

THE NEW AUDITOR'S REPORT

“Straight from the
horse's mouth”

A Joint SAICA / IRBA Event
(19 May 2015)



Stakeholder's Perspective – The Need for Change

Linda de Beer
Immediate Past Chairman of
the IAASB CAG



About the CAG

- IAASB Consultative Advisory Group (CAG)
 - Member organisation based group, currently 30 members
 - Spread of regulators, investors, preparers, etc. Also regional spread
 - Collectively as the CAG and individual organisations all important stakeholders of the IAASB and the auditing profession
 - No allocated country seat or individual in personal capacity
- Role
 - To provide input into the IAASB's technical projects and strategic agenda on a consultative basis
 - To advise on strategic and upcoming matters of importance

About the CAG (cont.)

- Investors: CFA Institute, International Corporate Governance Network, Brazilian Development Bank, Japan Securities Dealers Association, World Bank, International Monetary Fund
- Preparers: Business Europe, European- Asian- and North America bodies of Financial Executives
- Regulators: Basel, European Commission, IAIS, IFIAR, IOSCO, Islamic FSB, PCAOB
- Auditors: European Federation of SMPs, FEE
- Others: IBA, ISACA, INTOSAI, IVSC

The Need for Change

- Strong drive from INVESTORS to enhance the auditor's report
 - To gain insight into the company through the lens of the auditor
 - Less boiler plate language – more entity specific information
 - Interested in key areas and outcomes – not detailed audit procedures performed
 - Greater transparency in auditor's report regarding name of engagement partner, ethics requirements

The Need for Change (cont.)

- Investor views strongly supported by regulators such as IOSCO and Basel
- Need for change also driven by changes elsewhere - similar projects by the European Commission and PCAOB
- However, ultimately no CAG Member Organisation against the auditor reporting enhancements – either in principle or in detail
- Very strong support and encouragement for this project

Introducing the IAASB Leadership

- Prof. Arnold Schilder – Chairman of the IAASB
- Dan Montgomery – Immediate past Deputy Chair of the IAASB and Chair of the Auditor Reporting Implementation Working Group
- Kathy Healy – IAASB Technical Director and IAASB Staff Lead on the Auditor Reporting Project

Also on the Panel

- Willie Botha – Senior Executive: Assurance and Practice, South African Institute of Chartered Accountants (SAICA)
- Imran Vanker – Director: Standards, Independent Regulatory Board for Auditors (IRBA)

Background to and Focus on Key Changes to the Auditor's Report

Presentation by the IAASB



The New Auditor's Report

Prof. Arnold Schilder, IAASB Chairman
Dan Montgomery, Chairman of Auditor Reporting
Implementation Working Group
Kathy Healy, Technical Director

Johannesburg, South Africa
May 2015

Agenda

- Project Overview and Introduction
- Key Audit Matters (KAM)
- Going Concern (GC)
- Other Changes to the Auditor's Report
- Auditor Reporting Implementation

Overview of the IAASB's Auditor Reporting Project

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)

Public Consultation

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

Outreach and Roundtables

Exposure Draft
(June 2013)

Released new and revised Auditor Reporting ISAs in Jan 2015
Effective Date – Periods ending on or after December 15, 2016

Why Change the Auditor's Report Now?

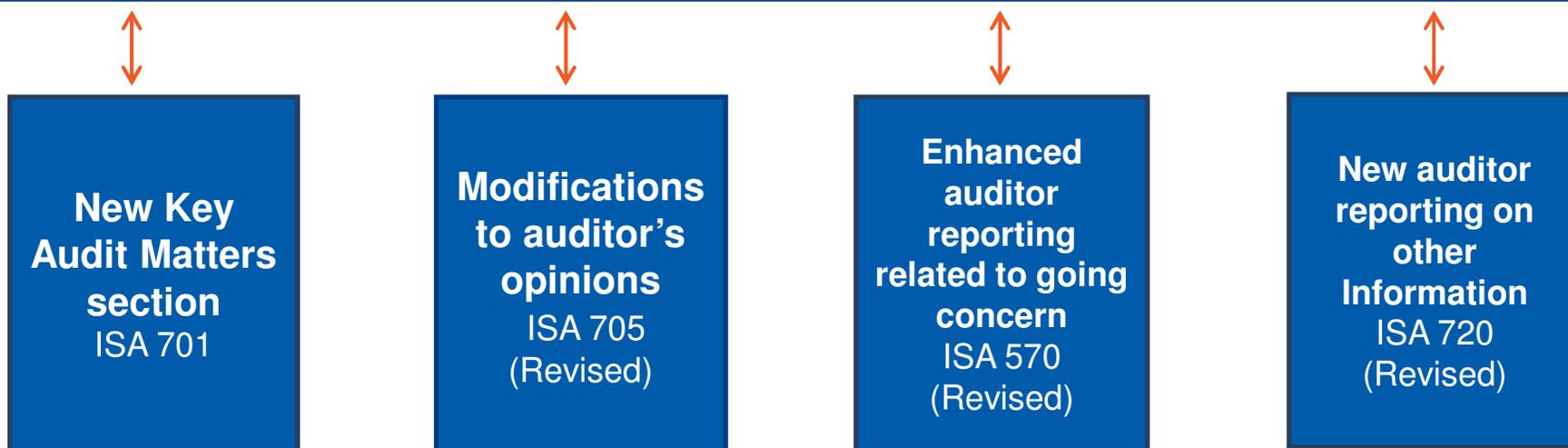
- Foundation for the future of global auditor reporting and improved auditor communications
- Essential to the continued relevance of the audit profession globally
 - Audit opinion is valued, but could be more informative
 - Users want more relevant and decision-useful information about the entity and the financial statement audit

Expected Benefits of the New Auditor's Report

- Enhanced communicative value to users
- More robust interactions and communication among users, auditors and those charged with governance (TCWG)
- Increased attention by management and TCWG to the disclosures referred to in the KAM section of the auditor's report
- Increased professional skepticism in areas where KAM are identified
- Increased audit quality or users' perception of audit quality

The New and Revised Auditor Reporting Standards

Overarching Standard for Auditor Reporting – ISA 700 (Revised)



Revisions to **ISAs 260 and 706** as a result of ISA 701, and related conforming amendments to **ISAs 210, 220, 230, 510, 540, 600, 710**

What Are KAM?

- KAM are defined as those matters that, in the **auditor's professional judgment**, were of **most significance** in the audit of the financial statements of the current period
- KAM are **selected from matters communicated with TCWG**

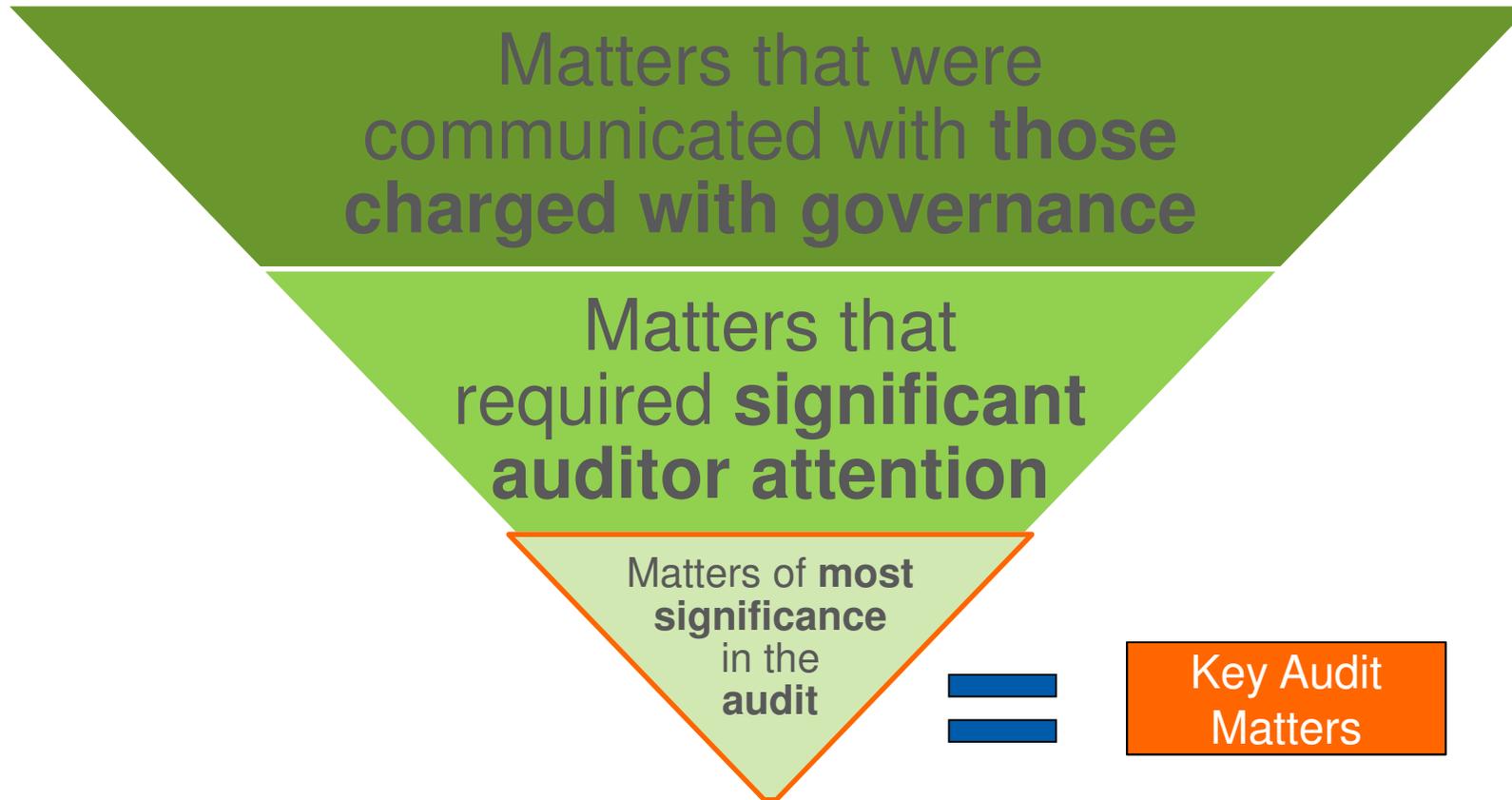
Which Auditor's Reports Will Include a KAM Section?

- **KAM are required** to be communicated in the auditor's report **for audits of financial statements of listed entities** in accordance with new ISA 701
 - **Law or regulation may require KAM** for audits of entities other than listed entities (e.g., “public interest entities”, or public sector entities)
 - **Auditors may voluntarily, or at the request of management or TCWG, communicate KAM** in the auditor's report for entities other than listed entities

Are KAM Always Communicated in the Auditor's Report?

- Auditor is required to include each KAM unless
 - Law or regulation precludes disclosure
 - In *extremely rare circumstances*, the auditor determines that the matter should not be communicated
 - Adverse consequences of communicating the KAM would reasonably be expected to outweigh the public interest benefits of such communication
- KAM is prohibited for a disclaimer of opinion, but required for a qualified or adverse opinion
- In certain *limited* circumstances, there may be no KAM to be communicated

The Decision-Making Framework for KAM



Initial Step in Determining KAM

Matters that were
communicated with **TCWG**



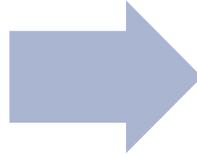
Matters that required
significant auditor attention

The auditor will always consider

- Areas of higher assessed risks of material misstatements or significant risks (i.e., 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

Determination of Matters of Most Significance in the Audit – KAM

Matters that required **significant auditor attention**



Matters of **most significance** in the audit

- KAM are determined by the auditor's consideration of the
 - Nature and extent of communication with TCWG
 - Importance to intended users' understanding of the f/s
 - Nature and extent of audit effort needed to address
 - Nature of the underlying accounting policy, its complexity or subjectivity
 - Nature and materiality, quantitatively or qualitatively, of corrected and accumulated uncorrected misstatements due to fraud or error (if any)
 - Severity of any control deficiencies identified relevant to the matter (if any)
 - Nature and severity of difficulties in applying audit procedures, evaluating the results of those procedures, and obtaining relevant and reliable evidence

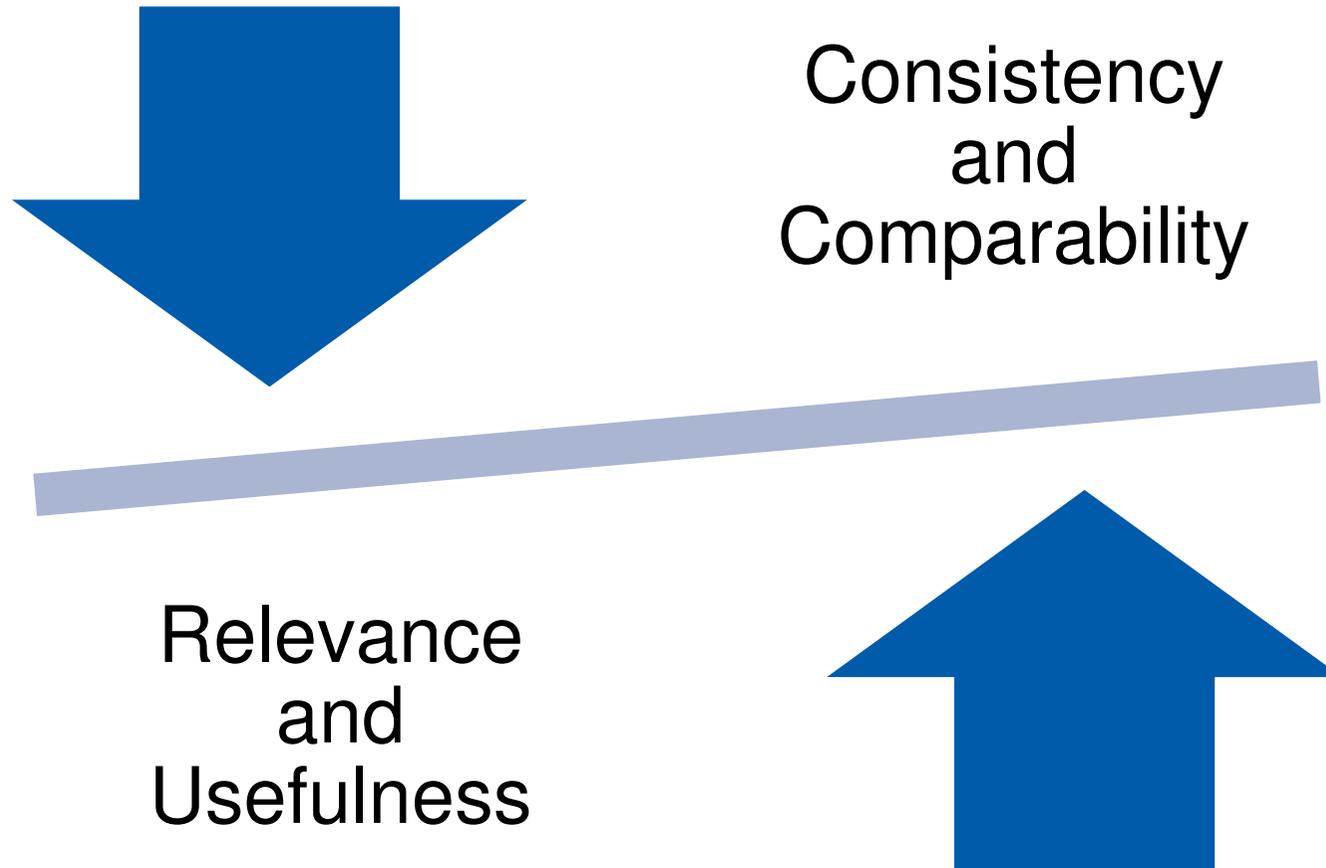
KAM – What Is Included in the Description?

- The description always includes
 - Why the matter was considered to be a KAM
 - How the matter was addressed in the audit
 - Reference to the related disclosure(s), if any
- The description of how the matter was addressed in the audit may include
 - Aspects of the auditor's response or approach
 - Brief overview of procedures performed
 - Indication of the outcome of the auditor's procedures
 - Key observations with respect to the matter

Considerations in Describing KAM

- KAM should be entity-specific and avoid standardized or overly technical language
- Description of a KAM should not
 - Imply that the matter has not been appropriately resolved by the auditor in forming the opinion on the financial statements
 - Contain or imply discrete opinions on separate elements of the financial statements (a “piecemeal opinion”)

KAM – Delivering Entity-Specific Information to Users



KAM – Relationship to Emphasis of Matter (EOM) and Other Matter (OM) Paragraphs and Modified Opinions

- Concepts of EOM and OM paragraphs are retained
- EOM and OM paragraphs cannot be used as a substitute for communicating a matter determined to be a KAM
- New requirement to use the term “Emphasis of Matter” in the heading in the auditor’s report when an EOM paragraph is included
- Modified opinion are KAM by their nature but are described in the Basis for Opinion section

KAM – What Are the Documentation Requirements?

- In accordance with ISA 230, ISA 701 requires the auditor to document the professional judgments made about
 - Why a matter that required significant auditor attention is or is not a KAM
 - If there are no KAM, the rationale why
 - Why a matter determined to be a KAM is not communicated
- No requirement to document the rationale for why matters communicated to TCWG were not matters that required significant auditor attention

More information about KAM is available in the Auditor Reporting Toolkit at: www.iaasb.org/auditor-reporting.

Enhanced Auditor Reporting on GC

- Changes to ISAs and the auditor's report to focus more on GC
 - Explicit description of the respective responsibilities of management and the auditor in all auditor's reports
 - Separate GC section required when material uncertainty exists, with a heading "Material Uncertainty Related to Going Concern"
 - New requirement to challenge adequacy of disclosures for GC "close calls"

Interaction Between KAM and GC

- Matters relating to GC, including “close calls”, may be determined to be KAM and communicated in the auditor’s report in accordance with new ISA 701
- When a material uncertainty related to GC exists, it is by nature a KAM, but is reported separately in the “Material Uncertainty Related to Going Concern” section of the auditor’s report

More information about GC is available in the Auditor Reporting Toolkit at: www.iaasb.org/auditor-reporting.

GC – Next Steps



- Further work on the topic of GC by both accounting and auditing standard setters
 - Possible opportunity for research?
 - IAASB to continue to monitor GC developments and, as appropriate, engage in discussions with the International Accounting Standards Board
 - Consider whether further work in the area of auditor reporting on GC is needed as part of the planned post-implementation review of the new and revised Auditor Reporting standards

Other Changes to the Auditor's Report

- Auditor's opinion required to be presented first
- Required Basis for Opinion section for unmodified opinions
- Statement about independence and other ethical responsibilities
- Naming of the engagement partner (listed entities only)
- Enhanced description of auditor responsibilities and key features of the audit
- Required identification section when TCWG are separate from management

Auditor Reporting and Law or Regulation

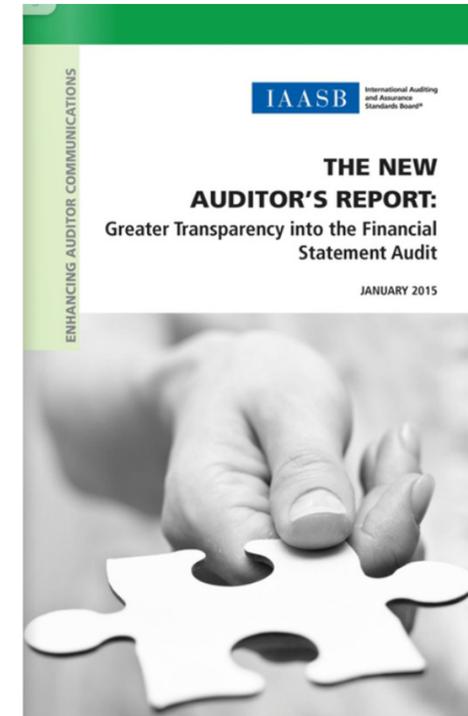
- New and revised Auditor Reporting standards continue to allow for
 - **Reference to the ISAs in the auditor's report when law or regulation** in a jurisdiction **specify the layout or wording of the auditor's report**, provided that certain requirements are met
 - **Any other reporting responsibilities** (ORR) prescribed by law or regulation in addition to those required by the ISAs, reported either
 - In a separate section in the auditor's report; or
 - If addressing the same topics required by ISAs, in the same section, provided the auditor's report clearly differentiates the ORR from the reporting required by the ISAs

Auditor Reporting – Effective Date

- Standards effective for audits of financial statements for periods ending on or after December 15, 2016
- Possibility of firms applying ISA 701 early in some jurisdictions, but not necessarily all other improvements
 - Investors and others are most interested in KAM, so it is in the public interest to allow for early application
 - But some concern that early application of areas other than KAM could be viewed as pre-empting how NSS might implement the ISAs
 - Clarification by the IAASB about whether early application of some or all of the reporting standards is permitted, and the practical challenges that might result, may be useful

Auditor Reporting – Implementation Support

- IAASB-supported efforts with objectives of
 - Promoting awareness of the standards
 - Informing and educating those who will use the auditor’s reports
 - Opening a dialogue to learn about experiences of those responsible for adoption and implementation
 - Preparing for post-implementation review efforts
- www.iaasb.org/auditor-reporting
 - Auditor Reporting Fact Sheet and “At a Glance”
 - Basis for Conclusions
 - Publications on GC and KAM
 - Illustrative KAM examples
 - Plans for webcasts, podcasts and other potential publications



Auditor Reporting – Implementation Support (cont.)

What more should the IAASB do to support adoption and promote effective implementation of the Auditor Reporting standards? e.g.,

- Encourage innovation by monitoring different approaches undertaken across jurisdictions and
 - Communicating views on best practices / positive benefits of the improvements?
 - Providing additional guidance for auditors as to how best to provide relevant and entity-specific information?
- Ensure management and auditors have an enhanced focus on going concern, in light of IFRIC Agenda Decision and changes to ISA 570 in relation to going concern “close calls” (and potential KAMs thereon)?
- Facilitate real-time feedback to the IAASB if an issue or concern is encountered?
- Assist SMPs in implementation, including promoting voluntary communication of KAM?



PROCEED TO Q&A SESSION