

29 June 2015

Ms Merran Kelsall, Chair
Australian Auditing and Assurance Standards Board
By email: edcomments@auasb.gov.au

Exposure Draft ED 01/15: Reporting on Audited *Financial Reports* – *New and Revised Auditor Reporting Standards and Related Conforming Amendments*

Thank you for the opportunity to provide comments on the changes proposed in the suite of auditing standards referred to in ED 01/15. This submission is based on:

- (i) experience as an independent audit committee member;
- (ii) experience as consultant to firms in a large international network of firms and their clients on audit issues;
- (iii) previous experience as the Technical Standards Partner for a large mid-tier firm in Australia.

1. General Comments

The new suite of reporting standards introduce a new paradigm for auditor reporting, which both expands and enhances the nature and extent of auditors communications to users of financial statements. Previously auditor responsibilities required binary reporting on the financial statements as a whole. The auditor's responsibilities to report now cover a much broader range of issues; in particular auditor responsibilities will include the need to "comment" on various aspects of the finance reporting process, in addition to forming an "opinion" on the financial statements as a whole. The auditing standards listed in paragraph 2 represent only the first phase of amendments to ISAs and ASAs, which will be necessary to operationalise the new paradigm.

Given the legislative requirement that the AUASB adopt the IAASB's auditing standards, then there is little scope for comment or change to the exposure drafts as presented, in the absence of compelling reasons to do so.

2. Exposure Draft ED 01/15 Explanatory Memorandum (EM) Questions

EM.3a Significant additional costs will be borne by the auditor. Directors and audit committees will also need to schedule more time to consider specific issues to be addressed in the planning, interim and final stages of the audit, to address audit procedures and findings relating to the detail to be included in the auditor's report. The IAASB and AUASB have not promoted the perceived "value-add" that will be delivered through the new reporting standards nor explained the additional work required to stakeholders. In contrast, the general message has been that the audit process is unchanged with enhanced reporting. Consequently, the new standards will be perceived as introducing matters of auditor compliance rather than matters of cost to clients. If additional costs cannot be recovered by the auditor, then in the long-term this service may not be sustainable.

EM3a(i) Although there are no significant changes to the range of issues that the auditor will examine during the course of the audit, the reporting changes will force increased audit documentation at every stage of the audit. Issues which were previously discussed and resolved internally with those charged with governance will need more extensive documentation in the audit work papers to describe how user *perceptions* have been addressed, akin to the increased documentation requirements for independence issues in recent years i.e. Documentation will be needed to explain *why* or *why not* an issue is of significance to users. In addition, regulators are likely to inspect audit documentation relating to both significant and *possibly* significant issues.

EM3(a)(ii) The costs of audits of mature entities with established governance practices and financial reporting processes will be less impacted than costs of audits for growing businesses. Growing businesses (which include the majority of listed companies in Australia by number), tend to have governance and internal control practices that lag behind processes that grow the business. Consequently costs may increase an estimated 20-40% depending on the stage of the entity's life cycle to determine *which* issues should be included as key audit matters, and *how* they should be described. Audit firms will need to consult with technical experts more regularly to ensure appropriate drafting of the auditors' reports issued, to mitigate practice risk.

EM3(a)(iii) Auditors' reports are written in a *technical financial reporting language* (or "*auditor speak*") and this is essential to be able to summarise issues by using terms, phrases and language that carry particular meanings. Qualified and modified auditors' reports under the current reporting regime are often drafted or reviewed by technical experts in audit, rather than practitioners, and this practice is likely to continue. It will be difficult to assess whether users gain appropriate understanding of matters reported, and thus whether benefit will be delivered. Empirical research will be needed in due course to make this assessment. However, the benefits described in paragraph 9 are likely to be achieved in the medium to long-term. In particular, those charged with governance are likely to be more focussed on matters to be included in a report available to all stakeholders.

EM3b Given that "an audit is an audit" the requirements of ASA 701 should apply in substance to all entities, with differentiation between public and private auditor reporting. Auditors of all **public interest entities** (or those with **public accountability**) should be required to provide enhanced auditors' reports. In contrast, auditors of privately held entities should (continue to) report matters arising during the course of the audit to those charged with governance, albeit identifying certain items with the new label "key audit matters".

EM3(c) The name of the engagement partner is essential for users to be able to identify who conducted the audit. In national and international firms it will be impossible to access the auditor to request information about the audit. This is particularly relevant when there is a change of auditor and the incoming auditor wishes to make contact with the predecessor auditor. The existing practice in Australia, to disclose the engagement partner's name in any auditor's reports conducted by that engagement partner, should be maintained.

EM3(d) In Australia auditing standards are legislative instruments and carry the force of law. Therefore it would be inconsistent and unreasonable for auditing standards to omit information related to application of associated legislative requirements. In terms of ensuring consistency with ISAs, or for audits not conducted under the Corporations Act 2001, it may be preferable to include information in an Appendix rather than within the body of the ASA. However, existing practice with Aus paragraphs has not caused problems and therefore this issue should not be seen as a priority, but perhaps incidental to the more substantial changes.

3. Exposure Draft ED 01/15 Proposed ASA 700 Questions

Q1: Yes

Q2: No

Q3: Refer responses to EM3(a) above

Q4: Auditors' responsibilities are currently summarised in the auditor's report using terms and phrases with particular technical audit meaning {"auditor speak"}, also used throughout paragraphs 36-44 in the proposed ASA 700. (For example: references to "reasonable assurance", "professional judgment", "professional scepticism", "risks of material misstatement", "effectiveness of internal control" etc.) An expectation gap is generally known to exist in relation to current practice. With the introduction of enhanced auditor reporting the need for a plain English, more comprehensive

explanation of the audit process is urgently needed, or the expectation gap will increase. It would be preferable for the IAASB or AUASB to provide a plain English explanation rather than firms introducing different plain English interpretations of the audit process.

It is doubtful the explanation of auditor responsibilities could be provided in short-form in plain English. Further, if the “audit speak” explanation of auditor responsibilities is provided (as anticipated in the proposed ASA 700) then it is doubtful that there is much benefit provided beyond limiting the auditor’s practice risk. Consequently auditor’s responsibilities should be explained in an Appendix.

Q5: Refer responses to EM3(d) above

Q6: Refer responses to EM3(c) above

Q7: The issues relating to the use of technical audit language and the expectation gap that arises (as described under Q4 above) is of significant public interest.

4. Exposure Draft ED 01/15 Proposed ASA 701 Questions

No additional comments except re Q5 significant public interest matters:

In those situations where there are no key audit matters to report, the auditor’s ability to provide insights relating to the continuous improvement of an entity’s internal processes may be adversely impacted. It is anticipated that those charged with governance will become more sensitive to any matters raised by the auditor, and there is the risk that auditor communications are expected to relate only to deficiencies rather than including matters that may add value. In broader terms, the introduction of key audit matters that relate to communications of concerns/deficiencies only, continues to reposition audit as an exercise in compliance rather than a value-adding process.

5. Exposure Draft ED 01/15 Proposed ASA 705 Questions

No additional comments

6. Exposure Draft ED 01/15 Proposed ASA 706 Questions

No additional comments

7. Exposure Draft ED 01/15 Proposed ASA 570 Questions

No additional comments except:

Q3: Any inter-relationship between key audit matters and matters relating to a material uncertainty related to going concern is likely to require significant time and cost through the use of expert and perhaps legal advice. There will be a need to anticipate these issues at the planning stage of the audit to ensure adequate time is scheduled with those charged with governance, for the resolution of matters arising, and acceptable disclosures in both the notes to the financial statements and the auditor’s report.

Q4: Retention of the “relevant period” concept in paragraph Aus 13.2 is supported, given this practice is well established in Australia.

Q6: The auditor’s report disclosures in respect of material uncertainty relating to going concern are often the most difficult, yet important communications. It is likely that stakeholders will focus on certain parts of a long-form auditor’s report rather than reading each paragraph in detail. Therefore

stakeholders will need assistance in understanding when to seek out this information and its location, to ensure that sensitive information does not become “hidden” in a long-form report.

8. Exposure Draft ED 01/15 Proposed ASA 260 Questions

No additional comments

9. Exposure Draft ED 01/15 Proposed ASA 2015-1 Questions

No additional comments

Other Matters

ASA 701 (KAM) introduces the most significant changes to audit procedures by changing the **emphasis** for audit attention and **documentation** at every stage of the audit and for every communication with management and those charged with governance. The relative significance of matters to an entity will require close discernment when making comparisons of issues reported by the auditors of different entities. In addition, communications and disclosures of key audit matters will need to be considered in the context of any audit qualifications, modifications, material uncertainty related to going concern, emphasis of matters or other matter paragraphs. Audit procedures are not conducted in isolation for individual matters, but are inter-related and iterative. The clarity of communications will be essential to stakeholder understanding. These are new communication and documentation skills which auditors will need to develop urgently.

Re EM17(c): Compilations need to be timely; amending standards are difficult to follow.

Re EM22: A 60 day comment period is reasonable but when numerous EDs are issued at the same time with the same due date, this period is very tight.

Please feel free to contact me to discuss further any matters arising from this submission.



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