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AICPA Adopts Changes to Auditor’s Report

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Changes are on the horizon for auditors.

Throughout 2019 and 2020, the AICPA's Auditing Standards Board (ASB) issued a collection of seven new auditing standards. Due to the coronavirus pandemic, the original effective date of the guidance was deferred. All seven standards went into effect in 2021. The new requirements build on the AICPA's continuous effort to improve audit quality and promote audit consistency between public and private companies. Many of the provisions of the new standards are closely aligned with previously issued standards by the PCAOB and IAASB. Statement on Auditing Standards (SASs) Nos. 134-140 impact several aspects of the audit, including the concept of materiality, communication to those charged with governance and reporting on employee benefit plan financial statements. The new standards also bring a heightened focus on related party relationships and significant unusual transactions. Modifications to the auditor's report are likely the biggest changes resulting from the new guidance. SAS No. 134 and No. 137 include revisions to both the form and content of the standard report, which will provide users with more information and enhance transparency. The new format is comprised of the following sections:

Opinion

The opinion is now at the forefront of the auditor's report. This section will begin with the existing introductory paragraph that describes the financial statements subject to the audit. It will immediately follow with the auditor's opinion. With the more prominent placement, users no longer need to read the entire report to know the final conclusion. Although the language of the opinion paragraph has not significantly changed, the requirements for formulating an opinion have been expanded to include the following key considerations:

- Qualitative aspects of the entity's accounting practices, including the possibility of bias in management's judgments (AU-C 700.14).

- The relevance of the accounting policies to the entity and whether they have been presented in an understandable manner (AU-C 700.15a).

- Whether the information presented in the financial statements is relevant, reliable, comparable and understandable. In making this evaluation, the auditor should consider whether all required information has been included and whether such information is appropriately classified, aggregated or disaggregated, and presented (AU-C 700.15d).

- Whether the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements (AU-C 700.15e).

- Whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation (AU-C 700.16b).

Basis for Opinion

A "Basis for Opinion" section is now mandatory for all audit reports, not just those with modified opinions. Like the verbiage in the current "Auditor's Responsibility" section, this paragraph includes a statement that the audit was conducted in accordance with auditing standards generally accepted in the United States (GAAS). The report should also discuss whether sufficient and appropriate evidence has been collected to provide a basis for the opinion.

Further, the guidance requires new language that refers to the auditor's independence and other ethical responsibilities. Users should be directed to the "Auditor's Responsibilities for the Audit of the Financial Statements" section of the report for a more detailed discussion of auditor responsibilities (AU-C 700.28).

Key Audit Matters

SAS No. 134 introduces the concept of Key Audit Matters (KAMs) for audits of private companies. KAMs are defined as those matters that are most significant to the audit and require the most attention. They are selected from matters communicated to those charged with governance, such as areas of higher assessed risk of misstatement, those involving management judgment or estimation, and significant transactions during the period (AU-C 701.07-.08). KAMs are intended to provide users of financial statements with insight into the riskier areas of the audit and how those matters were addressed by the auditors. Unlike Critical Audit Matters (CAMs) under PCAOB standards, communication of KAMs is not required (AU-C 701.01).

Private companies may, however, choose to engage the auditor to report on KAMs. If those charged with governance do elect the communication of KAMs, practitioners should clearly communicate that this is not simply the inclusion of additional language in the audit report. Additional work will be required by the audit team, which could result in additional costs to the client. The KAMs section should follow the "Basis for Opinion" section and include the following items related to each matter:

- Primary reason the matter was identified as a KAM,

- How the KAM was addressed in the audit, and

- Reference to the financial statement accounts or disclosures related to the KAM.

Furthermore, the report should also emphasize these matters were addressed in the context of the financial statements as a whole, and a separate opinion is not issued on them (AU-C 701.10).

Responsibilities of Management for the Financial Statements

Users will note minimal changes to the discussion of management's responsibilities within the report. This section will continue to include a discussion of management's responsibility for the preparation and presentation of the financial statements, as well as the design, implementation and maintenance of internal controls. The one addition to this paragraph is clarification of management's role in the evaluation of going concern. The revised report must clearly state management is required to consider whether any conditions or events raise substantial doubt about the company's ability to continue as a going concern for a reasonable period of time (AU-C 700.32b).

Auditor's Responsibilities for the Audit of the Financial Statements

While the previous contents of this section will still be included in the new format, additional wording must be incorporated to clarify certain responsibilities of the auditor during an engagement (AU-C 700.35). First, "reasonable assurance" should be defined as high level but not absolute assurance. Next, the report must note the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting a material misstatement resulting from an error. The definition of material misstatements is to be spelled out in accordance with SAS No. 138 as those misstatements which could influence the economic decisions of users. The expanded section will also provide more details about existing auditor responsibilities, including exercising professional judgment, maintaining professional skepticism, designing audit procedures in response to assessed risk, evaluation of going concern, and communications with those charged with governance (AU-C 700.36-.38).

Other Information

SAS No. 137 clarifies the auditor's responsibilities for other information included in a company's annual report. The auditor and management should agree upon which documents comprise the annual report and are subject to audit procedures. This understanding should be acknowledged in writing (AU-C 720.13a). The auditor's responsibility is limited to reading the annual report and performing procedures to ensure consistency between the audited financial statements and the unaudited other information.

When considering the other information, auditors should also remain alert for misleading information. If the audited financial statements are included in an annual report, a separate section should be added to the auditor's report describing the auditor's responsibility for the other information (AU-C 720.24).

Conclusion

What does this mean for audit professionals? The discussed changes apply to all audits of private company financial statements with a fiscal year-end date on or after Dec. 15, 2021. The AICPA has recommended all seven new standards be implemented concurrently due to the interrelated nature of the contents. Compliance with SASs Nos. 134-140 will likely be an area of focus during peer reviews, so implementation of the new reporting standards will be a vital task for professionals. Audit report templates should be appropriately updated, and employees need to be educated on the new requirements. Additionally, the language within the engagement letter should be revised to ensure consistency with the new audit report. It is also important to make clients aware of the upcoming changes to avoid any surprises during the engagement.

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About the Author

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