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International Auditing and Assurance Standards Board
International Federation of Accountants
529 Fifth Avenue, 6th Floor, New York, NY 10017, USA

November 7, 2013

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

Dear Sir or Madam,

The Chinese Institute of Certified Public Accountants (CICPA) welcomes the opportunity to comment on Proposed New and Revised International Standards on Auditing (ISAs). 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 believe that the proposed improvements 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 response.

Yours sincerely,

Yugui Chen
Secretary General
CICPA

Appendix

Responses to Questions in the Reporting on Audited Financial Statements

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. In general we believe that a new section to describe key audit matters could provide users more useful information and improve transparency about the audit performed. It could also help users understand audit procedures and professional judgments conducted by auditors so that they could understand the work of auditors better.

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?

Regarding the three types of KAM discussed in ISA 701.8, we believe that (a) is valuable for the users of audited financial statement but have doubts on how (b) and (c) would add value for the users.

<u>(b) Areas in which the auditor encountered significant difficulty during the audit, including with respect to obtaining sufficient appropriate audit evidence.</u>

The significant difficulty encountered by the auditor may lead to a modified opinion as required by ISA 705 and echoed in ISA701 A21. Inclusion of such a KAM, when it does not lead to a modified opinion, is likely to be confusing to users rather than providing informative value. Users may misunderstand that the KAM may have led to a modified opinion because for some reason the auditor concluded they could tolerate it. Users may have the impression that audit reports with KAMs of such nature imply that the quality of the financial statements is undermined.

When auditors communicate significant difficulty to TCWG, it is usually for the purpose of (1) obtaining assistance from TCWG to resolve the difficulty if they can; (2) informing TCWG of potential issues with management integrity or competence if the difficulty is imposed by management; (3) requesting for incremental fee when the difficulty results in additional cost to the auditor; or (4) explaining why they would issue a modified opinion if the difficulty remains and auditors are unable to obtain sufficient appropriate audit evidence. So what does 8(b) intend to cover?

Auditors have to obtain sufficient appropriate evidence to support an unmodified opinion. If they had ever encountered significant difficulty but subsequently resolved it (i.e. able to obtain sufficient appropriate audit evidence), then what's the value for the users to read such information in the audit report?

The same question could be asked for 8(a) but apparently significant risks do have high value for users as they make them better understand both the financial statements and the audit. And we wonder if 8(b) could actually be covered by 8(a) – the two examples in A20 (related party transactions and group audit) are very likely about significant risks anyway.

All in all, we believe that ISA701 should provide more guidance on why 8(b) is valuable for the users and consequently what kind of significant difficulty is to be communicated as KAM.

<u>(c) Circumstances that required significant modification of the auditor's planned approach to the audit, including as a result of the identification of a significant deficiency in internal control.</u>

8(c), similar to 8(b), seems to be KAM more relevant to audit, but less relevant to the financial statements, while we believe that for a KAM to be of most value for the users of the financial statements, it should be related to both aspects, as an audit is to add credibility to the audited financial statements. In other words, KAMs are not KAMs for auditors, but KAMs for users.

An auditor may change the planned audit approach for many reasons. Risk assessment / audit planning is dynamic as discussed in ISA 315 and ISA 300.

Users are interested in audit information because it helps them better understand the audited financial statements, or even assess the quality of the financial statements. Therefore, we wonder if material misstatements identified in the audit which makes the auditor change the planned audit approach (e.g. performing more audit procedures as the identified misstatements indicate higher risk than originally assessed) should also be a KAM.

A23 admits that "the auditor is not required by the ISAs to report externally on significant deficiencies in internal control identified during the audit." It then added that "the identification of a significant deficiency may be an indicator of a KAM relating to the area(s) of the financial statements affected by the significant deficiency".

If the auditor changes the audit approach due to significant deficiency in internal control, it is still possible for the auditor to obtain sufficient appropriate audit evidence supporting an unmodified opinion on the financial statements.

So it is not clear what exactly is expected to be derived from having a KAM on significant deficiency, in particular when the significant deficiency does not make the auditor unable to obtain sufficient appropriate audit evidence about the financial statements, and does not result in material misstatements in the financial statements.

We suggest the ISA701 provide more guidance on 8(c) to explain the rationale and also make it specific what scenarios are in route for a KAM.

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?

For each individual KAM, it would be more helpful if the ISA could provide the guidance on the key information that should be included in a KAM, such as, the reason why the auditor think the KAM is significant, the management's assertion and reference to the foot note of the financial statement, and highlight that no separate conclusion is provided.

The overriding principle in disclosing KAM should be to enhance effective communication through the providing of useful information in a succinct, insightful manner while emphasizing the importance of the disclosures provided by management through reference to the financial statement notes. Further, KAM should also be seen as a tool to be used by the stakeholder as a means to navigate to the pertinent information disclosed in the financial statements. We believe it is very important that there should be a clear and identifiable link from the significant matters disclosed as KAM to those matters disclosed by management and TCWG in the financial statements.

Also, due to the differences in the nature and content of key audit matters, different description should be allowed. Not all key audit matters need to have same elements. In this aspect, IAASB should allow auditors to decide how to describe key audit matters according to nature and characteristics of each key audit matter.

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.

We prefer illustrative examples about "Valuation of Financial Instrument" and "Revenue Recognition relating to Long-term Contracts" for the reason that they both tell the whole story by including auditor's response and conclusion. Examples about "Goodwill" and "Acquisition of XYZ Business" appear incomplete. They will probably trigger more questions or cause doubts of the users instead of providing useful information.

It is important for users to understand why a KAM is a KAM. It is equally important for them to understand that why, at the end of the day, a KAM is only a KAM, but does not become an "issue" (i.e. modification to the audit opinion).

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?

We do not foresee that many auditors will volunteer to provide KAM. It is more likely that some stakeholders may request auditors to provide KAM for non-listed entities, such as shareholders / potential investors of private companies or regulators.

We fully agree that if KAM is to be communicated, as agreed in the engagement terms, auditors should fully comply with the requirements of ISA701.

We are more concerned that stakeholders who do not understand ISAs well, will do "KAM shopping", for example, dictate to the auditor what matters should or could be included as KAM.

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?

We 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. We think that whether key audit matter exists or not is determined by the judgment of auditor, if auditor thinks the auditing process of the engagement is very smoothly, and there doesn't exist the matters which should draw special attention to financial statement user, it is not necessary to disclose key auditor matter.

Further, if auditors decide no key audit matters to communicate, according to proposed ISA 701 and by exercising professional judgment, the reason to make this decision must be explained in the auditor's report. We believe doing this can make sure users aware of auditor's determination.

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?

We have concerns on such proposals, for audit reports are issued under corresponding figure and comparative approach, respectively.

Corresponding Figure Approach

When the auditor undertakes an initial audit engagement as the incoming auditor, it is not uncommon that they may:

- identify material misstatements in opening balances / comparatives; or
- be unable to obtain sufficient appropriate audit evidence regarding certain opening balances / comparatives which could bear on both the current year amounts and corresponding figures, or affect corresponding figures alone therefore affect the comparability of the comparatives.

It would seem reasonable for the incoming auditor to determine that such a matter is a KAM worth of attention by the users.

Once ISA701 becomes effective, it could be reasonably expected that the users may be interested in tracking the subsequent development of prior year KAMs, especially when:

- a prior year KAM is related to a long-term transaction/event; or
- there is change of auditors in the current period.

Comparative Financial Statements Approach

Entities going for IPO are usually required to include their audited financial statements for a few years (normally 3 years) in the prospectus. NSS and security regulators may require auditors to disclose KAM in such audit reports which are issued under comparative financial statements approach.

For such comparative financial statements, users may not single out the most recent period as they may feel that the trend is of more importance than the recent for their decision.

The above potential issues relating to the comparatives cannot be simply disposed of by ISAs defining KAM as only for the current period. We suggest that IAASB revisit the proposal and make allowance for situations where reference to prior periods is essential.

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?

In general we agree with the decision to retain the concepts of EOM and OM for audits of all entities.

However, there will be practical issues due to the increased complexity of "audit report matrix" for listed entities and non-listed entities.

ISA706 requires that auditors should not use EOM or OM paragraphs for matters determined to the KAM in accordance with ISA701 when applicable. But to determine whether a matter is KAM or EOM/OM could be difficult and subjective– there is no clear cut given historically EOM/OM paragraphs were where the auditors place some KAMs and how to judge if auditors do or do not "hide" KAMs in EOM/OM?

Key Audit Matters

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.

If the management has included a disclosure on the use of going concern basis in their financial statement, it would be appropriate that the auditor include a paragraph to discuss the use of going concern basis. However, we are still concerned about whether additional value can be added by including a going concern paragraph in the auditor's report, as:

- There is a risk that the going concern conclusion is regarded as a separate opinion with an additional assurance, which may constitute an "expectation gap" with users.
- If users' knowledge of the role of auditor is still limited, this paragraph may lead to a misinterpretation by users that the auditor is providing a conclusion about the entity's future viability, potentially widening the expectation gap.

Thus, we suggest that a Going Concern statement be required only on an exception basis i.e., when a material uncertainty has been identified. This has the advantage of avoiding boilerplate language in the auditor's report. It also provides a stronger alert to users.

If the IAASB keeps the position as the ED is, to help address the potential for misunderstanding, it is important that the IAASB provide guidance as to what constitutes a material uncertainty and significant doubt.

We agree to make explicit statements to remind the users of the financial statements material uncertainty that may cast significant doubt on the entity's ability to continue as a going concern has been identified.

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?

Yes, we agree the explicit statement that auditor cannot guarantee the entity's ability to continue as a going concern should be included. However, the auditor may not be in the position of representing this on behalf of management.

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 do not object this disclosure as this may push the auditor to focus on the independent requirement and enhance the user's confidence on the auditor's report and the audited financial statements. However, additional guidance may be needed, for example, if the auditor identify threats to their independence and has taken necessary action to mitigate the affect, any disclosure requirement on this process or just "we are independent in accordance to…."

In practice, some regulators do make requirements about independence and ethnical requirements for auditors. The list may become extensive if all sources of independence and ethnical requirements are disclosed.

In addition, we believe more guidance on how to disclose such independence in a group audit is also needed. For example, disclosures could be extensive if required with respect to every component, as there could be numerous jurisdictions in the case of multinational entities. The disclosure of all the independence and other ethical requirements that may apply to group situations may be confusing and of questionable value to the user.

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 agree with the proposal to disclose engagement partner's name in the audit report, which is already required in our national auditing standards. But we do not see valid reasons for differentiating between listed entities and non-listed entities.

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?

- Improved description of the responsibilities of the auditor and key features of the audit (see paragraphs 35–38 and related application material of proposed ISA 700 (Revised)).

We agree with the proposal in these respects as an enhancement to the current version of the auditor's report. However, we would like to suggest of including more explicit description on the management's responsibilities in the "management responsibility" section in addition to the wording of "fairly present and maintain necessary control" to corresponding the auditor's KAM and auditor's responsibility in the appendix, such as, the evaluation of use of going concern basis, select appropriate accounting policy and make appropriate accounting estimate, etc.

- Provision for the descriptions of the responsibilities of the auditor and key features of the audit to be relocated to an appendix in the auditor's report, or for reference to be made to such a description on the website of an appropriate authority.

We think that such descriptions may be appropriately disclosed in an appendix, with appropriate referencing from the body of the report. Compare to referring the section to a website, we more prefer include this in an appendix to the auditor's report as we assume only few user would read such content through a website for each auditor's report.

- Reference to whom in the entity is responsible for overseeing the Company's financial reporting process – Inclusion of this reference in the auditor's report acknowledges this essential role in the financial reporting process.

We are supportive of disclosing those responsible for oversight.

- In respect of "Other reporting responsibilities"

We are supportive of allowing additional flexibility for national standard setters to determine how best to place the auditor's communication about such matters in the auditor's report in order to be meaningful to users.

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, we support the proposal not to mandate the ordering of sections of the auditor's report. The required heading for each section may provide some extent of consistency and comparability. However, for the description of the auditor's responsibility, we may suggest a standardized illustration is provided. Also, for "Auditor's Opinion" section, it makes the flow more logic if paragraph 27 is put before the current paragraph 24. This also applies to the illustrative audit reports.