

March 2016

Explanatory Guide *Auditor Reporting*

Issued by the **Auditing and Assurance Standards Board**

Draft

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ISSN 2201-3644

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EXPLANATORY GUIDE

Auditor Reporting

Purpose

1. The purpose of this Explanatory Guide (EG) is to provide auditors with information relevant to auditor reporting under the following Auditing Standards issued in December 2015:
 - *ASA 700 Forming an Opinion and Reporting on a Financial Report*; and
 - *ASA 701 Communicating Key Audit Matters in the Auditor's Report*.
2. Information in this EG comprises:
 - A. How the auditor refers in the auditor's report, to the description of the auditor's responsibilities located on the AUASB website (ASA 700);
 - B. An approach to determine whether ASA 701 applies when an entity does not fit clearly into the ASA definition of a "listed entity"; and
 - C. A decision diagram for determining key audit matters to be communicated in the auditor's report (ASA 701).

Background

3. In December 2015, the AUASB issued a number of revisions and other changes to the Australian Auditing Standards to align with the enhancements to auditor reporting made to the equivalent International Standards on Auditing (ISAs) issued by the International Auditing and Assurance Standards Board (IAASB).

ASA 700

4. ASA 700 is the base standard regarding the auditor's reporting responsibilities. All other auditor reporting standards refer back to ASA 700.
5. Under ASA 700 paragraph 41(c), the description of the auditor's responsibilities for the audit of the financial report required by paragraphs 39–40 of that standard may be included by a specific reference within the auditor's report to the location of such a description on the AUASB website.
6. This EG describes the approach to be taken by auditors when referring to the auditor's responsibilities located on the AUASB website.

ASA 701

7. ASA 701 is a new standard that introduces requirements and guidance for auditors to include information on key audit matters (KAM) in their reports on the audits of general purpose financial reports of listed entities. When the auditor decides to do so, KAM may be included in the auditor's report of other entities. The KAM enhancements provide users of the auditor's report with information on matters of most significance to the auditor.
 - (a) The definition of the term "listed entity" is included in the Auditing Standards (ASQC1 and ASA200). The definition mirrors the ISA definition. In Australia, there are situations that may present difficulties in determining whether or not the audited entity falls within the definition of "listed entity" and therefore whether ASA 701 is to be applied.

The AUASB has decided to provide guidance to assist auditors in exercising professional judgement when determining the application of ASA 701.

- (b) The auditor is required to exercise professional judgement in determining KAM to be communicated in the auditor’s report. This determination involves identification, assessment and decision making. As this process did not previously exist, the AUASB has decided to provide a high-level “roadmap” diagram to assist auditors with a systematic approach to applying the new standard.

A. The Auditor’s Responsibilities – AUASB Website

8. When an auditor decides to include in the auditor’s report, reference to the auditor’s responsibilities being located on a website, guidance is found in Auditing Standard ASA 700 paragraph Aus A57.1.

9. **Footnote *** is attached to paragraph Aus A57.1 and states:

The auditor’s report should refer to the specific webpage that applies to the auditor’s responsibilities applicable in the context of the engagement.

10. When the auditor wishes to refer to the AUASB website, the specific webpage link is to be included in the auditor’s report.

11. The auditor does not refer to the AUASB Homepage as the auditor’s responsibilities applicable in the context of the engagement would not be apparent to users of the auditor’s report. It is important that users read only the auditor’s responsibilities description that is applicable to the circumstances, and forming part of the relevant auditor’s report.

12. For example, if the audit relates to a single listed company under the *Corporations Act 2001*, the link to be included in the auditor’s report would be: <http://www.auasb.gov.au/Home.aspx>

13. **Appendix 1** of this document demonstrates how the auditor would refer to the auditor’s responsibilities located on the AUASB website, in the auditor’s report. The example is based on [Aus] Illustration 1A which is found in the appendix to ASA 700.

14. Auditors referring to the auditor’s responsibilities on the AUASB website should use the links in **Table 1** below depending on the specific circumstances of the engagement.

Table 1: AUASB Website Links

The links in Table 1 align with the 4 illustrative example auditor’s reports found in the appendix to ASA 700 (issued December 2015).

Example	Type of Entity [applicable to the auditor’s report]	AUASB Website Links
1	Single Company - <i>Corporations Act 2001</i> [Listed. Fair Presentation]	http://www.auasb.gov.au/Home.aspx
2	Group Entity - <i>Corporations Act 2001</i> [Listed. Fair Presentation]	http://www.auasb.gov.au/Home.aspx
3	Single Entity [Not listed. Fair Presentation]	http://www.auasb.gov.au/Home.aspx
4	Single Entity. [Not listed. Compliance]	http://www.auasb.gov.au/Home.aspx

B. Application of ASA 701

General Principle

16. In determining the application of ASA 701, the auditor looks to paragraph 5 of that standard.

This Auditing Standard applies to audits of general purpose financial reports of listed entities and circumstances when the auditor otherwise decides to communicate key audit matters in the auditor's report. This Auditing Standard also applies when the auditor is required by law or regulation to communicate key audit matters in the auditor's report...

17. The first step is to determine whether the audited final report and the entity fall *clearly* within the relevant definitions and other conventions found in the Auditing Standards.
18. With clarity about the nature of the financial report and the nature of the entity, there will be clarity about the application of ASA 701.
19. When the financial report is not a general purpose financial report or the entity is not a listed entity, the auditor may still decide to apply the standard.

Financial Report

20. The auditor needs to establish that the auditor's report relates to a general purpose financial report. Reference to the Australian Accounting Standards and the guidance in Appendix 2 of ASA 210 *Agreeing the Terms of Audit Engagements*, provide the necessary information for the auditor to conclude on the nature of the financial report.
21. A relevant criterion, spelled out in the appendix to ASA 210, is that the accounting conventions applied in a general purpose financial report exhibit attributes normally exhibited by acceptable financial reporting frameworks, such as providing information necessary to meet the common financial information needs of a wide range of users in making economic decisions.
22. The auditor needs to determine whether applicable laws or regulations governing the preparation of the relevant financial report, are intended to result in a general purpose financial report.

Listed Entity

23. The Auditing Standards¹ include a definition of "listed entity", which is identical to that contained in the equivalent ISAs, namely:

Listed entity means an entity whose shares, stock or debt are quoted or listed on a recognised stock exchange, or are marketed under the regulations of a recognised stock exchange or other equivalent body.

24. The second part of the definition should be read as the entity's *shares, stock or debt* are marketed under the regulations of a recognised stock exchange or other equivalent body.

When either the Financial Report or the Entity does not fall clearly within the Definitions

25. When either the financial report or the entity does not fall clearly within the definitions, the auditor may be able to obtain sufficient appropriate evidence to reasonably conclude that the financial report is *not* a general purpose financial report or that the entity is *not* a listed entity under the definitions in the standards. If this situation exists, the auditor is still able to decide to apply ASA 701.

¹ Auditing Standard ASQC 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, Other Assurance Engagements and Related Services Engagements*; and ASA 220 *Quality Control for an Audit of a Financial Report and Other Historical Financial Information*

26. Any such assessment and conclusion should be documented in the audit working papers.

Exercising Professional Judgement

27. The auditor exercises professional judgement when making determinations about:
- (a) The general purpose of the financial report;
 - (b) The “listed” status of the entity; and
 - (c) Circumstances when the auditor otherwise decides to communicate key audit matters.
28. The auditor uses applicable definitions, criteria and principles to assist in exercising professional judgement in the contest of applying ASA 701.

Considerations when the Auditor Decides to Communicate KAM

29. When either the financial report or the entity does not fall clearly within the definitions, the auditor exercises professional judgement in deciding whether to communicate KAM.
30. The auditor considers the intention of ASA 701 which is expressed in paragraph 2 of the standard:

The purpose of communicating key audit matters is to enhance the communicative value of the auditor’s report by providing greater transparency about the audit that was performed. Communicating key audit matters provides additional information to intended users of the financial report (“intended users”) to assist them in understanding those matters that, in the auditor’s professional judgement, were of most significance in the audit of the financial report of the current period. Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgement in the audited financial report.
(Ref: Para. A1–A4)

31. The stated purpose above is fundamental to the auditor’s decision making, especially the issue of providing information to *intended* users to assist them in understanding:
- Matters of most significance in the audit;
 - The entity; and
 - Areas of significant management judgement.
32. Other criteria that the auditor uses in deciding whether to include KAM, include:
- Shareholders’ interests
 - Other stakeholders’ interests
 - The public interest
 - The appropriateness of the auditor’s report in the circumstances
 - Relevant ethical issues, such as potential threats to independence if issues are *not* communicated in the auditor’s report.
33. In deciding whether to communicate a matter, the auditor may consider using an Other Matter paragraph under ASA 706 *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report*. Such paragraphs are permitted when the auditor decides to communicate a matter that is, in the auditor’s judgement, relevant to users’ understanding of the audit, the auditor’s responsibilities or the auditor’s report.

Consultation

34. When the circumstances of the audit are such that there is no clarity about the nature of the financial report, the nature of the entity or relevant laws or regulations for purposes of applying ASA 701, the auditor consults within their firm or externally if necessary. Consultation may involve specialists, legal advice and relevant regulators.

C. Determining Key Audit Matters

35. ASA 701, paragraph 8, defines KAM as:

Those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial report of the current period. Key audit matters are selected from matters communicated with those charged with governance.

36. ASA 701 provides extensive guidance in support of the requirements to communicate KAM. The requirements are implemented through a logical approach that uses criteria to identify KAM and to select those KAM that are to be communicated in the auditor's report.
37. The standard offers a number of considerations to assist the auditor to progress through the procedures necessary to arrive at those matters to be included in the auditor's report.
38. In order to assist auditors with this new process, the AUASB has developed a high level schematic [Appendix 2] that depicts the sequential flow of procedures and the essential considerations that the auditor needs to address in determining KAM to be communicated.
39. As the diagram in Appendix 2 is only high level, auditors will need to refer to the detail contained in the standard. Paragraph references are included in the diagram for this purpose.

* * *

REQUEST FOR AUASB MEMBERS:

The AUASB Technical Group recommend the diagram at Appendix 2, however AUASB Members are asked to consider whether the alternative diagrams in Appendices 2A and 2B are preferable.

Appendix 1

(Ref. Para. 7)

**HOW THE AUDITOR'S REPORT FOR A SINGLE LISTED COMPANY
WOULD REFER TO THE AUDITOR'S RESPONSIBILITIES LOCATED ON
THE AUASB WEBSITE**

[See Appendix to ASA 700 - [Aus] Illustration 1A—Single Company - *Corporations Act 2001*]

Auditor's Responsibilities for the Audit of the Financial Report

“Our objectives are to obtain reasonable assurance about whether the financial report as a whole is 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 the Australian Auditing Standards 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 this financial report.

A further description of our responsibilities for the audit of the financial report is located at the Auditing and Assurance Standards Board website at: <http://www.auasb.gov.au/Home.aspx>. This description forms part of our auditor's report”.

* * *

DETERMINING KEY AUDIT MATTERS

Decision Flow	Considerations in Exercising Professional Judgement	ASA 701 Para.
Starting population	All matters communicated with TCWG ²	9
Determination of matters that required significant auditor attention.	Areas of higher assessed risk. Significant auditor judgements. Significant events/transactions	9
Determination of matters that were of most significance	Nature and extent of communications with TCWG Importance to users’ understanding of the financial report Nature of underlying accounting policy, complexity or subjectivity Nature and materiality of corrected and uncorrected misstatements Nature and extent of audit effort Nature and severity of difficulties in applying audit procedures Severity of control weaknesses	A27 A29
Carve out (extremely rare circumstances)	Laws or regulations preclude disclosure Adverse consequences to the entity or the public reasonably expected to outweigh public interest benefit Management’s views on why the matter had not been publicly disclosed Relevant ethical requirements	14 A54 A55
Communication in the auditor’s report	Reference to (any) related disclosures Why the matter is considered to be one of the most significance How the matter was addressed in the audit	13

² TCWG = Those charged with governance.

DETERMINING KEY AUDIT MATTERS



