BT NEWS BRIEF

MAY 2016

INDEPENDENT AUDITOR'S REPORT

IMPENDING DRAMATIC CHANGE TO THE FORM AND CONTENT

HIGHLIGHTS

On 15 January 2015, the International Auditing and Assurance Standards Board ("IAASB") issued new and revised Auditor Reporting Standards, as well as its related conforming amendments, relating to the Form and Content of the Independent Auditor's Report. These new and revised standards are intended to enhance the communicative value of the auditor's report, to provide greater transparency about the audit that was performed, and to increase users' confidence in the audit performed on the financial statements. The new and revised standards do not change the scope of the independent audits, but require auditors to provide greater insights into the audit performed by enhancing the form and disclosure content of the auditor's report. In this BT News Brief, we provide an overview of the key changes in the auditor's report and the key considerations for "Key Audit Matters" and "Going Concern" matters.

WHAT SHOULD WE KNOW?

Changes applicable to audit of all type of entities:

- Relocation of the auditor's opinion
- Explicit compliance statement on independence and other relevant ethical requirements
- Enhanced description on auditor's responsibilities
- Enhanced auditor reporting on going concern
- Disclosure of material inconsistency under "Other Information" section

Changes applicable to audit of listed companies:

- Key Audit Matters
- Engagement partner's name to be disclosed
- Disclosure of other information not received under "Other Information" section

WHAT ARE THE KEY ENHANCEMENTS TO THE AUDITOR'S REPORT?

Amongst the key changes to the auditor's report is the requirement to report Key Audit Matters in accordance with new ISA 701 *Communicating Key Audit Matters in the Independent Auditor's Report*, as well as enhancing the information about an entity's ability to continue as a going concern in accordance with revised ISA 570 *Going Concern*.

The table below provides an overview of the key changes in the new auditor's report:

Changes applicable to all audits of all types of entities

- **Relocation of the auditor's opinion**
  The auditor's opinion is required to be presented first, followed by the Basis for Opinion section (including unmodified opinions), unless law or regulation prescribe otherwise.

- **Independence and other relevant ethical requirements**
  The auditor's report would include an explicit statement that the auditor is independent of the entity and has fulfilled the auditor's relevant ethical requirements, 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.*

- **Auditor's responsibilities**
  An enhanced description of the responsibilities of the auditor and key features of an audit.

- **Enhanced auditor reporting on going concern, including:**
  - a separate section when a material uncertainty related to going concern exists.
  - descriptions of the management's and the auditor's responsibilities in relation to going concern.

- **Other information**
  A statement by the auditor on whether or not the other information (i.e. other than the financial statements and auditor's report) is materially inconsistent with the financial statements, or our knowledge obtained in the audit or otherwise appears to be materially misstated.

Changes applicable to audits of listed entities

- **Key Audit Matters**
  A new section titled "Key Audit Matters" is to be included in the auditor's report. Key Audit Matters ("KAMs") are those matters that, in the auditor's judgement, were the most significant during the audit of financial statements of the current period. KAMs are usually identified from the list of significant audit matters that were communicated with those charge with governance.

- **Engagement partner's name**
  The auditor's report will have to disclose the name of the engagement partner unless, in rare circumstances, such disclosure is reasonably expected to lead to a significant security threat to the individual. (Note: it is the existing practice to disclose the name of engagement partner in the auditor's report in Malaysia).

- **Other information**
  Disclosure of other information not received before report date.

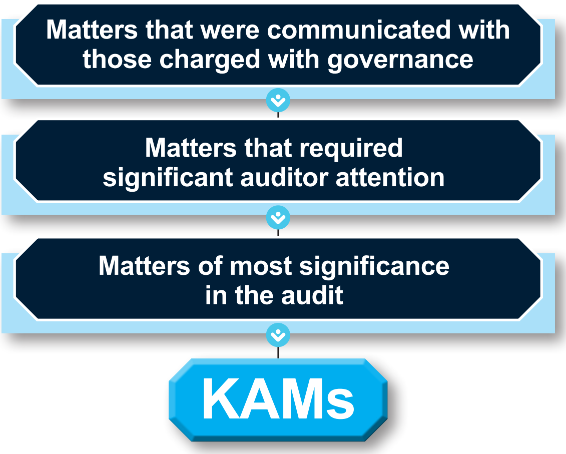
KEY AUDIT MATTERS

Key Audit Matters ("KAMs") are the subject of a new standard, ISA 701.

Currently, significant audit matters are reported to the audit committee and board members in the form of a memorandum presented at the end of the audit. However, this information is not available to other users of the financial statements. The inclusion of KAMs in the auditor's report is therefore intended to highlight those matters that, in the auditor's judgement, were the most significant during the performance of their audit.

It is important to note that the "Emphasis of Matter" and "Other Matter" paragraphs pursuant to ISA 706 *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report* are retained and such paragraphs cannot be used as a substitute for KAMs. The inclusion of KAMs in the auditor's report also does not change the auditor's underlying responsibilities in accordance with the ISA, nor does it change the responsibilities of the preparers of financial statements and those charged with governance.

The diagram below provides an overview of how KAMs are determined:



As a general guide, the starting point in identifying KAMs is to look at the list of significant audit matters that were communicated to the audit committee and the board. From this list, the auditor has to determine which matters require their significant audit attention. This second list is then narrowed down further by identifying the matters which were the most significance in the audit of the financial statements of the current period. This final list will then form the KAMs.

In identifying the KAMs to be reported in the auditor's report, the auditor must consider, at the minimum:

- areas of higher assessed risks of material misstatement, or significant risks identified during the audit;
- significant auditor judgements relating to areas that involved significant management judgement; and
- effect on the audit of significance events or transaction.

What is included in the description of a KAM?

The description of a KAM in the auditor's report always includes:

› why the matter was considered to be a KAM.
› how the matter was addressed in the audit. This may include (1) aspects of the auditor's response or approach, (2) brief overview of procedures performed and (3) indication of the outcome of the auditor's procedures and key observations with respect to the matter.
› a reference to the related financial statement disclosure(s), if any.

KAMs should:

› be entity-specific and the auditor should try to avoid generic, standardized or overly technical language.
› not imply that the matter has not been appropriately resolved by the auditor in forming the opinion on the financial statements or contain or imply discrete opinions on separate financial statement elements.

Are KAMs always communicated in the auditor's report?

› In extremely rare circumstances, the auditor is allowed not to communicate a matter determined to be a KAM when the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication. This does not apply if the entity has publicly disclosed information about the matter.
› If the auditor determines that there are no KAMs to be communicated, the KAM section would specifically highlight that the auditor has determined that there are no KAMs.
› Unless required by law or regulation, when the auditor disclaims an opinion on the financial statements, the auditor's report shall not include a KAM section. However, a KAM section is required for a qualified or adverse opinion.

GOING CONCERN

In line with calls by investors and other stakeholders to increase the focus on going concern matters, the IAASB made revisions to ISA 700 *Forming an Opinion and Reporting on Financial Statements,* to enhance the communications about going concern in the auditor's report, as well as revisions to ISA 570 which applies to audit of all entities.

The revised ISA 570 enhances the auditor's work relating to going concern disclosures by:

- providing further guidance regarding the consideration of appropriate disclosures when a material uncertainty exists.
- requiring the auditor to evaluate the adequacy of disclosures in going concern "close calls" situation. "Close calls" situation is where events or conditions were identified that may cast significant doubt on the entity's ability to continue as a going concern but, after considering management's plans to deal with these events or conditions, management and the auditor conclude that no material uncertainty exist.
- including a new description of management's responsibility for assessing the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate, as well as disclosing, if applicable, matters relating to going concern.
- including a new statement that the auditor's responsibilities are to conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.
- requiring a separate section under the heading "Material Uncertainty Related to Going Concern", drawing attention to those disclosures if the entity's going concern disclosures are adequate when a material uncertainty related to going concern exists; and
- requiring a modified opinion as the first section of the auditor's report if the entity's going concern disclosures are inadequate when a material uncertainty related to going concern exists.

In some circumstances, matters relating to going concern (including "close calls") may be determined to be a KAM and communicated in the auditor's report in accordance with new ISA 701.

On the other hand, when there is indeed a material uncertainty related to going concern, although it is by nature a KAM, it is reported separately in the "Material Uncertainty Related to Going Concern".

EFFECTIVE DATE

The new requirements are effective for audits of financial statements for periods ending on or after 15 December 2016. Early application is permitted.

KEY CHALLENGES

This new requirements on the auditor's report will impact the entire financial reporting chain, including the preparers and those charge with governance as the drafting and agreement of KAMs requires continuous communication and significant coordination efforts between various parties. In Malaysia, coupled with the shortened timeframe for issuance of annual reports for listed entities, auditors, preparers and those charged with governance should communicate now on this "New Style" auditor's report.

This article was prepared by the Quality Assurance and Technical team of Baker Tilly Malaysia.
For further information, please contact **esthercheah@bakertillymh.com.my**