The New Auditors' Report

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Why change the auditor's report?

- Foundation for the future of global auditor reporting and improved auditor communications
- Essential to the continued relevance of the audit professional globally
  - Audit opinion is valued, but could be more informative
  - Users want more relevant and decision-useful information about the entity and the financial statements audit

Global Change

- UK regulator introduced requirements effective 2013.
- Dutch standard setter adopted requirements similar to new ISAs in 2014.
- EU audit reforms introduce similar requirements for 2017 year ends.
- PCAOB currently re-deliberating similar proposals.

Comparison to EU requirements

- Key audit matters.
- Other information.
- Additional EU requirements:

– transparency statements including information on audit tenure and non-audit services

– opinion on whether management report is prepared in accordance with relevant legal requirements

– additional report to the audit committee.

What's KPMG's Global View?

The new requirements are an opportunity to demonstrate the relevance and value of the audit to stakeholders

"I have always felt that we as auditors, had more insight that we could share with investors. Now, with the advent of new international auditor reporting requirements, we have the opportunity to do just that."
Bill O'Mara, Global Head of Audit KPMG International

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What Investors and Preparers Have Said

"For the first time ever, audit reports are actually worth reading, because they say something different and interesting."
Paul Boyle, Chief Audit Officer at Aviva

"Ultimately, all of these reforms are about enhancing audit quality."
Vincent Papa, Director of Financial Reporting Policy at CFA institute

"What we get [with the current audit opinion] is pass/fail. [But with a car inspection] you get the advisory elements… 'Your car has passed, but the tyres are very close to the borderline limit.' And that's what we really want from an audit."
Participant at the Forbes Insights Summits on the Future Role of Audit

What ISAs are changing?

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

Key enhancements to the auditor's report

- Mandatory for listed entities
  - New section to communicate **key audit matters (KAM)**
  - Disclosure of the **name of the engagement partner**
- Mandatory for all audits
  - **Opinion section** to be presented first; followed by basis of opinion
  - Affirmative **statement about the auditor's independence** and fulfillment of **relevant ethical responsibilities**
  - Enhanced description of the **auditor's responsibilities**
  - Enhanced description of **management's responsibilities**
  - Enhanced reporting on **going concern**
  - Statement with respect to work performed over **"other information"**

Key enhancements to the auditor's report - summary

	Listed entities	Non-listed entities
Re-ordering of the auditor's report	√	√
Revised description of management responsibilities	√	√
Revised description of auditor's responsibilities	√	√
Statement of compliance with relevant ethical requirements and a reference to the origin of the ethical requirements complied with.	√	√
Descriptions of auditor's responsibilities for other information and statement with respect to the documents read and findings	√	√
Description of key audit matters	√	x
Disclosure of the engagement partner's name in the report	√	x

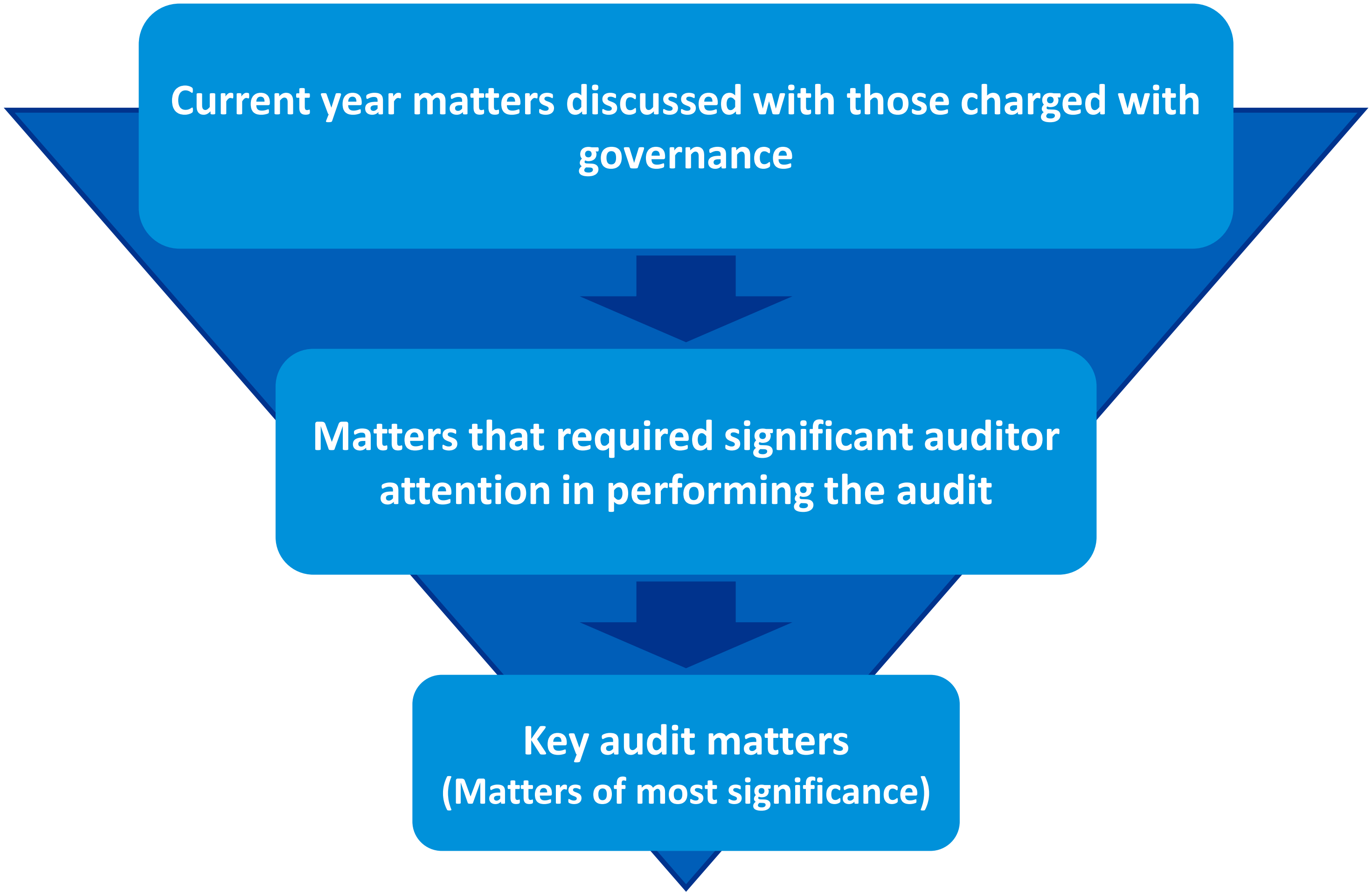
What is a KAM?

Key audit matters (KAMs) are defined as those matters that ***in the auditor's judgement*** were of ***most significance*** in the audit of the financial statements of the current period. They are matters that required ***significant auditor attention*** in performing the audit.

KAMs are ***selected from matters communicated*** with those charged with governance.

- Areas of higher risk of material misstatements(ROSM) or significant risks
- Significant management judgement, high estimation uncertainty
- Audit effect of significant events or transactions in the period

How KAMs are Identified



What is Required in The Description of a KAM?

Why

the matter was one of most significance in the conduct of the audit

How

the matter was addressed in the audit

Well Written KAMs

- Fact based
- Company specific
- Informative
- Concise
- Understandable
- Accurate description of the audit procedures performed

- Boiler plate
- Generic risks
- Generic wording
- Lacking detail
- Technical jargon
- Long lists of procedures
- Inconsistent with audit procedures performed

Enhanced auditor reporting on going concern

- New required descriptions **of management's and auditor's responsibilities in relation to going concern**
- New guidance to support the **auditor's evaluation of disclosures when a material uncertainty exists**
- New requirement for the auditor to **evaluate the adequacy of disclosures in "close call" situations**
- **Separate section in audit report** when a material uncertainty related to going concern exists
  - If disclosures adequate; separate section headed, "Material Uncertainty Related to Going Concern", drawing attention to those disclosures
  - If disclosures inadequate, a modified opinion as first section of the auditor's report

First Look at the New Auditor’s Report

- An example of the new auditor’s report

INDEPENDENT AUDITOR'S REPORT

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

Report on the Audit of the Financial Statements

Opinion[1]

We have audited the financial statements of ABC Company (the Company), which comprise the statement of financial position as at [December 31, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, (or give a true and fair view of) the financial position of the Company as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for Opinion[2]

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 Financial Statements section of our report. We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in [jurisdiction], and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters[3]

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

1 **Required to state the opinion first in the auditor's report, unless a different order is specified by local laws or regulation.**

2 **Required to state independence and specify the jurisdiction.**

3 **Description of key audit matters (mandatory for listed entities only).**

1

Effective Date

Periods ending on or after 15 December 2016 for financial statement audits undertaken in accordance with ISAs

KAMs only applicable for listed companies

Early adoption permitted

Expected benefits of the change

- **Increased transparency** and **enhanced informational value**
- **Enhanced communications** between the auditor and investors
- **Enhanced communications** between the auditor and those charged with governance
- **Increased attention** by management and those charged with governance to the disclosures in the financial statements to which reference is made in the auditor's report
- **Renewed focus of the auditor** on matters to be reported
- Increased professional skepticism in areas where KAM are identified
- Increased audit quality or users' perception of audit quality

Key Elements of Successful Implementation – The UK Experience

- **Response from users and regulators**
  - Extremely positive feedback from both users and regulators
  - Investors value the insight provided by the new report
- **Key elements for successful implementation**
  - Buy in from all key stakeholders
    - The regulator supporting and encouraging auditors to be innovative in meeting the requirements
    - Investors and audit committee members engaged and supportive of the process

Key Elements of Successful Implementation – The UK Experience

- **Investors saw value in reports that are:**
  - Innovative and engaging
  - Include descriptions that are company-specific
  - Include sufficient granularity to allow readers to understand the risks and how they were addressed

FRC Survey of 2013 UK Audit Reports (March 2015)

Surveyed 153 companies

Average number of risks disclosed 4.2

Top 3 risks

1. Impairment of assets
2. Tax
3. Goodwill impairment

Positive – extent of innovation and diversity of approaches

Area for improvement – granularity of risk reporting

Granular risk descriptions:
KPMG 89%
Other Big 4: 50%

FRC identified some inaccuaracies in auditor descriptions of the nature/extent of procedures performed

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Preparing for the Change - Auditors

- Start early in the audit process
- Have early and open communication with the audit committee and management
- Being specific about the areas of audit focus and what is done during the audit to address those matters
- Put yourself in the shoes of the shareholders when considering how to meet the requirements

Preparing for the Change - Audit Committees and management

- Understand the requirements of the new report
- Discuss with the auditor their implementation plan
- Discuss with the auditor how the new audit report will look
- Agree timeline with the auditor for first year of implementation

Preparing for the Change - Investors

- Understand what information will be available in the new audit report
- Familarise yourself with expanded auditor reporting by reviewing reports issued in other jurisdictions (e.g. UK)
- Signal to auditors your expectations regarding auditor's report prepared under the new requirements
- Identify how the information may be used to evaluate and compare companies
- Determine how the information may be used to engage with audit committees

Questions?

Thank you