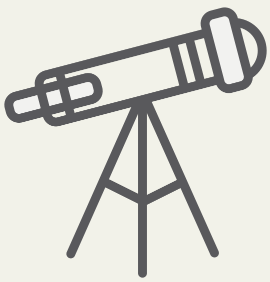

New Auditor's Report: Observations from the U.K. experience

In less than 100 days, the New Auditor's Report will be effective for audits of financial statements for periods ending on or after 15 December 2016.

The new and revised auditor reporting standards were issued in response to calls from investors to require the auditor's report to be more informative and relevant.

The cornerstone of the New Auditor's Report is the inclusion of key audit matters (KAMs). An auditor is required to take into account the following in determining what KAMs to communicate:

- **Risk areas**: areas of higher assessed risk of material misstatement, or significant risks.
- **Judgments**: significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.
- **Events**: the effect on the audit of significant events or transactions that occurred during the period.

KAMs are not boiler-plate – they should be tailored specific to the entity. As such, there is no one-size-fits-all template illustration.

Where can we look to for examples?

The inclusion of KAMs in the New Auditor's Report is broadly equivalent to the revised standard for extended auditor reporting issued by the United Kingdom Financial Reporting Council three years ago.

This article therefore outlines the findings from the U.K. experience to provide useful implementation tips and examples.

Common findings of U.K. extended auditor reporting

A recent study entitled *Consequences of Changing the U.K. Auditor's Report* found that:

- The average size of the report has tripled.
- The number of words in the New Auditor's Report has increased to 2,400 compared to 757 words in the old auditor's report, and about 30 percent of these words are used in the discussion of the significant risks of material misstatement.
- Auditors disclose on average four risks of material misstatement per report.
- Revenue recognition is the risk most often disclosed by the auditor, followed by impairment of goodwill and other long-lived assets, tax accounting and business combinations.

What was the investor feedback on the U.K. extended audit reports?

The FRC published a report *Extended Auditor's Report: A Further Review of Experience* in January detailing its review on U.K. extended audit reports that were issued in 2015. The report also includes investors' feedback.

It was found that the most positively received reports were those that incorporated the following aspects:

- Carefully structured reports with the

end-user in mind and markers that indicate key information;

- Clear, concise and transparent disclosures about risk, scope and materiality, as well as the critical areas where professional judgment and assumptions have been addressed;
- More granular risk descriptions and language;
- A close alignment between Audit Committee reporting and auditor's reports; and
- The auditor's findings for risks of material misstatement.

It was also found that many investors considered further enhancement could be made, including:

- Providing more complete information about the sensitivity ranges used in testing; the auditor's assessment of the quality of an entity's internal controls including its significant risk assessment; and the auditor's view on the appropriateness of management estimates;
- Increasing transparency about assumptions made by management and benchmarks used by auditors, balanced against the potentially competing demands of clarity and conciseness, as well as preserving the importance of reading an overall true and fair opinion; and
- Explaining changes in the audit approach (if any) and the assessed risks reported from one year to the next, that is, a dynamic analysis of changes over time.

Effective implementation is key

Effective implementation is critical to the success of the New Auditor's Report. Investors, regulators, audit oversight bodies, audit committees and others each have an important role in carrying out the new changes required in auditor reporting.

If management, their auditors and audit committees have not yet begun the assessment of KAMs nor have they had dialogues with all relevant stakeholders, now is the time to do so.

Resources available

The Institute has an e-seminar on the revised Auditor's Report that covers key changes to the auditor's report, provides practical application tips, and explores the implications for listed entities.

A more thorough overview of the requirements for the new and revised auditor reporting standards is set out in *A Plus* May 2015 issue. Further references on the New Auditor's Report are available at the IAASB website.

This article is contributed by the Institute's Standard Setting Department