragraphs in the current standard auditor's report dealing with management and the auditor's responsibilities were removed or re-positioned, might that have the unintended consequence of widening the expectations gap? Do respondents have a view regarding whether the content of these paragraphs should be expanded?**

We are concerned that removing the paragraphs dealing with management and the auditor's responsibilities may lead to widening of the expectation gap. We are against relocation of these paragraphs to a separate document as the auditors' report would no longer contain these information and readers may not have a clear understanding of the respective responsibilities.



The subject paragraphs may need to be expanded to explain that the current audit model is not designed to provide comfort on the financial health of a company but rather it results in an opinion as to whether the financial statements prepared by the directors' show a true and fair view in accordance with a relevant financial reporting framework.

If the opinion paragraph is the part of the auditor's report that is most valued by users then we would support this being given more prominence in some way.

## **B. OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS**

### **Question 6:**

**Respondents are asked for their reactions to the possibility that the standard auditor's report could include a statement about the auditor's responsibilities regarding other information in documents containing audited financial statements. Do respondents believe that such a change would be of benefit to users?**

We are of the view that including a statement about the auditor's responsibilities under ISA 720 "The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements" regarding other information would be beneficial to users. We believe that this would clarify and enable users to understand the existing responsibilities as part of an audit engagement.

We are assuming that at this stage of the paper the auditor's responsibilities regarding other information are unchanged from the current position. In case further explanations are needed from auditors to explain what specific procedures that are performed on other information, we believe that those explanations should be included in a stand-alone document and should not be included as part of the audit report

### **Question 7:**

**If yes, what form should that statement take? Is it sufficient for the auditor to describe the auditor's responsibilities for other information in documents containing audited financial statements? Should there be an explicit statement as to whether the auditor has anything to report with respect to the other information?**

Please refer to our response to question 6.

## **C. AUDITOR COMMENTARY ON MATTERS SIGNIFICANT TO USERS' UNDERSTANDING OF THE AUDITED FINANCIAL STATEMENTS, OR OF THE AUDIT**

### **Question 8:**

**Respondents are asked for their views regarding the auditor providing additional information about the audit in the auditor's report on the financial statements.**

We do not have any strong objection to the provision of additional information about the audit in the auditor's report. However, this is on the basis that such additional information





is provided solely for the purpose of enhancing better understanding of the audit. Careful consideration must be given when determining the nature and the extent of additional information to be provided in order to avoid creating further confusions to users and/or extending the scope of work and the responsibilities of auditor beyond those required for a financial statement audit under prevailing auditing standards inadvertently. We consider the additional information about audit should be limited to generic matters and not include engagement specific information such as audit materiality.

We would support the expansion of information included in emphasis of matter paragraphs to highlight information that is fundamental to an investors understanding of the financial statements. However, we would limit this to information that is disclosed in the financial statements. We also consider the information to be included in emphasis of matter paragraph should be specific and unique to the current audit and is not expected to be repeated year after year to mitigate the risk of boiler plate disclosure.

It is important that from an audit quality/consistency standpoint for standards to provide criteria and implementation guidance to help auditors evaluate matters to be included in the emphasis paragraphs, with reference to the relevant prevailing standard, ISA 706. The criteria should include the guiding principles that the matters are fact based, objective and make specific reference to where items appear in the financial statements. This recommendation is intended to avoid leading to significant differences in approach by auditors, i.e. to help avoid the situation where for two similar companies in terms of nature, risks, etc with different auditors - one company has five emphasis paragraphs and another ten.

#### **Question 9:**

**Respondents are asked for their reactions to the example of use of "justification of assessments" in France, as a way to provide additional auditor commentary.**

The French model has had very mixed reviews. Negative feedback on the model includes that it has added confusion and resulted in the use of boilerplate disclosures. On the positive side it has served to act as a prompt to management to provide more robust disclosures to avoid having auditors provide them. We believe that there is a risk that such a requirement could result in boilerplate disclosures of standard audit procedures relating to areas of risk and judgment rather than conveying any real information of value to shareholders. We recommend therefore that there should be a review of the nature of disclosures that are currently made to satisfy this requirement and stakeholders asked to assess whether these are of benefit. We believe that the investor should decide what information is needed and evaluate the cost/benefit (i.e. market driven).

We would not be supportive of the provision of "auditor commentary" or "auditor insights" about the entity or the quality of its financial reporting. While it is true that the auditor may have "insights" and "perceptions" about the entity or the quality of its financial reporting or any other aspects of the entity as a result of the work performed during the course of the audit, such "insights" or "perceptions" could only be deemed as by-products of the audit process whereas the procedures are designed and performed solely for the purpose of expressing an audit opinion on the financial statements taken as a whole, rather than providing "insights" or "perceptions" about matters other than the financial statements taken as a whole. However, we believe that consideration may be given to increase the transparency of the information in respect of the matters which



would have been communicated to those charged with governance as required by ISA 260, Communication with those charged with governance.

**Question 10:**

**Respondents are asked for their reactions to the prospect of the auditor providing insights about the entity or the quality of its financial reporting in the auditor's report.**

As explained in Question 9, we would not be supportive of this proposal as we believe this is beyond the scope of work and responsibilities of the auditor under prevailing auditing standards.

**D. AN ENHANCED CORPORATE GOVERNANCE MODEL: ROLE OF THOSE CHARGED WITH GOVERNANCE REGARDING FINANCIAL REPORTING AND THE EXTERNAL AUDIT**

**Question 11:**

**Respondents are asked for their reactions to the options for change relating to an enhanced model of corporate governance reporting, as described in Section III, Part D.**

We would support enhancements to the model of corporate governance and reporting, in particular the responsibilities for the financial reporting process by those charged with governance. It is important that the role of those charged with governance, including the work of the audit committee, is fully understood by users. Full and detailed reporting to the audit committee by the auditor should be encouraged to ensure that the audit committee can carry out its governance role effectively. Similarly the audit committee should be encouraged to report comprehensively on the work it has done in respect of corporate governance and the audit. In view of the wide spectrum of corporate governance reporting, it should be clarified that any enhanced model should focus on corporate governance issues relating to financial reporting.

**Question 12:**

**To the extent that respondents support this model, what challenges may be faced in promoting its acceptance? Also, what actions may be necessary to influence acceptance or adoption of this model, for example, by those responsible for regulating the financial reporting process?**

The key challenge would be to ensure that all parties have a clear understanding of the respective roles and responsibilities of auditor and audit committee. Care needs to be taken to ensure that users are not confused over the source of information being provided and which party is responsible for the conclusions and opinions given.





### **Question 13:**

#### **Do respondents believe assurance by the auditor on a report issued by those charged with governance would be appropriate?**

We have some concerns that it may in practice be difficult for the auditor to provide assurance on a report prepared by the audit committee and which contains information provided by the auditor and on the relationship between auditor and audit committee. The IAASB may also need to be mindful of the auditor independence issue as audit committee is usually responsible for selection and monitoring the discharge of duties by the entities' statutory auditors.

However, we would encourage the IAASB to explore that with the UK FRC on their proposed model which may be workable whereby the auditor is required to report on the "completeness" and "reasonableness" of the audit committee's report. Depending on the local corporate governance requirements in individual jurisdiction, we consider that the above proposed report by auditors may be extended to include report by those charged with governance included in the annual report. Such an engagement should be a separate engagement from the statutory audit engagement and further guidance should be provided on ascertaining "completeness" and "reasonableness" of the audit committee report to ensure there are clear objectives and criteria.

### **E. OTHER ASSURANCE OR RELATED SERVICES ON INFORMATION NOT WITHIN THE CURRENT SCOPE OF THE FINANCIAL STATEMENT AUDIT**

#### **Question 14:**

#### **Respondents are asked for their reactions to the need for, or potential value of, assurance or related services on the type of information discussed in Section III, Part E.**

We support consideration of different audit models to meet stakeholder expectations. Such consideration should be undertaken in line with the following principles:

- Auditors should not be the original source of disclosure about the entity; management's responsibility should be preserved in this regard.
- Any changes to the reporting model should add value and not create investor confusion.

However, changes in the scope of audit should consider the implications on the expected additional cost to be borne by the auditees, especially when auditors are required to perform extended services which require additional knowledge and expertise. Consideration should also be given to ensuring that scope amendments do not result in excessive liability burdens.

We consider that any assurance or related services in addition to a financial statement audit should constitute a separate engagement. The nature and scope of work as well as management and auditor responsibilities under such engagement should be considered and assessed on a case by case basis under relevant standards such as ISAE 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information".



In addition, auditors may not be able to provide assurance on certain matters given the nature of such matters and inherent limitations expected to be encountered by an auditor in respect of the work on such matters. For instance, in Hong Kong, there were some issues regarding auditor's letter on continuing connected transactions of listed companies until the HKICPA issued Practice Note (PN) 740 "Auditor's Letter on Continuing Connected Transactions under the Hong Kong Listing Rules" to give guidance to auditors in respect of such a limited assurance engagement undertaken in accordance with HKSAE 3000 (equivalent to ISAE 3000) and clarifying the responsibilities by management and auditor and certain inherent limitations. The PN 740 can be accessed at:

[http://app1.hkicpa.org.hk/ebook/HKSA\\_Members\\_Handbook\\_Master/volumelll/pn740.pdf](http://app1.hkicpa.org.hk/ebook/HKSA_Members_Handbook_Master/volumelll/pn740.pdf)

In case there is an increased scope of audit, we believe auditors would require additional standards and guidance to facilitate their performance of audit work and hence discharge of duties.

#### **Question 15:**

**What actions are necessary to influence further development of such assurance or related services?**

We believe it is preferable to identify clearly what are the market needs and expectation from auditor to facilitate an effective consideration on enhancing auditor reporting. To expand assurance services to cover additional information should only be done after full consideration of market expectation, liability implication, legislative or regulatory changes that will need to be brought in and the associated costs and benefits.

#### **Question 16:**

**Respondents are requested to identify benefits, costs and other implications of change, or potential challenges they believe are associated with the different options explored in Section III.**

Stakeholders must be prepared to bear the additional costs incurred by auditors by extending the scope of assurance. Liability implications for auditors must be fully considered and steps taken to cushion auditors against the presumed increase exposure to liability that will result in expanding the scope of audit and requiring assurance on additional information.

#### **Question 17:**

**Do respondents believe the benefits, costs, potential challenges and other implications of change, are the same for all types of entity? If not, please explain how they may differ.**

We do not think the benefits, costs and potential challenges are the same for all types of entity. We are of the view that this depends heavily on: the complexity of the activities of the entities; the identity and objectives of the report user groups; and the user groups'



involvement in and knowledge of the entities. Accordingly, it is important to consider whether all the suggested changes in auditor reporting are needed or being demanded by all types of entity. As mentioned above, we are of the view that changes are needed primarily for audit of listed entities and public interest entities.

**Question 18:**

**Which, if any, of the options explored in Section III, either individually or in combination, do respondents believe would be most effective in enhancing auditor reporting, keeping in mind benefits, costs, potential challenges, and other implications in each case? In this regard, do respondents believe there are opportunities for collaboration with others that the IAASB should explore, particularly with respect to the options described in Section III, Parts D and E, which envisage changes outside the scope of the existing auditor reporting model and scope of the financial statement audit?**

We have no specific comment in this regard.

**Question 19:**

**Are there other suggestions for change to auditor reporting to narrow the "information gap" perceived by users or to improve the communicative value of the auditor's report?**

We have no further suggestions at present.

~ END ~