

# AUASB Board Meeting Summary Paper

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**AGENDA ITEM NO.**        **2.6**  
**Meeting Date:**            12 June 2019  
**Subject:**                    Auditor Reporting Implementation Review  
**Date Prepared:**            3 June 2019

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**Action Required**

**For Information Purposes Only**

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## Agenda Item Objectives

1. At the June 2019 IAASB meeting the Auditor Reporting Implementation Working Group (ARIWG) is providing an update to the IAASB on:
  - an overview of global trends and key themes from research observed by the ARWIG to date;
  - the plans for the Auditor Reporting Post-Implementation Review (PIR).

Consistent with the International strategy the objective of this agenda item is for the AUASB to discuss and provide feedback / views on the ARIWG's plans for the PIR.

## Background

2. The Auditor Reporting Standards (Standards) have been in effect since December 2016. The IAASB focused initially on implementation support and monitoring the adoption of the Standards. The IAASB now focuses on PIR activities.
3. At this this meeting the ARIWG have provided an overview of global trends and key themes identified from research to date, and an updated PIR plan. The IAASB are being asked to:
  - consider the feedback/evidence gathered by the ARIWG to date, share relevant insights about the implementation experience with the auditor reporting standards that have not been identified or are inconsistent with this; and
  - approve and provide direction on the PIR plan including the scope, objectives and approach.
4. The AUASB Technical Group (ATG) have been observing the Australian implementation experience, and have conducted outreach and sought feedback from Australian stakeholders. Appendix A includes observations to date to assist the AUASB when considering the international feedback. Further outreach will need to be performed as part of the IAASB PIR.

## **Evidence gathered by the IAASB to date**

### ***Global trends identified by the IAASB***

5. The ARIWG have been monitoring the adoption of the Standards and have provided the following summary of global trends:
- Some jurisdictions are encouraging or mandating more extensive application of ISA 701, i.e. the inclusion of key audit matters (KAMs) for entities other than listed entities.
  - Some jurisdictions had imposed additional reporting requirements, such as the communication of matters related to independence, provision of non-audit services, audit scope and materiality, and inclusion of key observations about KAMs (i.e. outcome of audit procedures related to these matters), when relevant.
  - In the UK:
    - (i) the Financial Reporting Council (FRC) is currently consulting on increasing the auditor's responsibilities related to going concern, and new requirements for the auditor to communicate more on what they have done
    - (ii) The Kingman Review has recommended that the FRC consider requiring the inclusion of "graduated findings" in auditor's reports ("graduated findings" are described as judgmental views by the auditor on the KAMs, for example, describing an estimate as being cautious, balanced or optimistic).

### ***Global research / feedback to date***

6. The ARIWG have been monitoring relevant research and publications that included surveys of management, those charged with governance and shareholders, as well as desktop reviews of auditor's reports to identify trends in KAMs communicated (e.g., average number of KAMs, nature of KAMs and KAMs across industries).
7. Most of the publications highlighted the benefits of KAMs across stakeholders groups (TCGW, management and users). Other findings:
- KAMs have promoted more robust discussions among management, TCWG and auditors.
  - There appears to be an improvement in the disclosure in the financial statements on the matters to which the KAMs relate.
  - Some publications highlighted misconceptions about KAMs, for example, that a high number of KAMs are an indication that the entity is poorly managed or might have more problems compared with similar entities with fewer KAMs.
  - Generally, the publications highlight that users have found the KAMs useful as they provide transparency about the audit and highlight areas of attention for users, including helping users to navigate the financial statements and better understand the risks associated with their investments.
  - With respect to the informative nature of the KAMs, some reports noted that the KAMs that users found the most informative relate to those:

- (i) Not related to the financial statements (e.g., KAMs about the high turnover of staff in key financial roles).
- (ii) Linked to the entity's strategic goals or wider macro-economic or environmental factors.
- (iii) Highlighting the reliance of the entity and the auditor on complex IT systems and controls.

In reports that considered subsequent years, it was noted that explanations about changes in the audit approach or KAM from the previous audit were particularly useful.

- Some of the publications explored stakeholders' views on the other information disclosures in the auditor's reports and found that those charged with governance and users considered that the new disclosures provided them with greater confidence about the other information. However, some of the feedback suggested a need for the auditor to provide an update on the other information received after the auditor's report has been issued

8. Some implementation challenges identified:

- Describing KAMs in an informative, yet succinct manner. There has been criticism that some are "boilerplate" i.e. described in a standardised manner.
- The interaction between the going concern paragraph, KAM and emphasis of matter paragraphs. This has been raised by Australian auditors. This highlights a possible need for further guidance to explain the interactions between ISA 570, ISA 701 and ISA 706.
- The ARIWG are aware of concerns with ISA 720 and have recommended that this standard needs to be focused on as part of the PIR. Refer to Appendix A for the concerns raised. This is consistent with concerns raised by Australian stakeholders.

9. Disclosures in the Auditor's Report beyond those required

- Outcome of audit procedures - For the most part, across all of the publications there was an indication that users of financial statements, especially investors, prefer that auditors include the outcome of audit procedures performed regarding KAMs because they are otherwise unable to assess whether management appropriately dealt with the matter.
- Materiality and the scope of the audit – this is currently required in the UK. Publications indicated varying views from users. When materiality is disclosed users noted that it would be more useful if more was disclosed such as rationale etc. and reasons for using or changing particular materiality benchmarks or changes in the overall materiality level year on year.

**Actions for the AUASB**

- 1) Refer to Appendix A for the ATG's observations to date in Australia.
- 2) Do you have any further insights or views about the Standards that have not been identified from the research above, or that are inconsistent with the trends observed by the ARIWG?

## Post Implementation Review plans

10. The ARIWG have revised the objectives of the PIR. These changes are not significant and have been provided for the AUASB's information.
11. Objective of the PIR (in track changes from the objectives previously approved)
  - a) Determine whether the Standards are being consistently understood and implemented in a manner that achieves the IAASB's intended purpose in developing them so that the IAASB can determine what actions, if any, ~~changes~~ are needed:
  - b) To increase the consistency of practitioners' understanding of the Standards; and
  - c) For the Standards to achieve the intended purpose.
    - a. [Previously (d)] Identify how practical challenges and concerns are being addressed (by auditors, management and audit committees), and whether further action by the IAASB enhancements or refinements to the standards, or additional implementation support, is needed.
    - b. Understand the extent of global demand for additional information in the auditor's report ~~Determine whether further enhancements to the Standards are warranted~~ to improve the transparency of the audit (e.g., including the outcome of audit procedures with respect to KAMs, additional communications about going concern, the disclosure of materiality, and information about the scope of the audit).
    - d) Understand the extent of global demand for ~~Determine whether requiring~~ wider application of the requirements that currently apply only to audits of financial statements of ~~other than~~ listed entities (i.e. communication of KAM, the name of the engagement partner and, when applicable, communicating specific matters relating to other information) ~~would be in the public interest~~.
12. Scope of the PIR:
  - Included in the scope of the PIR are ISA 700, 701, 705, 706, 720, 260 and 570 (auditor reporting aspects only).
  - The ARIWG is also looking for the IAASB's views on whether to extend to the reporting aspects of the IAASB's Other Standards i.e. whether to align the reporting requirements. Is there a demand for the reporting requirements of the IAASB's Other Standards to be aligned with the ISAs?
13. Approach to the PIR:
  - The initial plan approved by the IAASB was to complete the PIR including finalising any actions / amendments to the Standards by the end of 2019. However the ARIWG's are asking the IAASB to support the recommendation to continue with ongoing monitoring and information gathering activities.
  - The ARIWG recognise that the information gathered to date has been from review of publications and research conducted, and that the IAASB should undertake further focused

information gathering activities so that there is an opportunity for all jurisdictions / stakeholders to provide input. The information gathering will cover:

- (i) General matters related to auditor reporting (KAMs, overall form and structure of the report, reporting of going concern matters).
- (ii) Whether to extend to other IAASB standards i.e. ISREs, ISAEs.
- (iii) ISA 720 – a separate focus area due to concerns raised (refer appendix B)

Refer to Appendix B for the topics and stakeholders the ARIWG plan to cover.

### **Actions / Questions for the AUASB**

- 1) Provide views on the planned approach to PIR.
- 2) Specifically do you agree that the focused information gathering activities are needed? Or is there sufficient information already gathered?
- 3) Do you agree with the proposed timing and the matters to be covered as outlined in Appendix C?
- 4) Do you agree with the ARIWG considering extending the auditor reporting aspects of the IAASB's other standards i.e. ISREs, ISAEs, ISRS?
- 5) Is there an indication of a need for the IAASB to take immediate action to respond to information already gathered globally (summarized in the "Global Trends" section of this paper), such as a project update, updating the Frequently Asked Questions publication, or other guidance?

### **ATG view**

Further information gathering is required especially when considering the following:

- further reporting by the auditor on outcomes of KAMs, materiality, scope of audit and increased disclosures related to going concern
- whether the structure and elements of other reports issued under the IAASB's standards (e.g., interim review reports) should be revisited.
- whether demand exists to extend the reporting of KAMs to all audits of financial statements (not just listed entities).

This needs to ensure there is demand for this, and consider the public interest benefit vs the cost.

### **Material Presented**

Agenda Item 2.6

AUASB Board Meeting Summary Paper

### Australian feedback gathered to date

The AUASB Technical Group (ATG) have been monitoring the implementation of the Standards in Australia and have conducted the following to gather feedback from Australian stakeholders:

- Worked with a Project Advisory Group to identify initial implementation issues and developed implementation FAQs;
- Met with representatives from the Big 6 Audit Firms to gather feedback on implementation / issues with the Standards based on the first year's experience. Their feedback is consistent with the challenges identified by the ARIWG in particular;
  - (i) Consistent feedback that ASA 720 is problematic;
  - (ii) The interaction between the going concern paragraph, KAM and emphasis of matter paragraphs needs to be relooked at and there should be flexibility for the auditor to report as they see appropriate.
- Included questions in the ACC survey and the investor survey targeted at gathering views on whether the new auditor's report had an impact on their views on audit quality;
  - (i) Feedback from ACC was Some / Minimal impact however the comments supported that this was because they have already been satisfied with their interactions with their auditor and the reporting of KAMs etc. did not impact this.
  - (ii) Feedback from investors was that the inclusion of KAMs had some impact on their perception of auditor quality. Also the quality of the information in the auditor's report (for example KAMs) was rated in the top 3 factors influencing perceptions on quality and the value of audit.
- Have discussed with ASIC who conducted a review of KAMs as part of their latest audit file inspection program. Their report includes an observation that there were instances where the descriptions of how a KAM was addressed were not evidenced in the file.
- Presented at ASIC's Audit Committee Chairs forum in 2018 and received feedback that ACCs agreed that reporting of KAMs was a very good improvement to the auditor's report, but the benefit was for users of the auditor's report.
- Reviewed a sample of auditor's reports to assess adoption of ASA 720.
- Have reviewed academic papers on the Auditor's report.

### Australian experience observed to date

Based on this the ATG believe that the implementation challenges identified by the ARWIG are accurate and specifically agree that the issues with ISA 720 in appendix A need to be addressed. In addition we have been informed that the cost of implementation was considerable and was not passed on entirely to clients.

We have observed that materiality and scope is being reported by PwC only. We are not aware if this is for all listed entities or not. We have not sought feedback on the users' views on the benefit of this reporting.

The ATG have not sought feedback from Australian stakeholders on extending the structure and elements of the enhanced auditor reporting to:

- The reporting of KAMs to other entities, such as PIEs;
- Requiring additional reporting by auditors on matters such as outcome of procedures on KAMs, or materiality and scope of the audit, going concern.

Prepared by the ARWIG

### **Summary of Challenges Identified with Respect to ISA 720 (Revised)**

ISA 720 (Revised) became effective for periods ending on or after December 15, 2016. In addition to changes addressing the auditor's responsibilities to consider the other information and respond appropriately when material inconsistencies appear, ISA 720 (Revised) introduced a new requirement for the auditor's report to include an "Other Information" section. Various questions related to ISA 720 (Revised) were included in the frequently asked questions publication released by the ARIWG in November 2016. However, feedback from outreach has highlighted a number of implementation issues as follows:

1. The determination of which documents constitute "other information," particularly when the individual components of the other information are not prepared and available at the same time, when additional voluntary information is included in the document, or when the document is not called an annual report.
2. The basis for selection of amounts or other items in the other information (that are intended to be the same as, to summarize, or to provide greater detail about, the amounts or other items in the financial statements) for comparison with the corresponding amounts or other items in the financial statements.
3. How the other information is described in the auditor's report, for example, whether the auditor refers to the "annual report" or more specifically to the components that make up the annual report.
4. How to address circumstances when the entity is not certain of what information will be included in the annual report.
5. How the auditor is expected to know that the other information has been finalized, since it may only be released after the financial statements and auditor's report.
6. How to apply the requirements of ISA 720 (Revised) to audits of financial statements prepared in accordance with a special purpose framework, and which often do not have other information that accompanies such financial statements.
7. Communication between the auditor, preparer and those charged with governance regarding responsibility for preparing the other information and the timing of providing the information to the auditor.

Prepared by the ARIWG

### **Draft Approach to Focused Information Gathering**

The table below sets out the matters that the ARIWG plans to explore with each stakeholder group. The way feedback would be solicited would be tailored for each stakeholder group and may include one or a combination of the following:

- (a) Direct meetings or discussions with the stakeholder.
- (b) Participation in the stakeholders' conferences or meetings (e.g., the IFIAR Standards Coordination Working Group annual meeting).
- (c) Surveys.
- (d) Presentations.

The ARIWG plans to further develop the plan for the focused information gathering in 2019, including the matters to be explored with each stakeholder group and how feedback will be solicited. The table below indicates the areas of focus for each stakeholder group (indicated with an X), but the topics may also be explored with other stakeholder groups.



Approach	Investors <sup>21</sup>	Regulators and other oversight authorities <sup>22</sup>	Preparers and TCWG <sup>23</sup>	NSS	Large Firms <sup>2</sup> 4	Small Firms <sup>25</sup>
<b>General matters related to auditor reporting</b>						
<ul style="list-style-type: none"> <li>Views about the new structure of the auditor's report and whether this has improved the communicative value of and transparency about the audit.</li> </ul>	X	X	X			
<ul style="list-style-type: none"> <li>Insightfulness and usefulness of the KAMs, and whether the communication of KAMs has met users' expectations.</li> </ul>	X	X	X			
<ul style="list-style-type: none"> <li>Whether the disclosure of the name of the engagement partner is useful.</li> </ul>	X	X	X			
<ul style="list-style-type: none"> <li>Usefulness of the separate section related to going concern in circumstances when a material uncertainty exists.</li> </ul>	X	X	X			
<ul style="list-style-type: none"> <li>Further possible improvements to the auditor's report to enhance the communication with users, including additional information that investors would find useful, such as the outcome of audit procedures that address KAMs, the disclosure of materiality, the scope of the audit and increased disclosures related to going concern (e.g., similar to UK proposals).</li> </ul>	X	X	X	X	X	X
<ul style="list-style-type: none"> <li>Whether the structure and elements of other reports issued under the IAASB's standards (e.g., interim review reports) should be revisited.</li> </ul>	X	X	X	X	X	X
<ul style="list-style-type: none"> <li>Whether demand exists for wider application of the requirements that apply to audits of financial statements of listed entities to all audits of financial statements.</li> </ul>	X	X	X	X	X	X
<ul style="list-style-type: none"> <li>Observations about implementation challenges.</li> </ul>		X	X	X	X	X
<ul style="list-style-type: none"> <li>Feedback on guidance issued and whether additional guidance or material should be developed to support implementation.</li> </ul>				X	X	X



<b>Approach</b>	<b>Investors<sup>21</sup></b>	<b>Regulators and other oversight authorities<sup>22</sup></b>	<b>Preparers and TCWG<sup>23</sup></b>	<b>NSS</b>	<b>Large Firms<sup>24</sup></b>	<b>Small Firms<sup>25</sup></b>
<b>ISA 720 (Revised)</b>						
<ul style="list-style-type: none"> <li>Views about the usefulness of the other information section of the auditor's report and whether this has improved the communicative value of and transparency about the audit</li> </ul>	<b>X</b>	<b>X</b>	<b>X</b>			
<ul style="list-style-type: none"> <li>Implementation challenges with respect to ISA 720 (Revised) drawing specific attention to the matters in Appendix C.</li> </ul>			<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>
<ul style="list-style-type: none"> <li>Actions taken to address implementation challenges.</li> </ul>				<b>X</b>	<b>X</b>	<b>X</b>

*This document contains preliminary views and/or AUASB Technical Group recommendations to be considered at a meeting of the AUASB, and does not necessarily reflect the final decisions of the AUASB. No responsibility is taken for the results of actions or omissions to act on the basis of reliance on any information contained in this document (including any attachments), or for any errors or omissions in it.*