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## Clear, transparent reporting

The new auditor's report

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Audit & Assurance 

*“The new auditor’s report will improve the transparency of our work. Disclosing key audit matters is an important milestone for audit committee members, users of the financial statements and auditors. We fully support this innovation that builds confidence in our audits and is, therefore, beneficial for our clients.”*

**Rik Neckebroeck**, Audit Business Leader, Deloitte Belgium

# Foreword

In Belgium and abroad, business has become more complex over the last few years, impacting areas of judgment, estimation and uncertainty. Financial reporting, reflecting the business of the entity, has had to evolve as well. However, the auditor's report, being the key deliverable addressing the output of the audit process, has been a standard pass/fail report until now, with limited, if any, information that relates specifically to the entity.

Investors and users of financial statements have demanded that the auditor's report provide more transparency and insight into the audit.

## **The auditor's report is being revolutionized.**

The International Auditing and Assurance Standards Board (IAASB) released in 2016 new and amended International Standards on Auditing (ISAs) which transform the auditor's report.

At the same time, the European Parliament and the Council of the European Union (EU) also released the Regulation 537/2014 on specific requirements regarding statutory audit of Public Interest Entities (PIEs). As a result of the combination of those two standards, the auditor's report on PIEs will include key information relating to the audit of the entity.

The IAASB and EU Regulation intend for the new and revised auditor reporting standards to result in an auditor's report that increases the transparency of and confidence in the audit and the financial statements, which is in the public interest.

Ultimately, the IAASB and the EU believe that the transformation of the auditor's report is critical to the perceived value of the financial statement audit and to the continued relevance of the auditing profession.

We welcome these innovations because they are beneficial for audit committees, shareholders, regulators and auditors in mainly two ways:

- The elements in the previous report will be reordered so that the most important information comes first: the audit opinion.
- For PIEs, the auditor's report will include a section about key audit matters after the opinion section. In this section the auditor will describe certain matters that were of most significance in the audit.

The IAASB's amended standards and EU Regulation are effective in Belgium for periods starting on or after 17 June 2016.

Auditor's reports for non-PIEs will have the same structure with the audit opinion at the top but they will not include key audit matters.

**Rik Neckebroeck**  
**Audit Business Leader**

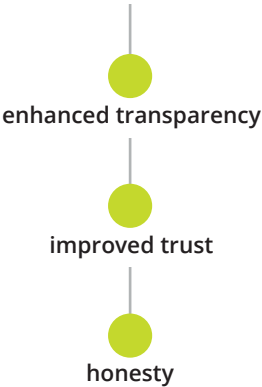
**Marie-Noëlle Godeau**  
**Audit Partner**

# Expected benefits



## Transparency and trust

Some stakeholders have demanded enhanced transparency into the audit for some time, and as a result, this is one of the benefits that is expected to be achieved from the revisions. Enhanced transparency improves trust.



## Relevance and credibility

The auditor's reports of PIEs will contain relevant entity-specific information on the most significant issues arising during the audit. No two reports will look the same. Up until now, users would merely look out for the pass / fail opinion and ignore the rest of the report. A more relevant report may improve the user's interest in the auditor's report and their understanding of the audit, adding to the credibility and value of the audit.



## Comparability

Audit committees and other stakeholders will be able to better compare different firms and evaluate audit quality. Comparison of the key audit matters for entities within similar industries will provide greater industry insight.





## Communications

The new reports will instigate more robust dialogue between the auditor and those charged with governance, enhancing audit quality as well as the financial reporting. It is also expected to improve communication between the auditor and all relevant stakeholders.

enhanced communications

users / regulators



## Quality

Although the new requirements do not change the underlying work effort required in the audit, they will improve the focus by the auditor on significant areas of the audit, including going concern, impacting audit quality and the auditor's professional skepticism. Furthermore, the quality of financial reporting is expected to improve as there will be increased focus on going concern disclosures and the disclosures in the financial statements to which the auditor's report makes reference.

audit quality

financial reporting quality

# Affected auditing standards

The changes to the reporting standards (revised ISA 700 and new ISA 701) come along with a broad range of amendments to existing auditing standards as illustrated. These are mainly changes to the going concern standard (ISA 570) and the communication standard (ISA 260).

ISA 700R –  
Forming an opinion  
and reporting  
on financial  
statements

**ISA 701 new**

Communicating key audit matters in the independent auditor's report

**ISA 705R**

Modifications to the opinion in the independent auditor's report

**ISA 570R**

Going concern

**ISA 720R**

The auditor's responsibilities relating to other information

**ISA 260R**

Communication with those charged with governance

**ISA 706R**

Emphasis of matter paragraphs and other matter paragraphs in the independent auditor's report

Various others in ISAs 210, 220, 230, 510, 540, 600, 710

# International developments

The key global focus area for audit regulators and standard setters has been on enhancing auditor reporting.



In the United Kingdom, the Financial Reporting Council (FRC) introduced changes that became effective for September 2013 year-ends. These have been well received by all stakeholders.

In conjunction with the enhancements to the auditor reporting, the changes impose obligations on the entity to include certain disclosures, including:

- The critical judgments formed and key estimates made by management in preparing the financial statements
- The audit committee's report on the significant issues it considered in relation to the financial statements and how these issues were addressed



On 1 June 2017, the PCAOB approved a new Auditing Standard (AS3101), The auditor's report on an audit of financial statements when the auditor expresses an unqualified opinion. Under the new standard, the most significant change to the auditor's report on the financial statements is a new requirement to communicate Critical Audit Matters arising from the audit of the financial statements.

Other changes to the auditor's report on the financial statements include (1) a standardized order and form, with "Opinion on the Financial Statements" required to be the first section; (2) enhanced descriptions of the auditor's role and responsibilities; and (3) required disclosure of the year we began serving consecutively as the company's auditor (referred to as "audit firm tenure").



The European Union has issued Regulation 537/2014 amending the Statutory Audit Directive, and the new regulation on public interest entity audits requires an enhanced audit report.

These changes also incorporate additional requirements relating to the auditor and audit committee, including auditor rotation, prohibitions relating to non-audit services and a requirement for the auditor of a public interest entity to submit a detailed report to the audit committee.

# Overview of the new requirements

## What's new in the auditor's report?

### Key audit matters

New section to communicate key audit matters (KAMs) – matters that in the auditor's judgment were of most significance in the audit of the current period financial statements.

(Please refer to pages 12-13 for a more detailed analysis of this requirement)

## How does this affect the audit committee and management?

- The audit committee should consider the timing of meetings of the audit committee and management and whether these will accommodate the audit process and reporting time frame. The timing and methods of communication with the auditor will be affected since:
  - Key audit matters are derived from matters communicated with the audit committee, therefore early communication of all relevant matters affecting the audit is critical.
  - The audit committee should challenge the auditor as early as possible on the auditor's responses to the key audit matters and whether these are appropriate.
  - The audit committee will want to review an early draft of the auditor's report in order to be able to understand which key audit matters are being reported.
  - The report is likely to go through rigorous review processes within the entity and the audit firm and therefore time frames need to be carefully considered to accommodate this.
- The audit committee should question disclosures in the financial statements and the annual report:
  - Whether the disclosures adequately and fairly describe the matters to which the key audit matters pertain in accordance with the financial reporting framework.
  - Whether additional disclosures or commentary beyond those required by the financial reporting framework are necessary for users to fully understand the key audit matters identified by the auditor and to ensure the auditor is not the original provider of information.
- The audit committee should question management's response to the key audit matters. Although not disclosed by the auditor or in the financial statements, the audit committee may want to question how management manages and responds to the key audit matters and whether this is appropriate.



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## What's new in the auditor's report?

## How does this affect the audit committee and management?

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### Name of the engagement partner

In Belgium, the engagement partner has been identified in the auditor's report for many years, as this is a requirement of the Belgian Auditing Standards. However, this is now a global requirement.

No impact

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### Going concern

Enhanced auditor reporting on going concern, including:

- Specific descriptions of the responsibilities of management and the auditor for going concern;
- When a material uncertainty exists and is adequately disclosed in the financial statements, a separate section is included in the auditor's report (previously this was included as an emphasis of matter paragraph).

- The audit committee should scrutinize management's process for assessing the entity's ability to continue as a going concern. Although these responsibilities are not new, there is an increased focus on going concern and the related disclosures. Therefore, it is a good opportunity to evaluate these processes.
- The audit committee should examine the relevance and completeness of the entity's disclosures in the financial statements related to going concern, particularly for entities that have "close call" situations (i.e. where there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, but management has mitigating plans, and the conclusion is that no material uncertainty exists).

Furthermore, the auditor is required to challenge the adequacy of disclosures for "close calls". Close calls are identified events or conditions that may cast significant doubt on an entity's ability to continue as a going concern but due to management's plans, it was concluded that no material uncertainty exists.

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## What's new in the auditor's report?

### Other information

Inclusion of a section that:

- explains management's responsibility for the other information;
- identifies the other information obtained or expected to be obtained;
- explains the auditor's responsibilities
- explains the work effort in relation to other information;
- contains a statement on whether there is something to report in regards to the other information or not;
- contains a statement describing any uncorrected material misstatements.

## How does this affect the audit committee and management?

The audit committee and management should:

- Determine which documents will be within the scope of "other information" as defined by the ISA and therefore within the scope of the auditor's responsibilities. ISA 720 applies to other information included in an annual report. It could include non-financial and diversity information (matters linked to environmental, social, diversity, etc.)
- Discuss with the auditor which documents comprise the annual report, and the entity's planned manner and timing of the issuance of such documents. Consider agreeing on this in the engagement letter with the auditor.
- Evaluate time frames for the drafting and finalizing of these documents because the auditor needs to be provided with the documents as soon as possible, and prior to their issuance.
- Assess documents comprising the annual reports for consistency with the financial statements. Implement processes to ensure that information contained therein is factually correct and reasonable.

## What's new in the auditor's report?

## How does this affect the audit committee and management?

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### **Responsibilities of the auditor, the management and those charged with governance**

Enhanced description of the responsibilities of the auditor and key features of an audit. Improved descriptions of the responsibilities of the management and those charged with governance particularly relating to going concern.

Furthermore, the auditor is now permitted to present these descriptions in an appendix to the auditor's report or, where law, regulation or national auditing standards expressly permit, refer to a website of an appropriate authority.

The standard auditor's report in Belgium will include these descriptions fully.

Please refer to page 9 (going concern section) regarding the impact of the enhanced descriptions of management's responsibility relating to going concern.

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### **Restructure of the report**

The "opinion" section is required to be presented first, followed by the "basis for opinion" section. Please refer to page 14.

No impact

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# Key audit matters

The auditor is required to communicate those matters that were of most significance in the audit of the financial statements, known as key audit matters. The intention is not to provide a comprehensive list, as doing so would diminish the value of the reporting.

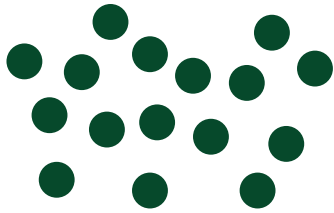
The intent is to determine those audit matters which were of the most significance in the context of the entity and the audit in the current period.

## **New ISA 701 – key audit matters**

In Belgium, the IAASB's amended standard ISA 701 is applicable for PIES. These are companies which have shares listed on a stock exchange, financial institutions and insurance companies.

The key audit matters applies for both, the auditor's report on the consolidated financial statements as well as on the statutory financial statements of the holding company.

For audits of PIES in accordance with other auditing standards than ISA (e.g. US GAAS), the key audit matters will also be applicable.



**Matters communicated with those charged with governance**



**Matters that require significant auditor attention:**

- Areas of higher assessed risks of material misstatements or significant risks;
- Significant auditor judgments relating to areas in the financial statements that included significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty;
- Significant events or transactions; or
- Other matters that required significant auditor attention e.g. the implementation of a new IT system.



**Matters of most significance:**

Factors the auditor would consider in determining which matters are of most significance:

- Significance of interactions between the auditor, the management and the audit committee;
- The importance of the matter to understanding the financial statements as a whole;
- The materiality of the matter;
- Corrected and uncorrected misstatements relating to the matter and the nature of these;
- Complexities relating to the accounting policy, for example subjectivity in selecting the accounting policy or difference in the policy compared to industry norms;
- The nature and extent of audit effort to address the matter, for example use of experts;
- Difficulties in performing audit procedures and obtaining sufficient audit evidence;
- Severe control deficiencies;
- Inter-relatedness with other matters, for example long-term contracts which affect revenue recognition, impairments, etc.

**Auditor's Judgement**



**Key audit matters:**

The description of the key audit matters in the auditor's report must include the following:

- Reference to the related disclosure in the financial statements (if any);
- Explanation of why the matter was considered as a key audit matter; and
- Explanation of how the matter was addressed in the audit.

# New reporting structure

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<b>Opinion</b>	With the new reporting structure, the auditor's report will begin with the "opinion" and the identification of what has been audited.
<b>Basis for opinion</b>	The basis for opinion is directly following the opinion section. It includes a statement that the audit was conducted in accordance with the ISAs it also refers to the auditor's responsibilities section and states the auditor's independence. If the auditor modifies the opinion the explanation would be in this section, too.
<b>Material uncertainty related to going concern</b>	If there is a material uncertainty related to going concern, this will be described in this section.
<b>Key audit matters</b>	For financial statements of PIEs, this section provides information about audit areas that mattered the most – the key audit matters (KAMs).
<b>Responsibilities for the financial statements</b>	In this section the auditor describes the management's responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework and the management's responsibility to assess the company's ability to continue as a going concern.
<b>The auditor's responsibilities for the audit of the financial statements</b>	The auditor describes his/her responsibilities under the ISAs including for example to obtaining reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error and exercising professional judgment.
<b>Other reporting responsibilities</b>	In some jurisdictions, the auditor may have additional responsibilities to report on other matters that are supplementary to the auditor's responsibilities under the ISAs.
<b>Name of the engagement partner</b>	The auditor's report shows the name of the engagement partner.
<b>Signature, address and date</b>	The auditor's report shall be signed and shows the auditor's address and date.

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# Where to go from here?

There are a few challenges that need to be overcome in this new reporting journey. Identifying the key audit matters will be difficult, particularly where the matter is not disclosed in the financial statements, and describing the key audit matters in a succinct and understandable manner, while keeping it relevant, will be challenging.

Naturally, this will impact audit hours and deadlines as the reports will go through quality assurance processes and reviews that would need to be considered in establishing reporting timelines.

Early engagement between the auditor and the audit committee is going to be critical in this transformation of the auditor's report.

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