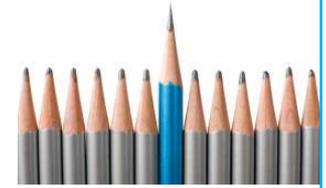


# ISAs – Developments in 2016 and a look ahead

Belize, 24 June 2016

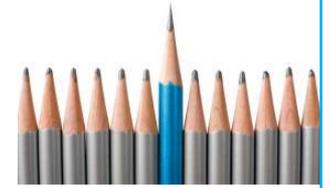
Arturo Fortún



## A short background

### The Clarity Project:

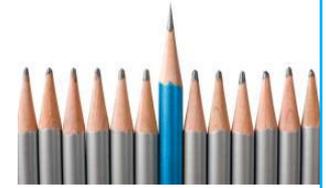
- From 2004 to February 2009
- Most important change in ISAs
- Definition of overall objectives of an audit
  - Obtain reasonable assurance; and
  - Report in accordance with findings
- Requirements addressing auditor's general responsibilities
- Scope, authority and structure of ISAs



## Elements of clarified ISAs

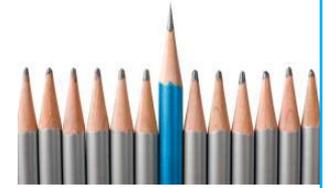
- Introduction
- Objectives
- Requirements
- Application and other explanatory material
- Definitions

Together all sections comprise the Standard



## Additional features of ISA 200

- Overview of an Audit
- Responsibilities of the Auditor
- Concepts such as Reasonable Assurance and Audit Risk
- Risk Based Approach
- Sufficiency & Appropriateness of Audit Evidence
- Professional Skepticism
- Professional Judgment



# Professional Judgment

- Essential to proper conduct of an audit
- New definition and requirement
  - Better articulates IAASB's expectations regarding exercise of professional judgment in an audit;
  - Helps stress auditor's professional responsibility for the exercise of judgment in a sound, consistent and justifiable manner
- Reminds the auditor of need to consult on difficult or contentious matters and for significant judgments to be evidenced
- Makes clear that judgment is not to be used as the justification for decisions that are not supported by the facts and circumstances or sufficient appropriate audit evidence

# ISA 230, Audit Documentation



- Objective
  - Sufficient appropriate record of the basis for auditor's report
  - Evidence that audit planned and performed in accordance with ISAs
- Benefits, e.g.,
  - Facilitates supervision and review, evaluation of evidence obtained and conclusions reached, internal and external inspections, etc.

# Additional features of ISA 230



- Documentation of items/matters tested, who performed the audit work, reviewer, and dates
- Documentation of discussions of significant matters with management, those charged with governance, and others
- Documentation of departure from a relevant requirement
- How alternative procedures achieve aim of the requirement and reasons for departure

# Documentation



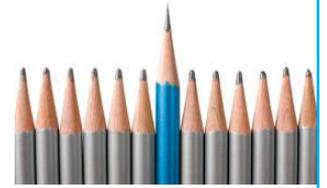
- Focus is on meaningful documentation
- Evidence Audit was planned and performed in accordance with ISAs and other applicable requirements
- Record of the procedures performed, results of those procedures and audit evidence obtained
- Documenting the conclusions reached on significant matters and significant professional judgments made

# Benchmark



- Sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:
  - Nature, timing, and extent of the audit procedures
  - Results of audit procedures , and the audit evidence obtained
  - Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions

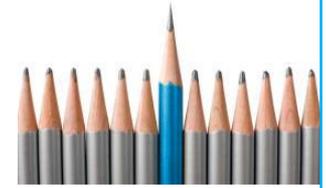
# Changes for 2016



- The most important since 2009
- Include revisions to ISA 700, 701 and 570 among others
- Add a new ISA (701)
- Effective for audits of financial statements for periods ending on or after 15 December 2016

Changes are not cosmetic

**AFFECT THE AUDIT REPORT**



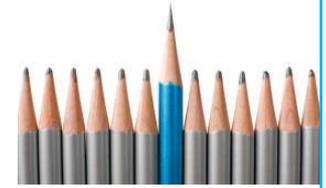
# Introduction

The IAASB view:

“The auditor’s report – the principal communication from the auditor to users of the audited financial statements – is undergoing dramatic change around the world. A more informative auditor’s report is the most visible change in auditing in more than 50 years...

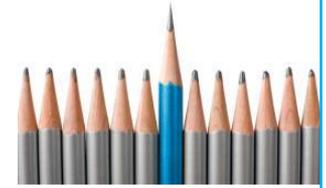
The IAASB ... released its suite of new and revised auditor reporting standards in early 2015. This was the culmination of a process starting in 2006 with jointly-commissioned international academic research on user perceptions of the standard auditor’s report. Along the way, others ...began parallel initiatives to change the way auditors communicate with investors and other users.

The end result is a new and improved auditor’s report that provides more transparency about important aspects of the audit, and better describes what an audit is and what the auditor does.”



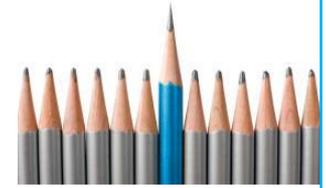
## Basic audit reports

- The opinion comes first
  - But now includes the statement of what has been audited
    - The entity
    - Statement that the financial statements have been audited
    - Identify the title of each financial statement (ie not page numbers)
    - Refer to the notes, including accounting policies
    - Specify the date or period of each statement



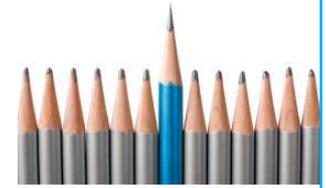
# Basic Audit Reports

- The basis for opinion follows
  - Including
    - A statement that the audit was conducted in accordance with ISAs
    - A reference to the section of the report describing the auditor's responsibilities
    - A statement that the auditor is independent in accordance with relevant ethical requirements and has fulfilled other ethical responsibilities under those requirements
    - A reference to the source of the ethical requirements
    - Whether the auditor believes that the audit evidence obtained is sufficient and appropriate to provide a basis for the opinion



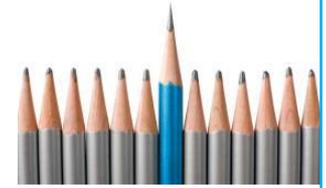
## Basic Audit Reports

- Responsibilities of management for the financial statements
- Cover
  - Responsibility for preparing the financial statements in accordance with the relevant financial reporting framework (including fair presentation or true and fair view where relevant) and for such internal control as management determines is necessary to enable the preparation of financial statements that are free for material misstatement whether due to fraud or error
  - Assessing the entity's ability to continue as a going concern and whether it is appropriate, including other relevant matters and a description of when the use of the going concern basis is appropriate



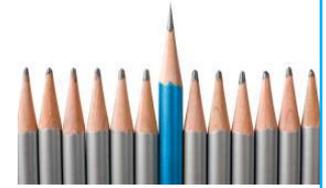
# Basic Audit Reports

- Where relevant:
  - Identification of those responsible for oversight of financial reporting, where they are not the same as those responsible for the preparation of the financial statements
    - NB A negative statement is not required where this does not apply



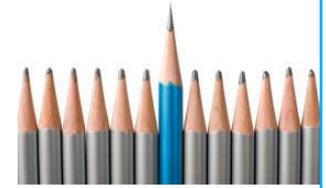
# Basic Audit Reports

- Auditor's responsibilities
  - State that the auditors' objectives are to:
    - Obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement whether due to fraud or error
    - Issue an auditor's report that includes the auditor's opinion
  - State that reasonable assurance is a high level of assurance but not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement



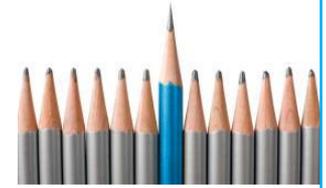
# Basic Audit Reports

- State that misstatements can arise from fraud or error and either:
  - Describe that they are material if individually or in aggregate they could reasonably be expected to influence the economic decisions of users or  
Provide a definition or description of materiality under the financial reporting framework



## Basic Audit Reports

- State that the auditor exercises professional judgement and maintains professional scepticism throughout the audit
- Describe an audit, stating that the auditor's responsibilities are:
  - To identify and assess the risks of material misstatement, whether due to fraud or error;
  - To design and perform audit procedures responsive to those risks
  - To obtain audit evidence that is sufficient and appropriate to provide a basis for the auditor's opinion;
  - To include noting that the risk of not detecting material misstatement due to fraud is higher than for error as it may involve collusion, forgery, intentional omission, misrepresentations or override of controls



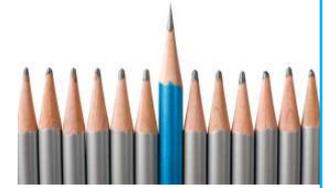
## Basic Audit Reports

- To obtain an understanding of internal control relevant to the audit in order to be able to design appropriate procedures, but not for the purposes of expressing an opinion on internal control (unless this is a separate responsibility, when omit)
- To evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures by management
- To conclude on the appropriateness of management's use of the going concern basis and whether a material uncertainty exists related to events or conditions that might cast significant doubt on the entity's ability to continue as a going concern. Note that where there is a material uncertainty the auditor is required to draw attention to this in the report, or modify the opinion as appropriate. The auditor's conclusions are based on the evidence obtained up to the date of the report but future events or conditions may cause an entity to cease to continue as going concern



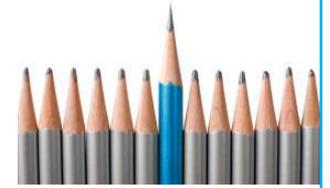
## Basic Audit Reports

- Where a fair presentation framework is applied, to evaluate the overall presentation, structure and content of the financial statements, including disclosures, and whether the financial statements represent the underlying transactions and events in manner that achieves fair presentation



## And for group reports

- State that
  - The auditor's responsibilities are to obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group to express an opinion on the group financial statements
  - The auditor is responsible for the direction, supervision and performance of the group audit
  - The auditor remains solely responsible for the auditor's opinion



## And finally...

- State that the auditor communicates with those charged with governance, among other matters, the planned scope and timing of the audit and significant findings including and significant deficiencies in internal control



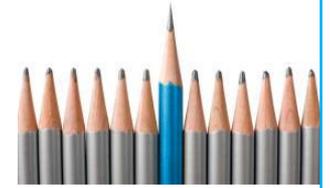
## And for listed entities (usually)

- Confirmation that the auditor provides those charged with governance with a statement of compliance with relevant ethical requirements regarding independence and communicates all relevant relationships and other matters to them
- Statement that the auditor determines key audit matters and that they are described in the report unless precluded by law or in rare circumstances where the auditor believes that matters should not be communicated because the adverse consequences of doing so would outweigh the public interest benefit of communication



## But where?

- In the audit report
- In an appendix (with a reference in the audit report)
- By reference to the website of an appropriate authority where this is allowed

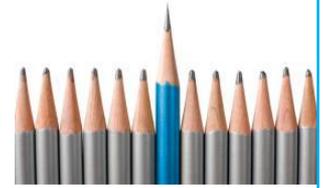


## And really finally...

For listed entities

- The name of the engagement partner
  - Unless there is a significant personal security threat

.. Is that it?



And we haven't got on to  
key audit matters yet

# IAASB



Key audit matters, assessed reflecting:

- Significant or higher risks
- Significant auditor judgement on management judgements, including those with high estimation uncertainty
- Significant events or transaction in the period

Then disclose

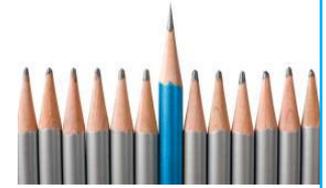
- Why the matter was considered to be one of the most significant during the audit (ie why a key audit matter)
- How the matter was addressed in the audit

Can be a negative statement(!)

# What about?



- Management override
- Revenue recognition



## Key Audit Matters

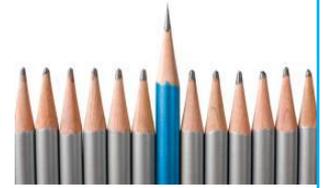
- Must introduce by stating
  - They are those matters that, in the auditor's professional judgement, were of most significance for the audit
  - They were addressed in the context of the audit of the financial statements as a whole, and in forming the opinion, and that the auditor does not provide a separate opinion on these matters



## Other matters

- Key audit matters are not an alternative to modifying an opinion
- Key audit matters do not overlap with grounds for modification
- Can only exclude if:
  - Required by law
  - In rare circumstances where the auditor believes that matters should not be communicated because the adverse consequences of doing so would outweigh the public interest benefit of communication

## Deciding

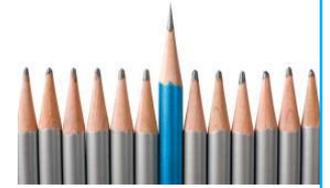


What kept you awake at night?

# Deciding

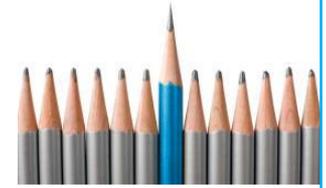


- Significant risks?
- Correlation with risk assessment?
- Challenging to audit?
- Complexity and judgement?



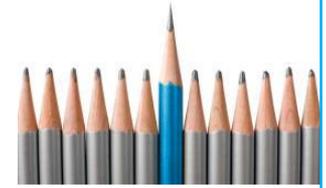
## Other standards

- Related party transactions
- Difficulties communicated to those charged with governance
- Areas of consultation



## Most significance?

- Materiality and relevance to users?
- Nature of the accounting policy?
- Uncorrected misstatements?
- Audit effort required?



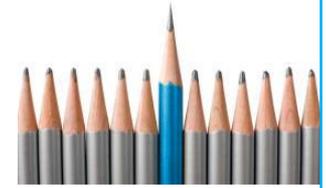
## Placement and Ordering

- May be useful near the opinion
- Could order on relative importance
- Stress current year only (for comparative information)



## Descriptions

- A succinct and balanced explanation
- No original information
- Reference to disclosure in financial statements and reports
  - Eg drawing attention to assumptions on estimates



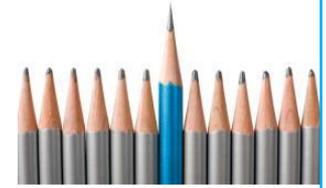
## Impact on the Audit

- Particular responses
- A brief overview of procedures performed
- An indication of the outcome of procedures
- Key observations

# Wording



- Do not imply that matter has been resolved by the auditor
- Relates to the entity (no generic language or boilerplate)
- Takes into account the wording and description in the financial statements
- Do not appear to give an opinion on separate elements of the financial statements



## Going Concern

- No specific statement required (in all cases)
- But:
  - Separate section making clear the responsibility of management and auditors in relation to going concern
  - Provide specific audit reporting model for material uncertainties which are properly disclosed
  - Consider “close calls” on material uncertainty as possible key audit matters

# Reporting to Those Charged with Governance



- Limited changes
  - Requirement to communicate significant risks
  - Overall requirement in relation to matters relating to audit reports

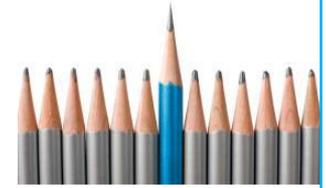
# Continuous work



- ISA implementation monitoring project completed in July 2013
- Findings showed the need for improvements to achieve more consistent and effective application
- Ongoing outreach to investors, audit committees, inspection bodies and regulators, firms, national standard setters
- IAASB Strategy 2015 – 2019 and work plan
- Public consultation: three topics:
  - - Professional skepticism
  - - Quality control
  - - Group audits
- Special considerations in audits of financial institutions (including a potential revision of the standard dealing with accounting estimates)

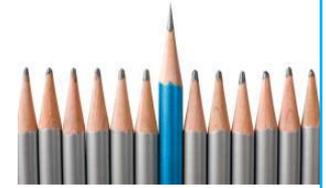
# Other upcoming changes

ISQC 1 and QCS in the firms



## Root Cause Analysis and action plans

- All part of the whole ‘every day in every way I get better and better’ raising the bar narrative
- This will be a Big Thing in 2016 and going forward
- What do we mean by root cause analysis:
  - Moving on from what went wrong to why did it go wrong
  - Final destination – being proactive – not fixing problems but stopping them and others like them occurring
- Inextricably linked to Leadership
- Not just about training
- Will require thought
- Will require change



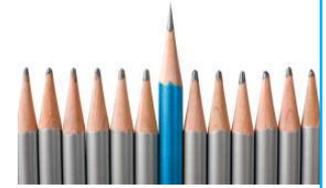
## Root Cause Analysis and action plans

- Now being regularly expected by regulators worldwide
- Root Cause Analysis specifically mentioned in the IAASB Invitation To Comment (ITC) – likely to be included in future revised ISQC 1
- Root Cause Analysis required by EU Audit Directive – not directly relevant to rest of world but Europe unlikely to be alone for long



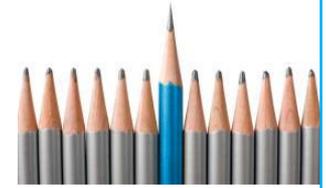
## Why do things actually go wrong?

- Staff make mistakes which aren't picked up
- Are the staff:
  - Accident prone? Possibly no fix for this – but are you recruiting people with the right skills or the potential to develop them? If not, why not?
  - Poorly trained? – target CPD better. Do they really understand the software you use? Do they need a refresher course?
  - Poorly supervised? – train people how to supervise
  - Poorly deployed? – look at composition of audit teams. Play to your existing strengths not the strengths you wish you had
  - Overworked? – look at staffing levels, look at portfolios
  - Time poor? – look at deadlines
  - Stressed? – why is this? Is the appraisal system working? Are staff properly supported? How could you help them?
- Or was it something to do with the client?



# Why do things actually go wrong?

- Why weren't the mistakes picked up?
  - Poor review during the course of the audit?:
    - Not enough time spent?
    - Not enough resources devoted to it?
    - Deadlines?
    - Custom and practice?
    - Not identifying issues early enough?
    - Not properly valuing the role of review during an engagement?
    - Not learning the lessons of history?
    - The buck ALWAYS stops with the engagement partner (and the EQCR if there is one)



## Things to consider...

- Role of engagement partner
  - Regulators have been consistently finding that engagement partners are not ‘in the file enough’
  - This does not only refer to evidence of review but that is definitely one aspect of it
  - ISQC 1 revision project – likely that we will see an increased number of requirements relating specifically to engagement partners
  - Audit Quality Indicator literature coming from several regulators also has an emphasis on engagement partners
  - IES 8 (see next slide)

# IES 8 and engagement partner competencies



- IES 8 is effective from July 2016
- Regulators WILL be considering IES 8 in reviews conducted after July 2016
- Engagement partners will be required to develop and maintain professional competence that is demonstrated by the achievement of learning outcomes including, but not limited to, those listed in Table A (see following slides)

# IES 8 Table A 1/3



**Table A: Learning Outcomes for the Professional Competence of an Engagement Partner**

| Competence Area                        | Learning Outcomes  |
|--|--|
| <b>Technical Competence</b>            |  |
| (a) Audit                              | <ul style="list-style-type: none"><li>(i) Lead the identification and assessment of the risks of material misstatement as part of an overall audit strategy.</li><li>(ii) Evaluate responses to the risks of material misstatement.</li><li>(iii) Evaluate whether the audit was performed and documented in accordance with applicable auditing standards (e.g., ISAs) and relevant laws and regulations.</li><li>(iv) Develop an appropriate audit opinion and related audit report, including a description of key audit matters as applicable.</li></ul>   |
| (b) Financial accounting and reporting | <ul style="list-style-type: none"><li>(i) Evaluate whether an entity has prepared, in all material respects, financial statements in accordance with the applicable financial reporting framework and regulatory requirements.</li><li>(ii) Evaluate the recognition, measurement, presentation, and disclosure of transactions and events within the financial statements in accordance with the applicable financial reporting framework and regulatory requirements.</li><li>(iii) Evaluate accounting judgments and estimates, including fair value estimates, made by management.</li><li>(iv) Evaluate the fair presentation of financial statements relative to the nature of the business, the operating environment, and the entity's ability to continue as a going concern.</li></ul> |

# IES 8 Table A 2/3



| Competence Area                      | Learning Outcomes  |
|--------------------------------------|--|
| (c) Governance and risk management   | (i) Evaluate corporate governance structures and risk assessment processes affecting the financial statements of an entity as part of the overall audit strategy.  |
| (d) Business environment             | (i) Analyze relevant industry, regulatory, and other external factors that are used to inform audit risk assessments including, but not limited to, market, competition, product technology, and environmental requirements.   |
| (e) Taxation                         | (i) Evaluate procedures performed to address the risks of material misstatement in the financial statements in respect of taxation, and the effect of the results of these procedures on the overall audit strategy.   |
| (f) Information technology           | (i) Evaluate the information technology (IT) environment to identify controls that relate to the financial statements to determine the impact on the overall audit strategy.   |
| (g) Business laws and regulations    | (i) Evaluate identified or suspected non-compliance with laws and regulations to determine the effect on the overall audit strategy and audit opinion.   |
| (h) Finance and financial management | (i) Evaluate the various sources of financing available to, and financial instruments used by, an entity to determine the impact on the overall audit strategy.<br>(ii) Evaluate an entity's cash flow, budgets, and forecasts, as well as working capital requirements to determine the impact on the overall audit strategy. |
| <b>Professional Skills</b>           |  |
| (i) Intellectual                     | (i) Resolve audit issues using inquiry, abstract and logical thought, and critical analysis to consider alternatives and analyze outcomes.   |
| (j) Interpersonal and communication  | (i) Communicate effectively and appropriately with the engagement team, management, and those charged with governance of the entity.<br>(ii) Resolve audit issues through effective consultation when necessary.   |
| (k) Personal                         | (i) Promote and undertake lifelong learning.<br>(ii) Act as a role model to the engagement team.<br>(iii) Act in a mentoring or coaching capacity to the engagement team.  |
| (l) Organizational                   | (i) Evaluate whether the engagement team, including auditor's experts, collectively has the appropriate objectivity and competence to perform the audit.   |

# IES 8 Table A 3/3



| Competence Area                                       | Learning Outcomes   |
|---|---|
|   | (ii) Manage audit engagements by providing leadership and project management of engagement teams.   |
| <b>Professional Values, Ethics, and Attitudes</b>     |   |
| (m) Commitment to the public interest                 | (i) Promote audit quality in all activities with a focus on protecting the public interest.   |
| (n) Professional skepticism and professional judgment | (i) Apply a skeptical mindset and professional judgment in planning and performing an audit and reaching conclusions on which to base an audit opinion.   |
| (o) Ethical principles                                | (i) Apply the ethical principles of integrity, objectivity, professional competence and due care, confidentiality, and professional behavior in the context of an audit and determine an appropriate resolution to ethical dilemmas.<br>(ii) Evaluate and respond to threats to objectivity and independence that can occur during an audit.<br>(iii) Protect the confidential information of the entity in accordance with ethical responsibilities and relevant legal requirements. |

# What will be the practical impact of all this?

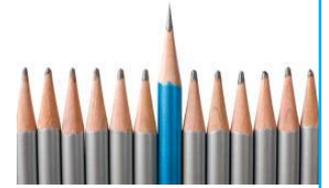


- Greater scrutiny by:
  - Regulators
  - Reviewers within networks (especially where transnational engagements are performed)
- Performance appraisal for engagement partners – always been required, always been a Touchy Subject. You may need to re-evaluate your firm's policies and procedures relating to:
  - Partner CPD
  - Partner performance appraisal
- You will need to make everything all about the outcomes not about the time spent



## Evaluating partner (and staff) CPD

- The sort of things you may find yourselves being expected to furnish evidence about may include (but are unlikely to be restricted to)
  - How CPD endured ties in with:
    - IMP review reports
    - Network level review reports
    - Regulatory review reports
    - Current issues
  - What outcomes were desired from CPD undertaken
  - How training courses were selected
  - What the content was
  - How outcomes were subsequently measured (BEFORE your next internal or other review)
  - What other types of CPD were considered, why they were considered, how the potential benefits were evaluated



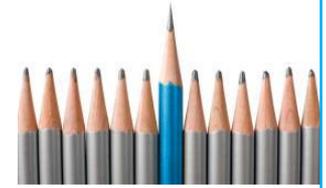
## It often boils down to the people

- Would be simplistic to say root cause *ALWAYS* lies with the people
- But it often does
- And this is something you might have more control over than eg wholesale changes to standards



## Why do we need action plans now?

- Many regulators are demanding them
- It makes sense
- Most international networks will require them from now on



## What should an action plan look like?

- A plan. That has actions
- Should cover all issues identified in internal or external reviews
- Should link directly to root cause analysis
- Should identify what steps will be taken, with timescales for these steps and an identified person or persons responsible for delivering
- Needs to be able to be evaluated against results
- Just saying 'we will do training' is not sufficient - training is a perfectly valid action to fix some things but consider (and document):
  - Who will be trained?
  - What will the training consist of?
  - Who will deliver it?
  - What outcomes are desired?
  - When will it happen?
  - How will the outcomes subsequently be measured?

# What are people hoping to achieve by placing so much emphasis on root cause and action plans



- Change for the better that is:
  - Demonstrable
  - Monitorable
  - Integrated with the IMP and MSEL NRP processes
  - Hard currency not fairy gold
  - Lasting



## IAASB – results of ITC consultation

Support for emphasizing importance of “tone at the top” and leadership responsibilities and accountability

- Driven down through the firm – importance of “tone at the middle” also highlighted

Support for updating ISQC 1 to incorporate and emphasize the importance of and need for monitoring / remediation / root cause analysis / expectation of “continuous improvement” mindset

Ongoing support for the importance of EQCR – a key quality control measure

- But keep balance and perspective relative to engagement partner who is ultimately responsible for quality

Support for looking at emphasizing and strengthening role of engagement partner (will also help in group audits)

- Including in situations where the engagement partner is not located where the majority of the work is performed



## IAASB results of ITC consultation

Mixed views on whether the IAASB should establish requirements for transparency reporting; however, calls from some to continue exploring the topic, including possible use of audit quality indicators

General support for incorporating a QMA in revising ISQC 1

- However, not enough understanding yet as to what this may entail and some reservations about extent of change that may be required

# Quality Management Approach



- Emphasize the responsibility of firm leaders to a more proactive, scalable and robust response to managing quality risk

## Elements of a QMA:

- Establish quality objectives
- Perform quality risk assessments
- Design and implement responses to quality risks
- Implement the quality control activities
- Inform, communicate and document
- Monitor quality

**Questions or comments?**

