



**The Institute of
Chartered Accountants
of Pakistan**

HEAD OFFICE

Technical Director
IAASB
Fifth Avenue, 6th Floor,
New York, USA

December 10, 2013

**ICAP COMMENTS ON EXPOSURE DRAFT 'REPORTING ON AUDITED FINANCIAL STATEMENTS:
PROPOSED NEW AND REVISED INTERNATIONAL STANDARDS ON AUDITING (ISAs)'**

Dear Sir,

The Institute of Chartered Accountants of Pakistan welcomes the opportunity to offer comments on the above Exposure Draft.

Please find enclosed the comments of the relevant Committee of the Institute for your perusal.

If you require any further clarification, please do not hesitate to contact us.

Yours faithfully,

Haroon Tabraze
Director Technical Services
The Institute of Chartered Accountants of Pakistan
haroon.tabraze@icap.org.pk

ICAP COMMENTS ON ‘EXPOSURE DRAFT, REPORTING ON AUDITED FINANCIAL STATEMENTS: PROPOSED NEW AND REVISED INTERNATIONAL STANDARDS ON AUDITING (ISAs)’

We appreciate the opportunity to comment on this Exposure Draft of the IAASB on auditor’s reporting which objective is to make the auditor’s report more informative and relevant to users. We are aware and recognize that the responses to the IAASB’s consultations on the subject reaching to this Exposure Draft showed the need to revise the current auditor reporting model.

The new auditor’s report includes certain changes which we expect to have profound impact on the auditors and the entities audited. While making changes it is imperative that we see the specific objectives in respect of each of the changes made. We have an undivided view that any change in the auditor reporting model is to be done with the objective of improving the quality and value of auditor’s report. Certainly the proposed changes achieve this objective however in the process IAASB must take into account that in none of the case auditor should become the source of original information.

In this respect you would appreciate that these changes have been brought without there being any change in the corporate reporting structure (e.g. no corresponding change in the IFRSs). The fundamental principle of auditing is to provide assurance on what management has done and not the provision of original information from the auditor. The role and objective of auditor should remain to be enhancing degree of confidence of intended users of the financial statements prepared in accordance with applicable financial reporting framework.

In the below summary we provide our overall view on the proposed key enhancements and present our views accordingly:

S.No	Key Enhancement	Comments
1	Include an explicit statement of auditor independence and disclose the source of relevant ethical requirement	Clearly enhances the quality and value of auditor’s report
2	Communicating Key Audit Matters in the auditor’s report	On one side there will be significantly more information available to the user of auditor’s report however at the same time the entities whose financial statements are audited run with the risk of providing information and that too coming out of auditors which has the potential to compromise client confidentiality. Also refer comments below
3	Communication to those charged with governance about the significant risks identified by the auditor	Refer comments below
4	Explicit statement in the auditor’s report about the going concern conclusion of	Clearly enhances the quality and value of auditor’s report.

the entity

However there should also be a requirement that financial statements include an express such statement from management. Also refer comments below.

5	Explicit statement in the auditor's report about the going concern of the entity based on auditor's own assessment	Clearly enhances the quality and value of auditor's report
6	Relationship between Emphasis of Matter paragraphs, Other Matters paragraphs and the Key Audit Matters section of the auditor's report	Sufficiently clear changes
7	Format of auditor's report	Clearly enhances the quality and value of auditor's report

AUDITOR REPORTING ON KEY AUDIT MATTERS

We agree that auditors can provide enhanced value to users by highlighting matters that are likely to be most important to users' understanding of the financial statements and drawing attention to management's disclosures of those matters. The current opinion provides users a concise conclusion as to whether the financial statements, taken as a whole, are presented fairly in accordance with the applicable financial reporting framework, whereas, additional contextual information about important matters would be helpful in their decision-making and would increase the overall informational value of the auditor's report. However, users may have different views regarding the type of information that might be most valuable.

It is very important to note that while highlighting the key audit matters in the auditor's report the auditor must not become the source of original information about the company. It would have been better had the same significant matters disclosure been required to be made part of the financial statements and the auditor makes reference to these. In case the auditor is not in agreement with the required disclosures a section in the auditor's report would then narrate the exceptions. In this way auditor will not be the original source of factual data or information about the entity and should not be providing independent views on particular positions or decisions taken by management.

In case IAASB continue to stick its decision of having key audit matters coming out of auditor we believe the more extensive and subjective auditor reporting is required to be, the greater the time and effort that may be expected in the preparation, internal review and approval of the auditor's report, and in discussing its contents with management and those charged with governance which will ultimately effect the cost of audit.

AUDITOR REPORTING ON GOING CONCERN

We support IAASB's efforts to consider improvements to the auditor's report with respect to going concern. Given the increased focus on the assessment of going concern and related disclosures, additional information in this area will be of value to users.

We understand that in the auditor report to include the auditor's conclusion that management's use of the going concern assumption is appropriate, as well as a statement, as to whether material uncertainties related to going concern have been identified, are consistent with the objectives of the auditor, and the related auditor work effort, under ISA 570. Accordingly, the inclusion of these statements would essentially make explicit what is already required under the auditing standards.

However, there appears to be a lack of clarity about the meaning of certain terminology used in current reporting, such as whether a conclusion on the "appropriateness of the use of the going concern assumption" is the same as the "ability to continue as going concern." In addition, the concepts of "material uncertainty" and "significant doubt" are not well understood by users, and can be subject to differing interpretations by both preparers and auditors. Moreover, there appears, to be an expectations gap between what users think auditors should warn of in respect of going concern, and what auditor are required to do under ISA 570.

As part of the process to address these areas, we believe further enhancements to going concern reporting could be considered. For example, further guidance regarding the point at which an uncertainty about going concern becomes material and when doubt becomes significant would be very helpful. In addition, the current "significant doubt" threshold could be replaced with a requirement for preparers to make specific disclosures about events or conditions identified and why they believe they do not rise to the level of a material uncertainty. The auditor could then be required to make an explicit statement about that disclosure. We believe that consideration of these areas could result in helpful improvements in the execution of the responsibilities of both preparers and auditors, as well as increase the utility of the related reporting to users of the financial statements. Accordingly, we also suggest the IAASB work closely with the IASB to consider improvements in this area.

Lastly we feel that given the importance of the changes and accordingly for the stakeholders to have proper implementation of the requirements the effective date of financial statements period ending 31 December 2016 is appropriate.

SPECIFIC QUESTIONS FOR RESPONDENTS

- 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?**

Please refer comments above. Although the inclusion of key audit matters in audit report will definitely enhance the usefulness of auditor's report in purview of the guidance provided in the paragraph 8, paragraphs A1–A24 and Paragraphs A30–A43 of proposed ISA 701., but at the same time it will bring more challenges for the auditors in terms of justifying their judgment in determining the inclusion of key audit matters in the audit report. Following are the few challenges which may be faced by the auditors:

- a. The incoming auditor includes a particular key audit matter in his report of current year while the referred matter was duly existed in prior period but not reported by the predecessor auditor in his report on prior period. This situation will bring into question the validity of judgment of the predecessor auditor who excluded the matter which reported by the incoming auditor;*
 - b. Different auditors of two competitors (assuming to have similar size, nature and environment) may come up with differing key audit matters based on their respective professional judgments. This situation may bring into question the validity of the auditor's judgment who excluded the key matter(s) which the other one has reported as key matter in his report of other competitor; and*
 - c. Inclusion of a key audit matter in a subsequent period relating to a matter that existed in a prior period could bring into question the validity of the auditor's judgment to exclude it as a key audit matter in the prior period.*
- 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?**

Please refer comments above. 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. However, since the determination of key audit matters ultimately rests on auditor's professional judgment, the application of proposed ISA 701 may not result in reasonably consistent auditor judgments about what matters are determined to be the key audit matters. The individual auditors' judgment may be affected due to their respective length of audit experience, previous experience with the client and the industry.

- 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?**

Agree.

The particular guidance provided in the paragraph 8, paragraphs A1–A24 and Paragraphs A30–A43 of proposed ISA 701 is sufficient.

- 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.**

Few members were of the view that the illustrative example # 4 "Revenue Recognition Relating to Long-Term Contracts" appeared to be most useful and informative since it sufficiently describes the

matter and its associated risks and the auditors approach to address the identified matter (the risk) and its outcome. Members believe the referred illustration provides the appropriate insight of the matter and the auditor's response.

Some members were of the view that all the illustrative examples are useful and informative.

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?**

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.

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?**

Agree with the requirements of proposed ISA 701.

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?**

Some members 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.

When comparative financial information is presented and the predecessor auditor has added the key audit matter in its report, then, it is proposed to include the para that the key audit matters for the previous year have been determined by the predecessor auditor.

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?**

Agree.

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.

There is a potential that the users of financial statements will misunderstand or misinterpret the above statements included in audit report being the reason that the term “material uncertainty” is more subjective in general perspective of users of financial statements. Moreover the proposed guarantee statement will serve to widen the expectations gap if users did not understand the statement in its true perspective.

Some members did not recommend including the above statements in auditor’s report and alternatively suggest that appropriate amendments are made in relevant IFRS to include more detailed management disclosures about going concern in financial statements incorporating the essence of above statements. Accordingly the auditor shall follow the guidance of ISA 570 in analyzing and reporting on the recommended disclosures about going concern basis of accounting.

Other members agree with the appropriateness of management’s use of the going concern basis and with regard to identification of a material uncertainty the auditor shall follow the guidance of ISA 570.

- 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?**

Agreed with IAASB’ approach to provide this statement in the auditor’s report

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

Agree with IAASB’s approach. The explicit disclosure of independence will further enhance the reliability of the auditor’s report. With regard the disclosure of source(s) of independence, the disclosure of the source(s) of independence is more appropriate since this will restrict the use of notional definitions/requirements of independence by the management and the other users of the financial statements.

- 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?**

The disclosure of the name of the engagement partner is appreciated and statements will enhance the personal responsibility and accountability of the engagement partner. In Pakistan we already have this requirement to disclose the name in the audit report.

Some members proposed to include the registration number of the partner, keeping in view the practical problems faced by the SECP in monitoring the auditors.

- 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?**

The changes to ISA 700 will help the users of financial statements to more clearly understand the respective responsibilities of the auditor, management and to those charged with governance. Moreover the changes will help the users to more clearly understand the audit process and inherent limitations.

- 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?**

Agree with the proposal not to mandate the ordering of sections of the auditor's report in any way since this will help the regional professional bodies to conform the order of the sections of auditor's report according to their laws, persistent practices and needs. In Pakistan local laws have prescribed the order and format of the audit report,

We also agree 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.