

IAASB proposals for enhancing the auditor's report: Potential impact on audits of unlisted entities

Brian Bluhm and Phil Cowperthwaite describe the most significant implications set out in the exposure draft

The International Auditing and Assurance Standards Board has released proposals that could fundamentally transform the auditor's report, greatly enhancing its communicative value.

The exposure draft proposes a new standard, International Standard on Auditing (ISA) 701 *Communicating Key Audit Matters in the Independent Auditor's Report*, and a number of revisions to existing standards, including ISA 700 *Forming an Opinion and Reporting on Financial Statements*.

While the proposals stand to significantly change the shape of auditor reporting for listed entities, the impact on unlisted entities is likely to be much smaller. Nevertheless, there are proposed requirements that apply to all audits. These are intended to help demonstrate the value of the audit and, furthermore, may improve service and promote engagement efficiency.

This article summarizes this impact and suggests how small- and medium-sized practices and small- and medium-sized entities can get involved to help ensure the best possible outcome.

Proposals

The proposed new and revised standards deal mainly with reporting considerations, which typically involve decisions by the auditor toward the end of the audit process. There are, however, aspects that may have implications for what the auditor does at or near the beginning of the audit, such as agreeing the terms of and planning the engagement, as well as communicating with those charged with governance.

Content of the auditor's report

The centrepiece of the proposals is proposed ISA 701. This completely new standard establishes requirements and guidance for the auditor's determination and communication of key audit matters in the auditor's report. Key audit matters, which are selected from matters communicated with those charged with governance, are required to be communicated in the auditor's report for listed entities. Auditors of financial statements of unlisted entities may also be required, or may decide, to communicate key audit matters in the auditor's report.

For example, law, regulation, or national auditing standards may require auditors of unlisted entities in a particular jurisdiction to communicate key audit matters. Moreover, the auditors of other unlisted entities may wish to use the new mechanism of key audit matters on a voluntary basis. Where key audit matters are communicated for audits of financial statements of unlisted entities (either voluntarily or when required by law or regulation) then such matters should be determined and communicated in the same manner as for listed entities (see paragraph 4 of proposed ISA 701 and paragraphs 30 and A30–A31 of proposed ISA 700 [Revised]).

ISA 700 has been revised to establish new required reporting elements, including a requirement for the auditor to include an explicit statement of auditor independence and disclose the source(s) of relevant ethics requirements, for all audits including those of unlisted entities.

Similarly, ISA 570 *Going Concern* has been amended to establish auditor reporting requirements applicable to all audits. The

IAASB believes it is in the public interest for this to have universal application.

Agreeing terms of engagement

In light of the possibility of auditors of unlisted entities communicating key audit matters in the auditor's report, or being requested by management or those charged with governance to do so, the IAASB has proposed limited amendments to other ISAs, including ISA 210 *Agreeing the Terms of Audit Engagements*. Specifically, if the auditor is not required to communicate key audit matters but intends to do so, a new requirement has been established for the auditor to include a statement in the audit engagement letter regarding such intent. This will provide an additional opportunity for the auditor to communicate with management and those charged with governance to ensure there's a clear understanding as to the nature of the key audit matters to be disclosed.

Communicating with those charged with governance

In light of proposed ISA 701, amendments are proposed to the required auditor communications with those charged with governance for all audits.

The most significant proposed change to ISA 260 relates to the existing requirement for the auditor to communicate an overview of the planned scope and timing of the audit with those charged with governance. Proposed ISA 260 (Revised) *Communication with Those Charged with Governance* expands this requirement to include communicating about the significant risks identified by the



auditor (see paragraph 15 of proposed ISA 260 [Revised]).

Communication with those charged with governance about significant risks is likely already occurring in many audits, including those of SMEs, as ISAs demand a risk-based approach to the audit. But the IAASB believes audit quality could benefit from explicitly requiring such communication in every audit.

The proposed requirement would provide those charged with governance with insight into those areas for which the auditor determined special audit consideration was necessary and, in so doing, help those charged with governance to fulfil their responsibility to oversee the financial reporting process. This will also provide the auditor with an opportunity to garner additional insights into significant risks from those charged with governance and, thereby, help ensure the audit programme is appropriately focused.

The IAASB believes it is in the public interest to establish this requirement for audits of financial statements of all entities, not only for listed entities. Communicating

with those charged with governance about significant risks is not expected to result in a significant burden on auditors who are not required to communicate key audit matters in the auditor's report (e.g. auditors of unlisted entities), as proposed ISA 260 (Revised) remains flexible for such communication to be made orally.

In addition, the IAASB proposes requiring the auditor to communicate, as part of communicating the significant findings from the audit, circumstances that require significant modification of the auditor's planned approach to the audit, to align with the factors the auditor considers in determining key audit matters (see paragraph 16(c) of proposed ISA 260 [Revised]). This will provide further opportunity for dialogue with those charged with governance to help ensure all responsible parties have a full understanding of areas of significant auditor attention.

Feedback

The IAASB believes that the proposed ISAs can be implemented in a manner proportionate to the size and complexity of an entity and welcomes the views of both pre-

parers and auditors of financial statements of unlisted entities, including SMEs, in this regard. The IAASB also invites respondents to comment on areas where additional guidance may be helpful to illustrate how the proposed ISAs can be implemented in a proportionate manner.

The International Federation of Accountants' SMP Committee has been providing regular and robust input to the IAASB

throughout the exposure draft's development, starting with a response letter to the invitation to comment. Please tell us (in the IFAC SMP Community on LinkedIn) and the IAASB website (click on Submit Comment) what you think about the exposure draft and consider field testing ISA 701 on unlisted entities.

For related resources for SMPs from IFAC, its members and others, see Implementation in the SMP area of the IFAC website, www.ifac.org/SMP, or the SMP Committee's Delicious page at delicious.com/ifacsmpcommittee.

Copyright © August 2013 by the International Federation of Accountants. All rights reserved. Contact permissions@ifac.org for permission to reproduce, store or transmit this document.



Brian Bluhm is deputy chair and **Phil Cowperthwaite** is a member of the IFAC SMP Committee.