

June 2017

Basis for Conclusions
ASA 701 Communicating Key Audit Matters
in the Independent Auditor's Report
(Amended June 2017)

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



Australian Government

Auditing and Assurance Standards Board

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Basis for Conclusions ASA 701 *Communicating Key Audit Matters in the Independent Auditor's Report*

The Basis for Conclusions ASA 701 *Communicating Key Audit Matters in the Independent Auditor's Report (Amended June 2017)* has been developed by the Auditing and Assurance Standards Board (AUASB) to provide the background and rationale for the development and approval of the Standard by the AUASB. The Basis for Conclusions relates to, but does not form part of, ASA 701 *Communicating Key Audit Matters in the Independent Auditor's Report (Amended June 2017)*.

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BASIS FOR CONCLUSIONS

ASA 701 Communicating Key Audit Matters in the Independent Auditor's Report

1. The Basis for Conclusions is issued by the Auditing and Assurance Standards Board (AUASB). It provides the background and rationale for the development and approval of the amendments to Australian Auditing Standard 701 *Communicating Key Audit Matters in the Independent Auditor's Report (Amended June 2017)* (ASA 701).

The Basis of Conclusions relates to, but does not form part of, ASA 701, and is not a substitute for reading the Standard.

Scope

2. This Basis for Conclusions applies to ASA 701.

Operative Date

3. The amended ASA 701 is operative for financial reporting periods ending on or after 15 December 2016.

Background

4. The AUASB issued ASA 701 in December 2015, effective for reporting periods ending on or after 15 December 2016. Subsequent to this, the AUASB considered the application of ASA 701 and the communication of key audit matters (KAMs) to the following scenarios:
 - Auditor's reports on financial reports containing parent entity and consolidated financial statements (4 column financial reports);
 - Auditor's reports on stapled security groups and separate issuer's financial reports; and
 - Condensed Interim Financial Reports prepared under Accounting Standard AASB 134 *Interim Financial Reporting* (AASB 134).
5. After careful consideration of these issues, the AUASB issued exposure draft 07-16 Proposed Auditing Standard ASA 2016-2 *Amendments to Australian Auditing Standards* (ED 07-16), on 22 December 2016, to gather stakeholder feedback on proposed amendments to ASA 701 to clarify that:
 - For consolidated and parent entity financial statements, KAMs are required to be communicated for the consolidated financial report as a whole, and the auditor may elect to communicate KAMs for the parent entity.
 - For a stapled security group, KAMs are required to be communicated for the stapled group financial report as a whole, and the auditor may elect to communicate KAMs for the separate stapled issuer.
 - KAMs are not required to be communicated in the auditor's reports on audited condensed Interim Financial Reports prepared in accordance with AASB 134.

Major Issues raised by Stakeholders on Exposure and the AUASB's Response

6. The AUASB received comments from nine stakeholders. The matters raised on the proposed amendments included in ED 07-16 and how these have been addressed by the AUASB are summarised below.

7. When considering feedback from respondents, the AUASB focused on the principles in International Standards on Auditing 701 *Communicating Key Audit Matters in the Independent Auditor's Report* (ISA 701), which are that a key audit matter is required to be communicated in auditor's reports when an entity:
 - (a) Has prepared a complete set of general purpose financial statements; and
 - (b) Is a listed entity.
8. When determining how the principles detailed above apply in the scenarios outlined in paragraph 5 the AUASB considered stakeholder feedback detailed below, consulted further with stakeholders and considered all relevant technical information.

Consolidated and parent financial reports

9. Eight out of nine respondents to ED 07-16 were in favour of the proposed amendment to ASA 701 for this matter, except for one respondent who raised a concern that the proposed amendments were not consistent with ISA 701.
10. The AUASB concluded that when parent entity financial statements are general purpose financial statements, prepared in accordance with the Australian Accounting Standards, and this is described as such in the basis of preparation note and the director's declaration, and the auditor is providing an opinion on the parent entity, the auditor communicates KAMs specific for the parent entity in accordance with ASA 701.
11. At its meeting on 26 April 2017, the AUASB decided not to amend ASA 701 as proposed in ED 07-16, and to instead release a frequently asked question (FAQ) on this matter.

Stapled security groups (listed)

12. A stapled group¹ means the group of entities consisting of:
 - (a) a stapled issuer and each other stapled issuer whose security must be traded with a security of the first-mentioned stapled issuer; and
 - (b) all other entities controlled by the stapled issuers referred to in paragraph (a).
13. A stapled issuer² means an entity to which both of the following apply:
 - (a) a security of the entity under the terms on which it is traded on a prescribed financial market, must be transferred together with a security of one or more other entities.
 - (b) There are no securities in the same class as the security first mentioned in paragraph (a) which may be transferred separately.
14. Seven out of nine respondents to ED 07-16 were in favour of the proposed amendment to ASA 701 for this matter. The two respondents not in favour commented that KAMs should be reported for general purpose financial reports of the stapled securities group and each stapled issuer separately, and that the proposed amendments were not consistent with ISA 701.
15. In its deliberations the AUASB discussed the following points:

¹ ASIC Corporations (Stapled Group Reports) Instruments 2015/838
² ASIC Corporations (Stapled Group Reports) Instruments 2015/838

- Each stapled issuer is required to prepare and lodge audited general purpose financial reports. These financial reports can be separate or may be presented in adjacent columns within the one report as allowed by ASIC Class Order 2015/838³.
 - A 'listed' entity is defined in the Auditing Standards as 'an entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognised stock exchange or other equivalent body'⁴.
 - There were alternative views expressed by Board members as to whether KAMs should be included at the stapled group level only, or whether KAMs should be included for each stapled issuer.
 - The arguments that were forwarded for supporting KAMs being included only for the auditor's report for the stapled group, are that the stapled group is, in substance, the listed entity, as this is the entity that is traded, and individual stapled issuers cannot be traded separately. There is only one quotation which is the stapled group, and the public can only see one listing on the ASX official list which is that of the stapled group (refer <http://www.asx.com.au/asx/research/listedCompanies.do>). In addition, there is a view that financial report users will gain communicative value primarily from the auditor's report associated with the stapled group, and the inclusion of KAMs in the auditor's reports of each of the stapled issuers, has the potential to confuse when read in isolation, in relation to investment decisions around the stapled group.
 - The arguments that were forwarded for supporting KAMs being included in the auditor's reports for each of the stapled issuers are that, based on AUASB staff consultations, the ASX verbally advised that each stapled issuer are 'listed' as they are admitted to the official (but unpublished) list held by the ASX, to enable them to be stapled and traded. Further arguments supporting the inclusion of KAMs are that, as investors investing in a stapled group receive securities eg. shares or units (and any associated income streams) in each of the underlying stapled issuers in equal proportion, they may be interested in KAMs in the auditor's report of each stapled issuer.
16. Following feedback on the exposure draft and continued deliberations and consultation with stakeholders, the AUASB considered these competing arguments and voted on the amendment to ASA 701 as proposed in ED 07-16, to clarify that KAMs are only required for the stapled group and not each stapled issuer. The vote to amend ASA 701 was not passed, with 7 out of the 11 members voting to amend in favour to clarify that KAMs are only required for the stapled group and not each stapled issuer. This failed to achieve the two-thirds majority required under the AUASB voting requirements to pass an amendment to an auditing standard.
17. The AUASB Technical Group will continue to research and engage with stakeholders in relation to this matter in order to re-evaluate the conclusions we have reached to date in this regard. This will involve evaluating investor presentation packs (preparer perspective), and investment analysts recommendations (users perspective), to identify if there are references to individual stapled issuers, as well as talking to auditors involved in signing of the reports for stapled groups (auditor's perspective) to better inform further AUASB deliberations on this issue.

Condensed financial reports

18. Eight out of nine respondents to ED 07-16 were in favour of amending ASA 701 for this matter, however one respondent did not support this amendment as in their view, if a company elects to have an audit performed in lieu of a review, it is appropriate to for the auditor's report to include KAMs.

³ ASIC Corporations (Stapled Group Reports) Instrument 2015/838

⁴ ASA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards

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19. When considering this feedback, the AUASB discussed that ISA 701 and the original version of ASA 701 (issued in December 2015) are inconsistent. Under ISA 701 KAMs are not required to be communicated in auditor's reports on condensed interim financial reports as they are not a complete set of general purpose financial statements.
20. This inconsistency was not identified at the time of issuing the original version of ASA 701. The AUASB did not think it was appropriate for ASA 701 to require the communicating of KAMs in the auditor's reports on condensed interim financial reports, when this was not within the scope of ISA 701.
21. Based on this the AUASB unanimously voted to amend ASA 701 to clarify that audit reports on condensed interim financial reports are not within the scope of ASA 701.
22. Auditors may elect to communicate KAMs in their audit reports on condensed interim financial reports.

Conclusion

23. In reaching its conclusions, the AUASB considered all stakeholder feedback, including the more significant issues outlined above.
24. At its meeting on 26 April 2017, the AUASB voted to approve and issue the following revision to ASA 701:

New paragraph Aus 5.1 inserted after paragraph 5 as follows:

Key audit matters are not required to be communicated in auditor's reports on condensed financial reports prepared in accordance with AASB 134 *Interim Financial Reporting*.
25. In addition the AUASB have issued a Frequently Asked Question "How are KAMs communicated for parent and consolidated financial reports?" which is available on the AUASB website.