

IFAC

Mr. James Gunn

Technical Director

International Auditing and Assurance Standards Board

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New York 10017

Prague, 6<sup>th</sup> November 2013

No: 28/2013

**Re: IAASB Exposure Draft: Reporting on Audited Financial Statements: Proposed New and Revised International Standard on Auditing (ISAs)**

Dear Mr. Gunn,

Chamber of Auditors of the Czech Republic appreciate the opportunity to provide comments on the IAASB Exposure Draft: Reporting on Audited Financial Statements: Proposed New and Revised International Standard on Auditing (ISAs).

Yours sincerely,



Ladislav Mejzlík

First Vice President of the Chamber of Auditors of the Czech Republic

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6 November 2013

Dear Mr Gunn,

**IAASB Exposure Draft: Reporting on Audited Financial Statements: Proposed New and Revised International Standard on Auditing (ISAs)**

We are pleased to respond on behalf of the Chamber of Auditors of the Czech Republic to the questions in the above Exposure Draft.

By way of introduction, we would like to make it clear that we fully support the IAASB's effort to enhance the auditor's report by including additional information that provides users with better insight into the audit. We believe that the proposed new requirements will result in audit reports that (content-wise) include new, valuable information previously not available to users. However, we are concerned that the proposed new requirements will result in audit reports that (structure-wise) may be difficult to understand for the users. We therefore apprehend that the goal of the initiative (to enhance perception of an audit as a value-added service) may not be fully achieved and that some users may be disconcerted when reading the new reports (simply due to their complexity and variability).

As can be seen from our comments below, most of our recommendations relate to the structure and wording of the report. As such, we believe that matters of our concern can be addressed and rectified without any unreasonable effort as they do not undermine the core concept of the newly-proposed ISA of providing more information to the users of the auditor's reports.

**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, we believe that providing users with more information on the key areas of audit may increase the value of our report to its users and reduce the expectation gap.

**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?**

While in general, we support the enhancement of the auditor's report to provide users with better insight into the audit, we have several concerns as to whether the proposed requirements and the related application material provide an appropriate framework for both the auditor (when preparing the report) and the user (when trying to understand the report).

First, we have concerns regarding the definition contained in par 8 of the proposed ISA 701. While paragraphs (a) and (c) are based on the concepts defined in the auditing standards, the term "significant difficulty encountered during the audit" used in paragraph (b) is not defined and can be understood very diversely by different auditors (with some focusing mostly on difficulties in the audit process itself rather than difficulties in obtaining and evaluating evidence and reaching conclusions). We believe that the concept contained in paragraph (b) should be reconsidered (or supported with additional application material).

Second, we have concerns regarding the communication of key audit matters within the audit reports of different entities. While in the past, the placement of matters in the auditor's report has been mostly given and fixed, under the new concept, a certain matter may "travel" between different sections of the report (depending on circumstances). Thus, the same matter may be included in the emphasis of matter paragraph (for a non-listed entity) or a key audit matter (for a listed entity) or a basis for opinion (if relating to a misstatement). A similar effect will occur for information on a going concern. This changeability of the placement of information within the report (though technically correct) will, in our view, reduce the proper understandability of the auditor's reports. This changeability may also increase opportunities for (and pressures on) a trade-off between modifications of opinion and key audit matters as auditors will now have a new flexible tool to report certain facts without qualifying the opinion.

We believe that the overall structure of the new audit report should be reconsidered towards a framework that is more stable and limits the variability of the placement of facts within the report. We strongly believe that there should be a clear dividing line in our report between (a) our view and comments regarding the financial information prepared by management, and (b) insight into the audit process. The information should never "travel" between the two, as is currently the case due to the information potentially floating between the basis of opinion / emphasis of matter (type (a) information) and key audit matters (type (b) information).

An example of a stable structure may be a report constituted of:

- (1) general introduction (such as the identification of a financial statement and a description of an engagement, including responsibilities),
- (2) auditor's conclusions (basis for opinion, opinion itself and possibly emphasis of matter), and
- (3) additional information to help users in understanding how an auditor reached his or her conclusion (key audit matters and possibly other matters).

**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?**

See our comments on question 2 above.

Also, we are concerned that a connection between key audit matters and confidentiality may not have been sufficiently covered in the proposed draft. There are many facts that may be

identified as key audit matters and considered confidential at the same time, such as a loss of an important customer or establishing a new strategic contract etc.

In practice, auditors will often take confidentiality into consideration while identifying key audit matters for reporting purposes. The IESBA Code of Ethics allows one to disclose confidential matters if required by professional standards. Even if the reporting of a key audit matter is required by professional standards it is an auditor (not the standard) that identifies the key audit matters and therefore there may be serious disagreements on whether such matter may be reported by the auditor or not.

Besides, confidentiality is also required by law. Within our jurisdiction, the law is stricter than the IESBA Code of Ethics. It is hard to foresee whether the reporting of key audit matters will be considered legal.

Therefore, we suggest that auditors be provided with further guidelines on confidentiality. Also, it may be appropriate that the audit engagement letter explicitly states the definition of key audit matters and the client's understanding that the reporting of key audit matters is exempt from confidentiality.

**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.**

From the illustrative examples, is not clear whether an auditor shall provide its conclusion on each of key audit matters or whether key audit matters should be only impartially described.

For example, Illustration 1 within ISA 700 in the section Valuation of Financial Instruments contains the language that "...we concluded the use of such a model was appropriate." We believe that such statement should not be included in the audit report (not even within the key audit matters section) as it may imply giving assurance on a certain matter that is clearly out of the scope of an audit engagement. We suggest that the wording of all illustrative examples be reviewed in order to remove any such language.

**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?**

Yes. Key audit matters should be communicated under the same framework when it is compulsory or when an auditor agrees to do so. In the latter case, we agree that it must be based on the audit engagement letter; an auditor should clearly indicate that ISA 701 will be used (also for confidentiality purposes mentioned above) and a later request by the management not to report key audit matters should be considered a change in the scope of the engagement (with the relevant consequences).

**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?**

Generally, we believe that users will always expect a report on key audit matters once ISA 701 is implemented. Consequently, if no key matters are communicated, an auditor should explicitly express such fact to leave no doubt among users of the report. We believe that an illustration of such language should be also included in the proposed standard.

**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.

**8. Do respondents agree with the IAASB's decision to retain the concepts of Emphasis of Matter paragraphs and Other Matter paragraphs, even when the auditor is required to communicate key audit matters, and how such concepts have been differentiated in the Proposed ISAs? If not, why?**

We believe that the concepts of both emphasis of matter and other matter paragraphs will still have relevant content even under the new framework that cannot always be covered by the remaining parts of the report. However, we are concerned regarding the structure of the report as described in our comments on question 2.

### **Going Concern**

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

**(a) The appropriateness of management's use of the going concern basis of accounting in the preparation of the entity's financial statements?**

**(b) Whether the auditor has identified a material uncertainty that may cast significant doubt on the entity's ability to concern, including when such an uncertainty has been identified (see the Appendix of proposed ISA 570 (Revised))?**

**In this regard, the IAASB is particularly interested in views as to whether such reporting, and the potential implications thereof, will be misunderstood or misinterpreted by users of the financial statements.**

We are concerned that the newly-proposed reporting may be misunderstood.

Firstly, structure-wise, in the illustrative examples, a going concern is mentioned in many places within a report and there is a risk that many users may not get an intended message (or may simply feel insecure whether they read the report properly). See our comments on question 2 above.

Secondly, the proposed reporting on a going concern contains two elements: (a) the appropriateness of the use of the going concern basis of accounting, and (b) whether material uncertainty has been identified. While this concept is very logical (when thought through deeply), we are concerned that it may confuse readers, namely in situations where it concludes that the use of the going concern basis of accounting is appropriate while there are material uncertainties (or even material misstatement related to a going concern). Illustration 2 in the proposed ISA 570 is an example of a report that (while technically correct) is extremely difficult for an average user to understand as going-concern information is provided piecemeal in four different sections/subsections. In addition, the order of information is counter-intuitive as the report starts with a repeated indication of a going concern “issue” only to end up with “no issue” language in the Going Concern Basis of Accounting section. We strongly believe that the reporting on the going concern should be reconsidered and simplified.

**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 believe that the statement is appropriate and should be expressed in the auditor’s report in both situations.

#### **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?**

We agree.

#### **Disclosure of the name of the Engagement Partner**

**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?**

We expect no difficulties as such requirement has already been implemented in the Czech Republic.

#### **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 believe that such information should be considered an “introduction” to the report. We agree with the wording itself.

**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?**

We believe that at least a recommended ordering would be useful for both auditors and users. One of the goals of ISAs is to harmonise. Some jurisdictions may even seek blueprints in ISAs.