



Clear, transparent reporting  
The new auditor's report

2015



Clear, transparent reporting




A high-speed photograph of a water droplet falling into a pool of water. The droplet is captured mid-fall, just above the surface, creating a clear, elongated shape. Below the droplet, the water surface is disturbed, showing concentric ripples and a small splash. The background is a solid, deep blue color, providing a clean, minimalist aesthetic.

# Introduction

Business has over the last few years become more complex, and financial reporting has had to evolve, increasing the judgement, estimates and uncertainty underlying the financial statements. However, the auditor's report, being the key deliverable addressing the output of the audit process, has up until now been a standard pass/fail report with limited, if any, information that relates specifically to the entity, while providing no indication of the complexities relating to the entity or the audit.

Since auditing is a profession that goes about its work behind the scenes, investors and other financial statements users have demanded more transparency and insight into the audit.





The auditor's report is about to be revolutionised. The International Auditing and Assurance Standards Board (IAASB) has, after a five-year project, released new and amended International Standards on Auditing (ISAs) which will transform the auditor's report, and for listed entities, will include key information relating to the audit of the entity.

The IAASB intends 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 believes 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.

The IAASB's amended standards are effective for years ending on or after 15 December 2016.



# Expected benefits



Users have demanded improved transparency into the audit for some time, and as a result, this is the main benefit that is expected to be achieved from the revisions. Improved transparency improves trust. The economic crisis brought a wave of distrust in the corporate world and their auditors. Openness and honesty are exactly what the world needs right now.



improved  
transparency



improved  
trust



honesty



relevant  
information



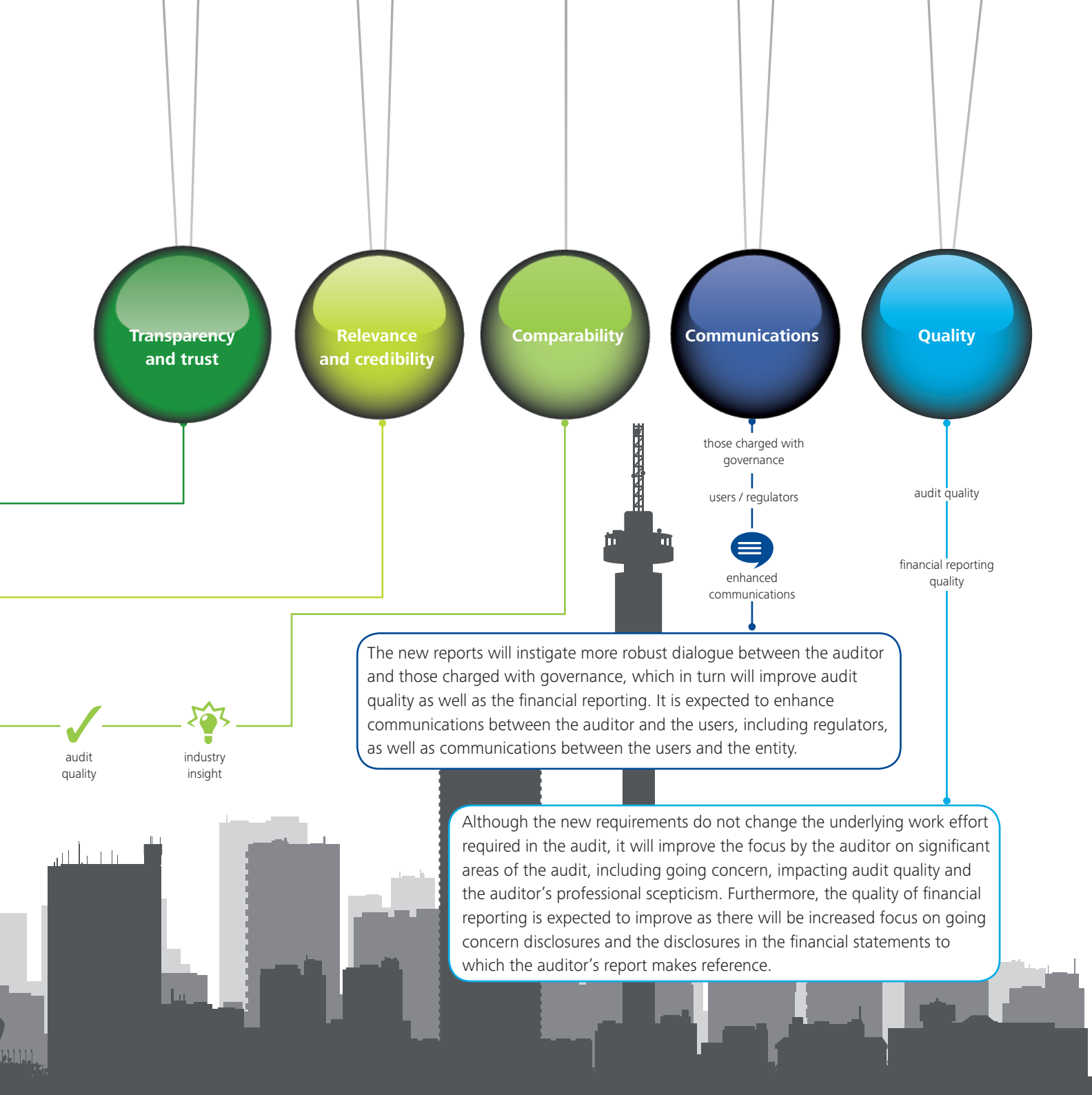
bespoke  
reports



credibility

The auditors' reports of listed entities 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, but 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 of the audit.

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









# International developments

Globally the key 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 judgements 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



The Public Company Accounting Oversight Board (PCAOB) published exposure drafts on 13 August 2013 proposing a more discursive audit report, which will be applicable to SEC registrants and potentially to brokers/dealers. We expect a reproposal to be released by September 2015.



The European Union has issued a directive 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

## Listed entities



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

#### Key audit matters

New section to communicate key audit matters (KAMs) which are those matters that, in the auditor's judgement, were of most significance in the audit of the current period financial statements.

*(Please refer to page 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 communications 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 are 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 in order 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. (Such disclosures may be in the financial statements or the annual report.)
- 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.

## Listed entities



What's new in the auditor's report?

### Name of the engagement partner

In South Africa, the engagement partner has been identified in the auditor's report for many years, as this is a requirement of the IRBA Code of Professional Conduct for Registered Auditors. However, this is now a global requirement.



How does this affect the audit committee and management?

No impact

## All entities



What's new in the auditor's report?

### Independence and ethics

An affirmative statement about the auditor's independence and fulfilment of relevant ethical responsibilities, with disclosure of the jurisdiction of origin of those requirements or reference to the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants*



How does this affect the audit committee and management?

- The audit committee should annually or regularly evaluate whether the auditor is independent in terms of the relevant codes and the Companies Act of South Africa by:
  - Monitoring and pre-approving all non-audit services provided by the audit firm
  - Monitoring non-audit services provided by other auditing firms due to the potential impact of rotation requirement, particularly for entities with affiliations in the UK and Europe, i.e. some firms may be prohibited from being appointed if they have provided the services set out in section 90(2) of the Companies Act of South Africa in the last five years
  - Assessing the independence of the auditor, both the firm and the individual engagement partner, when nominating the auditor for appointment



## All entities



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

#### Going concern

Enhanced auditor reporting on going concern, including:

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

Furthermore, the auditor is now required to challenge the adequacy of disclosures for "close calls" i.e. when events or conditions were identified 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.



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

- The audit committee should scrutinise management's process for assessing the entity's ability to continue as a going concern. Although these responsibilities are not new, there is 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 who 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).

## All entities



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

#### Other information

Inclusion of a section relating to other information that explains management's responsibility for the other information, identifies the other information obtained or expected to be obtained, explains the auditor's responsibilities and work effort in relation to other information and either that there is nothing to report or a statement describing any uncorrected material misstatements. This section is included as follows:

- Listed entities – where the auditor has obtained, or expects to obtain, the other information;
- Other entities – where the auditor has obtained some or all of the other information.



### 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. An annual report is widely defined, and therefore will include more documents than the traditional annual report routinely issued in South Africa. It would include the integrated report, directors' report, audit committee report and sustainability report [if the sustainability report is included in the annual report - a stand-alone sustainability report would be excluded].)
- 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 timeframes for the drafting and finalisation of these documents, in order that the auditor is 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 and implement processes to ensure information contained therein is factually correct and reasonable.



All entities



What's new in the auditor's report?

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

Enhanced description of the responsibilities of the auditor and key features of an audit, and improved descriptions of the responsibilities of 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.



How does this affect the audit committee and management?

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



What's new in the auditor's report?

**Restructure of the report**

The "Opinion" section is required to be presented first, followed by the "Basis for Opinion" section.



How does this affect the audit committee and management?

No impact



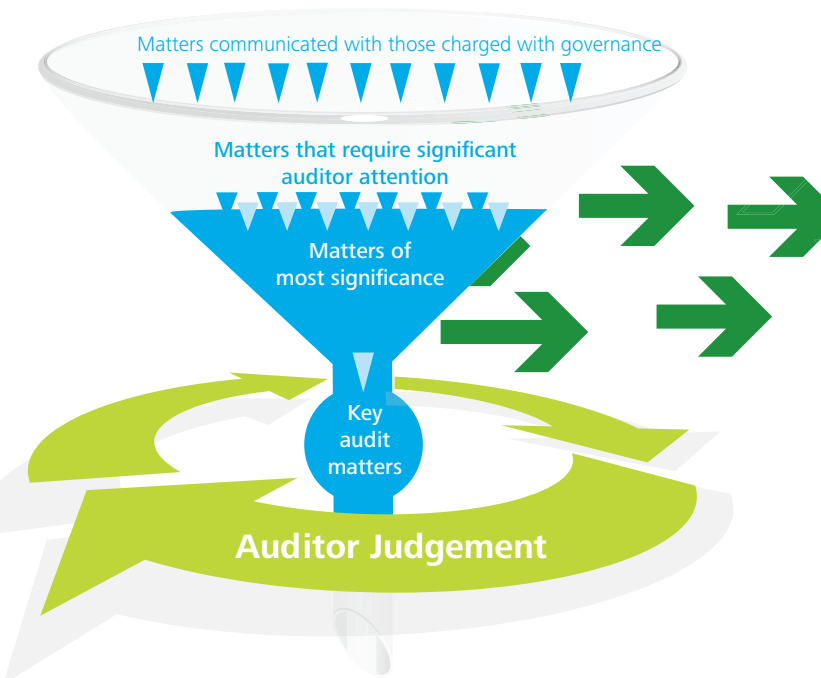


# Key audit matters

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 for the auditor to provide a comprehensive list, as doing so would diminish the value of the reporting. The point is to focus on a few key matters, in the context of the entity and the audit.

As concerns have been raised about the communication of sensitive matters, the auditor may decide not to communicate a key audit matter where:

- In extremely rare circumstances, the adverse consequences of doing so would outweigh the benefit of public disclosure; or
- Laws and regulations preclude public disclosure about the matter.



### Matters that require significant auditor attention:

- Areas of higher assessed risks of material misstatements or significant risks;
- Significant auditor judgements relating to areas in the financial statements that included significant management judgement, including accounting estimates that have been identified as having high estimation uncertainty;
- Significant events or transactions that had a significant effect on the financial statements or the audit; or
- Other matters that required significant auditor attention which may / may not be disclosed in the financial statements 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, 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.

### Key audit matters:

The auditor's 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 why the matter was considered to be one of most significance; and
- Explanation of how the matter was addressed in the audit.





# Where to from here?

There are a few challenges that we need to 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 rigorous 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. However, the dawn of new auditor's report is upon us and we are eager to launch into the transformation of the auditor's report.

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