



## Agenda Item 6

### Auditor Reporting — Cover Letter and Issue Paper

#### Objective

To consider a discussion draft of proposed AU-C section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*.

#### Task Force

The Auditor Reporting Task Force (task force) members are:

- Dan Montgomery (Chair)
- Audra Harrington
- Jan Herringer
- Susan Jones
- Richard Miller
- Jeffrey Rapaglia
- Rick Reisig
- Mike Westervelt (TIC)

#### Background

In 2015 the IAASB issued new and revised ISAs relating to reporting on audited financial statements. The following is a list of the new and revised ISAs, which are effective for audits of financial statements for periods ending on or after December 15, 2016.

- ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*
- ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*
- ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*
- ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*
- ISA 720 (Revised) *The Auditor's Responsibilities Relating to Other Information*
- ISA 570 (Revised), *Going Concern*
- ISA 800 (Revised), *Special Considerations — Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*
- ISA 805 (Revised), *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*

- ISA 810 (Revised), *Engagements to Report on Summary Financial Statements*

At previous meetings the ASB discussed certain threshold issues relating to ASB's stated goal of convergence with the new and revised ISAs while also considering the standards of the Public Company Accounting Oversight Board (PCAOB). The ASB discussed certain elements of the auditor's report relating to the ASB's convergence with ISA 700 (Revised) and a framework to help the task force with convergence.

At the October 2016 ASB meeting the ASB review a draft of proposed AU-C section 700, *Forming an Opinion and Reporting on Financial Statements* and provided the task force with feedback and direction. The ASB continued to support convergence with ISA 700 (Revised). The task force will bring a revised draft of proposed AU-C section 700 to a future ASB meeting.

### **Subsequent Task Force Discussion**

Subsequent to the October 2016 ASB meeting, the task force held a one-day meeting and developed a proposed SAS that provides requirements and guidance for auditors when key audit matters (KAM) are communicated in the auditor's report (proposed AU-C section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*). The task force used ISA 701 as a base for the proposed SAS. The proposed SAS is consistent with the previous ASB decision that KAM should be voluntary for nonissuers in the United States and reflects the task force's recommendations on how to implement the communication of KAM.

The task force noted that, when considering the proposed SAS, it is important to also understand the interaction between key audit matters (KAM) communicated in the auditor's report and the use of emphasis-of-matter (EOM) paragraphs and other-matter (OM) paragraphs, in accordance with AU-C section 706. Because the ASB is not discussing proposed changes to AU-C 706 at this meeting, the following is a brief summary of the more significant changes made to ISA 706 (Revised) to explain how the IAASB handled the interaction between KAM and EOM and OM paragraphs. The task force intends to propose similar changes to AU-C section 706 at a future ASB meeting.

ISA 706 (Revised) reflects the following:

- Prohibits the auditor from using an EOM paragraph or OM paragraph when the matter has been determined to be a KAM and explains that, when ISA 701 applies, the use of EOM paragraphs is not a substitute for a description of individual KAM (see paragraphs 8(b), 10(b) and A1 of ISA 706 (Revised)).
- Provides further guidance on the definition and purpose of KAM and the relationship with EOM paragraphs noting that, when KAM are communicated, there may be a matter not determined to be a KAM for which an EOM paragraph may be considered necessary (see paragraphs A1–A3 of ISA 706 (Revised)).
- Requires the use of the term “Emphasis of Matter” in the heading when an EOM paragraph is included in the auditor's report, with flexibility for the auditor to provide greater specificity in the heading to further differentiate the EOM paragraph from the individual matters in the KAM section (see paragraph 9(a) of ISA 706 (Revised) and Appendices 3 and 4).

- Provides illustrative examples that clearly distinguish the concepts in circumstances in which KAM, an EOM paragraph and an OM paragraph are included in the same auditor's report, with guidance on the possible placement of the respective elements in such cases (see paragraph A16 and Appendix 3 of ISA 706 (Revised)).

## Agenda Items Presented

Item 6 – Cover Letter and Issues Paper

Item 6A – Proposed AU-C 701, Communicating Key Audit Matters in the Independent Auditor's *Report*, marked to reflect changes from ISA 701

Item 6B – ISA 701 (clean)

Item 6C – *Determining and Communicating Key Audit Matters* diagram (prepared by the IAASB Auditor Reporting Implementation Working Group)

Mr. Montgomery will lead the discussion through this issue paper and agenda item 6A. Agenda items 6B and 6C have been provided for informational purposes only.

## Issue for ASB discussion

### **Issue—Applicability of Proposed AU-C 701 (paragraph .04 of proposed SAS)**

ISA 701 applies—

- to audits of complete sets of general purpose financial statements of listed entities
- to circumstances when the auditor otherwise decides to communicate key audit matters in the auditor's report.
- when the auditor is required by law or regulation to communicate key audit matters in the auditor's report.

The task force discussed the applicability of AU-C 701, given the previous ASB decision that the communication of KAM should be voluntary for nonissuers. The task force discussed and generally agreed that the decision to communicate KAM should be based on discussions with management and those charged with governance and reflected in the terms of the audit engagement. Accordingly, paragraph .04 of the proposed SAS states that the proposed SAS applies when the terms of the engagement include an agreement for the auditor to communicate KAM in the auditor's report.

ISA 701 addresses this point through application material to the requirement in ISA 210 that the terms of the engagement include a reference to the expected form and content of any reports to be issued by the auditor. The application material indicates that, when the auditor is not required

to communicate KAM, it may be helpful for the auditor to make reference in the terms of the audit engagement to the possibility of communicating KAM in the auditor's report.

***Action Requested of the ASB***

1. Does the ASB agree that agreement to communicate KAM in the auditor's report for nonissuers should be reflected in the terms of the audit engagement? What might be the possible consequences of doing so? For example, how would the auditor address the situation where management and those charged with governance initially agreed to the communication of KAM, but expressed concerns about the inclusion of the matters after seeing a draft of the auditor's report?