IAASB

International Auditing and Assurance Standards Board™

# REPORTING ON AUDITED FINANCIAL STATEMENTS: PROPOSED NEW AND REVISED INTERNATIONAL STANDARDS ON AUDITING (ISAs)

EXPOSURE DRAFT

## REQUEST FOR COMMENTS

This Exposure Draft, *Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs)*, was developed and approved by the International Auditing and Assurance Standards Board (IAASB).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by November 22, 2013**.

Respondents are asked to submit their comments electronically through the IAASB website, using the "Submit a Comment" link. Please note that first-time users must register to use this feature. Please submit comments in both a PDF and Word file. (Upon submission you will receive a confirmation receipt – If you do not receive this receipt, kindly contact Ameerah Brailsford at ameerahbrailsford@iaasb.org). All comments will be considered a matter of public record and will ultimately be posted on the website.

This publication may be downloaded free of charge from the IAASB website: www.iaasb.org. The approved text is published in the English language.

The IAASB develops auditing and assurance standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance.

The objective of the IAASB is to serve the public interest by setting high-quality auditing, assurance, and other related standards and by facilitating the convergence of international and national auditing and assurance standards, thereby enhancing the quality and consistency of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

The structures and processes that support the operations of the IAASB are facilitated by the International Federation of Accountants (IFAC).



COMMENTS

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## INTRODUCTION

1 This memorandum provides background to, and an explanation of, the International Auditing and Assurance Standards Board's (IAASB) auditor reporting proposals. The proposals include a proposed new International Standard on Auditing (ISA) and a number of proposed revised ISAs ("the Proposed ISAs"). The IAASB unanimously approved the Proposed ISAs in June 2013 for exposure.

| The Proposed ISAs, and the key enhancements to auditor reporting, are: | |
|---|---|
| Proposed ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements* | Revisions to establish new required reporting elements, including a requirement for the auditor to include an explicit statement of auditor independence and disclose the source(s) of relevant ethical requirements, and to illustrate these new elements in example auditor's reports |
| Proposed ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report* | New standard to establish requirements and guidance for the auditor's determination and communication of key audit matters. Key audit matters, which are selected from matters communicated with those charged with governance, are required to be communicated in auditor's reports for audits of financial statements of listed entities. Auditors of financial statements of entities other than listed entities may also be required, or may decide, to communicate key audit matters in the auditor's report. |

| The Proposed ISAs, and the key enhancements to auditor reporting, are: | |
|---|---|
| Proposed ISA 260 (Revised), *Communication with Those Charged with Governance* | In light of proposed ISA 701, amendments to the required auditor communications with those charged with governance, for example, to include communication about the significant risks identified by the auditor |
| Proposed ISA 570 (Revised), *Going Concern* | Amendments to establish auditor reporting requirements relating to going concern, and to illustrate this reporting within the auditor's report in different circumstances |
| Proposed ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report* | Amendments to clarify how the new required reporting elements of proposed ISA 700 (Revised) are affected when the auditor expresses a modified opinion, and to update the illustrative auditor's reports accordingly |
| Proposed ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report* | Amendments to clarify the relationship between Emphasis of Matter paragraphs, Other Matter paragraphs and the *Key Audit Matters* section of the auditor's report |
| Proposed Conforming Amendments to Other ISAs | Conforming amendments related to communicating key audit matters |

2 The IAASB continues to pursue auditor reporting on other information. Respondents to the IAASB's previous consultations broadly supported such reporting, and the IAASB is in process of considering comments on the exposure draft of proposed ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information in Documents Containing or Accompanying Audited Financial Statements and the Auditor's Report Thereon*. Pending finalization of proposed ISA 720 (Revised), proposed ISA 700 (Revised) includes a requirement for the auditor to report in accordance with proposed ISA 720 (Revised), and the illustrative auditor's reports therein include a placeholder for a section on *Other Information*. These elements of proposed ISA 700 (Revised) will be finalized when the revision of ISA 720 is completed, such that reporting on other information will come into effect at the same time as the other enhancements addressed by the Proposed ISAs.

## BACKGROUND

3 The auditor's opinion on the financial statements is valued; however, 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.

4 The accompanying Proposed ISAs, which aim to improve the auditor's report on audited financial statements, respond to this call.

5 The Proposed ISAs represent the culmination of IAASB deliberations to date on the topic of auditor reporting, which were informed by international research, public consultation, and stakeholder outreach undertaken by the IAASB. The IAASB's process to date included:

- Jointly commissioned international academic research on user perceptions of the standard auditor's report (the research reports dated May – September 2009 are available on the IAASB **website**)
- **May 2011 Consultation Paper, *Enhancing the Value of Auditor Reporting: Exploring Options for Change***, which incorporated findings from the above-mentioned research and input obtained from the IAASB's dialogue with stakeholders around the world, and explored options in light of this feedback and other national developments
- **June 2012 Invitation to Comment (ITC), *Improving the Auditor's Report***, which sought views on the indicative direction to improve how and what auditors communicate to users through the auditor's report
- Three global roundtables and additional outreach to solicit feedback on the indicative direction outlined in the June 2012 ITC
- Continued monitoring of, and interaction with, policymakers and national standard setters with auditor reporting initiatives.

6 The signals from these inputs were clear: Change is essential. There is support for the direction the IAASB is exploring, and for a global solution. Challenges exist, but they can be overcome. The IAASB is grateful for the active engagement from so many, including investors, preparers, regulators, national standard setters, and the audit profession.

*Expected Benefits from the Proposed ISAs*

7 The primary beneficiaries of the IAASB's work on auditor reporting will be investors, analysts and other users of the auditor's report. An audit enhances the credibility of financial statements and can directly or indirectly improve the quality of financial reporting. Because the auditor's report is the key deliverable addressing the output of the audit process for users of the audited financial statements, the IAASB is of the view that changes in auditor reporting may have positive benefits to audit quality or users' perception of it.[1] This in turn may increase the confidence that users have in the audit and the financial statements, which is in the public interest.

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

8 In addition, the IAASB believes the following benefits, among others, could be realized as a result of the Proposed ISAs:

- Enhanced communicative value of the auditor's report, providing more transparency about the audit that was performed.
- 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 (e.g., key audit matters, going concern, etc.), which may further improve the quality of financial reporting.
- Renewed focus of the auditor on matters to be reported, which could indirectly result in an increase in professional skepticism, among other contributors to audit quality.
- Enhanced communications between the auditor and those charged with governance, for example more robust dialogue about the key audit matters that will be communicated in the auditor's report.

9 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.

[1] As explained in the IAASB's recent consultation document, ***A Framework for Audit Quality***

## MATTERS ON WHICH FEEDBACK IS SOUGHT

10 The IAASB welcomes comments on all matters addressed in this Exposure Draft.

11 The key aspects of change within the Proposed ISAs are explained in the *Significant Proposals* section commencing on page 18. Where applicable, key differences from the suggested improvements included in the June 2012 ITC are noted.

12 This section addresses matters on which the IAASB's debates have focused, and where feedback from respondents is sought. Broadly, the IAASB is interested in feedback regarding:

- The appropriateness of the requirements and related application material in proposed ISA 701 addressing the auditor's determination and communication of key audit matters, and the related 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 of the financial statements in light of the auditor's work effort under the ISAs.
- The implications of other proposals, for example the proposed requirement for the auditor's report to include an explicit statement of auditor independence and the disclosure of the source(s) of relevant ethical requirements, and the proposal to require disclosure of the name of the engagement partner for audits of financial statements of listed entities.
- The overall form and content of the proposed auditor's report.
- 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.

13 Questions for respondents have been included in the *Significant Proposals* section to solicit specific feedback on the Proposed ISAs. For convenience, pages 40–42 list all the questions for respondents. The IAASB welcomes responses, including an articulation of underlying reasoning for respondents' views, even if only some of the listed questions are addressed.

14 When answering the specific questions for respondents and providing overall views on the Proposed ISAs, various stakeholders may find the following considerations to be relevant and may wish to explicitly comment on these areas:

- Users, regulators and audit oversight bodies have expressed a desire for increased transparency about the audit that was performed. The IAASB invites views on the Proposed ISAs in this regard, in particular in relation to the overall form and content of the auditor's report and the anticipated benefits arising as a result of these proposals.
- The processes by which management and those charged with governance prepare and present the financial statements, including related disclosures, may be affected by the proposed changes to auditor reporting. The IAASB is therefore interested in views from these stakeholders about the implications of the Proposed ISAs in this regard, including additional effort or costs that may be expected.
- The IAASB is of the view that the Proposed ISAs can be implemented in a manner proportionate to the size and complexity of an entity. The views of both preparers and auditors of financial statements of entities other than listed entities, including small- and medium-sized entities (SMEs), are welcome in this regard. The IAASB also invites respondents to comment on areas where additional guidance may be helpful to illustrate how the Proposed ISAs can be implemented in a proportionate manner.
- The IAASB is of the view that its proposals are sufficiently flexible to enable them to be implemented along with other relevant national laws or regulations that may exist in certain jurisdictions. The feedback of national standard setters, supreme audit institutions and policymakers in relation to flexibility or perceived implementation challenges would be welcome, especially in those jurisdictions where alternative approaches may have been taken or are being considered as a means of providing additional information to users of the financial statements. Feedback is also desired from users and other stakeholders as to whether the degree of flexibility provided may reduce the comparability of ISA auditor's reports on a global basis.
- Recognizing that many developing nations have adopted or are in the process of adopting the ISAs, the IAASB invites respondents from these nations to comment on the Proposed ISAs, in particular, on any foreseeable difficulties in applying them in their respective national environments.
- Recognizing that many respondents may intend to translate the final ISAs for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents may note in reviewing the Proposed ISAs.

**The IAASB is particularly interested in views on the overall form and content of the auditor's report, the anticipated benefits arising as a result of these proposals, and additional effort or costs that may be expected.**

15 Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, where appropriate, make specific suggestions for any proposed changes to wording.

16 When a respondent agrees with proposals in this Exposure Draft (especially those calling for change in current practice), it will be helpful for the IAASB to be made aware of this view.

**Application of Proposed ISA 701 in Practice**

17 For auditors in most jurisdictions, the Proposed ISAs would result in change from current auditor reporting on complete sets of general purpose financial statements. While the nature and extent of change would depend on the circumstances of individual audits, the communication of key audit matters in accordance with proposed ISA 701 represents a particularly significant change in practice.

18 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.

19 Field testing may be done, for example, by applying proposed ISA 701 on a retrospective basis to a number of recently completed audit engagements for a range of audit engagement circumstances and discussing the results with those charged with governance and others involved in an entity's financial reporting process. Through field testing, audit firms may identify implementation challenges that arise as a result of the proposals and obtain feedback about the effects of the proposals.

20 Field testing 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.

**The IAASB strongly encourages audit firms and public sector equivalents to "field test" the application of proposed ISA 701.**

21 The IAASB invites feedback from the experiences of field testing as part of the comments in response to this Exposure Draft. It is essential that the IAASB be made fully aware of such feedback so that the final ISA 701 is both robust and workable in practice.

22 A staff-prepared document highlighting considerations that may be of assistance to those who plan to undertake field testing will be made available in early August 2013 on the IAASB website.

**Effective Date**

23 In setting the effective date for a new or revised ISA that affects the work effort of the auditor in performing an audit, the IAASB typically provides a period of at least 12–15 months after issuance of the final standard[2] for purposes of translation, national adoption, and implementation (including training and changes to firms' audit methodologies). This implementation period typically ends, and the new or revised ISA comes into effect, at the beginning of the applicable audit cycle – that is, "for audits of financial statements for periods beginning on or after [date]".

[2] Final standards are issued after they are approved by the IAASB and the Public Interest Oversight Board has confirmed that due process has been followed in their development (which typically occurs in the quarter following IAASB approval).

24 While the Proposed ISAs deal mainly with reporting considerations, which typically involve decisions by the auditor towards the end of the audit process, there are aspects of the Proposed ISAs (in particular proposed ISA 701, related revisions to ISA 260 and conforming amendments to ISA 210) that may have implications for auditor actions at or near the beginning of the audit engagement. For example, in applying proposed ISA 701, the IAASB believes that auditors will be considering matters that are likely to be determined as the key audit matters, and how they would be communicated, as they are developing the audit plan.

25 Accordingly, assuming the Proposed ISAs are issued as final standards in the fourth quarter of 2014, a possible effective date for the standards may be for audits of financial statements for periods beginning on or after December 15, 2015 – that is, for December 31, 2016 reporting periods. Should this be the effective date, the enhanced auditor's reports would be available to users in early 2017.

26 It is important, however, that enhancements to auditor reporting come into effect as soon as possible. The IAASB is therefore interested in views on whether, assuming that final standards are issued in the fourth quarter of 2014, an earlier effective date would be feasible, for example, for audits of financial statements for periods ending on or after December 15, 2015 – that is, for December 31, 2015 reporting periods – and whether early adoption should be permitted or encouraged.

**Post-Implementation Review**

27 The IAASB intends to undertake a post-implementation review of the Proposed ISAs after auditors, regulators, national standard setters and users of auditor's reports have had a period of experience with the Proposed ISAs and the new auditor's reports resulting from their application. The objective of the post-implementation review will be to inform the IAASB about whether the Proposed ISAs have achieved their intended effect, and to assist the IAASB in, among other matters:

- Determining whether wider application of the proposals initially limited to audits of financial statements of listed entities would be in the public interest;
- Identifying implementation challenges and possible areas for improvement within the standards;
- Understanding the way in which the requirements in the Proposed ISAs have been adopted and implemented by various jurisdictions in light of their national frameworks; and
- Considering whether further enhancements to auditor reporting are necessary, for example as a result of developments at the national level.

**The IAASB intends to commence a post-implementation review of the Proposed ISAs after two full years of implementation.**

28 The IAASB therefore intends to commence the post-implementation review after two full years of implementation.

## ILLUSTRATIVE AUDITOR'S REPORT

29 The illustrative auditor's report that follows is intended to show the result of the IAASB's proposed changes to the auditor's report for the common scenario of a "clean" (i.e., unmodified) opinion issued on an audit of consolidated financial statements of a listed entity prepared in accordance with International Financial Reporting Standards (IFRSs). No material uncertainty relating to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern has been identified in accordance with proposed ISA 570 (Revised).

30 It also acknowledges that other reporting responsibilities specified by national law or regulation could be included in the auditor's report (for example, reporting on Directors' remuneration), although these other responsibilities are not specified.

31 This report is also included as Illustration 2 in the Appendix of proposed ISA 700 (Revised), which provides more specific details on the context in which such a report would be issued. Reference to where auditor's reports illustrating various circumstances are included in the Proposed ISAs is presented on page 17.

# INDEPENDENT AUDITOR'S REPORT

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

**Report on the Audit of the Consolidated Financial Statements[3]**

## 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 (see Questions 1–8)

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

[3] 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** (see Questions 9–10)

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[4] 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,[5] 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. (see Question 13)

**Auditor's Responsibilities for the Audit of the Consolidated Financial Statements** (see Question 13)

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)).*

[4] 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.

[5] 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.[6]
- 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.* (see Question 13)]

The engagement partner responsible for the audit resulting in this independent auditor's report is [*name*]. (see Question 12)

[*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*]

[6] 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.

*References to Illustrative Auditor's Reports Included in the Proposed ISAs*

*The following table identifies where auditor's reports illustrating various circumstances are included in the Proposed ISAs.*

| CIRCUMSTANCES[7] | LOCATION |
|---|---|
| Unmodified ("clean") opinion for audits of financial statements of a listed entity when no material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern has been identified | Illustrations 1 and 2 in the Appendix of proposed ISA 700 (Revised) |
| Example key audit matters | Illustrations 1 and 2 in the Appendix of proposed ISA 700 (Revised) |
| Illustration of the option to refer to the description of the auditor's responsibilities included on a website of an appropriate authority | Illustration 3 in the Appendix of proposed ISA 700 (Revised) |
| Unmodified opinion when a material uncertainty relating to going concern is identified and disclosure is adequate in the financial statements (i.e., extant Emphasis of Matter paragraph relating to going concern). The material uncertainty related to going concern is a key audit matter, but is presented outside of the *Key Audit Matters* section. | Illustration 1 in the Appendix of proposed ISA 570 (Revised) |
| Qualified and adverse opinions when disclosure of a material uncertainty relating to going concern in the financial statements is inadequate, illustrating how the language in the *Going Concern* and *Key Audit Matters* sections would be adapted, because a material uncertainty related to going concern is a key audit matter, but is presented outside of the *Key Audit Matters* section | Illustrations 2 and 3 in the Appendix of proposed ISA 570 (Revised) |
| Other qualified and adverse opinions, updated for changes as a result of proposed ISA 700 (Revised), illustrating how the introductory language in the *Key Audit Matters* section would be adapted, because the matter for which the opinion is modified is a key audit matter that is not presented in the *Key Audit Matters* section | Illustrations 1-3 in the Appendix of proposed ISA 705 (Revised) |
| Examples of disclaimers of opinions, updated for changes as a result of proposed ISA 700 (Revised) and revised requirements in proposed ISA 705 (Revised) relating to wording to be used in such circumstances | Illustrations 4-5 in the Appendix of proposed ISA 705 (Revised) |
| Illustration of an Emphasis of Matter paragraph for an audit of financial statements of an entity other than a listed entity | Appendix 3 of proposed ISA 706 (Revised) |
| Illustration of the interaction between the *Key Audit Matters* section and an Emphasis of Matter paragraph | Paragraph A16 of proposed ISA 706 (Revised) |

[7] Appendices in ISAs 510, *Initial Audit Engagements—Opening Balances*, 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, and 710, *Comparative Information—Corresponding Figures and Comparative Financial Statements*, include seven illustrative auditor's reports that will need to be conformed to the IAASB's preferred presentation as illustrated in proposed ISAs 700 (Revised) and 705 (Revised). The nature of such conforming amendments relate solely to updating the placement and structure of the content of those illustrative reports and incorporating the new proposed ISA 700 (Revised) elements. No changes are to be made to the requirements of those ISAs or the examples included in the illustrative reports as a result of those requirements. These conforming amendments will be issued at the time the IAASB finalizes the Proposed ISAs.

## SIGNIFICANT PROPOSALS

32 Broadly, the responses to the June 2012 ITC indicated strong global support for the IAASB's objectives in proposing change to auditor reporting. However, varied views were expressed as to how best to effect change.

33 The IAASB believes that its deliberations have resulted in an appropriate path forward in response to the feedback received. This section describes the key enhancements to auditor reporting. Respondents are welcome to raise views on any matter described below or within the Proposed ISAs.

*A High-Level Comparison: The Proposed ISAs vs. the June 2012 ITC Suggested Improvements*

34 The following table highlights the key enhancements to the auditor's report included in the Proposed ISAs, in reference to the suggested improvements that were included in the June 2012 ITC.

Key enhancements that differ from the suggested improvements in the ITC:

- Auditor reporting on "Key Audit Matters" required for audits of financial statements of listed entities. This replaces the concept in the ITC of "Auditor Commentary," which was suggested as required for public interest entities (PIEs).
- 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. This refines the suggested statement of auditor compliance with relevant ethical requirements, including those relating to independence, in the ITC.
- Disclosure of the name of the engagement partner, required for audits of financial statements of listed entities, with a "harm's way exemption". This refines the suggested disclosure of the engagement partner name for audits of financial statements of all entities in the ITC.
- Preferred ordering and placement of the required auditor reporting elements highlighted through the illustrative auditor's reports. Specific ordering is not mandated.

Key enhancements broadly consistent with the suggested improvements in the ITC:

- Prominent placement of the auditor's opinion and other entity-specific information in the auditor's report
- 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)
- Improved description of the responsibilities of the auditor and key features of the audit. Proposed ISA 700 (Revised) now permits certain components of the description of the responsibilities of the auditor and key aspects of the audit to be relocated to an appendix to the auditor's report, or for reference to be made to such description on a website of an appropriate authority.

## Key Audit Matters: Proposed New ISA 701

*Objectives*

35 Broadly, respondents to the ITC supported the suggested concept of "auditor commentary", recognizing the need for the auditor to provide more information to enhance the value of the auditor's report. Many were of the view that enhancements to auditor reporting, such as auditor commentary, would add further value to the pass/fail opinion and help to reinvigorate the public's trust and confidence in the independent auditor and increase the relevance of the audit.

36 However, there were a number of significant concerns in relation to how the concept was described and how the proposed objective was articulated: "*…for the auditor's report to highlight matters that are, in the auditor's judgment, likely to be most important to users' understanding of the audited financial statements or the audit.*"

37 In particular, respondents interpreted the proposed objective as implying that it is the responsibility of the auditor to determine what is most important to users' understanding of the financial statements. Many respondents strongly disagreed with the auditor doing so, as they believed it is explicitly the role of management and those charged with governance, not the auditor, to provide information to assist users in interpreting the financial statements. Concerns also were expressed about the possibility that original information about the entity would be provided by the auditor in the auditor's report – further blurring the respective roles of management, those charged with governance and the auditor.

38 The IAASB agrees that it is important to avoid confusion about the responsibilities of the auditor, management and those charged with governance for disclosing information about the entity but believes that, by providing information about aspects of the audit, the auditor's report can provide information of interest to users.

39 Accordingly, the IAASB proposes the following objectives in new ISA 701:

The objectives of the auditor are to determine key audit matters and, having formed an opinion on the financial statements, communicate those matters by describing them in the auditor's report. (See paragraph 6 of proposed ISA 701.)

Key audit matters are defined as those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance (see paragraph 7 of proposed ISA 701).

40 In formulating the above, the IAASB focused on the interest expressed by users of the financial statements in those matters about which the auditor and those charged with governance had the most robust dialogue – for purposes of understanding areas of significant auditor attention in performing the audit – and the calls for additional transparency about those communications. This approach is largely consistent with the view by ITC respondents that it would be appropriate for the auditor to signal areas of focus in the audit, or "key audit matters," in the auditor's report.

41 The IAASB believes that the proposal for the auditor to communicate key audit matters will not only assist users in understanding those matters that were of most significance in the audit of the financial statements, but may also:

- Assist users of the financial statements in understanding the entity and areas of significant management judgment in the audited financial statements, as such matters are areas of focus in performing the audit.
- Provide users of the financial statements a basis to further engage with management and those charged with governance about certain matters relating to the entity and the audited financial statements.

The interrelationship between users' understanding of the audit and users' understanding of the financial statements is further explained in paragraphs 2–3 and A2–A5 of proposed ISA 701.

*Determining Key Audit Matters*

42 Importantly, respondents to the ITC supported the IAASB's view that the entity-specific matters to be communicated in the auditor's report should be a matter of professional judgment, rather than the IAASB designating certain items as key audit matters that would be required to be communicated in all circumstances. Nevertheless, there are areas relating to matters of significance in the audit that have been consistently mentioned by investors, regulators and others that would be anticipated to be communicated with those charged with governance and about which additional information could be provided in the auditor's report.

43 The IAASB has taken into account this input in developing the requirement in paragraph 8 of proposed ISA 701:

The auditor shall determine which of the matters communicated with those charged with governance are the key audit matters. In making this determination, the auditor shall take into account areas of significant auditor attention in performing the audit, including:

(a) Areas identified as significant risks in accordance with ISA 315 (Revised)[8] or involving significant auditor judgment.

(b) Areas in which the auditor encountered significant difficulty during the audit, including with respect to obtaining sufficient appropriate audit evidence.

(c) Circumstances that required significant modification of the auditor's planned approach to the audit, including as a result of the identification of a significant deficiency in internal control.

[8] ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

44 In developing this proposed requirement, the overarching focus on "areas of significant auditor attention" is intended to assist the auditor in narrowing the matters communicated with those charged with governance to the key audit matters communicated in the auditor's report. To further guide the auditor's professional judgment in determining the key audit matters, the requirement includes factors that the IAASB anticipates would typically constitute such areas of attention, i.e., those that meet the threshold of "most significance" in the audit of the current period financial statements.

45 Further, there was a strong view in response to the ITC that appropriate guidance would be necessary to adequately inform the auditor's decision-making and foster consistency in auditor's reports across similar entities. The IAASB has therefore developed the related application material in paragraphs A1–A24 of proposed ISA 701 with this in mind, and is of the view that the proposed requirement and guidance, taken together, provide a sufficient basis for the auditor's decision-making process.

*Communicating Key Audit Matters*

46 The requirement in paragraph 10 of proposed ISA 701 is intended to be sufficiently principles-based to allow for auditor judgment as to the level of detail to include in the auditor's report about individual key audit matters.

47 The IAASB believes, consistent with the examples included in the ITC, that it will be useful for the description of key audit matters to include a reference to the related disclosure(s), if any, in the financial statements. Doing so enables users to understand both management's and the auditor's perspectives on these matters. However, feedback from responses to the ITC indicated the description of key audit matters cannot merely reiterate what is disclosed in the financial statements or simply point to those disclosures without providing additional context from the auditor.

**In order for the communication of key audit matters to have value to users, it is necessary for the auditor to provide insight about why the matter was determined to be a key audit matter.**

48 Accordingly, the IAASB agreed that, in order for the communication of key audit matters to have value to users, it is necessary for the auditor to explain more about why the auditor considered the matter to be one of most significance in the audit (i.e., to provide insight about why the matter was determined to be a key audit matter).

49 The IAASB had significant debate on whether it would be necessary, or appropriate, in all cases to require auditors to include a discussion of the auditor's procedures or the outcome of such procedures (e.g., findings or a conclusion) in the description of a key audit matter. Respondents to the ITC had raised concerns about the possibility of key audit matters being perceived as separate assurance or "piecemeal opinions," which they viewed as being inconsistent with the fact that the auditor's procedures are designed in the context of the audit of the financial statements as a whole. Challenges are also likely to exist in summarizing the auditor's procedures in complex areas in a clear and succinct manner – auditors have expressed concern that users may incorrectly underestimate the work the auditor had actually performed, and investors have signaled that such information would be likely to become boilerplate over time. On balance, the IAASB believed it was necessary for proposed ISA 701 to allow for flexibility for the auditor to determine whether it may be necessary, in explaining why a matter was determined to be a key audit matter, for the auditor to describe its effect on the audit, rather than mandating a discussion of audit procedures or a conclusion in all cases.

50 Paragraphs A30–A43 of proposed ISA 701 represent detailed application material to support the auditor's professional judgment about the nature and extent of the description of an individual key audit matter, including the sufficiency and appropriateness of the description and whether it is necessary to describe the effect of a key audit matter on the audit. Among other things, this application material addresses:

- Aspects that the auditor might include to enable the description of a key audit matter to be entity-specific, for example to explain factors that may have influenced the auditor's risk assessment or approach to the matter or highlight key communications with those charged with governance.
- How the factors and guidance relating to determining the key audit matters, as well as the underlying audit documentation, may assist the auditor in preparing the description of a key audit matter.
- Challenges in communicating key audit matters, for example in relation to key audit matters that are seen to be more sensitive, including key audit matters relating to fraud risks or significant deficiencies in internal control, or when the auditor may find it necessary to provide additional information about the entity.
- Potential approaches to describing the effect of a key audit matter on the audit, which may include a brief overview of procedures performed, the auditor's approach to the matter or an indication of the outcome of the auditor's procedures.
- How the description of the key audit matter may be influenced by the nature and extent of the entity's disclosures in the financial statements.

**Proposed ISA 701 includes detailed guidance to support the auditor's professional judgment about how key audit matters should be communicated in the auditor's report.**

*Illustrative Examples of Key Audit Matters*

51 Illustrative examples of key audit matters are included in the illustrative auditor's report on pages 13–16. Different approaches have been taken intentionally in developing the illustrations of individual key audit matters. This has been done to show how an auditor's judgments about the nature and extent of the description, and the information to include, in explaining key audit matters may vary depending on the situation.

- The first example is intended to explain how certain entity-specific factors relating to countries and business lines affected the goodwill impairment test. It describes certain audit procedures and areas of focus and the use of a valuation expert, but does not include a conclusion or findings. Reference to particularly important aspects of management's disclosure has been made.
- The second example includes reference to entity-specific information expected to be disclosed in the notes to the financial statements relating to the type of model used in valuing the entity's financial instruments. It references key communications with those charged with governance, and describes certain audit procedures. The example also includes a conclusion in relation to the appropriateness of the use of an entity-developed model.
- The third example is intended to highlight that a significant acquisition was an area of difficulty in the audit, in light of the circumstances explained. No explicit mention of procedures or findings has been included; however, reference is made to the fact that amounts recorded as of the balance sheet date could change in the future, illustrating how the auditor may draw attention to key aspects of management's disclosures.

- The fourth example includes reference to the risk of material misstatement due to fraud with respect to revenue recognition. This is likely to be a sensitive area because the reference to a risk of fraud is not likely to be disclosed in the financial statements. A conclusion has been included in this example to illustrate the outcome of the auditor's specific procedures to respond to this risk (i.e., confirmation of terms of contracts).

52 In order for key audit matters to have the value that users are seeking, the IAASB believes it will be necessary in practice for auditors to describe key audit matters in a manner that is as specific as possible in the context of the current-period audit. In addition, auditors will need to take steps to try to avoid, over time, the descriptions of key audit matters becoming boilerplate.

53 Information about the entity included in key audit matters is likely to highlight or summarize key aspects of the entity's disclosure about the matter. Further, in response to concerns about the auditor providing original information about the entity, proposed ISA 701 suggests that the auditor seek to avoid doing so (as this is the responsibility of the entity's management and those charged with governance) unless, in the auditor's judgment, the additional information that the auditor may provide is critical to the auditor's description of the key audit matter and providing such information is not prohibited by law or regulation.

**QUESTIONS**

1. Do users of the audited financial statements believe that the introduction of a new section in the auditor's report describing the matters the auditor determined to be of most significance in the audit will enhance the usefulness of the auditor's report? If not, why?
2. Do respondents believe the proposed requirements and related application material in proposed ISA 701 provide an appropriate framework to guide the auditor's judgment in determining the key audit matters? If not, why? Do respondents believe the application of proposed ISA 701 will result in reasonably consistent auditor judgments about what matters are determined to be the key audit matters? If not, why?
3. Do respondents believe the proposed requirements and related application material in proposed ISA 701 provide sufficient direction to enable the auditor to appropriately consider what should be included in the descriptions of individual key audit matters to be communicated in the auditor's report? If not, why?
4. Which of the illustrative examples of key audit matters, or features of them, did respondents find most useful or informative, and why? Which examples, or features of them, were seen as less useful or lacking in informational value, and why? Respondents are invited to provide any additional feedback on the usefulness of the individual examples of key audit matters, including areas for improvement.

*Applicability of Proposed ISA 701*

54 It was suggested in the ITC that the concept of "auditor commentary" in the auditor's report could be made applicable to audits of public interest entities (PIEs). While noting the potential benefits of doing so, respondents to the ITC acknowledged the challenges of establishing a globally accepted definition of PIEs, and suggested it would be more appropriate for the IAASB to initially limit its proposals to audits of financial statements of listed entities. Furthermore, the definition of PIEs as currently used in the ISAs was conceived by the International Ethics Standards Board for Accountants (IESBA) for independence purposes and not for differentiating auditor reporting requirements. The IAASB agrees, and believes the planned post-implementation review could inform the IAASB whether broader applicability of proposed ISA 701 to entities other than listed entities, including application to non-listed SMEs, might be appropriate in the future.

55 Nevertheless, the IAASB recognizes that law, regulation or national auditing standards may require auditors of entities other than listed entities (e.g., PIEs, public sector entities, or all entities) in a particular jurisdiction to communicate key audit matters. It was also acknowledged by respondents to the ITC that auditors of financial statements of entities other than listed entities may wish to use the new mechanism of key audit matters on a voluntary basis. The IAASB therefore believes it is important, if key audit matters are communicated for audits of financial statements of entities other than listed entities (either voluntarily or when required by law or regulation), that such matters should be determined and communicated in the same manner as for listed entities (see paragraph 4 of proposed ISA 701 and paragraphs 30 and A30–A31 of proposed ISA 700 (Revised)).

56 In light of the possibility of auditors of other than listed entities communicating key audit matters in the auditor's report, or being requested by management or those charged with governance to do so, the IAASB has proposed limited amendments to ISA 210, *Agreeing the Terms of Audit Engagements*. Specifically, if the auditor of the financial statements of an entity other than a listed entity is not required to communicate key audit matters but intends to do so, a new requirement has been established for the auditor to include a statement in the audit engagement letter regarding such intent. This is both a relevant practical consideration and one important to the principle that the form and content of the auditor's report is the sole responsibility of the auditor. In addition, application material clarifies that in certain jurisdictions it may be necessary for the auditor to include a reference to the possibility of communicating key audit matters in the terms of the audit engagement in order to retain the ability to do so (e.g., due to legal or regulatory requirements, including those relating to confidentiality).

57 Revisions are also proposed to the Appendix in ISA 210 that contains an example of an audit engagement letter to further align with changes to the description of the auditor's responsibilities in proposed ISA 700 (Revised) (see page 192).

**QUESTION**

**5.** Do respondents agree with the approach the IAASB has taken in relation to key audit matters for entities for which the auditor is not required to provide such communication – that is, key audit matters may be communicated on a voluntary basis but, if so, proposed ISA 701 must be followed and the auditor must signal this intent in the audit engagement letter? If not, why? Are there other practical considerations that may affect the auditor's ability to decide to communicate key audit matters when not otherwise required to do so that should be acknowledged by the IAASB in the proposed standards?

*Application of Proposed ISA 701 in Particular Circumstances*

58 The Proposed ISAs also address other circumstances that are relevant to the application of proposed ISA 701, including:

- *When the auditor expresses a qualified or adverse opinion in accordance with proposed ISA 705 (Revised)*. The IAASB determined that matters giving rise to a modification of the auditor's opinion are, by their nature, key audit matters, but are to be reported separately in the *Basis for Qualified (or Adverse) Opinion* section of the auditor's report. The IAASB agreed that a discussion of any other key audit matters would still be relevant to enhancing users' understanding of the audit and therefore the auditor should be required to communicate key audit matters. See paragraphs 11 and A44 of proposed ISA 701 and the illustrative examples in the Appendix of proposed ISA 705 (Revised), which address the presentation of the key audit matters in such circumstances.

- *When the auditor disclaims an opinion in accordance with proposed ISA 705 (Revised)*. Proposed ISA 705 (Revised) expressly prohibits the auditor from communicating key audit matters in such cases. The IAASB is of the view that any discussion of key audit matters other than the matter(s) giving rise to the disclaimer of opinion may suggest the financial statements are more credible in relation to those matters than would be appropriate in the circumstances, and would be inconsistent with the disclaimer of an opinion on the financial statements as a whole (see paragraphs 29 and A28 of proposed ISA 705 (Revised)).
- *When law or regulation requires the auditor to provide information similar to key audit matters or requires those charged with governance to issue a report that includes similar information*. Proposed ISA 700 (Revised) addresses such circumstances and provides guidance on how the *Key Audit Matters* section may need to be adapted (see paragraph 46(g) and A53–A54 of proposed ISA 700 (Revised)). The IAASB believes this will accommodate different national approaches to the communication of this information, for example, the approach required by the UK Financial Reporting Council (FRC) where reports of Audit Committees of listed entities will contain a description of the main issues discussed with their auditors. The IAASB will continue to monitor with interest the forthcoming proposals from the US Public Company Accounting Oversight Board (PCAOB) and the European Commission (EC) regulatory proposals affecting the auditor's report to further consider whether more is needed within the proposed ISAs to acknowledge diverse jurisdictional approaches.

**The IAASB believes the proposed ISAs will accommodate different national approaches to the communication of information similar to key audit matters.**

*Auditor Determination that There Are No Key Audit Matters*

59 Because key audit matters are matters "of most significance" in the audit of the financial statements of the current period, and therefore a relative concept, there are likely to always be one or more matters of "most significance" in an audit.

60 Nevertheless, the IAASB accepts it is conceivable that there may be certain limited circumstances (e.g., a listed entity that has very limited operations or assets) in which, in the auditor's professional judgment, there are no key audit matters to communicate in the auditor's report.

61 If the auditor concludes that there are no key audit matters to communicate, proposed ISA 701 requires the auditor to discuss this conclusion with the engagement quality control reviewer, where one has been appointed, and communicate this conclusion with those charged with governance. The IAASB believes these actions may provide an opportunity for those most familiar with the significant matters arising during the audit to provide input that may cause the auditor to re-evaluate the determination that there are no key audit matters. Such a conclusion also would be required to be documented (see paragraph 14 of proposed ISA 701).

62 Further, proposed ISA 701 would require a statement in the auditor's report that there are no key audit matters to report (see paragraphs 13 and A47–A48 of proposed ISA 701). This requirement is consistent with feedback from some respondents to the ITC that there is a need to signal that the auditor was required to make this determination in accordance with proposed ISA 701. The IAASB recognizes, however, that such a statement may be confusing to users, as some may believe it is inconsistent with the relative concept of "matters of most significance."

QUESTION

**6.** Do respondents believe it is appropriate for proposed ISA 701 to allow for the possibility that the auditor may determine that there are no key audit matters to communicate?

(a) If so, do respondents agree with the proposed requirements addressing such circumstances?

(b) If not, do respondents believe that auditors would be required to always communicate at least one key audit matter, or are there other actions that could be taken to ensure users of the financial statements are aware of the auditor's responsibilities under proposed ISA 701 and the determination, in the auditor's professional judgment, that there are no key audit matters to communicate?

*The Determination of Key Audit Matters When Comparative Financial Information Is Presented*

63 Key audit matters are defined as those matters of most significance in the audit of the financial statements of the current period. Users are interested in the most recent information possible to make informed decisions, and therefore are more likely to value information from the auditor about the audit of the current period. Nevertheless, the IAASB acknowledges it may be useful for the auditor to consider whether a matter that was a key audit matter in the audit of the financial statements of the prior period continues to be a key audit matter (see paragraphs A8–A9 of proposed ISA 701).

64 The IAASB further believes that the determination of key audit matters should be limited to those matters of most significance in the audit of the financial statements of the current period, even when comparative financial statements are presented (i.e., even when the auditor's opinion refers to each period for which financial statements are presented in accordance with ISA 710).[9]

65 The IAASB noted the view that there may be merit in including the auditor's description of key audit matters for all periods presented. However, there are likely practical challenges in doing so that could result in further lengthening the auditor's report and a presentation that could be potentially confusing to users, such as:

- The possible expectation that the auditor would update key audit matters from the prior period, for example to explain the matter's effect in the current period audit – even if such matter was not determined to be a key audit matter in the current period.
- Whether the inclusion of a key audit matter in a subsequent period relating to a matter that existed in a prior period could call into question the validity of the auditor's judgment to exclude it as a key audit matter in the prior period.
- The potential consequences when the prior-period financial statements were audited by a predecessor auditor, because the determination of key audit matters in the prior period would have been made by another auditor.

[9] In the case of corresponding figures, the auditor's opinion generally refers only to the financial statements of the current period. In the case of comparative financial statements, the auditor is required to report on both the current period financial statements and the prior period financial statements in connection with the current year's audit.

**QUESTION**

7. Do respondents agree that, when comparative financial information is presented, the auditor's communication of key audit matters should be limited to the audit of the most recent financial period in light of the practical challenges explained in paragraph 65? If not, how do respondents suggest these issues could be effectively addressed?

*Audit Documentation*

66 Paragraph 14 of proposed ISA 701 includes a requirement for the auditor to document the matters that will be communicated as key audit matters, and the significant professional judgments made in reaching this determination, in accordance with ISA 230, *Audit Documentation*. Proposed ISA 701 explains that both the written communications with those charged with governance and other audit documentation may assist the auditor in developing a description of key audit matters that explains the significance of the matter (see paragraph A32 of proposed ISA 701).

67 The proposed ISA also notes that the documentation of significant professional judgments made in determining the key audit matters draws upon this documentation and may also provide an indication that other matters communicated with those charged with governance are not key audit matters (see paragraph A49 of proposed ISA 701). However, the intent of the proposed documentation requirement is not to require the auditor's documentation to explain why each of the other matters communicated with those charged with governance was not determined to be a key audit matter.

68 The documentation required by proposed ISA 701 also includes, where applicable, the rationale for the auditor's determination that there are no key audit matters to communicate in the auditor's report. The IAASB has also included proposed application material to assist the auditor's consideration of documentation of professional judgments, and proposed amendments to the application material in ISA 230 to support the documentation requirement in proposed ISA 701 (see changes to paragraph A10 of ISA 230).

## Relationship between Key Audit Matters and Communications with Those Charged with Governance: Revisions to ISA 260 as a Result of Proposed ISA 701

69 Key audit matters are selected from matters communicated with those charged with governance. Accordingly, the IAASB determined that limited amendments to the required auditor communications with those charged with governance were necessary in light of proposed ISA 701.

70 The most significant proposed change to ISA 260 relates to the existing requirement for the auditor to communicate with those charged with governance an overview of the planned scope and timing of the audit. The IAASB proposes to expand this requirement to include communicating about the significant risks identified by the auditor (see paragraph 15 of proposed ISA 260 (Revised)).

**The IAASB is proposing to require that auditors of all entities communicate with those charged with governance about the significant risks the auditor has identified.**

71 In many audits, communication with those charged with governance about significant risks is likely already occurring, because an audit conducted in accordance with ISAs is risk-based and therefore significant risks are fundamental to the scope of the audit. Nevertheless, the IAASB is of the view that requiring such communication could enhance audit quality. In this regard, the IAASB believes the proposed requirement would further support effective two-way communication by providing those charged with governance insight into those areas for which the auditor determined special audit consideration was necessary, and thereby assist those charged with governance in fulfilling their responsibility to oversee the financial reporting process.

72 The IAASB believes it is in the public interest to establish this requirement for audits of financial statements of all entities, not only for listed entities. It is not expected to result in a significant burden on auditors who are not required to communicate key audit matters in the auditor's report (e.g., auditors of entities other than listed entities), as proposed ISA 260 (Revised) remains flexible for such communication to be made orally.

73 In addition, the IAASB proposes to require the auditor to communicate, as part of communicating the significant findings from the audit, circumstances that required significant modification of the auditor's planned approach to the audit, to align with the factors the auditor considers in determining key audit matters (see paragraph 16(c) of proposed ISA 260 (Revised)).

*The following table illustrates the interaction between proposed ISA 260 (Revised) and proposed ISA 701, specifically in relation to the matters required to be communicated with those charged with governance and the factors the auditor is required to take into account in determining the key audit matters.*

| Proposed ISA 701 | Reference to the Basis in Proposed ISA 260 (Revised) and Other ISAs that Require Specific Communications with Those Charged with Governance |
|---|---|
| In determining which of the matters communicated to those charged with governance are the key audit matters, proposed ISA 701 requires the auditor to take into account areas of significant auditor attention in performing the audit, including: | |
| Areas identified as significant risks in accordance with ISA 315 (Revised) | Paragraph 15 of proposed ISA 260 (Revised), and also likely discussed as part of significant findings from the audit required by paragraph 16 of proposed ISA 260 (Revised) |
| Areas involving significant auditor judgment | Relates primarily to paragraph 16(a) of proposed ISA 260 (Revised), but also to any other matters communicated with those charged with governance that are relevant to their oversight responsibilities. See also Appendices 1 and 2 of proposed ISA 260 (Revised). |
| Areas in which the auditor encountered significant difficulty during the audit, including with respect to obtaining sufficient appropriate audit evidence | Paragraph 16(b) of proposed ISA 260 (Revised) |
| Circumstances that required significant modification of the auditor's planned approach to the audit, including as a result of the identification of a significant deficiency in internal control | Paragraph 16(c) of proposed ISA 260 (Revised) and paragraph 9 of ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management* |

## Relationship between Key Audit Matters and Emphasis of Matter Paragraphs and Other Matter Paragraphs: Revisions to ISA 706 as a Result of Proposed ISA 701

74 Respondents to the ITC were of the view, broadly, that the mechanism of an Emphasis of Matter paragraph should be retained even when "auditor commentary" would be required, in order to alert users to matters that would not otherwise be considered key audit matters in the event the auditor judges it necessary to do so. Further, the IAASB believes it is necessary to retain this mechanism for audits of financial statements of entities for which the auditor is not required to communicate key audit matters. Similar considerations apply to Other Matter paragraphs.

75 After considering and defining key audit matters, the IAASB specifically evaluated how Emphasis of Matter paragraphs and Other Matter paragraphs could best be retained in light of the requirement to communicate key audit matters for audits of financial statements of listed entities, and how the interaction of such communications should be articulated within the Proposed ISAs.

**Emphasis of Matter and Other Matter paragraphs will be retained. Proposed ISA 706 (Revised) clarifies the relationship between these paragraphs and key audit matters.**

76 The IAASB is not proposing any change to the underlying concepts in extant ISA 706, including the definition of Emphasis of Matter paragraphs and Other Matter paragraphs.

77 The IAASB is proposing, however, certain clarifications in proposed ISA 706 (Revised) to:

- Explain the relationship between proposed ISA 701 and proposed ISA 706 (Revised) (see paragraph 2 of proposed ISA 706 (Revised)).
- Clarify that auditors should not use Emphasis of Matter paragraphs or Other Matter paragraphs for matters determined to be key audit matters in accordance with proposed ISA 701 when applicable (see paragraphs 8(b), 10(b) and A1–A2 of proposed ISA 706 (Revised)).
- Facilitate users' understanding of the difference between Emphasis of Matter paragraphs and Key Audit Matters, when key audit matters are communicated in the auditor's report and the auditor judges it necessary to also include an Emphasis of Matter paragraph about another matter not determined to be a key audit matter, by:
  - Requiring a statement in the Emphasis of Matter paragraph in the auditor's report that explains that the matter being emphasized is separate from the key audit matters (see paragraph 9(b) of proposed ISA 706 (Revised)); and
  - Encouraging the use of the heading "Emphasis of Matter in the Financial Statements" (see paragraph 9(a) of proposed ISA 706 (Revised)).
- Provide further guidance on the placement of the *Key Audit Matters* section and any Emphasis of Matter paragraphs (see paragraphs A15–A16 of proposed ISA 706 (Revised)).

78 The IAASB understands that the most common use of Emphasis of Matter paragraphs currently is to highlight material uncertainties relating to going concern, which will now be replaced by a similar paragraph as part of a separate *Going Concern* section (see paragraph 87 below), and that use of Emphasis of Matter paragraphs for other matters is infrequent. When a *Key Audit Matters* section is included in the auditor's report, the IAASB believes Emphasis of Matter paragraphs will be rare, except when otherwise required by other ISAs or by law or regulation. Feedback from national standard setters supported this view.

79 In relation to Other Matter paragraphs, the IAASB does not believe certain matters related to the planning and scoping of the audit (such as a description of the materiality applied to the engagement) would meet the definition of a key audit matter. In light of feedback from respondents to the ITC, the IAASB does not consider it appropriate to establish a requirement for the auditor to disclose such matters in the auditor's report. Nevertheless, the auditor may judge it appropriate, or be required by law or regulation, to do so in an Other Matter paragraph.[10]

**QUESTION**

**8.** Do respondents agree with the IAASB's decision to retain the concepts of Emphasis of Matter paragraphs and Other Matter paragraphs, even when the auditor is required to communicate key audit matters, and how such concepts have been differentiated in the Proposed ISAs? If not, why?

### Going Concern

80 The IAASB continues to be of the view that auditor reporting related to going concern would be appropriate and in the public interest. Accordingly, proposed ISA 570 (Revised) includes the following requirement:

If the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances and no material uncertainty [related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern (hereinafter referred to as "material uncertainty")] has been identified, the *Going Concern* section of the auditor's report shall include:

(a) An explanation of the going concern basis of accounting in the context of the applicable financial reporting framework;

(b) A statement that, as part of the audit of the financial statements, the auditor has concluded that management's use of the going concern basis of accounting in the preparation of the entity's financial statements is appropriate;

(c) A statement that, based on the audit of the financial statements, the auditor has not identified a material uncertainty that may cast significant doubt on the entity's ability to continue as a going concern; and

(d) A statement that neither management nor the auditor can guarantee the entity's ability to continue as a going concern.

*These statements and how they are presented in the auditor's report would change if a material uncertainty was identified, including circumstances in which such an uncertainty was not adequately disclosed in the audited financial statements. See the illustrative reports in the Appendix of proposed ISA 570 (Revised).*

[10] Proposed ISA 706 (Revised) explains that law or regulation may require the auditor to communicate about planning and scoping matters in the auditor's report, or the auditor may consider it necessary to communicate about such matters in an Other Matter paragraph (see paragraph A8 of proposed ISA 706 (Revised)).

81 Respondents to the ITC recognized the heightened attention on going concern, particularly in light of the global financial crisis and the EC proposals on audit reform. However, there were mixed views as to whether the proposed statements on going concern that were illustrated in the ITC would have sufficient value to users or be appropriate in light of the auditor's work effort under extant ISA 570. Many also acknowledged and emphasized the need for, or importance of, a more holistic approach to addressing going concern in financial reporting. There was also a concern that auditor statements on going concern could serve to widen the expectations gap if users did not understand that such statements were not a guarantee as to the entity's future viability, or if the meaning of the term "material uncertainty" and the requirements for disclosure of such uncertainties were not clearly defined across different financial reporting frameworks.

82 An important part of the IAASB's work to date has therefore been active liaison with the accounting standard setters. There are some underlying accounting issues, including a lack of consistent understanding of certain concepts, for which clarification or additional guidance from the accounting standard setters may be necessary such that the IAASB's proposed statements about going concern in the auditor's report are not misunderstood or misinterpreted by users of the financial statements. Both the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) have active projects addressing going concern; however, the scheduled timelines to finalize and implement the revised accounting standards are still unclear. The IAASB intends to continue to liaise with these Boards, in part to ensure they are aware of the need to move forward on a timely basis to respond to stakeholders' concerns relating to the adequacy and timeliness of management's disclosures about going concern, and the related effect on the work effort and reporting by independent auditors.

**The IAASB will need to carefully consider the status and planned actions of the accounting standard setters when finalizing its auditor reporting proposals.**

83 Notwithstanding these developments, there remains a possibility that the requirements of IFRSs and US Generally Accepted Accounting Principles (GAAP) ultimately may differ as to the definition of a material uncertainty or the threshold for such disclosures. This would potentially affect when disclosure in the notes to the financial statements of a material uncertainty would be required, as different accounting frameworks may take different approaches. As a result, as the accounting standards continue to develop, there may be a need for the IAASB to revisit the underlying concepts in proposed ISA 570 (Revised) and consider whether and, if so, when further amendment may be needed to the requirements addressing the auditor's work effort to ensure they are appropriate in light of the different financial reporting frameworks.

84 As noted above, the IAASB has been encouraged to work together with the accounting standard setters as part of a holistic approach to reporting on going concern. The IAASB acknowledges that it will therefore need to carefully consider the status and planned actions of the accounting standard setters when finalizing its auditor reporting proposals to determine the best course of action, which may involve deferring finalization of auditor reporting related to going concern. At this stage, however, in recognition of the importance that certain stakeholders place on having explicit auditor statements about going concern in the auditor's report, the IAASB believes it is appropriate to solicit feedback on the potential changes to ISA 570 that would be necessary to underpin the IAASB's proposed statements relating to going concern in the auditor's report.

85 Within the context of the broader developments previously described, the IAASB has developed the auditor reporting proposals using extant ISA 570 as the base, which itself was drafted in light of requirements included in extant IAS 1.[11] This approach involved making minimal amendments to ISA 570, limited to those necessary to underpin auditor reporting on going concern, with the possibility of additional changes to proposed ISA 570 (Revised) once future amendments to the underlying accounting standards are known.

86 In considering the nature and extent of changes to proposed ISA 570 (Revised), the IAASB acknowledged that there are a number of areas for potential improvement, but in view of the likely future accounting developments explained in paragraphs 82–84, has sought to limit the changes to the proposed new reporting requirements and replace the term "going concern assumption" with the concept of "going concern basis of accounting" included in IFRSs.

87 The IAASB recognizes that the identification of a material uncertainty relating to going concern would, by its nature, be a key audit matter. However, it is of the view that information relating to the identification of a material uncertainty relating to going concern should be presented as part of the *Going Concern* section of the auditor's report to give it appropriate emphasis (see the illustrative reports included in the Appendix of proposed ISA 570 (Revised)). Accordingly, the identification of a material uncertainty relating to going concern will no longer be a required Emphasis of Matter paragraph (see paragraph 22 of proposed ISA 570 (Revised)).

88 Proposed ISA 570 (Revised) also includes a new Appendix to provide illustrative auditor's reports that include circumstances in which issues relating to going concern are present and how the required statements and their presentation in the auditor's report are to be modified. Of note, when a material uncertainty has been identified:

- A subheading "Disclosures about a Material Uncertainty Identified" or other appropriate subheading would be required to alert users to these circumstances, and the IAASB believes it would be preferable for the statement about the material uncertainty to be presented before the statement about the appropriateness of the use of the going concern basis of accounting in the *Going Concern* section.
- When the auditor's opinion is modified because a material uncertainty has not been adequately disclosed, the auditor would be required to discuss this in the *Basis for Qualified (or Adverse) Opinion* section and include a cross-reference to that section in the *Going Concern* section rather than including the required statement about the material uncertainty.
- The statement that neither management nor the auditor can guarantee the entity's ability to continue as a going concern is not required in the auditor's report in this situation, although the auditor would not be precluded from including this statement. The IAASB had mixed views on whether such a statement would be helpful in light of the fact that reference was made to material uncertainties that had been identified.

[11] International Accounting Standard (IAS) 1, *Presentation of Financial Statements*

## QUESTIONS

**9.** Do respondents agree with the statements included in the illustrative auditor's reports relating to:

(a) The appropriateness of management's use of the going concern basis of accounting in the preparation of the entity's financial statements?

(b) Whether the auditor has identified a material uncertainty that may cast significant doubt on the entity's ability to concern, including when such an uncertainty has been identified (see the Appendix of proposed ISA 570 (Revised)?

In this regard, the IAASB is particularly interested in views as to whether such reporting, and the potential implications thereof, will be misunderstood or misinterpreted by users of the financial statements.

**10.** What are respondents' views as to whether an explicit statement that neither management nor the auditor can guarantee the entity's ability to continue as a going concern should be required in the auditor's report whether or not a material uncertainty has been identified?

### Compliance with Independence and Other Relevant Ethical Requirements

89 In light of the importance of compliance with ethical requirements as a basis for the audit and the increased focus on auditor independence, it was suggested in the ITC that the auditor include an explicit statement of compliance with relevant ethical requirements in the auditor's report. While broadly supporting this suggested enhancement, respondents and others believed further clarification was needed in relation to the meaning and scope of such a statement.

90 Given this input, the IAASB reconsidered the wording of this statement and proposes that it be changed to a statement in the auditor's report that the auditor is independent of the entity within the meaning of the relevant ethical requirements or applicable law or regulation and has fulfilled the auditor's other ethical responsibilities under those requirements (see paragraph 28(c) and related application material in proposed ISA 700 (Revised) and the *Basis for Opinion* section in the illustrative auditor's report).

91 As part of this statement, the auditor would also be required to disclose the source(s) of the specific independence and other relevant ethical requirements or applicable law or regulation. Paragraph 28(c) of proposed ISA 700 (Revised) acknowledges that the sources of such requirements may not be the same, in which case all relevant sources would be required to be named. Doing so provides additional transparency about the basis on which the audit has been conducted, in a manner similar to disclosing that the audit was conducted in accordance with ISAs or that the financial statements were prepared in accordance with IFRSs.

92 The IAASB acknowledged, however, that such disclosure may have practical implications. For example, the list could become extensive and thereby lack value to users of the auditor's report, or considerations could exist in group audit situations that would make identifying all sources unduly complex or create confusion or misunderstanding among users.

93 The IESBA has expressed support for the proposals in paragraphs 90–91 in light of the underlying requirements of the IESBA *Code of Ethics for Professional Accountants* (the IESBA Code). The IAASB intends to continue to consult with the IESBA in light of responses received to this Exposure Draft.

94 The IAASB encourages national standard setters and audit firms to provide feedback on what such a disclosure would comprise in their national environments and in the context of complex group audit situations, respectively. For example, it would be helpful for the IAASB to understand whether such a disclosure might make reference to both the IESBA Code and other national requirements.

**QUESTION**

**11.** What are respondents' views as to the benefits and practical implications of the proposed requirement to disclose the source(s) of independence and other relevant ethical requirements in the auditor's report?

*Public Reporting of Breaches of Independence*

95 The IESBA project addressing a breach of a requirement of the IESBA Code was noted in the ITC. At the time, the IAASB believed it would be premature to consider putting forth proposals relating to the disclosure of breaches of relevant ethical requirements in the auditor's report until such time as the outcome of this IESBA project work was known and the value and impediments of doing so have been fully considered. The IESBA has now finalized and released the changes to the IESBA Code arising from its project. These changes, which will be effective in 2014, do not require public disclosure of breaches of independence requirements by the auditor.

96 While the IAASB acknowledged that some users, including some regulators, may wish to know more about breaches of independence requirements, the IAASB took the same view as the IESBA regarding public disclosure of breaches and agreed not to require such disclosure in the auditor's report. The IAASB believes that the impediments of doing so likely would outweigh the value, in particular because:

- Reporting of all breaches would be impracticable, especially in the context of a large, global audit, as the IESBA Code does not establish thresholds for what may constitute either a minor or a significant breach of independence requirements and minor inadvertent breaches of independence requirements may have occurred that have been appropriately addressed.
- Despite the perceived value of increased transparency about breaches, investors may draw incorrect conclusions about the auditor's ability to issue an auditor's report if all breaches were required to be communicated publicly, even when those charged with governance and the auditor had agreed that any breaches had been appropriately addressed.

97 The IAASB believes that the proposed statement that the auditor is independent of the entity within the meaning of the relevant ethical requirements is therefore a more appropriate way of addressing transparency about independence, as the auditor's ability to make such a statement takes into account the interactions between the auditor and those charged with governance if breaches have been identified. The IAASB acknowledged that:

- Regulators or national standard setters in some jurisdictions require the auditor to publicly disclose breaches of independence requirements, which is likely more appropriate at the national level as such a requirement takes into account the specific local circumstances and reporting environment.
- There is an opportunity within the Proposed ISAs and the illustrative auditor's report to further reinforce the importance of communications with those charged with governance about independence.

**Disclosure of the Name of the Engagement Partner**

98 Feedback received in response to the ITC indicated divergent views about the appropriateness of mandating disclosure of the name of the engagement partner in the auditor's report for audits of financial statements of all entities. There was generally more support from those jurisdictions where disclosure of the name of the engagement partner is already required by law or regulation, and less from those jurisdictions where it is not, especially when such a disclosure was thought to expose the named individual to possible litigation.

99 Investors and analysts, regulators and oversight authorities, and others who supported disclosure of the engagement partner's name in the auditor's report were of the view that doing so:

- Improves transparency for users of the auditor's report; and
- Is believed to provide the engagement partner with a greater sense of personal responsibility and accountability, which they believe translates to improved audit quality.

**Investors and analysts, regulators and oversight authorities, and others have called for disclosure of the engagement partner's name in the auditor's report.**

100 While it was recognized this is already done in many jurisdictions, respondents cautioned against the IAASB establishing an international requirement without the ability to address the potential auditor liability implications or influence the establishment of "safe harbors" for individual auditors in the jurisdictions where such a requirement does not exist. Many respondents suggested the call for transparency could be most appropriately addressed at the national level in the context of the legal environment in the particular jurisdiction.

101 The IAASB believes it is important to respond to the public interest call for increased transparency. Accordingly, it is proposing in ISA 700 (Revised) that the name of the engagement partner be disclosed in the auditor's report. However:

- Rather than require disclosure of the name of the engagement partner for all entities as suggested in the ITC, the IAASB has concluded it would be appropriate to limit the requirement in proposed ISA 700 (Revised) to audits of financial statements of listed entities. This is because the demand for such transparency has primarily come from institutional investors and, for many non-listed entities, including SMEs, the engagement partner's name is already available or known to the users of the financial statements through other means, albeit informal in many circumstances.
- The IAASB proposes the inclusion of a "harm's way" exemption, consistent with what is done in some national jurisdictions.

See paragraph 42 and related application material in proposed ISA 700 (Revised).

**QUESTION**

**12.** What are respondents' views as to the proposal to require disclosure of the name of the engagement partner for audits of financial statements of listed entities and include a "harm's way exemption"? What difficulties, if any, may arise at the national level as a result of this requirement?

### Other Improvements to Proposed ISA 700 (Revised)

102 In addition to changes described above, proposed ISA 700 (Revised) incorporates the following suggested improvements noted in the ITC and further enhancements:

- *Improved description of the responsibilities of the auditor and key features of the audit* (see paragraphs 35–38 and related application material of proposed ISA 700 (Revised)).
- *Provision for the descriptions of the responsibilities of the auditor and key features of the audit to be relocated to an appendix in the auditor's report, or for reference to be made to such a description on the website of an appropriate authority*. The wording in the illustrative report would effectively be mandated if included in the body of the auditor's report or in an Appendix, with some flexibility for a broader description of the auditor's responsibility on a website, provided it is not inconsistent with the wording prescribed by the requirements in proposed ISA 700 (Revised) (see paragraphs 39–40 and related application material of proposed ISA 700 (Revised)).
- *Reference to whom in the entity is responsible for overseeing the Company's financial reporting process* – Inclusion of this reference in the auditor's report acknowledges this essential role in the financial reporting process. Proposed ISA 700 (Revised) allows for flexibility in jurisdictions where the roles of "management" and "those charged with governance" may not be as clearly differentiated or when other terms are used for those involved in the preparation and presentation of the financial statements or oversight of the financial reporting process (see paragraph 33 and related application material in proposed ISA 700 (Revised)).

- *Other reporting responsibilities* – Under extant ISA 700, the auditor was prohibited from combining a discussion of other reporting responsibilities with reporting required by ISA 700 (i.e., such information was required to be presented in a separate section *Report on Other Legal or Regulatory Requirements*). Because the proposed new sections in the auditor's report (i.e., going concern, other information and key audit matters) relate to areas for which there may be additional reporting responsibilities, the IAASB believes it is appropriate to allow additional flexibility for national standard setters to determine how best to place the auditor's communication about such matters in the auditor's report in order to be meaningful to users. However, even if presented in the same section as ISA reporting requirements, these other reporting responsibilities will continue to be required to be clearly differentiated from reporting required by the ISAs (see paragraph 41 and related application material in proposed ISA 700 (Revised)).

103 The IAASB is also proposing clarification to the requirements and guidance in ISA 700 addressing supplementary information (see paragraphs 49–50 and related application material in proposed ISA 700 (Revised)). Feedback from the ISA Implementation Monitoring project indicated that the intent of the existing requirements is unclear when supplemental information that is not required by the applicable financial reporting framework is presented with the audited financial statements, in particular in relation to when such information is "an integral part of the financial statements" or cannot be "clearly differentiated."

*Degree of Prescription in Requirements of Proposed ISA 700 (Revised)*

104 It was suggested in the ITC that the IAASB would mandate the ordering and placement of the required elements in the auditor's report. As a result of feedback from respondents to the ITC, the IAASB reconsidered its position. This feedback included views that, in some countries, there are cultural reasons why placement of certain elements, for example the auditor's opinion at the end of the report, is preferred.

**The IAASB believes proposed ISA 700 (Revised) reflects an appropriate balance between consistency in auditor reporting globally and the need for flexibility to accommodate national reporting circumstances.**

105 The IAASB concluded that proposed ISA 700 (Revised) should not mandate the ordering of the elements of the auditor's report. With the exception of the requirement in extant ISA 700 for an introductory paragraph, this is largely consistent with extant ISAs 700, 705 and 706, and represents an important degree of flexibility in presentation.

106 However:

- The IAASB acknowledged that, in order to meet the objective of improving auditor reporting on a global basis, it was important that certain requirements be prescriptive to result in particular wording in the auditor's report in the absence of law, regulation or national auditing standards prescribing a specific form and content, and others be more principles-based to accommodate national circumstances (as further explained in paragraphs 107–109). Consequently, the IAASB determined it necessary to have relatively prescriptive requirements (other than ordering) in paragraphs 20–45 of proposed ISA 700 (Revised) aimed at promoting a degree of consistency in the ISA auditor's report. The IAASB has agreed to require specific headings in the auditor's report to ensure the required reporting elements can be recognized in all reports for audits conducted in accordance with ISAs, even if they are presented in a different order from that of the illustrative auditor's reports.

- The IAASB has intentionally presented the requirements in proposed ISA 700 (Revised) in a particular order that also aligns with the suggested presentation in the illustrative auditor's report. Further, the IAASB has not included any guidance or illustration in proposed ISA 700 (Revised) to suggest an alternative presentation of the elements in the auditor's report, so as to encourage consistency in presentation.

107 The IAASB has also determined that it is necessary for proposed ISA 700 (Revised) to retain the level of flexibility in auditor reporting that exists in extant ISA 700, by allowing a departure from more detailed requirements in the following circumstances:

- When an auditor claims compliance with the ISAs in performing the financial statement audit, and law or regulation prescribes a specific layout or wording of the auditor's report (see paragraph 46 of proposed ISA 700 (Revised)); or
- When an auditor is required to conduct an audit in accordance with the auditing standards of a specific jurisdiction (the "national auditing standards") but may have additionally complied with the ISAs in the conduct of the audit and refers to both ISAs and the national auditing standards in the auditor's report (see paragraphs 47–48 of proposed ISA 700 (Revised)).

108 The flexibility allowed by these paragraphs enables the auditor to tailor the wording of the auditor's report to meet the legal and regulatory requirements of a particular jurisdiction, or its national auditing standards, while still making reference to ISAs in the auditor's report and complying with proposed ISA 700 (Revised).

109 The IAASB believes that the minimum required elements articulated in paragraphs 46–47 of proposed ISA 700 (Revised) reflect an appropriate balance between consistency in auditor reporting globally when reference is made to the ISAs in the auditor's report, and the need for flexibility to accommodate national reporting circumstances.

**QUESTIONS**

**13.** What are respondents' views as to the appropriateness of the changes to ISA 700 described in paragraph 102 and how the proposed requirements have been articulated?

**14.** What are respondents' views on the proposal not to mandate the ordering of sections of the auditor's report in any way, even when law, regulation or national auditing standards do not require a specific order? Do respondents believe the level of prescription within proposed ISA 700 (Revised) (both within the requirements in paragraphs 20–45 and the circumstances addressed in paragraphs 46–48 of the proposed ISA) reflects an appropriate balance between consistency in auditor reporting globally when reference is made to the ISAs in the auditor's report, and the need for flexibility to accommodate national reporting circumstances?

### Revisions to ISA 705 as a Result of Proposed ISA 700 (Revised)

110 Proposed ISA 705 (Revised) incorporates amendments to the requirements for modified auditor's reports necessary to reflect the proposals in ISA 700 (Revised) and ISA 701.

111 In addition to certain minor drafting changes, the amendments include re-ordering of the requirements relating to the form and content of the auditor's report when the auditor's opinion is modified. Further, the illustrative reports in the Appendix of proposed ISA 705 (Revised) highlight the IAASB's preferred presentation when modified opinions are issued.

112 Proposed ISA 705 (Revised) also clarifies the auditor's reporting responsibilities when the auditor disclaims an opinion on the financial statements. In particular, the proposed ISA:

- Prohibits the auditor from including additional information on going concern, key audit matters, and other information when the auditor disclaims an opinion. The IAASB is of the view that providing details about the audit, including addressing the auditor's responsibilities about going concern, other information, or providing an extensive description of the auditor's responsibilities for the audit of the financial statements, may overshadow the disclaimer of opinion on the financial statements as a whole (see paragraphs 29 and A27–A28 of proposed ISA 705 (Revised)).
- Modifies the required words to be used in the auditor's report relating to the description of the auditor's responsibilities (see paragraph 28(a) of proposed ISA 705 (Revised)).
- Requires the statement relating to independence to be placed in the *Auditor's Responsibilities for the Audit of the Financial Statements* section rather than the *Basis for Disclaimer of Opinion* section (see paragraph 28(c) of proposed ISA 705 (Revised)).

See also Illustrations 4 and 5 of proposed ISA 705 (Revised)).

### Effect on ISA 800 Series

113 The IAASB acknowledges the need to give due consideration to the potential effect on ISAs 800[12], 805[13] and 810[14] (the "ISA 800 Series") of changes arising from the Proposed ISAs. However, it concluded that this should be progressed after feedback is received on the Proposed ISAs in the ISA 700 Series. The IAASB intends to propose any necessary changes to the ISA 800 Series through a separate exposure draft, with the aim of having the effective dates of all of the ISA reporting standards aligned to the extent practicable.

114 Respondents are nevertheless welcome to raise initial views on potential necessary amendments to the ISA 800 Series arising from the Proposed ISAs to assist informing the IAASB's deliberations as they commence in 2014.

[12] ISA 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*

[13] ISA 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*

[14] ISA 810, *Engagements to Report on Summary Financial Statements*

## SUMMARY OF SPECIFIC QUESTIONS FOR RESPONDENTS


The following is a summary of all questions for respondents that have been included in the *Significant Proposals* section on pages 18–39. The IAASB welcomes responses, including an articulation of underlying reasoning for respondents' views, even if only some of the listed questions are addressed. When answering the specific questions for respondents and providing overall views on the Proposed ISAs, various stakeholders may find the considerations in paragraph 14 of the *Matters on Which Feedback Is Sought* section to be relevant and may wish to explicitly comment on these areas.

The IAASB also welcomes detailed comments on the wording of the Proposed ISAs. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, where appropriate, make specific suggestions for any proposed changes to wording.

When a respondent agrees with proposals in this Exposure Draft (especially those calling for change in current practice), it will be helpful for the IAASB to be made aware of this view.

Finally, the IAASB is interested in respondents' views on an appropriate effective date for the Proposed ISAs (see paragraphs 23–26 of the *Matters on Which Feedback Is Sought* section).

## Key Audit Matters

1. Do users of the audited financial statements believe that the introduction of a new section in the auditor's report describing the matters the auditor determined to be of most significance in the audit will enhance the usefulness of the auditor's report? If not, why?

2. Do respondents believe the proposed requirements and related application material in proposed ISA 701 provide an appropriate framework to guide the auditor's judgment in determining the key audit matters? If not, why? Do respondents believe the application of proposed ISA 701 will result in reasonably consistent auditor judgments about what matters are determined to be the key audit matters? If not, why?

3. Do respondents believe the proposed requirements and related application material in proposed ISA 701 provide sufficient direction to enable the auditor to appropriately consider what should be included in the descriptions of individual key audit matters to be communicated in the auditor's report? If not, why?

4. Which of the illustrative examples of key audit matters, or features of them, did respondents find most useful or informative, and why? Which examples, or features of them, were seen as less useful or lacking in informational value, and why? Respondents are invited to provide any additional feedback on the usefulness of the individual examples of key audit matters, including areas for improvement.

5. Do respondents agree with the approach the IAASB has taken in relation to key audit matters for entities for which the auditor is not required to provide such communication – that is, key audit matters may be communicated on a voluntary basis but, if so, proposed ISA 701 must be followed and the auditor must signal this intent in the audit engagement letter? If not, why? Are there other practical considerations that may affect the auditor's ability to decide to communicate key audit matters when not otherwise required to do so that should be acknowledged by the IAASB in the proposed standards?

6. Do respondents believe it is appropriate for proposed ISA 701 to allow for the possibility that the auditor may determine that there are no key audit matters to communicate?

   (a) If so, do respondents agree with the proposed requirements addressing such circumstances?

   (b) If not, do respondents believe that auditors would be required to always communicate at least one key audit matter, or are there other actions that could be taken to ensure users of the financial statements are aware of the auditor's responsibilities under proposed ISA 701 and the determination, in the auditor's professional judgment, that there are no key audit matters to communicate?

7. Do respondents agree that, when comparative financial information is presented, the auditor's communication of key audit matters should be limited to the audit of the most recent financial period in light of the practical challenges explained in paragraph 65? If not, how do respondents suggest these issues could be effectively addressed?

8. Do respondents agree with the IAASB's decision to retain the concepts of Emphasis of Matter paragraphs and Other Matter paragraphs, even when the auditor is required to communicate key audit matters, and how such concepts have been differentiated in the Proposed ISAs? If not, why?

### Going Concern

9. Do respondents agree with the statements included in the illustrative auditor's reports relating to:
   (a) The appropriateness of management's use of the going concern basis of accounting in the preparation of the entity's financial statements?
   (b) Whether the auditor has identified a material uncertainty that may cast significant doubt on the entity's ability to concern, including when such an uncertainty has been identified (see the Appendix of proposed ISA 570 (Revised)?

   In this regard, the IAASB is particularly interested in views as to whether such reporting, and the potential implications thereof, will be misunderstood or misinterpreted by users of the financial statements.

10. What are respondents' views as to whether an explicit statement that neither management nor the auditor can guarantee the entity's ability to continue as a going concern should be required in the auditor's report whether or not a material uncertainty has been identified?

### Compliance with Independence and Other Relevant Ethical Requirements

11. What are respondents' views as to the benefits and practical implications of the proposed requirement to disclose the source(s) of independence and other relevant ethical requirements in the auditor's report?

### Disclosure of the Name of the Engagement Partner

12. What are respondents' views as to the proposal to require disclosure of the name of the engagement partner for audits of financial statements of listed entities and include a "harm's way exemption"? What difficulties, if any, may arise at the national level as a result of this requirement?

### Other Improvements to Proposed ISA 700 (Revised)

13. What are respondents' views as to the appropriateness of the changes to ISA 700 described in paragraph 102 and how the proposed requirements have been articulated?

14. What are respondents' views on the proposal not to mandate the ordering of sections of the auditor's report in any way, even when law, regulation or national auditing standards do not require a specific order? Do respondents believe the level of prescription within proposed ISA 700 (Revised) (both within the requirements in paragraphs 20–45 and the circumstances addressed in paragraphs 46–48 of the proposed ISA) reflects an appropriate balance between consistency in auditor reporting globally when reference is made to the ISAs in the auditor's report, and the need for flexibility to accommodate national reporting circumstances?