

# Agenda Item 3-A

## ***Consequential Amendments to ISA 800<sup>1</sup> and ISA 805<sup>2</sup> – Issues and Drafting Team Recommendations***

### **Summary of the IAASB's Discussions at Its September 2014 Meeting**

#### *Proposed ISAs 800 (Revised) and 805 (Revised)*

Except for various editorial and non-substantive changes that were suggested during the meeting, the Board generally agreed with DT-700's proposed consequential amendments to proposed ISAs 800 and 805 as proposed in Agenda Items 5-A, 5-B and 5-C.<sup>3</sup>

With respect to the requirement to disclose the name of the engagement partner (EP) in the auditor's report for listed entities, two Board members challenged the need to do so in the case of the auditor's reports on financial statements prepared in accordance with special purpose frameworks, or single financial statements or specific elements. Those Board members noted that the name of the EP is typically known among users of auditor's reports in these circumstances. Ms. de Beer noted that the IAASB's Consultative Advisory Group (CAG) provided a very strong steer for including the name of the EP in all auditor's reports. Ms. Healy explained that the requirement to disclose the name of the EP for audits of special purpose financial statements, or single financial statements or specific elements for listed entities, can be included in the exposure draft (ED) for ISAs 800 and 805 as a proposed conforming amendment to ISA 700 (Revised).<sup>4</sup> The Board agreed with this approach.

One Board member questioned whether the communication of key audit matters (KAM) would be beneficial to users of auditor's reports on financial statements prepared in accordance with special purpose frameworks, or single financial statements or specific elements. Mr. Winter explained that the communication of KAM in those circumstances is not required, but voluntary.

#### *Way Forward*

The Board agreed to consider the approval of an ED for proposed ISAs 800 and 805 at its December 2014 meeting.

### **Objectives of the IAASB Discussion**

The following are the objectives of the IAASB discussion at its December 2014 meeting:

- Discuss issues and DT-700's recommendations relating to outstanding issues related to the consequential amendments to ISAs 800 (Revised) and 805 (Revised);
- Consider revisions made to the proposed ISAs in light of the input received at the September 2014 IAASB and CAG meetings; and
- Approve an ED for public comment.

<sup>1</sup> ISA 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*

<sup>2</sup> ISA 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*

<sup>3</sup> Agenda Items 5-A, 5-B and 5-C are available at the September 2014 IAASB Meeting page at: <http://www.ifac.org/auditing-assurance/meetings/new-york-usa-7>

<sup>4</sup> ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

## Introduction

1. At previous meetings, the IAASB agreed that, as a matter of principle, the enhancements that form part of the new and revised auditor reporting standards would be extended to ISAs 800 and 805.
2. Revisions to the drafts of proposed ISAs 800 (Revised) and 805 (Revised) since the September 2014 IAASB meeting are intended to:
  - Address the feedback received from the IAASB and CAG September 2014 meetings; and
  - Align them to the finalized new and revised auditor reporting standards, taking into account the refinements and editorials made to the illustrative auditor's reports contained therein.

### *Treatment of Anticipated Changes Arising from Other Projects*

3. The drafts of proposed ISAs 800 (Revised) and 805 (Revised) as presented at the September 2014 meeting included changes relating to reporting about Other Information that were presented in shaded text for IAASB reference purposes. The IAASB agreed that these changes will be finalized as part of the proposed ISA 720 (Revised)<sup>5</sup> conforming amendments. Those proposed changes have been retained in shaded text as part of the December 2014 agenda materials, and will be updated during the December 2014 meeting to be included in the ED.
4. Proposed ISA 800 (Revised) and 805 (Revised) as presented at the September 2014 meeting also included proposed conforming amendments that DT-700, together with the Disclosures Task Force Chair, intended to take into account other changes proposed in the Disclosures ED.<sup>6</sup> Those proposed changes have been reversed. DT-700 determined that it would be more appropriate to consider these changes once the IAASB had considered and deliberated on the feedback received from respondents to its May 2014 ED. Those changes are currently planned to be finalized in March 2015.
5. As noted at Agenda Item 3, options for a way forward with respect to ISA 810 are discussed separated in Agenda Item 9.<sup>7</sup>

## Issues and DT Recommendations

### Naming of the EP

6. DT-700 continues to recommend that the auditor be required to disclose the name of the EP for audits of special purpose financial statements, and for single financial statements or specific elements of listed entities. However, due to the interaction of the ISA 800 series with ISA 700 (Revised), this requirement is set out as a proposed conforming amendment to ISA 700 (Revised), rather than separate requirements in proposed ISAs 800 (Revised) and 805 (Revised) (see **Agenda Item 3-G**). This proposed conforming amendment will be included in the ED for public comment.

#### **Matter for IAASB Consideration**

1. Does the IAASB agree with the proposed requirement (included as a conforming amendment to ISA 700 (Revised)) related to naming the EP in ISA 800 and ISA 805 auditor's reports?

<sup>5</sup> Proposed ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*

<sup>6</sup> At the time that the May 2014 ED, *Proposed Changes to the International Standards on Auditing (ISAs)–Addressing Disclosures in the Audit of Financial Statements*, was finalized, it was determined that the Disclosures Task Force would work with DT-700 to determine the conforming amendments for auditing disclosures in the ISA 800 Series.

<sup>7</sup> ISA 810, *Engagements to Report on Summary Financial Statements*

## Communication of KAM in the Auditor’s Report on a Single Financial Statement or Specific Element

7. The IAASB agreed that communication of KAM should be voluntary, but not required, for audits of listed entities of single financial statements or specific elements of a financial statement (ISA 805 engagement).<sup>8</sup> While the communication of KAM is not required by proposed ISA 805 (Revised), guidance within the standard has been proposed to explain that:
- Where communication of KAM is required by law or regulation, or the auditor elects to communicate KAM, KAM is to be communicated in an ISA 805 auditor’s report in the context of the audit of the single financial statement or element by applying ISA 701 in its entirety<sup>9</sup> (“ISA 805-specific KAM”) (see paragraph A19 of **Agenda Item 3-C**).
  - KAM that has been communicated in the auditor’s report on the complete set of general purpose financial statements (“ISA 700 auditor’s report” and “complete-set KAM”) may be communicated in the ISA 805 auditor’s report (see paragraph A23 of **Agenda Item 3-C**).

### Recap of IAASB Decisions

8. The IAASB supported DT-700’s initial recommendation that KAM should be voluntary (unless required by law or regulation) when proposed ISA 805 (Revised) applies, and agreed that it was not necessary to have a requirement for the auditor to communicate KAM in the context of the ISA 805 engagement, or a requirement to determine the relevance of complete-set KAM to the ISA 805 auditor’s report. The IAASB’s September 2014 agenda materials noted that practical challenges may exist for the ISA 805 auditor’s report to refer or include a sub-set of the complete-set KAM. Those challenges included, for example:
- The need to tailor the introductory language of the KAM sub-section (as required by ISA 701) for the purposes of presentation in the ISA 805 auditor’s report.
  - That inclusion of only the relevant KAM from the ISA 700 auditor’s report) may not represent what would have been KAM in an ISA 805 auditor’s report had the auditor performed a separate determination in the context of the ISA 805 engagement. This is because:
    - For an audit of a complete set of financial statements, KAM are determined using a threshold of most significance to the audit as a whole, taking into account the communications with those charged with governance (TCWG). If KAM were to be communicated in the ISA 805 auditor’s report, it would likely result in matters of “most significance” that differ in the context of the ISA 805 engagement compared to those determined in the context of the engagement to audit the full set of general purpose financial statements.
    - TCWG may not have the same oversight responsibilities for the single financial statement or element as they do for the complete set of financial statements.
9. The IAASB generally agreed with DT-700’s recommendation for a principles-based approach to drafting the application material in paragraph A23 of proposed ISA 805 (Revised) permitting complete-set KAM to be included in an ISA 805 auditor’s report. However, some IAASB members had a different view and suggested that DT-700 consider further expanding paragraph A23. There

<sup>8</sup> Accordingly, paragraph 30 of ISA 700 (Revised) states that “For audits of complete sets of general purpose financial statements of listed entities, the auditor shall communicate key audit matters in the auditor’s report in accordance with ISA 701.”

<sup>9</sup> ISA 701, *Communication of Key Audit Matters in the Independent Auditor’s Report*. See also paragraph 31 of ISA 700 (Revised), which states that: “When the auditor is otherwise required by law or regulation or decides to communicate key audit matters in the auditor’s report, the auditor shall do so in accordance with ISA 701.”

was also a suggestion to explain the interaction between paragraphs A19 (ISA 805-specific KAM) and A23 (complete-set KAM) of proposed ISA 805 (Revised).

#### *DT Considerations*

10. Upon further reflection, some DT-700 members noted concerns about the application material in paragraph A23 of proposed ISA 805 (Revised)<sup>10</sup> as presented in the September 2014 IAASB meeting materials. This application material permits the auditor to communicate a sub-set of complete-set KAM in the ISA 805 auditor's report. For example, it was noted that if there was a number of KAM communicated in the ISA 700 auditor's report, notwithstanding that one (or more) of these KAM may relate to the subject of to the ISA 805 engagement (and therefore potentially relevant to users of the ISA 805 auditor's report), it may not be appropriate to just refer or repeat this one KAM from the complete-set KAM in the ISA 805 auditor's report. These DT-700 members characterized the application material in paragraph A23 permitting the auditor to include relevant KAM from the ISA 700 auditor's report as possibly being interpreted as something different to the concept of KAM as described in ISA 701 (for example, "KAM-lite" or "cherry-picking KAM"), as there may be other matters of most significance in the ISA 805 engagement that would be communicated if ISA 701 was applied to that engagement (but which were not complete-set KAM). They suggested that the auditor should be permitted to communicate the relevant KAM that had been included in the ISA 700 auditor's report *only* in circumstances when ISA 701 was also applied in its entirety to the ISA 805 engagement (i.e., apply paragraph A19 of proposed ISA 805 (Revised)), such that all relevant KAM to the engagement would then be included in the ISA 805 auditor's report.
11. Taking a different view, other DT members acknowledged that the initial intent of paragraph A23 of proposed ISA 805 (Revised) as set out in the September 2014 IAASB meeting agenda materials was to permit the auditor to include a sub-set of complete-set KAM in the ISA 805 auditor's report, because:
  - TCWG may not have the same oversight of an ISA 805 engagement, which may be a barrier in the auditor performing a separate determination of KAM for the ISA 805 engagement in accordance with ISA 701; and
  - In principle, extant ISA 805 already acknowledges the need to consider whether certain matters included in the ISA 700 auditor's report would be relevant for inclusion in the ISA 805 auditor's report. Extant ISA 805 permits the inclusion of an Emphasis of Matter (EOM) paragraph or Other Matter (OM) paragraph based on the auditor's determination of the effect that the EOM or OM paragraph may have on the ISA 805 auditor's report (i.e., its relevance).<sup>11</sup>
12. DT-700 considered the following issues:
  - Whether a reference to any relevant complete-set KAM should be forbidden, permitted, or required.
  - How the KAM in the ISA 700 auditor's report should be addressed in the ISA 805 auditor's report (i.e., reproduced in full, or summarized).

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<sup>10</sup> Proposed ISA 805, paragraph A23 as presented in the September 2014 IAASB agenda materials stated that: "When the auditor has audited the complete set of financial statements and communicated key audit matters in the auditor's report thereon, the auditor may consider whether it may be relevant to communicate in the auditor's report on the single financial statement or on a specific element of a financial statement any key audit matters that are also relevant to the single financial statement or a specific element of a financial statement."

<sup>11</sup> See extant ISA 805, paragraph 14

- How to address various circumstances, such as if the audit firm of the complete set of financial statements and the ISA 805 engagements were different or TCWG were different parties.

#### *DT-700 Recommendations*

13. DT-700 members recommend that the application material in paragraph A23 be re-drafted as shown in **Agenda Item 3-C**, taking into account the approach in paragraph A22 of proposed ISA 805 (Revised). Paragraph A22 of proposed ISA 805 (Revised) assists auditors in determining the effect of an EOM paragraph or OM paragraph from ISA 700 auditor's report on the complete set of financial statements on the ISA 805 auditor's report. ISA 706 (Revised)<sup>12</sup> would also allow for the auditor to include an EOM paragraph or OM paragraph if considered necessary in the context of the ISA 805 engagement (i.e., beyond what may be included in the ISA 700 auditor's report).
14. DT-700 considered various options, for example being silent about referring to complete-set KAM in the ISA 805 auditor's report, but ultimately agreed to retain but revise the application material in paragraph A23 in **Agenda Item 3-C**, to provide a clear signal that referring to complete-set KAM in an ISA 805 auditor's report is permitted (although voluntary). This allows for information included in the ISA 700 auditor's report to be communicated to users of the ISA 805 auditor's report in circumstances where the auditor believes it would be relevant to do so, which is in the public interest.
15. However, in allowing such reference to be made in the ISA 805 auditor's report, DT-700 members also deemed it important to:
  - Ensure that any statement in the ISA 805 auditor's report that indicates the existence of complete-set KAM was appropriately distinguished from the concept of KAM as it would be applied to an ISA 805 engagement itself. Accordingly, DT-700 concluded that the reference to, or inclusion of, relevant complete-set KAM in the ISA 805 auditor's report would be best presented in the form of an OM paragraph in accordance with ISA 706 (Revised),<sup>13</sup> rather than be included under the heading of "Key Audit Matters". Doing so also alleviates the need to modify the introductory language in a KAM section in these circumstances, as the introductory language relates to the application of ISA 701 in its entirety.
  - Suggest that, when the auditor considers that one or more of the complete-set KAM may be relevant for inclusion in the ISA 805 auditor's report, the auditor may instead decide to determine and communicate ISA 805-specific KAM in the ISA 805 auditor's report (i.e., whether ISA 701 should be applied to the ISA 805 engagement as contemplated in paragraph A19 of ISA 805 (Revised)).
16. DT-700 acknowledged that, at the jurisdiction level, ISA 805 engagements are likely to be more common for entities other than listed entities. As KAM is required for audits of financial statements listed entities only, it may be uncommon for an ISA 805 auditor's report to refer to complete-set KAM. Accordingly, DT-700 agreed that it was preferable to keep proposed ISA 805 (Revised) and the guidance therein simple and flexible, thereby allowing for further tailoring at the national

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<sup>12</sup> ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*

<sup>13</sup> Paragraph 10 of ISA 706 (Revised) states that "If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report, the auditor shall include an Other Matter paragraph in the auditor's report, provided:

- (a) This is not prohibited by law or regulation; and
- (b) When ISA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report."

level by law, regulation or auditing standards to provide greater specificity in the context of ISA 805 engagements typical to the jurisdiction.

**Matters for IAASB Consideration**

2. Does the IAASB agree with DT-700's recommendation with respect to communication complete-set KAM in the ISA 805 auditor's report and the related guidance included in paragraphs A19 and A23 of **Agenda Item 3-C**?
3. Does the IAASB agree with the other revisions made to proposed ISAs 800 (Revised) and 805 (Revised) in **Agenda Item 3-B** and **Agenda Item 3-C**?