Communicating Key Audit Matters in the Independent Auditor’s Report – ISA 701

Background & Purpose

- Auditor reporting initiatives around the world were largely prompted by the global financial crisis

- Users of the auditors' report want more information about the audit especially areas of dialogue with TCWG

- Assist users in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period.

- The purpose is to enhance the communicative value of the auditor's report

- The objective of this ISA is to determine key audit matters and, having formed an opinion on the FS, communicate those matters by describing them in the auditor's report.

Scope & Effective Date 1/2

- Applies to audits of complete sets of general purpose financial statements of listed entities

- Applies when the auditor is required by law or regulation to communicate key audit matters in the auditor's report

- Applies to circumstances when the auditor otherwise decides to communicate key audit matters in the auditor's report.

- ISA 705 (Revised) prohibits communicating key audit matters when the auditor disclaims an opinion on the financial statements, unless such reporting is required by law or regulation

Scope & Effective Date 2/2

- Reporting key audit matters **IS NOT**:
  - (a) A substitute for disclosures in the financial statements
  - (b) A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with ISA 705 (Revised);
  - (c) A substitute for reporting in accordance with ISA 570 (Revised) when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern; or
  - (d) A separate opinion on individual matters.
- Effective for audits for periods ending on or after 15 December 2016

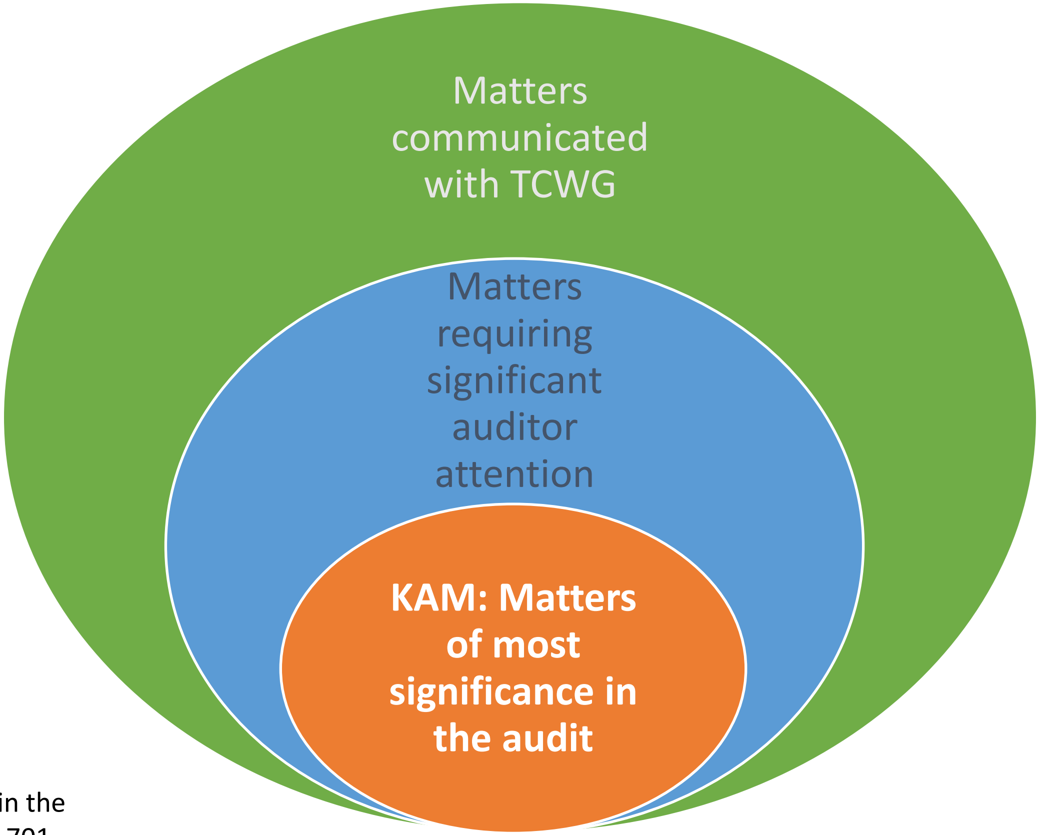
Key Audit Matters (KAM) – Defined

- Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

A. How to determine these matters ?

B. How to communicate these matters?

C. How to document these matters?



How to Determine KAM 1/5

Matters requiring significant auditor's attention

Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with ISA 315 (Revised)

- Recognizes the risk-based approach of the audit and communicating significant risks to TCWG
- Matters that pose challenges in obtaining sufficient appropriate audit evidence
- Can relate to complex areas and significant management judgment (extensive hours, senior involvement, experts, etc.)
- Can involve specific communications with TCWG required by ISAs such as:
  - ISA 260 (Revised) – difficulties encountered during the audit (related parties, group audit procedures, etc…)
  - ISA 220 – Complex matters requiring consultation

How to Determine KAM 2/5

Matters requiring significant auditor's attention

Significant auditor judgments relating to areas that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty

- ISA 260 requires reporting to TCWG on the qualitative aspects of the accounting policies used including management judgments and estimates together with related disclosures.

- Users of the financial statements expressed interest in accounting estimates that have been identified as having high estimation uncertainty that may have not been determined to be significant risks
- Among other things, such estimates are highly dependent on management judgment and are often the most complex areas of the financial statements, and may require the involvement of both a management's expert and an auditor's expert.

How to Determine KAM 3/5

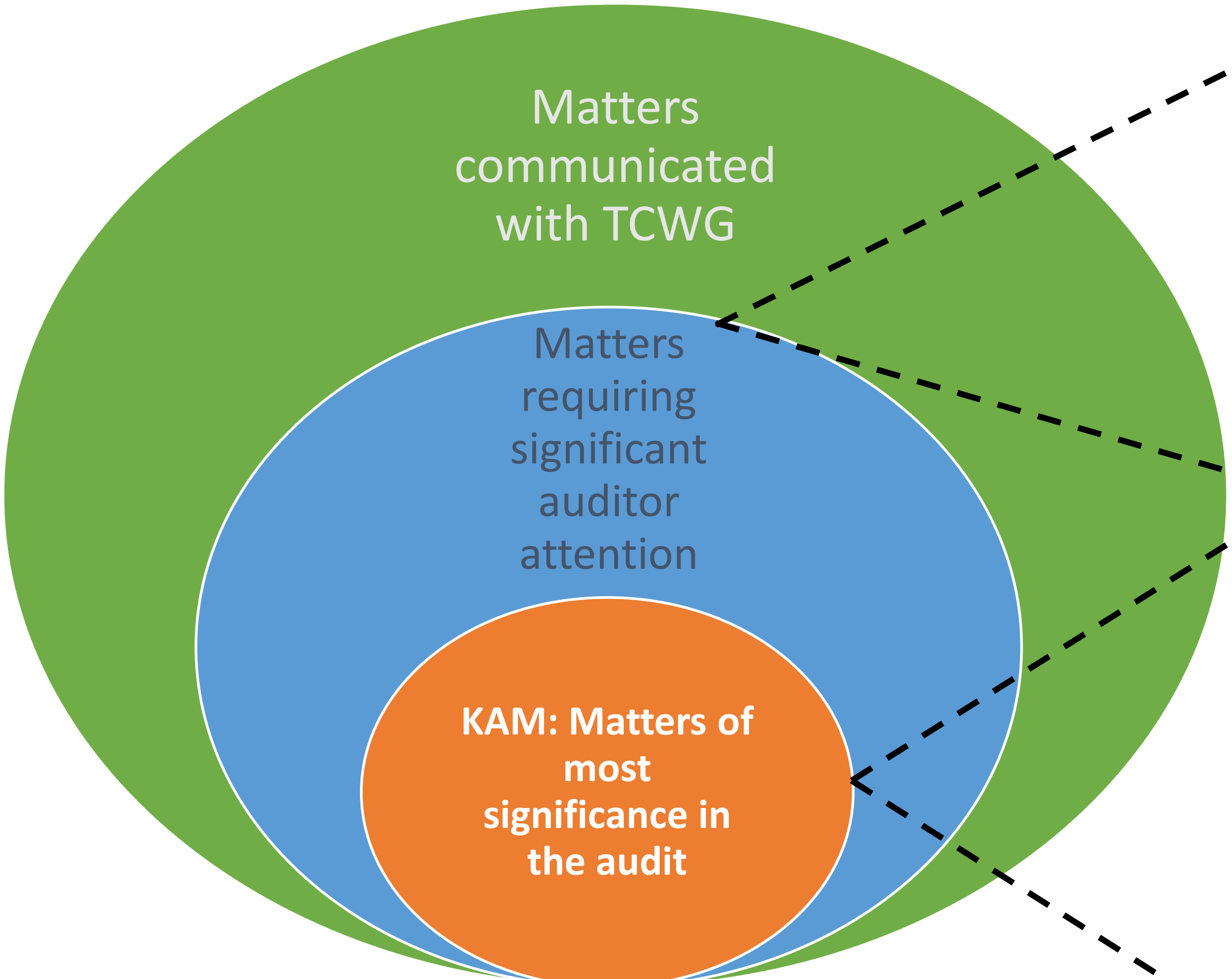
Matters requiring significant auditor’s attention

The effect on the audit of significant events or transactions that occurred during the period

- Transactions having significant effect on the financial statements
- Significant transactions with related parties
- Outside the normal course of business
- Unusual transactions
- Significant economic, accounting, regulatory, industry, or other developments that affected management’s assumptions or judgments may affect the auditor’s overall approach and result in a matter requiring significant auditor attention.

How to Determine KAM 4/5

Matters requiring significant auditor's attention



Always consider:

- Higher assessed risks and significant risks
- Areas of significant management judgment and estimation uncertainty
- Significant transactions or events

Description of each KAM in the auditors' report required to include:

- Why the matter was considered to be one of most significance in the audit
- How the matter was addressed in the audit
- Reference to the related disclosure(s)

How to Determine KAM 5/5

Considerations to determine matters of most significance

- The importance and materiality of the matter to intended users' understanding of the financial statements as a whole

- The nature of the underlying accounting policy relating to the matter or the complexity or subjectivity involved in management's selection of an appropriate policy compared to other entities within its industry.

- The nature and extent of audit effort needed to address the matter, (specialized skills, consultations)

- The nature and severity of difficulties in applying audit procedures, evaluating the results of those procedures, and obtaining relevant and reliable evidence on which to base the auditor's opinion, in particular as the auditor's judgments become more subjective.

APPLY PROFESSIONAL JUDGEMENT

How to Communicate KAM 1/6

- Use separate key audit matters section in the auditor's report stating the following introductory paragraph:

- **Key Audit Matters**

  Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In addition to the matter described in the *Basis for Qualified Opinion* section we have determined the matters described below to be the key audit matters to be communicated in our report.

- Then describe each key audit matter, using an appropriate subheading. The order of presentation of individual matters within the KAM section is a matter of professional judgment.

How to Communicate KAM 2/6

Description of individual Key Audit Matters

- The description of each key audit matter shall include a reference to the related disclosure(s), if any, in the financial statements and shall address:
  - (a) Why the matter was considered to be one of most significance in the audit and therefore determined to be a key audit matter; and
  - (b) How the matter was addressed in the audit.

- The description should be “succinct and balanced”
- Limit the use of highly technical auditing terms
- Made without providing original information about the entity

APPLY PROFESSIONAL JUDGEMENT

How to Communicate KAM 3/6

Why the matter was considered of most significance

Examples

- *Effects of New Accounting Standards*

  As of January 1, 2013, IFRS 10 (Consolidated Financial Statements), 11 (Joint Arrangements) and 12 (Disclosure of Interests in Other Entities) became effective. IFRS 10 requires the Group to assess for all entities whether it has: power over the investee; exposure, or rights, to variable returns from its involvement with the investee; and the ability to use its power over the investee to affect the amount of the investor's returns. The complex structure, servicing and ownership of each vessel, requires the Group to assess and interpret the substance of a significant number of contractual agreements.

- *Valuation of Financial Instruments*

  The Company's investments in structured financial instruments represent [*x%*] of the total amount of its financial instruments. Due to their unique structure and terms, the valuation of these instruments are based on entity-developed internal models and not on quoted prices in active markets. Therefore, there is significant measurement uncertainty involved in this valuation. As a result, the valuation of these instruments was significant to our audit. The Company's disclosures about its structured financial instruments are included in Note 5.

How to Communicate KAM 4/6

How the matter was addressed in the audit

- The amount of detail to be provided in the auditor’s report to make the description is a matter of professional judgment

- The auditor may describe:
  - Aspects of the auditor’s response or approach that were most relevant to the matter or specific to the assessed risk of material misstatement;
  - A brief overview of procedures performed;
  - An indication of the outcome of the auditor’s procedures; or
  - Key observations with respect to the matter,
  - or some combination of these elements.

How to Communicate KAM 5/6

How the matter was addressed in the audit

- Care may be necessary so that language used in the description of a key audit matter:
  - Does not imply that the matter has not been appropriately resolved by the auditor in forming the opinion on the financial statements.
  - Relates the matter directly to the specific circumstances of the entity, while avoiding generic or standardized language.
  - Takes into account how the matter is addressed in the related disclosure(s) in the financial statements, if any.
  - Does not contain or imply discrete opinions on separate elements of the financial statements.

How to Communicate KAM 6/6

How the matter was addressed in the audit

Examples

- *Goodwill*

  Our audit procedures included, among others, using a valuation expert to assist us in evaluating the assumptions and methodologies used by the Group, in particular those relating to the forecasted revenue growth and profit margins for [*name of business line*]. We also focused on the adequacy of the Group's disclosures about those assumptions to which the outcome of the impairment test is most sensitive, that is, those that have the most significant effect on the determination of the recoverable amount of goodwill.

- *Revenue Recognition*

  Our audit procedures to address the risk of material misstatement relating to revenue recognition, which was considered to be a significant risk, included:

  - Testing of controls, assisted by our own IT specialists, including, among others, those over: input of individual advertising campaigns' terms and pricing; comparison of those terms and pricing data against the related overarching contracts with advertising agencies; and linkage to viewer data; and
  - Detailed analysis of revenue and the timing of its recognition based on expectations derived from our industry knowledge and external market data, following up variances from our expectations.

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Circumstances in which A KAM is Not Communicated

- The auditor shall describe each key audit matter in the auditor's report unless:
  - (a) Law or regulation precludes public disclosure about the matter; or
  - (b) In extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication. This shall not apply if the entity has publicly disclosed information about the matter.

What if there is No KAM to Report?

- **Key Audit Matters**

  [Except for the matter described in the *Basis for Qualified (Adverse) Opinion* section or *Material Uncertainty Related to Going Concern* section,] We have determined that there are no [other] key audit matters to communicate in our report.

- This can happen in three circumstances:
  - The auditor determines that there are no key audit matters.
  - The auditor determines that a key audit matter will not be communicated in the auditor's report and no other matters have been determined to be KAM.
  - The only matters determined to be key audit matters are those subject of qualified opinion or existence of a material uncertainty which is reported on in separate sections of the report
- The standard considers it to be rare that the auditor of a listed entity would not determine at least one KAM from the matters communicated with TCWG to be communicated in the report.

Communication with those Charged with Governance

- Communicate and discuss KAM throughout the audit to avoid challenges of discussing them when the FS are being finalized for issuance

- Communication enables TCWG to:
  - Seek further clarification where necessary, and
  - Consider whether new or enhanced disclosures may be useful in light of the fact that these matters will be communicated in the auditor's report

- If applicable, depending on the facts and circumstances of the entity and the audit, communicate the auditor's determination that there are no key audit matters to communicate in the auditor's report.

Documentation

- The auditor shall include in the audit documentation:
  - The matters that required significant auditor attention, and the rationale for the auditor's determination as to whether or not each of these matters is a key audit matter;
  - Where applicable, the rationale for the auditor's determination that there are no key audit matters to communicate in the auditor's report; and
  - Where applicable, the rationale for the auditor's determination not to communicate in the auditor's report a matter determined to be a key audit matter.

Questions