

## Exposure Draft, *Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs)*

This summary provides an overview of the IAASB's [Exposure Draft on Auditor Reporting](#).

### Objective:

The Exposure Draft (ED) includes a proposed new ISA and a number of proposed revised ISAs (“the Proposed ISAs”) which aim to improve the auditor’s report on audited financial statements. The IAASB unanimously approved the Proposed ISAs in June 2013 for exposure.

The Proposed ISAs represent the culmination of the IAASB’s deliberations to date on the topic of auditor reporting, which were informed by international research, public consultation (including the responses to the IAASB’s [June 2012 Invitation to Comment: Improving the Auditor’s Report](#)), and stakeholder outreach.

### Comment Date:

The ED is open for public comment through **November 22, 2013**.

### How To Access the ED and Submit Comments:

The ED is available on the IAASB [website](#). Respondents are asked to submit their comments electronically through the website, using the “Submit a Comment” link. Please submit comments in both a PDF and Word file. All comments will be considered a matter of public record and will ultimately be posted on the website.

During the exposure period, the IAASB strongly encourages audit firms (and public sector equivalents, as applicable) to “field test” the application of proposed ISA 701, and thereby gain experience about how it may operate in practice.

### For More Information:

Visit the Auditor Reporting page at [www.iaasb.org/auditor-reporting](http://www.iaasb.org/auditor-reporting).

## The IAASB’s proposed key enhancements to the auditor’s report

The auditor’s opinion on the financial statements is valued; however, in the wake of the global financial crisis, many have called for the auditor’s report to be more informative – in particular, for auditors to provide more relevant information to users based on the audit that was performed.

The Proposed ISAs respond to that call.

### Key enhancements

- Prominent placement of the auditor’s opinion and other entity-specific information in the auditor’s report
- Auditor reporting on “Key Audit Matters”, required for audits of financial statements of listed entities. Key audit matters are those matters that, in the auditor’s judgment, were of most significance in the audit of the current period financial statements.
- Auditor reporting on going concern, including a conclusion on the appropriateness of management’s use of the going concern basis of accounting in preparing the financial statements and a statement as to whether a material uncertainty that may cast significant doubt on the entity’s ability to continue as a going concern has been identified
- Auditor reporting on other information (to be finalized as part of the separate project to revise ISA 720, *The Auditor’s Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements*)

An illustrative auditor’s report for an audit of a listed entity’s consolidated financial statements, showing the result of the IAASB’s proposals, is included as an Appendix.

- An explicit statement that the auditor is independent of the entity and has fulfilled the auditor’s other relevant ethical responsibilities, with disclosure of the source(s) of those requirements
- Disclosure of the name of the engagement partner, required for audits of financial statements of listed entities, with a “harm’s way” exemption
- Improved description of the responsibilities of the auditor and key features of the audit (together with provision for 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)

## What ISAs are changing and what are the expected benefits?

The Proposed ISAs represent a significant change in practice, but enhanced auditor reporting is viewed as critical to the perceived value of the financial statement audit and thus to the continued relevance of the auditing profession.

The primary beneficiaries of the IAASB's work on auditor reporting will be investors, analysts and other users of the auditor's report and the audited financial statements.

### Proposed ISAs in the ED

The proposed ISAs included in the ED are:

- Proposed ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*
- Proposed ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report* (a new standard)
- Proposed ISA 260 (Revised), *Communication with Those Charged with Governance*
- Proposed ISA 570 (Revised), *Going Concern*
- Proposed ISA 705 (Revised), *Modification to the Opinion in the Independent Auditor's Report*
- Proposed ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*
- Proposed Conforming Amendments to Other ISAs

### Expected benefits

Because the auditor's report is the key deliverable addressing the output of the audit process, changes in auditor reporting may have positive benefits to audit quality or users' perception of it. This in turn may increase the confidence that users have in the audit and the financial statements, which is in the public interest.

In addition, the following benefits could be realized as a result of the Proposed ISAs:

- Enhanced communicative value of the auditor's report
- Increased attention by management and those charged with governance to the disclosures in the financial statements to which reference is made in the auditor's report
- Renewed focus of the auditor on matters to be reported, which could indirectly result in an increase in professional skepticism
- Enhanced communications between the auditor and those charged with governance

## Feedback to the IAASB

The ED includes specific questions for respondents on key aspects of the proposals.

Responses to the ED will assist the IAASB in finalizing its proposed standards in 2014.

### Matters on which feedback is sought

Broadly, the IAASB is interested in feedback regarding:

- The appropriateness of the requirements and guidance in proposed ISA 701 addressing the auditor's determination and communication of key audit matters, and the illustrative examples
- The appropriateness of the requirements in proposed ISA 570 (Revised) addressing auditor reporting on going concern and the related wording in the illustrative auditor's reports. The IAASB is particularly interested in views as to whether such reporting, and the potential implications thereof, will be misunderstood or misinterpreted by users in light of the auditor's work effort under the ISAs.
- The overall form and content of the proposed auditor's report, and the implications of other proposals within the ED
- The anticipated benefits and costs arising as a result of the proposals, changes that will be needed to implement them, and any significant foreseeable difficulties

### Stakeholder perspectives

The IAASB particularly welcomes views from:

- Users, regulators and audit oversight bodies in relation to the overall form and content of the auditor's report and the anticipated benefits arising from the IAASB's proposals
- Preparers and audit committees about the implications of the Proposed ISAs on the processes to prepare and present the financial statements, including additional effort or costs that may be expected
- Preparers, small and medium practices (SMPs) and other auditors of small- and medium-sized entities (SMEs) about whether the Proposed ISAs can be implemented in a manner proportionate to the size and complexity of the entity
- Developing nations
- Respondents in relation to potential translation issues

## INDEPENDENT AUDITOR'S REPORT

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

### Report on the Audit of the Consolidated Financial Statements<sup>1</sup>

#### 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 matters.

*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.*

#### *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

<sup>1</sup> The sub-title "Report on the Audit of the Consolidated Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

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 long-term 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 Information

*[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.]*

## Responsibilities of [Management<sup>2</sup> 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,<sup>3</sup> 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 financial statements.

*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)).*

<sup>2</sup> Throughout the illustrative auditor's reports in the Proposed ISAs, the term management may need to be replaced by another term that is appropriate in the context of the legal framework in the particular jurisdiction. For example, those charged with governance, rather than management, may have these responsibilities.

<sup>3</sup> Where management's responsibility is to prepare financial statements that give a true and fair view, this may read: "Management is responsible for the preparation of consolidated financial statements that give a true and fair view in accordance with IFRSs, and for such ..."

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.<sup>4</sup>
- ✦ 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.]*

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*]

<sup>4</sup> This sentence would be modified, as appropriate, in circumstances when the auditor also has responsibility to issue an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements.