

Guidance to Assist in Field Testing of Proposed International Standard on Auditing (ISA) 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

The following has been prepared by Staff of the International Auditing and Assurance Standards Board (IAASB) to highlight considerations that may be of assistance to audit firms as they plan their field testing of proposed ISA 701.¹ This document is not intended to be prescriptive in terms of an approach to field testing.

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

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. 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 approach to be taken for field testing is entirely up to individual firms. It is assumed, however, that firms that are members of a global or regional network will coordinate their efforts internally.

As proposed ISA 701 may be applied voluntarily to audits of financial statements of entities other than listed entities, field testing on audit engagements for such entities (including non-listed, small- and medium-sized entities) is encouraged, including field testing by small and medium practices. The IAASB also encourages audit firms from emerging and developing economies to participate in field testing.

The IAASB invites feedback from the experiences of field testing as part of the comments in response to the IAASB Exposure Draft, *Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing*. 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.

The IAASB is interested in knowing the extent to which there is planned field testing of proposed ISA 701. Accordingly, we would be grateful if you could indicate to James Gunn, IAASB Technical Director (at jamesgunn@iaasb.org) by September 15, 2013 if you plan to undertake field testing.²

In addition to changes arising from proposed ISA 701, audit firms are encouraged during the exposure period and field testing process to communicate with their audit clients about the other proposed changes included in the IAASB Exposure Draft, including changes to the format and content of the auditor's report, and to begin dialogue about the process for preparing for the proposed changes.

During the exposure period, the IAASB also plans outreach to investors and other users to obtain their further feedback on key aspects of proposed ISA 701 and the other proposals in the Exposure Draft.

¹ Proposed ISA 701 is part of the July 2013 Exposure Draft, *Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing*, issued by the IAASB. The Explanatory Memorandum to the Exposure Draft provides background to, and an explanation of, key aspects of proposed ISA 701.

² IAASB staff would also welcome, on a confidential basis, a brief overview of the planned coverage of the field tests in terms of, for example, the types of engagements that are expected to be included in the field testing, countries or regions involved, and whether discussion with those charged with governance of the respective entities will be part of the scope of the field testing.

Matters for Consideration in Planning Field Testing

Selection of Engagements for Audits of Financial Statements

Selecting recently completed audit engagements enables field testing of proposed ISA 701 on a retrospective basis that would not be disruptive to audit engagements that are now commencing or currently in process.

Considerations when selecting a sample of audit engagements for purposes of field testing may include:

- Engagements that cover audits of listed entities, whether large or small, with complex activities or that involve complex auditing issues, including group audits.
- Engagements that cover audits of less complex listed entities.
- Engagements covering different industries.
- Engagements where proposed ISA 701 may be applied voluntarily to audits of financial statements of entities other than listed entities, such as audit engagements for non-listed, small- and medium-sized entities.

Feedback about the process of communicating key audit matters with those charged with governance, including reactions to how such matters are described in the auditor's report, is of value in terms of understanding the possible effects on the audit and the financial reporting process, and thereby fully understanding the potential implications of applying the proposed ISA 701.

The scope and extent of testing will depend on field testing participants' time and other resource constraints.

Approach to Field Testing

For the selected engagements, one approach to field testing is to request the respective audit engagement partners to retrospectively apply the requirements in proposed ISA 701 to develop sample Key Audit Matters sections and discuss the results with those charged with governance and others involved in an entity's financial reporting process. The results and feedback about the experiences of the individuals involved in the field testing for all selected engagements could then be summarized. Other approaches, such as use of focus groups, may also be effective.

Soliciting Feedback about Field Testing Experiences

The following questions may be useful in soliciting experiences about specific aspects of proposed ISA 701 from individuals involved in field testing ISA 701 on the selected engagements:

Determining the Key Audit Matters

- Did the requirement and related guidance in proposed ISA 701³ for the auditor to take into account "areas of significant auditor attention in performing the audit" and the related factors assist in determining the key audit matters?

In this regard, which aspects of the requirement and related guidance in proposed ISA 701 were the most or least helpful? Were there other factors considered that were of particular importance in the determination of the key audit matters?

³ See proposed ISA 701, paragraph 8 and related application and other explanatory material.

- Were there matters communicated with those charged with governance for which you were not clear as to whether they should, or should not be, determined as key audit matters?
- Were there circumstances where, in your judgment, there were no key audit matters to communicate?⁴ If so, please explain, including your view on the appropriateness of the required statement in the auditor's report in such situations.⁵

Describing the Key Audit Matters

- Did the guidance in proposed ISA 701⁶ assist in your thought process for developing the description of the key audit matters, including why you considered the matter to be one of most significance in the audit?
- Did you determine a key audit matter that:
 - (i) Did not have a related disclosure(s) in the entity's financial statements? If so, how did this affect your description?
 - (ii) May be viewed as sensitive because of its nature? If so, how did this affect your description?
- Please explain whether you considered it necessary to describe the effect on the audit as part of the explanation of why the matter was considered to be one of most significance in the audit. If so, please share your experience in doing so, including any issues and challenges you encountered.

Communicating the Key Audit Matters with Those Charged with Governance

- Please share your experience related to the process of communicating with those charged with governance (and, where appropriate, representatives of the entity's management) the key audit matters, and their descriptions, that you would have included in the auditor's report in accordance with proposed ISA 701.
- How, if at all, did discussion with those charged with governance (and, where appropriate, representatives of the entity's management) affect either your determination of the key audit matters or the description thereof?

Feedback from those charged with governance about the process of communicating key audit matters

As noted above, obtaining feedback about the process of communicating key audit matters, including reactions to how such matters are described in the auditor's report, from those charged with governance (and management) of the entities that the audit firms involve in their field testing activities is of value in terms of understanding the possible effects on the audit and the financial reporting process, and thereby fully understanding the potential implications of applying proposed ISA 701.

Accordingly, audit firms are encouraged to solicit such feedback from these individuals. The following questions may be useful for this purpose:

- Please share your experience related to the process of discussing with the auditor the key audit matters, and their descriptions, that the auditor would have communicated in the auditor's report.⁷

⁴ See proposed ISA 701, paragraph 13 and related application and other explanatory material.

⁵ See proposed ISA 701, paragraph 13(c) and related application and other explanatory material.

⁶ See proposed ISA 701, paragraph 10 and paragraphs A30-A44.

- Please indicate your thoughts about the effects (both in the first year of implementation and ongoing) of the proposals from your point of view, for example, in terms of time required for discussing the key audit matters, as well as any anticipated effects on the entity's process for preparing the financial statements and related audit timetable.
- Please share your overall view on the usefulness to users of your financial statements of the key audit matters determined by the auditor, and any other information that you believe would be useful to your auditor or the IAASB based on the field test.

Other Matters for Consideration

In considering the effects of applying proposed ISA 701, other matters for consideration may include obtaining information concerning whether applying the proposals resulted in undue cost or audit effort, or would have other significant implications to audit firms. If so, the IAASB encourages views on how the proposals might be modified to address such concerns while achieving their aims.

Illustrative Key Audit Matters Sections

The IAASB invites audit firms, to the extent possible, to prepare generic illustrative Key Audit Matters sections in accordance with proposed ISA 701 that illustrate the typical result from the field testing processes, and to share these illustrative Key Audit Matter sections with the IAASB. Any such information will be treated as confidential data provided to the IAASB. The IAASB may use such information to assist in further developing its own, illustrative Key Audit Matters sections for purposes of final ISA 701.

IAASB Contact

If you have any questions on the field testing process or on proposed ISA 701, please contact Kathleen Healy, IAASB Deputy Director, at kathleenhealy@iaasb.org

⁷ It should be noted that in future practice, communication with those charged with governance about the overview of the planned scope and timing of the audit, typically at the beginning of the audit process, may further facilitate the auditor's determination of the key audit matters and the communication thereof with those charged with governance.