

IAASB

The New Auditor's Report: *Revealing Key Audit Matters*

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Agenda

- Auditor reporting project timeline
- Background – why change the auditor’s report?
- The new ISA auditor’s report – what’s different?
- Key Audit Matters – what are they?
- Other changes to the auditor’s report
- Effect on practice globally and in the U.S.
- When will these new reports be available?
- Other relevant IAASB initiatives
- Questions?

Auditor Reporting Project Timeline

Research & Consultation

Academic research
(2006 – 2009)

Review of national developments / initiatives
(2009-2010)

Consultation Paper:
Enhancing the Value of Auditor Reporting
(May 2011)

Commencement of Standard Setting

Project Proposal
(December 2011)

Task Force and Drafting Teams
(January 2012)

Consultation on Indicative Direction

Invitation to Comment: **Improving the Auditor's Report**
(June 2012)

Outreach and Roundtables

Auditing Standards

Exposure Draft
(June 2013)

Final Standards
(Approved September 2014)

Background – Why Change the Auditor’s Report?

- Academic research, ongoing consultation and outreach
 - Auditor’s report is valued, including the “pass/fail” opinion, but could be more informative
- Changing financial reporting environment
 - Greater complexity, more areas of judgment, qualitative disclosures
- Demand from investors and other users (“we want to hear more”)
 - Audit is a “black box”
- Global financial crisis triggered some key questions
 - Quality of auditing – effectiveness, professional judgment, professional skepticism
 - Relevance of audit and confidence in the audit profession

The New ISA Auditor's Report – What's Different?

- Auditor's opinion presented first
- New Key Audit Matters section (listed entities)
- More focus on going concern
- New section to address Other Information when such information is presented with the audited financial statements (being addressed in a separate project)
- Other suggested improvements to enhance transparency or clarify responsibilities
 - Statement about independence and other ethical responsibilities
 - Naming of the engagement partner (listed entities)
 - Improved description of auditor responsibilities and key features of the audit

Key Audit Matters (“KAM”)

New **Key Audit Matters** section to be required in the auditor’s report for listed entities in accordance with **new ISA 701**; may be required by law or regulation, or auditor may provide voluntarily, for other entities

Definition:

- Those matters that, in the auditor’s professional judgment, were of **most significance** in the audit of the financial statements of the current period. Key audit matters are **selected from matters communicated with those charged with governance**.

Matters communicated with TCWG



Matters that required **significant auditor attention**



Matters of **most significance**

What Types of Matters Will Be KAMs?

- In determining matters that required significant auditor attention, the auditor is required to consider:
 - Areas of **higher assessed risks of material misstatement** or **significant risks** (risks requiring special audit consideration)
 - **Significant auditor judgments** relating to areas of significant management judgment (e.g., complex accounting estimates)
 - Effect on the audit of **significant events or transactions**
- In most cases, KAM will relate to significant or complex matters disclosed in the financial statements
 - Impairment, valuation of financial instruments, accounting for significant acquisitions, other areas of estimation uncertainty
 - But KAM not limited to matters disclosed in FS

Key Audit Matters Section of the Auditor's Report

INDEPENDENT AUDITOR'S REPORT

Report on the Audit of the Financial Statements

Opinion

Basis for Opinion

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on those matters.

[Description of each key audit matter, with appropriate sub-heading]

- *Why matter was considered one of most significance in the audit*
- *How the matter was addressed in the audit*

Key Audit Matters – Other Points

- KAM required to be communicated unless
 - Law or regulation precludes public disclosure, or
 - In extremely rare circumstances, the auditor determines that a matter should not be communicated because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication
- KAM required for a qualified or adverse opinion, but prohibited for a disclaimer of opinion
- In certain limited circumstances, may determine that there are no KAM to communicate
- Documentation requirements
- Emphasis of Matter and Other Matter paragraphs retained

Other Changes to the Auditor's Report

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. **We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in [jurisdiction], and we have fulfilled our other ethical responsibilities in accordance with these requirements.** We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Changes to the Auditor's Report

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Other Changes to the Auditor's Report

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, **whether due to fraud or error**, and to issue an auditor's report that includes our opinion. **Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists.** Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Note: A description of additional responsibilities is required but can be included in the body of the report, within an appendix to the report, or by specific reference within the report to the location of such a description on the website of an appropriate authority, where expressly permitted by law, regulation or national auditing standards.

Other Changes to the Auditor's Report

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance ...

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. **The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.**
- Obtain an understanding of internal control ...
- **Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to ... going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the disclosures ... Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.**

Effect on Practice Globally and in US

- Communication of KAM in the auditor's report is expected to represent a significant change in practice
 - Already a similar requirement in the UK, soon to be required in Netherlands, and part of audit reform in the EU
- The auditor's report is the key deliverable from the audit, so changes may
 - Help investors and other users better understand the audit
 - Have positive benefits to audit quality or users' perception of it
 - Increase attention by management and those charged with governance to disclosures in the financial statements
- AICPA will consider changes to its standards (non-issuers)
- PCAOB has its own project (re-exposure expected)

When Will the New Reports Be Available?

- IAASB's new and revised standards are effective for audits of financial statements for periods ending on or after December 15, 2016
 - Early application permitted
- Final approved standards, along with Basis for Conclusions, will be submitted to Public Interest Oversight Board for approval of due process
- Standards expected to be released by mid January 2015
- IAASB next steps
 - Activities to promote awareness and understanding, and support effective implementation
 - Post-implementation review

Other Relevant IAASB Initiatives

- Other Information (OI) – ISA 720 (Revised)
 - Objective of strengthening the auditor’s responsibilities for OI and establishing reporting requirements
 - Expected approval in December 2014 or March 2015
- Auditing Financial Statement Disclosures
 - Aim of the project is to enhance the auditor’s work effort in relation to both quantitative and qualitative disclosures
 - Exposure draft in May 2014, with approval expected in mid 2015
- A Framework for Audit Quality
 - Issued in February 2014 with the objectives of raising awareness, encouraging stakeholders to consider ways to improve AQ, and promoting dialogue among stakeholders

Questions?

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