

Attn: IFAC

22nd November 2013

**Comment on: Reporting on Audited Financial Statements:
Proposed New and Revised International Standards on Auditing**

Don't allow Audit Report users be Blinded by Boilerplate

The IAASB's 'At a Glance' document¹ makes a good case for its proposed revised International Standards on Auditing until it gets the example Independent Auditor's Report.

It notes the calls for the auditor's report to provide more relevant information to users based on the audit that was performed. Its welcome proposals include:

- Prominent placement of the auditor's opinion
- The auditor reporting on "Key Audit Matters" and the appropriateness of management's use of the going concern basis of accounting
- Disclosure of the name of the engagement partner,

So what is wrong with example audit report? For a clue note its length of about 1,400 words excluding a section of about 400 words which '*can be placed in appendix*'.

A long audit report falls into the trap of allowing the key information to be buried in standing statements on matters such as the basis for doing audits, division of responsibility between management and the auditor.

So let's move more information from the Independent Auditor Report to the appendix.

To illustrate this see attachment 1 which reprints the sample report provided by the IAASB with the sections covering the results of the audit highlighted. Attachment 2 presents these highlighted items plus a reference to the remaining information and where it can be found.

It is to be hoped that the IAASB will require this approach and thus reduce the risk of report users being blinded by boilerplate.

Further, the Independent Auditor's Report must be kept short if it is to become part of future Integrated Reports which are aimed at being 'concise'.

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1

www.ifac.org/sites/default/files/publications/files/Auditor%20Reporting%20At%20a%20Glance%20July%202013-final.pdf

Example report for the IAASB summary with key wording highlighted.

See attachment 2 for a presentation based on this key wording

INDEPENDENT AUDITOR'S REPORT

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

Report on the Audit of the Consolidated Financial Statements¹

Opinion

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 ABC Company and its subsidiaries (the Group) as at December 31, 20X1, and *(of)* their consolidated financial performance and their consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

We have audited the consolidated financial statements of 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.

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 within the meaning of *[indicate relevant ethical requirements or applicable law or regulation]* and have fulfilled our other responsibilities under those ethical requirements. (see Question 11) 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. Key audit matters are selected from the matters communicated with *[those charged with governance]*, but are not intended to represent all matters that were discussed with them. Our audit procedures relating to these matters were designed in the context of our audit of the consolidated financial statements as a whole. Our opinion on the consolidated financial statements is not modified with respect to any of the key audit matters described below, and we do not express an opinion on these individual matters².

Goodwill

Under IFRSs, the Group is required to annually test the amount of goodwill for impairment.

² The four specific topics and content presented below are purely for illustrative purposes. This section would be tailored to the facts and circumstances of the individual audit engagement and the entity. Accordingly, the IAASB has intentionally drafted these examples in a manner that illustrates that Key Audit Matters will vary in terms of the number and selection of topics addressed and the nature in which they may be described, and are intended to be consistent with the disclosures in the entity's consolidated financial statements.

This annual impairment test was significant to our audit because the assessment process is complex and highly judgmental and is based on assumptions that are affected by expected future market or economic conditions, particularly those in [Countries X and Y]. As a result, our audit procedures included, among others, using a valuation expert to assist us in evaluating the assumptions and methodologies used by the Group, in particular those relating to the forecasted revenue growth and profit margins for [name of business lines]. We also focused on the adequacy of the Group's disclosures about those assumptions to which the outcome of the impairment test is most sensitive, that is, those that have the most significant effect on the determination of the recoverable amount of goodwill. The Group's disclosures about goodwill are included in Note 3, which specifically explains that small changes in the key assumptions used could give rise to an impairment of the goodwill balance in the future.

Valuation of Financial Instruments

The Group's disclosures about its structured financial instruments are included in Note 5.

The Group's investments in structured financial instruments represent [x%] of the total amount of its financial instruments. Because the valuation of the Group's structured financial instruments is not based on quoted prices in active markets, there is significant measurement uncertainty involved in this valuation. As a result, the valuation of these instruments was significant to our audit. The Group has determined it is necessary to use an entity-developed model to value these instruments, due to their unique structure and terms. We challenged management's rationale for using an entity-developed model, and discussed this with [those charged with governance], and we concluded the use of such a model was appropriate. Our audit procedures also included, among others, testing management's controls related to the development and calibration of the model and confirming that management had determined it was not necessary to make any adjustments to the output of the model to reflect the assumptions that marketplace participants would use in similar circumstances.

Acquisition of XYZ Business

As described in Note 2, in December 20X1, the Group completed the acquisition of XYZ Business.

XYZ Business was a division of a large private company. As of December 31, 20X1, the Group has completed the initial acquisition accounting on a preliminary basis. The Group will finalize the initial acquisition accounting during 20X2, and the amounts recorded as of December 31, 20X1 could change. We focused on this transaction because it is material to the consolidated financial statements as a whole and the fact that values had not previously been assigned to the division as a standalone operation. In addition, determining the assumptions that underlie the initial acquisition accounting and the useful lives associated with the acquired intangible assets involves significant management judgment given the nature of the [name of industry].

Revenue Recognition Relating to Long-Term Contracts

The terms and conditions of the Group's long-term contracts in its [name of segment] affect the revenue that the Group recognizes in a period, and the revenue from such contracts represents a material amount of the Group's total revenue. The process to measure the amount of revenue to recognize in the [name of industry], including the determination of the appropriate timing of recognition, involves significant management judgment.

We identified revenue recognition of long-term contracts as a significant risk requiring special audit consideration. This is because side agreements may exist that effectively amend the

original contracts, and such side agreements may be inadvertently unrecorded or deliberately concealed and therefore present a risk of material misstatement due to fraud. In addition to testing the controls the Group has put in place over its process to enter into and record longterm contracts and other audit procedures, we considered it necessary to confirm the terms of these contracts directly with customers and testing journal entries made by management related to revenue recognition. Based on the audit procedures performed, we did not find evidence of the existence of side agreements. The Group's disclosures about revenue recognition are included in the summary of significant accounting policies in Note 1, as well as Note 4.

Going Concern

The consolidated financial statements of the Group have been prepared using the going concern basis of accounting. The use of this basis of accounting is appropriate unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so. As part of our audit of the consolidated financial statements, we have concluded that management's use of the going concern basis of accounting in the preparation of the Group's consolidated financial statements is appropriate.

Management has not identified a material uncertainty that may cast significant doubt on the Group's ability to continue as a going concern, and accordingly none is disclosed in the consolidated financial statements of the Group. Based on our audit of the consolidated financial statements of the Group, we also have not identified such a material uncertainty. However, neither management nor the auditor can guarantee the Group's ability to continue as a going concern.

Other Information³

Responsibilities of [Management² and Those Charged with Governance or other appropriate terms] for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with IFRSs,³ 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. *[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

The objectives of our audit 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

³ *[The illustrative wording for this section is subject to the IAASB's finalization of proposed ISA 720 (Revised). The content of this section may include, among other matters: (a) a description of the auditor's responsibilities with respect to other information; (b) identification of the document(s) available at the date of the auditor's report that contain the other information to which the auditor's responsibilities apply; (c) a statement addressing the outcome of the auditor's work on the other information; and (d) a statement that the auditor has not audited or reviewed the other information and, accordingly, does not express an audit opinion or a review conclusion on it.]*

financial statements.

Other information continued⁴

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the planning and performance of 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 entity's internal control.⁴
- ✪✪ Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- ✪✪ 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 and 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 are required to 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 are also required to 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.

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. Depending on the matters addressed by other law, regulation or national auditing standards, national standard setters may choose to combine reporting on these matters with reporting as required by the ISAs (shown in the Report on the Audit of the Consolidated Financial Statements section), with wording in the auditor's report that clearly distinguishes between reporting required by the ISAs and other reporting required by law or regulation.*]

⁴ *The remaining material in this section can be located in an Appendix to the auditor's report (see paragraph 39 of proposed ISA 700 (Revised)). When law, regulation or national auditing standards expressly permits, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report (see paragraph 40 of proposed ISA 700 (Revised)).*

The engagement partner responsible for 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]

Key sections from the example report provided by the IAASB
Parts highlighted in yellow are from the IAASB document in attachment 1

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Key Audit Matters

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Goodwill

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This annual impairment test was significant to our audit because the assessment process is complex and highly judgmental and is based on assumptions that are affected by expected future market or economic conditions, particularly those in [Countries X and Y]. As a result, our audit procedures included, among others, using a valuation expert to assist us in evaluating the assumptions and methodologies used by the Group, in particular those relating to the forecasted revenue growth and profit margins for [name of business lines]. We also focused on the adequacy of the Group's disclosures about those assumptions to which the outcome of the impairment test is most sensitive, that is, those that have the most significant effect on the determination of the recoverable amount of goodwill. The Group's disclosures about goodwill are included in Note 3, which specifically explains that small changes in the key assumptions used could give rise to an impairment of the goodwill balance in the future.

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Going Concern

Management has not identified a material uncertainty that may cast significant doubt on the Group's ability to continue as a going concern, and accordingly none is disclosed in the consolidated financial statements of the Group. Based on our audit of the consolidated financial statements of the Group, we also have not identified such a material uncertainty.

Preparation of the Independent Auditor's Report

Refer to [] for information on the regulations and standards under which this Independent Auditor's Report is given. This includes:

- The scope of our audit work and the basis of our audit opinion.
- The disclosure of key audit matters
- A business being a 'going concern'.
- The responsibilities of Management and those charged with Governance for the Consolidated Financial Statements
- The Auditor's responsibilities for the audit of the Consolidated Financial Statements

The engagement partner responsible for 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]