REVOLUTIONISING REPORTING: WHY CARE?

The Future of Audit Reporting

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REVOLUTIONISING REPORTING

Trust is the heart of effective financial markets. Trust used to be a given. In an increasingly complex and connected business world, investors are demanding more evidence that they can trust those managing their investments. These demands extend to all participants in the financial reporting chain. Directors are being challenged to explain complex affairs more clearly. Auditors are being challenged to explain their work and focus.

Since auditing began, consistency in how auditors report to shareholders has been a predominant feature. Audit is complex, technical work and consistency in explaining the role and the results of the audit work has taken prevalence.

This is being turned on its head. The increasing demands for transparency of process, to help justify trust, has led to the introduction for the first time of unique commentary in the audit report to shareholders.

This is a major change to market communication.

We have explored the issues associated with the expanded reporting changes with market representatives globally. We have also held in depth discussions with those who have already gone through the process.

In this paper we highlight the key messages shared with us and highlight insights to demonstrate why this matters.

The future of market communications is in the balance. In relation to audit reporting this paper is a first step to help drive a positive outcome which enhances the value and efficiency of our markets.

Will you be ready?

“

THIS IS A HUGE CHANGE IN THE WAY AUDITORS COMMUNICATE with investors and other users. The preparation of these new style reports with so-called Key Audit Matters and other innovations will result in more intense communication with management and those charged with governance, such as audit committees. The public interest benefit hopefully will be better understanding of companies and their audits.

PROFESSOR ARNOLD SCHILDER
CHAIRMAN, INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD

CONTENTS

This paper is part of the FutureInc series and focuses on Future Directions.

BRIEF SUMMARY OF THE CHANGES

KEY AUDIT MATTERS (KAM)

- New section in the public audit report to explain key audit matters (KAM). KAM are those matters which were of most significance in the audit of the current period financial statements.
- Section to include a succinct description of the matter and a meaningful summary of how the matter was addressed in the audit.

AUDIT OPINION

- Audit opinion brought to the start of the report.

GOING CONCERN

- Going concern explanation clarified.
- New format in the audit report when a material uncertainty over going concern exists and is adequately disclosed in the financial statements.
- Audit standard ISA 570 on work effort is also revised.

REST OF ANNUAL REPORT

- New section to cover auditor's work in relation to other information in the annual report.
- Audit standard ISA 720 on work effort is also revised.

RESPONSIBILITIES

- More explicit statement on independence, including which standards were followed.
- Enhanced description of responsibilities of the auditor and management with option to move text on responsibilities to appendix or website.

This is a brief summary of the package of changes. For further detail see page 28.
In this paper we explore issues relating to the introduction of Key Audit Matters only.

AUSTRALIA AND NEW ZEALAND STAKEHOLDER EXCHANGES

In March 2015, Chartered Accountants Australia and New Zealand brought together key stakeholders in Australia and New Zealand to work through the implications and impact of the extended reporting by auditors.

The Revolutionising Reporting Stakeholder Exchanges engendered vibrant discussion on the impact in our markets. Both challenges and values were identified.

VALUE

The discussions at the Exchanges identified some clear values from the proposals. These include:

VALUE FOR INVESTORS

- Clearer understanding of audit role
- Better appreciation of responsibilities
- Useful signpost to financial statements
- Additional understanding of judgemental areas in financial statements
- Clearer information to allow investors to decide for themselves the level of trust they place on the financial statements (and in turn, the company or management).

VALUE FOR COMPANIES

- Better engagement between market participants
- More constructive communication with investors in key areas
- More informed investors leading to lower cost of capital
- Audit reports that are interesting, useful and relevant to the company
- Enhances trust through transparency about areas identified as risks by company, also being highlighted by auditors.

VALUE OF AUDIT PROFESSION

- Demonstrates a confident and engaged profession
- Enhances trust in the audit role through better understanding of responsibilities and work
- Enables audit firms to explain matters of relevance
- Provides mechanism for audit firms to differentiate.

CHALLENGES

As with all change, there will be challenges and potential obstacles. Some of these explored at the Exchanges include:

- Potential for increased liability
- Concern over additional time and cost
- Unease over additional workloads when filing deadlines are already tight
- Possibility to confuse investors through attempts to summarise complex matters
- Possibility that audit report will be seen as more relevant than the directors or company reporting.

"It's a challenge, but I'm sure we can all rise to it."

Chartered Accountants Australia and New Zealand, Stakeholder Exchange March 2015

INSIGHTS

The Stakeholder Exchanges highlighted some key themes for Australia and New Zealand in relation to the upcoming revolution.

The changes however are international. The International Auditing and Assurance Standards Board introduced these changes which are being adopted by other countries globally. The USA standard setter is preparing similar standards[1].

The UK introduced standards in 2013 which expanded the audit report for listed entities[2]. This was part of a package to improve corporate reporting overall and also included a requirement for the Audit Committee to publicly report on areas of judgement in the financial statements. We have pored over many examples of published expanded reports from the UK to extract useful commentary and understand the practical application.

We met with individuals at international and overseas bodies, audit firms and companies to glean an understanding of their perspectives on the impact of the reporting changes.

In the next few pages we set out insights and commentary from all of these activities.

Our markets are at a crossroads in relation to transparency and communication. Our insights in relation to the auditor reporting aspect show that a positive route can be chosen.

1. The Public Company Accountants Oversight Board (PCAOB) in the US is working on similar standards.
2. The UK audit standards differ in some respects from the international version and include other reporting matters. The KAM requirements are broadly consistent and it is only this aspect we are considering for the purposes of this paper.

KEEP IT REAL

"The worst thing will be if auditors just add more and more KAM each year so reports get longer and longer."

Chartered Accountants Australia and New Zealand, Stakeholder Exchange March 2015

The major value of expanded reporting by the auditor is to highlight what was relevant that year. This encompasses many aspects and will require thought and discussion with directors and management.

Important elements to work through are:

- which of the important matters assessed during the audit would fall within the KAM description for the year
- how to describe the matter in a meaningful way
- how to summarise the audit procedures in a succinct but relevant manner.

The UK experience can be helpful. There were distinct differences between the reports in the first year and the second year in the UK. It was noticeable that more KAM were reported in the second year, and also that the level of detail in the descriptions changed.

In this section, we use the published **Vodafone Group PLC UK** audit reports to demonstrate these points:

WHICH TO INCLUDE

The March 2013 report listed five KAM, the March 2014 report listed seven. It is interesting to note that three matters – goodwill and intangible assets, legal claim, and revenue recognition – were included in both years. In the second year two were removed and replaced with four more specific matters:

KAM identified in 2013 Audit Report	KAM identified in 2014 Audit Report
Ongoing matters	
Goodwill and intangible assets	Goodwill and intangible assets
Legal claim for withholding tax	Tax affairs and legal claim
Revenue recognition	Revenue recognition
Year specific matters	
Recognition and measurement of deferred tax assets	Disposal of investment
Risk of management override of internal controls	Acquisition in Germany
	Deficiencies in user access control
	Legal, regulatory and tax cases

The intention of the standard is to have year-specific matters included. It is to be expected therefore that even if a matter is important in both years, it may not be in the audit report both years. It will depend on what else was considered of most significance during the audit each year. This will be a substantial change in approach for many. All participants will need to get used to KAM moving in and out of the audit report.

INSIGHT

Every year there needs to be challenge as to whether something should be included in the report. Just because it was in one year, does not mean it automatically stays the next.

"The huge change in the UK audit report is widely seen as an equally huge success. For the first time in my career, shareholders are actually reading audit reports with interest. It's helping to demonstrate the value of audit to the benefit of the stewardship relationship between shareholders and the company." Mike Metcalf Partner, KPMG *(Pictured left)*

"The extended audit report is invaluable in making clear not only what our conclusions are, but in setting out what we considered in getting to those conclusions. There is also a symmetry with the annual report taken as a whole: the risks that we considered to be significant as set out in our audit report can be read in conjunction with the risks identified elsewhere in the annual report by the company itself." Tim Biggs Partner, Deloitte UK

HOW TO EXPLAIN

The 2013 Vodafone Group audit report had relatively high level explanation of the matters, whereas the 2014 report was noticeably more specific.

2013 KAM explanation	2014 KAM explanation
The recognition and measurement of deferred tax assets in Germany and Luxembourg.	The tax affairs of the Group are complex, particularly as they relate to the legal claim in respect of withholding tax on the acquisition of Hutchinson Essar Limited and the recognition and measurement of deferred tax assets in Germany and Luxembourg. Evaluation of the legal claim in respect of the withholding tax on the acquisition of Hutchinson Essar Limited is subject to significant uncertainty. The recognition of deferred tax assets in Germany and Luxembourg requires assessment of both the availability of losses and future profitability.
Revenue recognition including the timing of revenue recognition, the recognition of revenue on a gross or net basis, the treatment of discounts, incentives and commissions and the accounting for multiple element arrangements.	We have identified three critical judgement areas in relation to revenue recognition and the associated presumption of fraud risk, namely: • Accounting for new products and tariff plans including multiple element arrangements • The timing of revenue recognition and • The accounting judgements associated with dealer and agency relationships including the presentation of revenue on a net or gross basis and the treatment of discounts, incentives and commissions.

The changes between years in the UK mostly reflect a bedding in of the new standards. Investors took great interest in the application of the standard. All firms and companies we met reported feedback from investors on the style and content of the audit reports which impacted how they were prepared in the second year. An interesting element of the UK experience is that investors did not "mark auditors down" for their choice of KAM. Any questions about what was included, or not included, or what a KAM meant, were directed to the company and not the auditor.

INSIGHT

How the wording of the new reports will be interpreted by New Zealand and Australian markets is an unknown. The changes are so revolutionary it may be easy to draw erroneous conclusions based on number of matters included, or subtle wording differences.

> "There will be growing pains but there is good reason to be optimistic about the changes to the overall quality of reporting."
>
> Chartered Accountants Australia and New Zealand, Stakeholder Exchange March 2015

SUMMARISING SUCCINCTLY

The 2014 description of procedures in the Vodafone Group audit report was more specific than the previous year, while still keeping it in a summarised form.

KAM example	2013 description of audit procedures	2014 description of audit procedures
Impairment of goodwill and intangible assets.	We challenged management's assumptions used in the impairment model for goodwill and intangible assets, described in note 12 to the financial statements, including specifically the cash flow projections, discount rates, perpetuity rates and sensitivities used, particularly in respect of the Group's interest in southern Europe.	Our work focused on detailed analysis and challenge of the assumptions used by management in conducting the impairment review as described in Note 4 to the Group financial statements. This included: • Challenging forecasts with particular attention paid to the European businesses where we have evaluated recent performance, carried out trend analysis and compared to market expectations • Using our valuations specialists to independently develop expectations for the key macroeconomic assumptions driving the analysis, in particular discount rates, and comparing the independent expectations to those use by management; and • Comparing growth rates against those achieved historically and external market data where available. We have also evaluated the sensitivity analysis performed by management and the disclosure relating to the impairment review.
Contingent liability in relation to legal claim for withholding tax.	We considered the legal advice in connection with management's disclosure in note 21 of contingent liabilities, including the impact of the introduction by the Indian government of legislation which amends Indian tax law with retrospective effect to overturn a judgement in the Group's favour.	Our approach was to use our tax specialists to evaluate tax provisions and potential exposures for the year ended 31 March 2014 challenging the Group's assumptions and judgements through our knowledge of the tax circumstances and a review of relevant correspondence. In particular we have assessed legal advice obtained by management to support the judgement taken in relation to the withholding tax case in India, which included discussion with external counsel. We also considered the adequacy of disclosure in this respect.

The standard requires explanation of how the matter was addressed. This generally means explaining some of the audit procedures. It is important to make the description of procedures relevant to the actual audit work and not just a broad rewriting of procedures listed in the auditing standards. Australia and New Zealand auditors will be able to take the second year examples from the UK as the starting point and use this to gauge the level of specificity to include in their reports.

KEEP IT PERSONAL

One matter which was commonly raised at the Stakeholder Exchanges was the idea of consistency.

Discussion centred on whether there needed to be consistency of wording within a firm for similar KAM, whether there needed to be consistency between how different firms worded their reports, and whether there needed to be consistency in similar industries of KAM identified or procedures chosen to be included.

This is quite understandable as the role of standard setters and market regulation has in many ways been driven by a desire for consistent process and approach. The audit report evolved into template wording to meet this desire. The expanded audit report breaks this mould. Attitudes and perceptions need to break too.

INSIGHT

Chartered Accountants Australia and New Zealand encourages differences. The value of the reporting is that it is unique to the entity and unique to that year. We challenge our markets and regulators to support and embrace differences and to use any perceived difference as an opportunity to discuss, not an opportunity to dismiss.

"The Center for Audit Quality commends the efforts of policymakers worldwide—including the PCAOB, IAASB, and Chartered Accountants ANZ—who have worked to advance auditor reporting. We believe such a modification could improve the information communicated to investors and others, enabling them to analyse more closely any related financial statement accounts and disclosures." Cindy Fornelli CEO, The CAQ *(Pictured above, left)*

"It's been exciting to be involved in the most fundamental change in auditor reporting in decades. We see implementation bringing both opportunities and challenges. The new reports will be as new to management, audit committees and users as they are to auditors – we will all be on a learning curve. The aim is audit reports that are insightful and tailored to the company. It would be a setback if this just becomes a boilerplate exercise. That said, there will be a certain degree of similarity when auditors address similar facts, circumstances and outcomes, both for the same company over time and across industries. But that, in and of itself, provides insight." Diana Hillier Partner, PwC UK *(Pictured above, middle)*

"Auditors and listed companies in the UK are about to enter the second year of extended audit reports. The feedback from both investors and auditors has been very positive and audit committees have also embraced greater transparency in their reports to shareholders. The new audit reports have begun to open the audit "black box" and facilitate an important dialogue with stakeholders". Nick Land Independent Director, Vodafone *(Pictured above, right)*

SAME MATTER, SAME WORDING?

From our review of UK reports, it is clear that there are some matters which are consistently included as KAM. The most common matters are revenue, impairment and taxation. The two examples below illustrate that even where KAM are on the same topic, the explanation of the matter can be unique to the company:

Petropavlovsk PLC December 2013	Avocet Mining PLC December 2013
Revenue recognition	
The Group entered into a number of forward sales contracts which it designated as cash flow hedges. The accounting for these derivative financial instruments and documentation requirements in order for transactions to qualify as hedges is complex. In addition ISA (UK & Ireland) 240 requires us to presume that there are risks of fraud in revenue recognition.	Revenue is recognised in the financial statements in accordance with IAS 18 "Revenue". There is a presumption that there are risks of fraud in revenue recognition because determining the appropriate timing of recognition can be judgemental. As the timing of revenue recognition is subject to the conclusion of a trading contract on the bullion market or a relevant forward contract, which is after the gold ore is shipped from Inata and refined into bullion in South Africa, we identified revenue recognition as a significant risk requiring special audit consideration.

The reason the description is different is because the auditors are being specific about the issue in relation to the company.

SAME INDUSTRY, SAME MATTERS?

For entities in similar industries, there was a thought that the KAM would be the same. UK experience to date shows that while there will be common matters, there will also be KAM unique to the entity. The two companies used above also demonstrate this point:

Petropavlovsk PLC	Avocet Mining PLC
London-listed (gold) mining and exploration company with its principal assets located in Russia.	Gold mining and exploration company with assets in West Africa.
Risks of material misstatement identified in the Independent Auditor's Report, December 2013.	Risks of material misstatement identified in the Independent Auditor's Report, December 2013.

Common KAM

- Going concern
- Revenue
- Impairment of property, plant and equipment
- Impairment of exploration and evaluation assets
- Going concern
- Revenue recognition
- Impairment review of Burkina Faso property, plant, equipment and deferred exploration asset
- Carrying value of Guinea deferred exploration expenditure (intangible asset)

Company specific KAM

- Inventory
- Management override of controls
- Burkina Faso taxes
- Carrying value of intercompany loan and debtor balances within the parent company

INSIGHT

The importance of the new style audit report is that it is specific to the entity and to the audit. The auditors' role will be to describe the issue and procedures with sufficient specificity to make this clear.

What will the markets make of this? Our discussions overseas highlighted that investors used the insights from the audit report to look for further information from the company disclosures and directors' reports.

SAME YEAR ON YEAR?

It is to be expected that some matters will be KAM year on year for some entities (subject to annual challenge as stated above). We examined UK audit reports to assess whether this occurred and how this impacted on the usefulness of the information being provided to the market. We found that where the same matter was identified in subsequent years, the text for both the description of the issue and the explanation of the audit procedures was customised for the particular year. We set out KAM extracts from the Ashmore Group PLC audit reports to illustrate this:

June 2013 text: Share-based payments (extract)	**June 2014 text: Share-based payments** (extract)
The Group issues share awards to employees under share-based compensation plans. As explained in the report of the Audit and Risk Committee on pages 47 to 48, the key risk associated with share-based compensation arrangements is the quantification of such arrangements, as certain assumptions need to be taken into account in determining the fair value of those share-based compensations that are subject to market-based performance conditions. This is therefore the key area we focused on during our audit.	Refer to pages 49-50 (Audit and Risk Committee Report), page 85 (accounting policy) and note 10 of the financial statements disclosure. The risk – the Group issues share awards to employees under a number of share-based compensation plans. The number of shares that vest for executive Directors are subject to the relative total share return (TSR) condition over the vesting period. This is one of the key judgemental areas that our audit is concentrated on because of the judgements involved in determining the likelihood of the TSR condition being met.

If boilerplate language is used to describe a matter, the value investors will be able to derive will be decreased. The colour added to the matter by the auditor explanation helps to direct and focus the investor on issues they may wish to consider further with the company.

INSIGHT

The UK examples so far show different language but this may be a reflection of the bedding in of the new standards rather than a deliberate attempt to make the information meaningful in a different year. How this matter is covered in the third year of reporting will be most useful for Australia and New Zealand markets.

MOVING THE MARKET

Much discussion arose around whether the new style audit report would move the market. One view, strongly held, was that it would not and should not. Both Australia and New Zealand have continuous disclosure regimes and any information likely to move markets would be disclosed in advance of financial statement publication.

Other matters arising considered whether the audit report would include matters not covered elsewhere in the financial statements and how potentially price sensitive matters would be addressed.

MATTERS NOT ADDRESSED ELSEWHERE IN THE FINANCIAL STATEMENTS

One of the great values of the new style report may be the increased communication which is likely between auditors and boards, and boards and management. KAM are those areas of most relevance to the audit of the financial statements for the year. Increased focus on those areas by the board may include heightened consideration of the disclosures of the matters in the financial statement notes, the directors' report or other parts of the annual report. It has potential to improve the clarity of information across the board in areas of most relevance.

The UK experience cannot be used to help our markets in this regard as they have a different reporting regime. The 2013 changes in the UK introduced a regime requiring the company's audit committee to make a public report on their work, including identification of matters considered by the audit committee to be of most importance. There have been isolated examples of matters being included in an audit report as a KAM but not included in the audit committee report but this has not been common. There is recognition that the audit committee and auditors have different roles and so their reporting will be complementary but not identical.

INSIGHT

The UK reporting model ensures the integrity of the governance framework is maintained by requiring direct communication by directors as well as auditors. The Australian and New Zealand models allow for this to occur on a voluntary basis, but do not require a company to specifically report. Chartered Accountants Australia and New Zealand encourage directors and companies take a lead in reporting.

SENSITIVE ISSUES

An audit is designed to allow the auditor to form an opinion as to whether the financial statements are prepared and presented in accordance with accounting standards.

The financial statements are a reflection of the company's business for the period. In order to assess whether the figures are fair, auditors need to understand the business, the process for recording the financial aspects of the business, the controls over the processes and many other operational matters.

Some of this may be price or commercially sensitive. The Stakeholder Exchanges explored how an audit focus on some of these other issues would be reflected under the KAM structure.

"These new standards give us an opportunity to deliver innovation and insight in a way not previously permitted. We can demonstrate publicly the relevance of the audit, rebuild trust in auditors and, crucially, underpin confidence in reported financial information. This a game-changer for all stakeholders." Richard Sexton, Vice Chairman, Global Assurance PwC *(Pictured left)*

"Along with enhanced audit committee reporting, the new style audit reports have provoked considerable interest in the investor community and media. They have assisted with the profession's efforts to engage with our broader stakeholders and have helped demonstrate the continued relevance of audit. Our partners have enjoyed the challenge of producing reports and working with audit committees to provide additional insight and transparency. I look forward to seeing how these reports continue to develop and stimulate investor engagement on the topics raised."
Hywel Ball, Management Partner Assurance, UK & Ireland, EY

A review of UK audit reports shows that matters which may be sensitive, such as litigation or new IT systems, can and have been raised as KAM. A key is to understand the impact of the matter in an audit context. We set out four examples to demonstrate how these matters have been approached:

Rolls-Royce Holdings PLC
December 2013

Bribery and corruption

A large part of the Group's business is characterised by competition for individually significant contracts with customers which are often directly or indirectly associated with governments and the award of individually significant contracts to suppliers. The procurement processes associated with these activities are highly susceptible to the risk of corruption.

In addition the Group operates in a number of territories where the use of commercial intermediaries is either required by the government or is normal practice. The Group is currently under investigation by law enforcement agencies, primarily the Serious Fraud Office in the UK and the US Department of Justice. Breaches of laws and regulations in this area lead to fines, penalties, criminal prosecution, commercial litigation and restrictions on future businesses.

Our response: We evaluated and tested the Group's policies…..

BHP Billiton PLC
June 2014

IT system development and deployment

The Group's accounting records and financial reporting processes rely on the effectiveness of the IT platform used. During the year the Group completed a multi-year IT transformation project with the result that the entire Group operates on a consistent global platform.

There are various risks associated with major IT projects including data integrity, underlying system accuracy and maintaining appropriate levels of system security.

Our procedures included among others: Assessing the Group's processes and controls…

Vedanta Resources PLC
March 2014

Litigation, environmental and regulatory risk

Given the significant number of legal claims a risk exists that the Group may not have adequately provided for liabilities. There is also a risk of the Group's reputation being brought into disrepute resulting in financial and reputational damage. The Group continues to be involved in a high number of legal claims.

As it is not unusual for claims to remain outstanding for a number of years, there has been a resultant steady increase in the number of cases over time with the regulatory environment becoming increasingly complex and regulators focusing on the environmental and social impacts. These ongoing claims, environmental and regulatory enquiries are a threat to the future operations as well as the Group's current financial performance and reputation. (see notes 37 & 41)

We have: Challenged management regarding their assessment of the probability of success in these cases…

Xplorer PLC
March 2014

Going concern

The Company has no revenues and limited cash resources to finance its activities whilst it identifies and completes suitable acquisition opportunities. At 31 March 2014 it had not announced any such acquisitions. There is a risk that the company may be unable to secure suitable acquisition opportunities or to make a suitable acquisition or will have insufficient fund to secure a suitable acquisition.

The ways in which we scoped our response are…we reviewed cash flow projections for the company.…

INSIGHT

The changes are not intended to require the auditor to disclose information not provided by the entity, or to divulge price sensitive material. A KAM covers matters which have high potential of resulting in a material misstatement in the financial statements and therefore where the auditor has undertaken heightened audit focus. This may include potentially sensitive matters. The UK experience shows that such circumstances can be managed. Communication between auditors, directors and management is key.

MOVING MINDSETS

"This will require real discipline to do it well but will be helpful for investors."

Chartered Accountants Australia and New Zealand, Stakeholder Exchange March 2015

Consistency is not essential. Just as earnings volatility needs to be accepted under accounting standards, so too do market participants need to accept that audit reports are not going to be the same.

The Stakeholder Exchanges highlighted the enormity of this change to the mindsets of those in the markets. Simple examples of differences of interpretation of simple words are already in evidence. This will be exacerbated by the variability of style and wording in the new audit reports.

Is a different description of a common KAM due to some underlying difference in the risk of the business, or merely a difference in the writing skills of the auditor?

Simple answers are not possible and these discussions again highlighted the importance of early and clear communication.

Questions were also considered on the impact of the changes on the running of the Annual General Meeting. The policy has not changed. The auditor is available at the AGM to answer questions in relation to their audit and not in relation to the business or financial report items. The inclusion of KAM in the audit report may confuse this distinction for some, so the role of the AGM chairman to articulate the policy may become more important.

There may indeed be more questions of the auditor on the audit. The changes require not only a description of the matter, but also a succinct summary of audit procedures undertaken in relation to the issue.

This may be the first time many investors have been aware of the type or depth of the procedures undertaken by the auditor. Interestingly UK experience has not resulted in more questions to the auditor on their procedures. Time will show how this unfolds in the Australian and New Zealand markets.

GOING BEYOND

In the UK, a few auditors have chosen to go beyond the requirements of the auditing standards and include a brief commentary on the findings of their audit procedures. Examples of this include the recent audit reports for Roll-Royce, New World Resources, Ashmore and AstraZeneca. This is still in experimental stage and has not been widely adopted to date.

"... The new auditor reporting standards are the biggest change to auditing in decades. The market is demanding more information and these changes respond to those demands." Fayez Choudhury CEO, International Federation of Accountants *(Pictured above, left)*

"The response of both audit committees and audit engagement partners to these changes has been most encouraging and widely welcomed by investors. In particular, auditor's reports now seem to be considered more worthy of reading than the traditional cursory look at the binary opinion. Many are now considered to provide a valuable insight into the audit process and issues. In implementing the changes, many of the auditing firms have gone further than the changes required by our standards, and have been both innovative and resisted any temptation to report in bland standardised language. In the UK we are now moving into the second year of extended auditor reporting. It is already clear that auditing firms intend to innovate further and see this as a way in which to distinguish their firm from their competitors." Marek Grabowski, UK FRC

"As a profession we have been on the back foot for too long now. We invariably say 'no', and I really believe now is the time for us to shape our own future, because, otherwise, others will do that for us." Jimmy Daboo, Partner. KPMG UK

MAKING IT WORK

COMMUNICATION

A consistent message from our meetings and Exchanges has been the importance of communication. Communication between management and auditor, auditor and board, board and management, and company and markets. This revolution in reporting has the opportunity to enhance the information to the markets – through both the audit report KAM and through potentially clearer explanations in the company financial statements.

SUPPORT

However to make this work, the change needs to be supported. This includes support for experimentation and support for variety. This applies across market participants:

- Company management need to support the fact that there will be increased focus on how they prepare and present certain aspects of the financial statements
- Company directors need to support management in understanding and accepting this focus, support auditors in their choice of reporting and the additional time this may take, and support their shareholders in understanding the matters raised and business implications
- Audit firms need to support their partners finding their own voice for reporting and using their judgement over what and how to include matters
- Investors need to support the objective of additional information and not be tempted to draw conclusions or seek responses without communication with the company
- Regulators need to support the substantial move to professional judgement being used for public reporting and accept experimentation and variety.

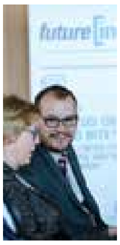
TIME AND PRIORITY

There is no doubt that the preparation of a judgemental report for public distribution will increase the time required. This can be particularly difficult when year-end financial reporting processes have tight deadlines. Early planning is vital. Presenting and discussing the expected KAM wording with the board at the audit planning stage will enable the matters to be finalised smoothly at the end of the process (subject of course to changes which may arise during the audit work).

Boards and audit committees have many things on their plates. Shareholder communication should be a high priority and these changes go to the heart of shareholder communication.

"Auditor communication of key audit matters – one of the most innovative aspects of the new standards – is a significant step-change. It will recalibrate how auditors approach communications to users of their reports. It will renew how users look at the auditor's reports. It will make those reports more transparent and relevant. And it will stimulate greater attention to and discussion on important matters identified from an audit perspective – towards improved audit quality and public confidence."

James Gunn Professional Standards, International Standard Setting Boards *(Pictured left)*



THE DETAILS

Here we set out a little more detail about the changes in the international auditing standards which are introducing the revolution in reporting.

WHAT?

- There is a new standard, ISA 701 which introduces the concept of key audit matters.
- There are changes to the auditor reporting standard, ISA 700, to amend the template wording and format of the report.
- There are changes to audit standard ISA 720 which sets out requirements for the auditor to read other information included with the audited financial statements. This was issued in April 2015.
- There are changes to audit standard ISA 570 in relation to audit work on going concern.
- Finally, there are amendments to a number of other auditing standards so that the wording and requirements are consistent with changes introduced through ISA 700 and ISA 701.

Audit reporting

Who?

- Most changes for all audit reports.
- Key Audit Matters (KAM) for listed entities only.
- Standard setters in Australia and New Zealand will consult on whether to extend KAM to other entities.

Where?

- Applicable to every country which adopts international auditing standards.
- UK introduced similar requirements in 2013.
- PCAOB consulting on US equivalent standard.

When?

- International standard applicable for year ends on or after 15 December 2016.
- Australia and New Zealand expected to be same adoption period – 31 December 2016/30 June 2017 year ends.

"The Public Interest Oversight Board (PIOB) congratulates the IAASB and its Chairman, Professor Arnold Schilder, for the inclusive and very thorough process followed in the development of this complex project. The auditor's report project includes significant enhancements introduced to six International Standards on Auditing (ISAs). The main innovations introduce a new section calling for the disclosure of the Key Audit Matters that, in the opinion of the auditor, constitute the most relevant matters during the audit; a statement relating to the auditor's independence from the audited entity and his compliance with relevant ethical requirements; the disclosure of the name of the audit engagement partner; and further detailed descriptions of both the auditor's and management's responsibilities, including going concern. The enhanced standards are a critical development in auditing globally, and their timely and proper application will provide important public interest benefits."

Gonzalo Ramos CEO public Interest Oversight Board *(Pictured left)*

What does the new standard ISA 701 require?

- A new section in the audit report to explain **key audit matters (KAM)**.
- A succinct description of the matter being included as a KAM, and a meaningful summary of the audit procedures undertaken to address the matter.
- KAM are those matters which were of most significance in the audit of the current period financial statements. They will be a subset of matters communicated to those charged with governance and may be an area:
  - With a higher risk of financial statement material misstatement
  - Requiring significant judgement, including accounting estimates
  - Where there was a significant event or transaction in the year,
- The new KAM section is not to be used for matters that otherwise would give rise to a modified opinion.
- The wording must not contain or imply that there are discrete opinions on separate elements of the financial statements.

What changes in the updated ISA 700?

- The audit opinion is brought to the start of the report.
- The going concern explanation wording is clarified, specifically references to the going concern "basis of accounting" concept as separate from a "solvency" definition.
- There is a new section in the audit report when a material uncertainty over going concern exists and it is adequately disclosed in the financial statements.
- There is a more explicit statement on independence, including which standards or code were followed by the auditor.
- There is an enhanced description of the responsibilities of the auditor and of management, with an option to move text on responsibilities to an appendix or website.

There is a new section to cover the auditor's work in relation to other information in the annual report. ISA 720 is the auditing standard which will dictate the work and reporting and this standard is in the process of being finalised.

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