Perspective

This is one of a series of articles where experts in assurance, reporting and regulatory matters discuss recent technical and policy developments in these areas.

New auditor reporting requirements are imminent

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The overall objective of the improvements to auditor reporting is to respond to calls for auditors to provide more relevant information to users based on the audit that was performed. Accordingly, the new requirements are aimed at enhancing the informational value of the auditor's report.

Application in Australia is planned for financial reporting periods commencing on or after **1 January 2016**.

The AUASB plans to adopt a number of changes to the Australian Auditing Standards resulting from International Auditing and Assurance Standards Board (IAASB) projects that are nearing completion. A composite Australian exposure draft is expected in the second quarter of 2015, which will introduce one new standard (ASA 701) and contain revisions and amendments to 21 existing standards.

From early next year, regular updates, technical issues and key messages regarding these projects and changes to the Australian Auditing Standards will be posted on the AUASB's website: auasb.gov.au

Of these IAASB projects, changes to auditor reporting are the most significant, particularly with the introduction of a new standard on "key audit matters" (KAM), and changes to the way going concern issues are included in the auditor's report.

Key Audit Matters (KAM)

Overview

The new auditing standard (ISA 701) applies to audits of complete sets of general purpose financial statements (financial reports) of listed entities and when the auditor otherwise decides to communicate KAM in the auditor's report.

KAM are those matters that, in the auditor's professional judgement, required significant auditor attention in performing the audit. KAM are selected from matters communicated with those charged with governance and are determined by taking into account areas of higher risk; significant auditor judgements; and the effect on the audit of significant events or transactions.

In describing KAM in the auditor's report, the auditor is required to include the reason a matter was considered a KAM and how the auditor dealt with the matter. The auditor takes care in the KAM to ensure descriptions do not include "original information" about the entity which has not otherwise been made publicly available; and do not contain or imply discrete opinions on the KAM or separate elements of the financial report.

Suggestions

Using ISA 701, have the audit team select an appropriate audit file from last year and:

(a) Determine KAM that would have included in the auditor's report.

(b) Draft the KAM, addressing the "why" and "how" criteria set out in paragraph 13.

(c) Communicate with relevant clients, advising them of the impending KAM disclosure requirements and the auditor's proposed strategy for dealing with them.

KAM Not Communicated

The standard provides for circumstances when a KAM is not included in the auditor's report—when law or regulation precludes public disclosure; or in extremely rare circumstances, the auditor determines that the adverse consequences of public disclosure would reasonable be expected to outweigh the public interest benefit.

The auditor exercises professional judgement and considers relevant factors, including the views of management and those charged with governance, in determining to not communicate a matter that is a KAM. Additionally, the auditor may seek a written representation from management as to why public disclosure is not appropriate; and management's views on the significance of adverse consequences. The auditor also considers relevant ethical requirements.

The issues considered are complex and involve significant auditor judgement—the auditor may consider it appropriate in the circumstances, to seek legal advice.

No KAM Determined

The standard also provides for when in exceptional circumstances, the auditor determines that there are no KAM. In such circumstances the auditor is required to include a statement to this effect in the auditor's report.

Suggestions

Become familiar with the requirements and the detailed application and other explanatory material in ISA 701 that deals with KAM that are sensitive, confidential or may have adverse consequences if communicated publicly.

(a) Identify all audit engagements where these types of KAM may, or do, exist.

(b) Commence discussions with management and those charged with governance.

Documentation

As expected, ISA 701 includes specific documentation requirements relating to matters that required significant auditor attention and those chosen to be communicated in the auditor's report; and where applicable, the rationale for those KAM that the auditor has determined not to communicate; or the auditor's rationale when no KAM have been determined.

Suggestions

Select the management letter or comparable document from an appropriate audit file from last year and:

(a) Identify matters that would qualify for disclosure as KAM in the auditor's report.

(b) Select the relevant working papers and consider whether the form and content of those supporting working papers would need to change under ISA 701.

(c) Provide appropriate training for partners and staff to establish changes in documentation practice. As soon as a matter is identified as a KAM, immediate consideration should be given to drafting the KAM and what supporting documentation is required under the new standard.

Going Concern

Overview

The revision of ISA 570 has resulted in a helpful improvement in terminology. The "*going concern assumption*" has been replaced with the "*going concern basis of accounting*". This basis of accounting is used unless management either intends to liquidate the entity or cease operations, or has no realistic alternative but to do so.

The underlying fundamentals of the standard and the auditor's approach to going concern remain unchanged. The standard continues to require the auditor to report on an "exception basis". This means the auditor reports only when the going concern basis of accounting has been inappropriately used; or, when applicable, the financial statements do not include appropriate disclosures about a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

Reporting a material uncertainty that has been adequately disclosed in the financial report is no longer referred to as an emphasis of matter but is to be reported in a separate section of the auditor's report under the heading "Material Uncertainty Related to Going Concern".

Important Enhancement

The standard now includes a new requirement when events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, but no material uncertainty exists.

In such circumstances the auditor is required to evaluate whether the financial statements provide adequate disclosure about the events or conditions in accordance with the requirements of the applicable financial reporting framework.

To put this into context, an Australian listed company, for example, is required, under the *Corporations Act 2001*, to prepare an annual financial report that presents a *true and fair view* (a fair presentation framework). This principal requirement means that even when the financial report is prepared in accordance with the Australian Accounting Standards, it may be necessary to include further disclosures…*in order to achieve fair presentation*.

Suggestions

Select from prior engagements where the auditor's work on going concern has been of significance to the audit but no material uncertainty existed and:

(a) Reassess whether the previous financial report achieves "fair presentation" in accordance with the applicable framework – consider the matters listed at paragraph A24 of ISA 701.

(b) Determine the likelihood of a repeat of significant audit work on going concern, and what additional disclosure(s) may be necessary.

(c) Discuss with management the requirements of the standard and any potential need for additional disclosure(s) to achieve fair presentation.

Other Reporting Changes

The revised ISA 700 remains the cornerstone standard for auditor reporting and is consequently the starting point for the latest amendments. In addition to KAM and going concern developments, several other enhancements have been introduced with the aim of improving the informational value of the auditor's report.

Location of Paragraphs

The auditor's opinion is now required to be located in the first section of the auditor's report with the basis for opinion paragraph to follow directly thereafter. There are no further requirements on the location of other paragraphs, however, inferences from the standard's layout and the example reports suggest that any going concern reporting would be next, followed by KAM.

Responsibilities

Management responsibilities now includes a new paragraph on assessing the entity's ability to continue as a going concern, disclosing applicable matters relating to going concern and the use of the going concern basis of accounting. There is a further statement that those charged with governance are responsible for overseeing the financial reporting process.

The description of auditor responsibilities has been enhanced to include how the auditor exercises professional judgement, identifies and assesses risk, understands internal control, evaluates accounting policies, concludes on management's use of the going concern basis of accounting and identifies material uncertainties, communicates with those charged with governance, complies with independence requirements, and reports KAM.

Independence and Ethics

The auditor is now required to make positive statements on independence from the entity, compliance with ethical requirements relevant to the audit and fulfilment of other ethical responsibilities.

Communications

Needless to say, the auditor reporting changes will generate additional responsibilities to communicate with management/those charged with governance. Early discussions with clients will provide the best opportunities for both the auditor and the entity's management to understand the new auditor reporting regime, its impact on the audit and the identification of potential issues specific to the entity.

Other Projects

Although not directly linked to the auditor reporting project, the revision of ISA 720 (responsibilities relating to other information) and the "Disclosures" projects also have reporting implications. These projects, scheduled for completion in 2015, are planned to have the same application date as auditor reporting. For these reasons, the AUASB's planned composite exposure draft will set out the impact of these projects on the Australian Auditing Standards to facilitate constituents' understanding.