



Agenda Item 4

Auditor Reporting

Objective

To update the ASB on the auditor reporting project and discuss threshold issues relating to ASB's convergence with the International Auditing and Assurance Standards Board (IAASB) auditor reporting standards while minimizing differences with the Public Company Accounting Oversight Board (PCAOB).

Task Force

The Auditor Reporting Task Force members are:

- Dan Montgomery (Chair)
- Jan Herringer
- Marc Panucci
- Rick Reisig
- Chris Smith
- Mike Westervelt (TIC)
- Susan Jones (observer)

Background

In January 2015, the IAASB issued new and revised International Standards on Auditing (ISAs) relating to reporting on audited financial statements (hereinafter referred to as the new and revised ISAs). In April 2015, the IAASB issued ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information* that contained conforming amendments to certain of the reporting ISAs. The Other Information Task Force is considering revisions to AU-C section 720 *Other Information in Documents Containing Audited Financial Statements* to converge GAAS with ISA 720 (Revised). The following is a list of the significant new and revised ISA standards relating to reporting on a complete set of general purpose financial statements.

- 1) ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*
- 2) ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*
- 3) ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*
- 4) ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*
- 5) ISA 720 (Revised) *The Auditor's Responsibilities Relating to Other Information*

6) ISA 570 (Revised), *Going Concern*

The new and revised standards are effective for audits of financial statements for periods ending on or after December 15, 2016.

The following is a brief summary of the key changes in the auditor reporting requirements under the new and revised ISAs.

For all audits of financial statements:

- a. Requires the “Opinion” section to be presented first, followed by the “Basis for Opinion” section, unless law or regulation prescribe otherwise
- b. Requires the “Basis for Opinion” section of the auditor’s report to include an affirmative statement about the auditor’s independence and fulfillment of other relevant ethical responsibilities, with disclosure of the origin of those requirements
- c. Expands the description of the responsibilities of management including when those responsible for the oversight of the financial reporting process differ from those responsible for the preparation of the financial statements
- d. Expands the description of the responsibilities of the auditor and key features of an audit with the provision that certain components of this description may be presented in an appendix to the auditor’s report or referenced to a website of an appropriate authority when law or regulation or auditing standards of a specific jurisdiction (national auditing standards) expressly permit such reference
- e. Requires a description of the respective responsibilities of management and the auditor related to going concern
- f. Requires, when applicable, a section that addresses the reporting requirements in ISA 720 (Revised)²

For audits of financial statements of listed entities (voluntary for other than listed entities):

- a. Requires key audit matters (KAM) to be communicated for audits of complete sets of general purpose financial statements. When KAM are communicated on a voluntary basis in audits of other than listed entities, ISA 701 should be followed.
- b. In order to allow for KAM in the reporting model, the following ISAs were amended.
 - i. ISA 700 was amended to
 - a. Include application material to discuss KAM and what types of entities might communicate KAM
 - b. Require disclosure of the auditor’s responsibilities in relation to KAM when the auditor is required or otherwise elects to include KAM
 - ii. ISA 706 was amended to
 - a. Prohibit using an EOM paragraph as a substitute for KAM

² To be considered by the Other Information Task Force.

The first stage was to develop an interpretation to address matters that may arise when performing an audit under both GAAS and the new and revised ISAs and the auditor intends to issue one report that refers to both sets of standards. The ASB discussed the draft interpretation at the October 2014 and January 2015 meetings to address how the auditor might report when the audit is conducted in accordance with GAAS and the new and revised reporting ISAs. In March 2015, the interpretation was submitted to the AITF for positive clearance and ASB for negative clearance. The interpretation is currently being finalized by the auditor reporting task force.

The second stage was to evaluate the need to revise AU-C 700 *Forming an Opinion and Reporting on Financial Statements* and other relevant AU-C sections that will consider the final IAASB standards and a final PCAOB standard (when issued). This issue paper includes threshold questions for the ASB to consider to provide the auditor reporting task force with guidance now.

Issues for Discussion with the ASB

Issue 1: Timing of ASB Project

As discussed in the “Prior ASB Discussion” section, the ASB directed the auditor reporting task force to wait until the PCAOB re-exposes its auditor reporting model before considering converging with the IAASB’s new and revised auditor reporting standards. While the auditor reporting task force recognizes the need to wait for the PCAOB auditor reporting model exposure document to be released (in keeping with the ASB’s commitment to converge with the ISAs yet minimize differences with the PCAOB), the task force believes there are threshold questions that the ASB can address now based upon certain assumptions about the PCAOB reporting model. By addressing these questions now, the auditor reporting task force and the ASB will have more time to vet the issues once the PCAOB exposure document is released and provide the ASB with a more timely development of revisions to GAAS.

Matters for ASB Consideration

1. Does the ASB continue to support waiting until the PCAOB reporting model is re-exposed before proposing revisions to the ASB’s auditor reporting standards or does the ASB support moving forward with the project based on the assumption that the PCAOB project is moving closer to the IAASB model and that certain issues can be discussed now to inform development of an exposure draft?

Issue 2: Ordering of the Opinion Section of the Auditor’s Report

ISA 700 (Revised) requires the “Opinion” section to be presented first, followed by the “Basis for Opinion” section, unless law or regulation prescribes a specific layout or

wording of the auditor's report provided that certain minimum elements are included within the auditor's report. The exception to placing the opinion section first also applies to situations in which an auditor's report refers to both national auditing standards and the ISAs, and in certain other situations such as when reporting on summary financial statements. The IAASB mandated the opinion section to be placed first due to the importance of this section to the users and to promote consistency across ISA auditor's reports.

The ASB is asked to provide their views on the following:

1. Assuming the PCAOB aligns with the IAASB and also requires the opinion section to be placed first:
 - a. Should the ASB converge with ISA 700 (Revised) and PCAOB and require the opinion section first?
 - b. Should the ASB remain silent on the ordering to allow for flexibility in the U.S.?
 - c. Should the ASB require a different placement of the opinion section (for example, require the opinion section to be placed at the end of the report)?
2. Would the ASB's views differ if the PCAOB does not align with the IAASB and retains the opinion paragraph at the end of the auditor's report as it is today?

Matters for ASB Consideration

2. The ASB is asked to consider the questions in this section and provide the task force with their views about the placement of the opinion section in the auditor's report?

Issue 3: Expanded Standardized Language in the Auditor's Report

The revisions to ISA 700 (Revised) include expanded description of the responsibilities of the auditor and key features of an audit (together with the provision to permit certain components of this description to be relocated to an appendix to the auditor's report, or for reference to be made to such description on the website of an appropriate authority.)

The ASB is asked to provide their views on the following

1. Assuming the PCAOB does not align with the IAASB's expanded description of the responsibilities of the auditor and key features of an audit, should the ASB converge with the ISAs to expand this description? (See appendix 1 to this issue paper for an example of the IAASB's auditor's report illustrating the expanded description of the auditor's responsibilities.)
2. If so, what are the ASB's views on relocating certain components of the descriptions outside of the body of the report? The following excerpt from ISA 700 (Revised) contains the requirements when an auditor decides to relocate such information:

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Location of the description of the auditor's responsibilities for the audit of the financial statements

40. The description of the auditor's responsibilities for the audit of the financial statements required by paragraphs 38–39 shall be included: (Ref: Paras. A49)
 - (a) Within the body of the auditor's report;
 - (b) Within an appendix to the auditor's report, in which case the auditor's report shall include a reference to the location of the appendix; or (Ref: Para. A49–A50)
 - (c) By a specific reference within the auditor's report to the location of such a description on a website of an appropriate authority, where law, regulation or national auditing standards expressly permit the auditor to do so. (Ref: Para. A49, A51–A52)
41. When the auditor refers to a description of the auditor's responsibilities on a website of an appropriate authority, the auditor shall determine that such description addresses, and is not inconsistent with, the requirements in paragraphs 38–39 of this ISA. (Ref: Para. A51)

Matters for ASB Consideration

3. What are the ASB's views on converging with the IAASB's expanded description of the responsibilities of the auditor and key features of an audit if the PCAOB does not align with such wording?
4. What are the ASB's views on allowing parts of the auditor's responsibilities to be placed in an appendix or on a website?

Issue 4: Communicating Key Audit Matters

ISA 701 addresses communicating key audit matters (KAM) in the auditor's report and is required only for audits of complete sets of general purpose financial statements of listed entities, however other entities are permitted to follow ISA 701 on a voluntary basis.

Assuming that the PCAOB's re-exposure document relating to critical audit matters (CAM) aligns with the IAASB's KAM, the ASB is asked to consider the following:

- 1) Whether the communication of KAM should be required for all or certain nonissuers (for example, public interest entities) or should be permitted on a voluntary basis under GAAS as provided for in ISA 701?
- 2) If permitted on a voluntary basis, whether the communication of KAM should be developed as a standard in the U.S. or is another form of guidance appropriate?

Considerations:

- developing a standard similar to ISA 701 may be a simpler approach because of the various standards that are affected by allowing the communication of KAM and to better align with the ASB's mission to converge with the ISAs
- voluntary reporting may not warrant standard level attention and would be better handled through an interpretation or other guidance.

Matters for ASB Consideration

5. What are the ASB's views about whether communicating key audit matters should be included as a standard in the U.S. that would either require or allow voluntary communication of key audit matters?
6. What are the ASB's views on the alternative to develop an auditing interpretation that would not preclude an auditor from including KAM in accordance with ISA 701?

Appendix 1

Excerpt from “At A Glance: New and Revised Auditor Reporting Standards and Related Conforming Amendments”

Framework Appendix Illustration of an Auditor’s Report on Consolidated Financial Statements of a Listed Entity Prepared in Accordance with a Fair Presentation³

For purposes of this illustrative auditor’s report, the following circumstances are assumed:

- Audit of a complete set of consolidated financial statements of a listed entity using a fair presentation framework. The audit is a group audit of an entity with subsidiaries (i.e., ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*) applies.
- The consolidated financial statements are prepared by management of the entity in accordance with International Financial Reporting Standards (IFRSs) (a general purpose framework).
- The terms of the audit engagement reflect the description of management’s responsibility for the consolidated financial statements in ISA 210, *Agreeing the Terms of Audit Engagements*.
- The auditor has concluded an unmodified (i.e., “clean”) opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit comprise the International Ethics Standards Board for Accountants’ *Code of Ethics for Professional Accountants* together with the ethical requirements relating to the audit in the jurisdiction, and the auditor refers to both.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern in accordance with ISA 570 (Revised).
- Key audit matters have been communicated in accordance with ISA 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and has not identified a material misstatement of the other information.

³ For purposes of this illustration, this auditor’s report has been prepared assuming IFRSs is the applicable financial reporting framework. All references to IFRSs (or requirements under IFRSs) would be tailored to reflect the application of another financial reporting framework.

- Those responsible for oversight of the consolidated financial statements differ from those responsible for the preparation of the consolidated financial statements.
- In addition to the audit of the consolidated financial statements, the auditor has other reporting responsibilities required under local law or regulation.

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Report on the Audit of the Consolidated Financial Statements

Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at December 31, 20X1, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, (or give a true and fair view of) the consolidated financial position of the Group as at December 31, 20X1, and (of) its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

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 Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants (IESBA Code)* together with the ethical requirements that are relevant to our audit of the consolidated financial statements in [jurisdiction], and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

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

[Description of each key audit matter in accordance with ISA 701.]

Other Information [or another title if appropriate such as “Information Other than the Consolidated Financial Statements and Auditor’s Report Thereon”] ⁴

Management⁵ is responsible for the other information. The other information comprises the *[information included in the X report (i.e., a more specific description of the other information, such as “the management report and chairman’s statement,” may be used to identify the other information), but does not include the financial statements and our auditor’s report thereon.]*

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

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

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

In preparing the consolidated financial statements, management is responsible for assessing the Group’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 Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group’s financial reporting process.

Auditor’s Responsibilities for the Audit of the Consolidated Financial Statements ⁶

⁴ See footnote 1 above.

⁵ Throughout this illustrative auditor’s report, the terms management and those charged with governance may need to be replaced by another term that is appropriate in the context of the legal framework in the particular jurisdiction.

⁶ ISA 700 (Revised) explains that the shaded text in the “Auditor’s Responsibilities for the Audit of the Consolidated Financial Statements” section above can be located either: in the body of the auditor’s report; an Appendix to the auditor’s report; or when law, regulation or national auditing standards expressly permit, reference can be made to a website of an appropriate authority that contains a description of the auditor’s responsibilities.

Our objectives are to obtain reasonable assurance about whether the consolidated 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 consolidated financial statements.

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 consolidated 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 relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- 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 events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. 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 Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities prescribed by local law, regulation, or national auditing standards. The matters addressed by other law, regulation or national auditing standards (referred to as "other reporting responsibilities") shall be addressed within this section unless the other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the ISAs as part of the Report on the Audit of the Consolidated Financial Statements section. The reporting of other reporting responsibilities that address the same topics as those required by the ISAs may be combined (i.e., included in the Report on the Audit of the Consolidated Financial Statements section under the appropriate subheadings) provided that the wording in the auditor's report clearly differentiates the other reporting responsibilities from the reporting that is required by the ISAs where such a difference exists.]

The engagement partner on the audit resulting in this independent auditor's report is [name].

[Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate for the particular jurisdiction]

[Auditor Address]

[Date]