

The Evolving Role of Auditors and Auditor Reporting

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Good afternoon ladies and gentlemen, it is my pleasure to be with you again. I say 'again' as there are many familiar faces in the audience from the 2012 CReCER Conference in Nicaragua. For me, this in and of itself is a clear signal of the commitment of stakeholders in Latin America to engage in dialogue on international developments.

At last year's conference, I noted a number of important challenges in financial reporting and auditing, and in the surrounding environment. For example, today's financial reporting involves more complexity, more areas of judgment, and more qualitative disclosures; and users have higher expectations than ever before, with many saying "We want to hear more." Perhaps most importantly, the global financial crisis has triggered questions concerning the quality of audits, their effectiveness, and the role of professional judgment and skepticism – which have given way to fundamental questions to the profession about *relevance* and *trust*.

So why change the auditor's report now? What we learned from research is a positive message: the auditor's opinion is valued, *and* users want to hear more from the auditor – more pertinent, and more tailored, information about the specific audit performed on an entity's financial statements. There is symbolic value in the current report, but little communicative value – and users see the potential for the auditor to provide more value and more transparency. So, *now* is the time to lay the foundation for the auditor's report of the future.

The Beginning of a New Era

I am pleased – indeed proud – to announce that in July the IAASB published its Exposure Draft "Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs)." The IAASB has delivered on the promise it made a year ago to have these proposals available by this time, proposals that set forth substantive change to how auditors contemplate and approach communication to users of their reports.

Let me highlight a few key aspects of the proposals.

Firstly, a fairly simple, but important, change: to place the auditor's opinion as the first matter that users read in the auditor's report. Users have said that the auditor's opinion is what they value most – so why hide it at the end of the auditor's report, only after the standardized language about auditor and management responsibilities? Instead, as the single most important outcome from all of the work undertaken in an audit, it should be given the prominence it deserves.

Next, a very crucial proposal that I would like to spend some time on: a proposed new standard, ISA 701, titled "Communicating Key Audit Matters in the Independent Auditor's Report." This new ISA would be required to be applied for audits of financial statements of listed

entities, and also when auditors of financial statements of entities other than listed entities communicate key audit matters in the auditor's report on a voluntary basis or in accordance with law or regulation.

This proposal involves a new section in the auditor's report in which the auditor communicates to outside users – not just to those inside an entity such as the entity's audit committee or directors – those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements. We refer to these matters as "Key Audit Matters."

Today, the auditor considers all of the matters addressed during the audit, and then selects those matters of relevance for purposes of communicating with those charged with governance of an entity in light of their responsibilities. Our proposal is an extension of this activity: that is, for the auditor to determine which of the matters communicated with those charged with governance are Key Audit Matters, and to communicate these in the auditor's report to enhance transparency and the communicative value of the report.

This new communication is intended to focus on areas of significant auditor attention in performing the audit. These are likely areas identified as significant risks, but may include, for example: areas involving significant auditor judgment; areas in which the auditor encountered significant difficulty during the audit, including with respect to obtaining sufficient appropriate audit evidence; or circumstances that required a significant modification to the auditor's planned approach to the audit.

The proposed ISA establishes requirements and provides guidance for how Key Audit Matters are to be determined, and how and what is to be communicated in the auditor's report. In setting these proposed requirements, the IAASB noted stakeholders' views of the importance of the auditor not providing original information about the entity that is the responsibility of the entity's management and those charged with governance.

Bringing Concept to Life

Within the illustrative auditor's report in the Exposure Draft, there are four examples of Key Audit Matters. I emphasize that they are illustrative only; it is up to the individual auditor to determine what is to be reported taking into account the circumstances of the individual engagement. Nevertheless, let's take one of the examples (shown below) and analyze what it communicates.

Illustrative Key Audit Matter: Goodwill

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

To start, the paragraph tells users a bit about what is required for purposes of preparing the financial statements. Essential context, in brief.

From there: it explains that the matter is important from an audit perspective, why, and how it relates to the audit process. In this regard, it draws attention to specific conditions that are particularly relevant to the matter and unique to the audited entity. It also explains that the auditor has focused attention on key assumptions that effect the determination of the recoverable amount of goodwill, and broadly how the auditor has approached obtaining assurance – in this case, by bringing to bear valuation expertise.

Finally: the communication draws attention to the auditor's consideration of the adequacy of disclosures, and highlights a specific aspect of the disclosures that is relevant to helping users fully appreciate the importance of the matter.

So, for users, this is a clear indication that, from an audit perspective, this is significant matter because of the estimation uncertainty inherent in its measurement – and therefore likely significant to users' understanding of the audit and the financial statements. It also signals that it is a matter to which attention should be paid when studying the financial statements and should not be overlooked. Finally, knowing that the auditor's report will draw users' attention to this matter, management and those charged with governance will likely give careful consideration to the quality of the financial statement disclosure.

Further Enhancements to Auditor Reporting

The IAASB is also proposing requirements for auditors to include specific statements about going concern in their reports. In particular: a statement by the auditor regarding the appropriateness of management's use of the going concern basis of accounting in preparing the financial statements; and a statement whether the auditor has identified a material uncertainty that may cast significant doubt on the entity's ability to continue as a going concern. In addition, the IAASB is proposing an explicit statement in the auditor's report on Other Information, based on the auditor's work effort specified by the ISAs.

Users are generally aware that the auditor has some responsibilities to consider these matters as part of their audits, and have called for greater transparency about what those responsibilities are and the outcome of the auditor's work. The proposals therefore simply make explicit in the auditor's report what is now only implicit.

Furthermore, the IAASB proposes that the auditor's report include an explicit statement about the auditor's independence from the audited entity and, for listed entities, to disclose the name of the engagement partner in the auditor's report. It also proposes clarification of respective responsibilities for the financial statements and the audit, while permitting some of the

standardized working describing an audit to be placed in an appendix to the auditor's report or, in appropriate circumstances, to be relocated to the website of an appropriate authority.

The proposed new and revised standards are open for public comment for the next four months, to the end of November 2013. We intend to finalize the standards in 2014, which would then become effective for 2016 audits.

'A Game Changer'

The IAASB's proposals represent a *huge* change in practice, but they are *critical* to the continuing perceived value of the financial statement audit and thus to the relevance of the auditing profession. Earlier today, IFAC President Warren Allen has called the proposals 'A game changer', for which there is now no turning back. I fully agree.

So the question then is: How do we start preparing for the future to help ensure success?

As a start, the IAASB has encouraged audit firms (and public sector equivalents, as applicable) to field test the application of the new standard addressing Key Audit Matters, and thereby gain experience about how it may operate in practice. Through field testing, firms may identify implementation challenges that arise as a result of the proposals. It also provides audit firms the opportunity to learn about practical considerations, including any changes that may be needed to be made to internal policies, procedures and training to support the eventual implementation of the proposed standard effectively.

But investors and other users, preparers, those charged with governance, regulators, and others also need to be involved. They are the beneficiaries of an audit and have a vested interest in high quality reporting. We therefore encourage not only comment letters on the Exposure Draft, but roundtables and other fora for discussions with stakeholders to raise awareness, stimulate debate, and exchange views.

We want to hear from all stakeholders, including those from this important part of the world, in helping inform our deliberations when finalizing these landmark standards.

Thank you for your attention.