

21 November 2013

The Chairman & Members

International Auditing & Assurance Standards Board

529 Fifth Avenue, 6th Floor, New York, NY 10017

Honourable Members of the Board:

Re: ED - Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs)

We are pleased to share our thoughts and thank you for the opportunity.

The Board and all those involved in this project¹ deserve our appreciation for doing a fine job and boldly marching towards “strengthening public confidence in the global auditing and assurance profession”²; and achieving its objective of serving “the public interest by setting high-quality auditing, assurance, and other related standards”³.

We are genuinely pleased to see the proposed enhancements in the auditor report. They bring about “a significant change in practice”⁴. We have been questioning for long the value of standard audit report for the stakeholders⁵; it left many aspects unsaid⁶ thereby adversely affecting the very basis of audit and assurance service. As such, in an unmodified audit opinion, the auditor adds nothing to the understanding of the user; and *prima facie* to a layman a single-page opinion is the only reason for audit fee.

We see the proposed enhancements as a step on the path to improve the users' perception of audit and assurance services. And that path goes through the corporate governance practices.

¹ We would like to particularly laud those who contribute to the objectives of the Board on voluntary basis.

² ED, page 2

³ ibid

⁴ See p.9. Also see p.17

⁵ “The primary beneficiaries of the IAASB’s work on auditor reporting will be investors, analysts and other users of the auditor’s report”. See p.5. We find this statement to be contrary to the holistic objective of “strengthening public confidence” and “serving public interest”. We see general public as the primary stakeholders in global accounting and auditing standards of which investors, analysts, customers, suppliers, employees, financiers, etc. are a sub-group. We acknowledge the direct financial stake of investors in an entity. Also, that if government holds a stake in an entity it represents the general public. Hence, we consider general public to be a principal stakeholder, top of which are those who hold direct interest in an entity. We see a need to get our angle right and recommend the Board to drop the term “other users”.

⁶ Primarily, why the most important points are conveyed to the those charged with governance through the management letter and not made part of the audit report.

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The user's perception on record⁷ is that the financial reporting is an annual affair of a secretive unhealthy compromising collaboration between auditors and management. Auditors have been found to be uncomfortably close to the management of an entity to be independent and effective.

Abbreviations used frequently:

ED = Exposure Draft

p. = paragraph in the Explanatory Memo unless stated otherwise.

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1. Auditor's appointment process...

The user's perception is reinforced by the process for appointing the auditors. As an investor, why we are so skeptical of the same auditors being appointed year in year out⁸? And if it is nothing embarrassing why there's not a single entity we know of that discloses in its Annual Report for how long the same auditor have been there in case of reappointing the same auditor.

And when the auditors' report and financial statements are presented for approval at the Annual Meetings, the auditor or its representative remains unidentified and the report is not open for any questions. His⁹ report is approved as a parcel with financial statements¹⁰.

Add to it that the auditor is appointed by the shareholder but his fee is not fixed in the Annual Meeting in full public view but is decided later in the Board Room.

2. Words and actions: Honey! don't say, prove it!

We can therefore see the rationale of, "for example the proposed requirement for the auditor's report to include an explicit statement of auditor independence and the disclosure of the source(s) of relevant ethical requirements"¹¹. However the statement, solitarily, is unlikely to bring about the change desired¹².

3. Lets convey, not conceal....

We now come to the "communicative value of the auditor's report"¹³. Here the user's perception is that the most significant of matters are presented in a language which has more to conceal than to reveal. And the auditors are naturally assumed to be a contributor to the arcane language used for conveying most significant matters in the financial statements.

(Related comment: See #7llocal environment and issues).

⁷ There are a number of studies accessible on net which draw similar conclusions.

⁸ And to ask: why the professionals have not been able to evolve some mechanism for audit rotation globally?.

⁹ He or she

¹⁰ We are yet to hear of any auditor given an opportunity of making any presentation in an Annual Meeting anywhere.

¹¹ Para 34, bullet point 2 in the table.

¹² Let's face it. The pecuniary interest of auditor acts as a counter-weight against his independence. We are yet to discover a better viable arrangement.

¹³ See p.8

4. Sense of balance and proportion...

Most user's find going through the corporate reports to be onerous. What appears to be missing is a sense of proportion. A matter requiring a description is a one-liner or in few words whereas a matter of insignificance requiring few words fills pages.

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User's understandability of the affairs of an entity is nothing to worry about. Entities are concerned about customer feedback but not so about investor's/reader's feedback on the readability and understandability of its annual report? Ever heard about one? May be a reason why corporate reports are not a popular read for many is because of the effort required to understand... and the effort required to make it understandable¹⁴.

The Board and practitioners need to be conscious of the risk of the inability of auditor to see matters from user's view, diminishing the communicative value of the auditor's and financial reports.

5. Cost and benefits...(p.14 bullet point 2)

The fact is that an annual audit is a regulatory requirement in most places and that there is a cost of carrying out this service paid by auditee.

Indeed the cost of audit will increase by this initiative and so will the audit fee¹⁵. As in such matters, cost/benefit analysis is partly subjective. On one hand we have incremental cash outflows and on the other a subjective incremental benefit¹⁶ expected from its implementation. Since the client will be sponsoring this outlay, naturally there will be a resistance. "Why should we be expected to pay extra for improving audit report?" If so, why have audit in the first place?

(Related comment: see #7 below and ED Q.1)).

6. Apply enhancements to all audit reports....

We believe that the enhancements should also be applicable to all audits including those of small and medium entities¹⁷.

Now that the auditors have a forum to mention these matters, its likely to be challenging in the initial phase. It's realistic to expect dedicated guidance on issues of such entities however we do not support delaying its implementation

¹⁴ Something as simple as cross-referencing is not done properly. For example, accounting policies are mentioned in one place in any financial statements. Is the note on accounting policy on long-term tangible fixed assets indicates to the reader where to find the note that shows the application of the policy?

¹⁵ Respondents have been requested to comment on "additional effort or costs that may be expected". P.14 bullet point 2.

¹⁶ See p. 41. Two benefits have been stated and we agree with both.

¹⁷ "The IAASB also invites respondents to comment on areas where additional guidance may be helpful to illustrate how the Proposed ISAs can be implemented in a proportionate manner". See p.14, point 3

because of lack of guidance. The “field test”¹⁸ concept may be applicable for auditors of such entities as well.

The Board may rightly expect the enhancements to reduce the comparability of audit reports¹⁹ - for all the right reasons. Perhaps the audit opinion was not meant to be put in that way. Such uniformity should pass in history as an epitaph of a fair audit opinion. The pass/fail opinion is most simplistic if not misleading. It fails to reflect what auditor came across before²⁰ reaching his opinion.

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7. Local environment and issues...

The Institute of Chartered Accountants of Pakistan is the statutory regulatory body of accounting profession. It acts as principal stakeholder in advising Securities & Exchange Commission of Pakistan to adopt international accounting standards²¹. Consequently, It was one of the first to have adopted the International Accounting Standards way back in the early eighties.

Our local environment has been such that we have never been cent percent IAS compliant²² to claim fair presentation of financial statements in accordance with the IFRSs. The reason was the wisdom that implementing certain requirements of the IAS would create unwarranted hardship locally.

One such requirement is that of inclusion of management commentary as a part of the annual report²³; initially deferred for many years and vanished gradually.

We expect that this initiative will be tied to the competence of many rather than to the inability of few. A generous transition²⁴ has already been provided. Lets change history by embracing such watershed event with solid plan-n-implementation. No doubt this initiative will increase the cost of practitioner²⁵ but for a grand reason.

Let us consult practicing members²⁶ at the earliest. With 400 practicing firm and 2,000 members engaged in practice, our size is our advantage in implementing this initiative. You have taken a good step by alerting the practicing members to look into this ED and comment.

¹⁸ See p.19

¹⁹ Feedback is also desired from users and other stakeholders as to whether the degree of flexibility provided may reduce the comparability of ISA auditor's reports on a global basis. P.14

²⁰ See p.43 + ISA260 p.16. The three situations – significant risk, significant difficulties, and significant modifications are spot on.

²¹ The Institute is the sole authority for approving the ISAs for implementation by the practicing members..

²² Few sectors have been exempted from following certain IFRS/IAS.

²³ The management commentary is a part of annual “Best Corporate Report” Award criteria, however, and companies comply with it voluntarily.

²⁴ “...the enhanced auditor's reports would be available to users in early 2017”. See p.25

²⁵ These enhancements will increase the cost of the Institute as well in its role as regulator on recurring basis,

²⁶ This too will require a financial allocation.

7.1 Language....

English is the official language of Pakistan. Virtually all financial reporting is in English²⁷. The issue is: hardly 0.5%²⁸ of our 180 million of our estimated population is competent to understand the contents of corporate reports²⁹. How many actually go through them is not known. What we know is that only a handful of shareholders come prepared and raise relevant questions at the Annual Meeting, many of which get over within half an hour of declaration of quorum.

In our environment, the enhancements may be resisted for implementation on the ground that it will benefit a minuscule minority only and is not worth the allocation of already scarce resources; however, carrying out these enhancements is critical because they mitigate the financial reporting risk.

The most challenging aspect of the enhancements is to make them meaningful and relevant. It should not be to fill up the pages with information that users find boring to go through and conceal in the lines the main crux.

8. Early adoption and implementation...

We fully support the early adoption and implementation of this initiative.

On its part, the Board should monitor its member institutes to provide a plan for implementation³⁰. Implementation has never been strength of the Board.

9. Post-implementation (p.28).

We do not agree with the approach of the Board of conducting the post-implementation after two years (after 2019). You need to devote resources to this major task and assist in real time implementation. We propose a task force till 2019 concerned only with the implementation phase.

10. Annexure A: Our response to the questions specifically raised in the ED.

Finally....We wish to appreciate the quality of ED and wish the Board our best in its implementation.

Thank you.

Sincerely, Altaf Noor Ali, Chartered Accountants.

²⁷ Our national language is Urdu.

²⁸ No study of such nature ever conducted. This is a personal estimate.

²⁹ 99.5% of our population have no understanding of audit or financial reporting.

³⁰ I am quite aware of the non-mandatory nature of enforcement mechanism of the Board. There is no point in churning out the standards if these can not be implemented by general members of IAASB.

Annexure A

Key Audit Matters

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?

Yes.

A relevant aspect of carrying out these enhancements in audit report is its costs of compliance and its acceptance by the auditee – for all the right reasons³¹. This topic has not been given the importance it deserved in the ED. (Also see #5 of our general comments)

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?

Yes.

There is no concept of absolute learning in professional matters. A practitioner should be ever ready to learn.

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?

Yes.

4. Which of the illustrative examples of key audit matters³², 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.

³¹ We have commented on this in main comments. See "Cost and Benefits".

³² We have referred to the Appendix (ISA 701) to respond to this question. IT contains four illustrations.

We found all the four illustrations to be relevant, but not sufficient³³.

Illustration 4 is most relevant to us.

Each audit is unique in its own way with features not to be found the same way at any other client. A practitioner needs to be clear conceptually. An encyclopedia of application is not practical. We would recommend improving the contents of these illustrations on the basis of field tests.

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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?

No.

What Board is suggesting is logical but highly theoretical.

We propose that these enhancements should be available to the auditor. We do not wish to tie it up with a term in engagement letter. Our experience suggests that the stakeholders in other than listed companies are equally enthusiastic to hear from auditor about the significant risks, significant difficulties, and significant modifications communicated to those charged with the governance.

The strength of profession is not indicated by how fine the audit and financial reporting of the listed entities is but that of other than listed entities. We understand priority of listed entities over others but other than listed entities are far greater in volume.

*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?*³⁴

³³ We are not in a position to comment specifically on individual element of the audit report because of time constraint.

³⁴ ISA 701 p.13

- (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?

The Board should also make it a requirement to refer to the audit reports of similar entities and reconsider if at all there are no such matters that needs to be included in the audit report.

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?

Yes, We agree.

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?

Yes.

We agree. However, in the light of explanation³⁵ our concern is that it will only add to the already long list of things-to-do and not-to-do. If shunning of Emphasis of Matter paragraphs and Other Matter paragraphs simplifies the understanding of audit report by the practitioners and users, we would go for it.

Going Concern

9. Do respondents agree with the statements included in the illustrative auditor's reports relating to:

³⁵ "The IAASB understands that the most common use of Emphasis of Matter paragraphs currently is to highlight material uncertainties relating to going concern, which will now be replaced by a similar paragraph as part of a separate *Going Concern* section (see paragraph 87 below), and that use of Emphasis of Matter paragraphs for other matters is infrequent." See p.78.

- (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.

Yes. We consider the emphasis on going concern in audit report is valid.

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 do not agree.

Compliance with Independence and Other Relevant Ethical Requirements

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?*

The matter of independence is of sufficient concern to the stakeholders and its reflection in the audit report is not out of place. However, we are neutral about it. Related additional proposed disclosures as annexure to the audit report are: in case if any government or other regulatory agency investigated client or any of the audit of previous year by the same auditor; if any action was taken against the lead external auditor by any regulatory authority?; who initiated the audit³⁶?; who concluded it and the reason for the change?; Who did it for the last year?

Disclosure of the Name of the Engagement Partner

³⁶ On the pattern of key management personnel, we propose having names of the key audit personnel. This kind of disclosure is likely to bring out more transparency in who's assigned to conduct audit.

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?

Agreed.

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Name of the engagement partner should be mandatory for every audit³⁷.

The name of CFO should also be mentioned on the financial statements³⁸.

Other Improvements to Proposed ISA 700 (Revised)

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?

We agree.

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?

Yes.

End of Annexure. Thank you.

³⁷ We do not agree with the Board that: "for many non-listed entities, including SMEs, the engagement partner's name is already available or known to the users of the financial statements through other means, albeit informal in many circumstances. See p.101

³⁸ We categorically propose that 'a greater sense of personal responsibility and accountability' are equally applicable for the CFO as well. See p.99. A cfo is the top management stakeholder in the financial reporting hierarchy. Such disclosure will inform user of any changes during interim or if the position was vacant. This matter is of sufficient importance to be included in the corporate reports. ISA 700 p.32 & 33 not refers to the cfo.