



# Institute of Certified Public Accountants of Kenya

## **TECHNICAL RELEASE No. 4/1999**

**Council's Statement on Applicability of International  
Standards for Financial Reporting in Kenya**

December, 1999

## INTERNATIONAL ACCOUNTING STANDARDS

### Reporting Framework

1. Following the decision of Council that International Accounting Standards be applied for financial statements covering periods commencing 1st January 1999, and that International Standards on Auditing be applied for all audit reports issued on or after 1 January 2000, Council wishes to remove any misunderstanding that might exist about the applicability of International Accounting Standards (IASs) and International Standards on Auditing (ISAs), and the obligations the accountants and/or auditors carry with regard to the compliance with such standards while preparing accounts or expressing an audit opinion on published financial statements, as the case may be. The Council wishes to draw the attention of all members to paragraph 4 of the revised Preface to Statements of International Accounting Standards which reads as under:-

### Obligations

2. As a member of the International Accounting Standards Committee (IASC), the Institute is obliged to support the objectives of IASC by undertaking the following obligations:

*"to support the work of IASC by publishing in their respective countries every International Accounting Standard approved for issue by the Board of IASC and by using their best endeavours."*

- i) to ensure that published financial statements comply with International Accounting Standards in all material respects and disclose the fact of such compliance.
- ii) to persuade Governments and standard-setting bodies that published financial statements should comply with International Accounting Standards in all material respects;
- iii) to persuade authorities controlling securities markets and the industrial and business community that published financial statements should comply with International Accounting Standards in all material respects and disclose the fact of such compliance;
- iv) to ensure that the auditors satisfy themselves that the financial statements comply with International Accounting Standards in all material respects;
- v) to foster acceptance and observance of International Accounting Standards internationally.

3. The Institute of Certified Public Accountants of Kenya as a member of the International Federation of Accountants (IFAC) is committed to the Federation's broad mission of the worldwide development and enhancement of an accountancy profession with harmonized standards, able to provide "services of consistently high quality in the public interest". In working towards this mission, the Council of IFAC has established the International Auditing Practices Committee (IAPC) to develop and issue, on behalf of the council, standards and statements on auditing and related services. IAPC believes that the issue of such standards and statements will help to improve the degree of uniformity of auditing practices and related services throughout the world.
4. As a condition of its membership, Institute of Certified Public Accountants of Kenya is obliged to support the work of IFAC by informing its members of every pronouncement developed of IFAC and by using their best endeavours, to work towards implementation, when and to the extent possible under local circumstances, of those pronouncements and specifically to incorporate the principles on which are based IFAC's International Standards on Auditing in national auditing pronouncements.

#### **Applicable IASs**

The Council of the Institute has determined that all IASs (Nos. 1 - 39) and any others, which might be issued from time to time by the IASC, should be adopted for financial reporting in Kenya, to the extent that they apply to the specific circumstances of the reporting entity.

#### **International Standards on Auditing and International Auditing Practice Statements**

5. The Institute of Certified Public Accountants of Kenya has determined to adopt the ISAs as the basis for approved standards on auditing and related services in Kenya.

These standards include International Standards on Auditing Numbers 100 to 930 and International Auditing Practice Statements numbers 1000 to 1011

*The Council of the Institute of Certified Public Accountants of Kenya has determined that these International Standards on Auditing should be adopted for all audit reports issued on or from 1st January, 2000.*

*ISAs are to be applied in the audit of financial statements. ISAs are also to be applied, adapted as necessary, to the audit of other information and to related services.*



*ISAs contain basic principles and essential; procedures (identified in bold type black lettering) together with related guidance in the form of explanatory and other material. The basic principles and essential procedures are to be interpreted in the context of explanatory and other material that provides guidance for application.*

*To understand and apply the basic principles and essential procedures together with the related guidance, it is necessary to consider the whole text of the ISA including explanatory and other material contained in the ISA not just that text which is black lettered.*

*In exceptional circumstances, an auditor may judge it necessary to depart from an ISA in order to more effectively achieve the objective of an audit. When such a situation arises, the auditor should be prepared to justify the departure.*

*ISAs need only be applied to material matters.*

*Any limitation of the applicability of a specific ISA is made clear in the introductory paragraphs to that ISA.*

*The Public Sector Perspective (PSP) issued by the Public Sector Committee of the International Federation of Accountants is set out at the end of an ISA. Where no PSP is added, the ISA is applicable in all material respects to the public sector.*

7. In the event that an IAPC - issued ISA contains guidance which is significantly different from Kenyan Law or practice, the auditor is expected to take such differences into account and act appropriately.
8. Where the Council deems it necessary, additional standards and pronouncements may be developed on matters of relevance in Kenya not covered by ISAs of IASs.

### **Compliance**

9. The Council desires to direct all members to ensure that in accordance with the obligations undertaken by the Institute, as one of the members of IASC and IFAC the accountant, while preparing the financial statements, and the auditor, while expressing an audit opinion on published financial statements, should satisfy himself that they do comply with IASs in all material respects and that in the event of any departure from or inconsistency with such standards, the auditor's report should contain suitable qualification. It should however be emphasized that IASs complement the local statutory provisions under the Companies Act Cap 486, or disclosure requirements under the Capital Markets Authority Act Cap 485 A. Compliance with the provisions of IASs shall be mandatory in so far as such standards are not inconsistent with local regulations, directives or pronouncements issued by the Institute and other regulatory agencies.

10. Companies referring to the use of IASs in their financial statements should comply fully with all IASs relevant to the specific circumstances with full compliance meaning compliance in all material respects. However, where full compliance is not possible, a clear and unambiguous disclosure of any exceptions from full compliance should be made, coupled with an appropriately qualified audit opinion. Under ISAs, a material exception should result in a qualified opinion, or possibly, in an adverse opinion, dealing with the exceptions.

### **Audit Report**

11. In the context of the wording of the Audit Report in accordance with ISA 700, *Auditors Report on Financial Statements* members are expected to note the following.

### **Scope Paragraph**

The auditor's report should describe the scope of the audit by stating that the audit was conducted in accordance with ISAs in line with the adoption of ISAs as the basis for auditing in Kenya. Any other wording is not acceptable.

Furthermore, in addition to the usual wording, the report should include a statement by the auditor that the audit provides a reasonable basis for the opinion.

### **Opinion Paragraph**

The auditors report should clearly state the auditor's opinion as to whether the financial statements give a true and fair view (or are presented fairly, in all material respects) in accordance with:

- Financial reporting framework (in this case IASs)
- Statutory requirements, where appropriate (in this case, Companies Act Cap. 486)

Examples of the audit opinions, which might be given by auditors under ISAs, are included as an appendix to this document

12. Members are required to finalise the review and report on the financial statements on the basis of ISAs, regardless of the size of the entity. This is in line with IFAC statement No. 1005, *Particular Considerations in the Audit of Small Businesses*.
13. Members of the Institute of Certified Public Accountants of Kenya are expected to comply with all standards on auditing and related services issued by IFAC. Similarly members are also required to comply with all International Accounting Standards issued by IASC. Failure to do so may result in an investigation into a member's conduct by the Disciplinary Committee of the Institute under the provisions of the Accountants Act Cap 531.



14. It is impracticable to establish standards on auditing and related services or indeed accounting standards which universally apply to all situations and circumstances an auditor may encounter. Therefore, auditors should consider the adopted standards as the basic principles which they should follow in performing their work. The precise procedures required to apply these standards are left to the professional judgement of the individual auditor and will depend on the circumstances of each case.
15. The date from which IASs are applicable are financial periods beginning on or after 1 January 1999 and the date from which members are expected to observe the ISAs is 1st January 2000 as set out in the paragraph 1 of this bulletin.

#### **Requirements of the Companies Act**

16. Section 162 (i) of the Companies Act stipulates the statements that an auditor's report should contain. This section requires auditors to state:
  - a) Whether they have obtained all the information and explanations which to the best of their knowledge and belief were necessary for the purposes of their audit.
  - b) Whether, in their opinion, proper books of account have been kept by the company, so far as appears from their examination of those books, and proper returns adequate for the purposes of their audit have been received from branches not visited by them.
  - c) Whether, the company's balance sheet and profit and loss account dealt by the report are in agreement with the books of account and returns.
  - d) Whether, in their opinion and to the best of their information and according to the explanations given to them, the financial statements give the information required by the Act in the manner so required and give a true and fair view:
    - in the case of the balance sheet, of the state of the company's affairs as at the end of its financial year; and
    - in the case of the profit and loss account, of the state of the profit or loss for its financial year,
  - e) In the case of a holding company submitting group financial statements whether in their opinion, the group financial statements have been properly prepared in accordance with the provisions of the Act so as to give a true and fair view of the state of affairs and profit or loss of the company and its subsidiaries.

## **Appendix - Examples of audit reports**

For simplicity all the examples refer to audits of companies incorporated in Kenya under the Companies Act. The principles illustrated are equally applicable to other types of enterprises. The examples are listed below:

1. Unqualified Audit Report (Example 1)
2. Unqualified Audit Report with emphasis of matter (Example 2)
3. Unqualified Audit Report with emphasis of matter on a Going Concern problem (Example 3)
4. Qualified Audit Report - Limitation on scope (Example 4)
5. Disclaimer of Opinion - Limitation on scope (Example 5)
6. Qualified Audit Report - Disagreement on accounting policies due to inappropriate accounting method (Example 6)
7. Qualified Audit Report - Disagreement on accounting policies due to inadequate disclosure (Example 7)
8. Adverse Audit Report - Disagreement on accounting policies due to inadequate disclosure (Example 8)

## Example 1: Unqualified Audit Report

AUDITOR'S REPORT TO THE MEMBERS OF ABC Co. LTD.

(APPROPRIATE ADDRESSEE)

We have audited the accompanying<sup>1</sup> balance sheet of the ABC Company as of December 31, 20 x 1, and the related statements of income, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statement based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements give a true and fair view of (or 'present fairly, in all material respects,') the financial position of the Company as of December 31, 20X1, and of the results of its operations and its cash flows for the year then ended in accordance with International Accounting Standards and comply with the Companies Act.

AUDITOR

Date

Address

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<sup>1</sup> The reference can be by page numbers.



## Example 2: Unqualified Audit Report - emphasis of matter

"We have audited... (remaining words are the same as illustrated in the introductory paragraph - Example 1 above).

We conducted our audit in accordance with ... (remaining words are the same as illustrated in the scope paragraph - Example 1 above).

"In our opinion... (remaining words are the same as illustrated in the opinion paragraph - example 1 above).

*Without qualifying our opinion, we draw attention to Note X to the financial statement. The Company is the defendant in a lawsuit alleging infringement of certain patent rights and claiming royalties and punitive damages. The Company has filed a counter action, and preliminary hearings and discovery proceedings on both actions are in progress. The ultimate outcome of the matter cannot presently be determined, and no provision for any liability that may result has been made in the financial statements."*

**Note:** *The addition of an emphasis of matter paragraph does not affect the auditor's opinion. The paragraph would preferably be included after the opinion paragraph and would ordinarily refer to the fact that the auditor's opinion is not qualified in this respect.*

## Example 3: Unqualified Audit Report - emphasis of matter on a Going Concern problem

"We have audited... (remaining words are the same as illustrated in the introductory paragraph - Example 1 above).

We conducted our audit in accordance with ... (remaining words are the same as illustrated in the scope paragraph - Example 1 above).

"In our opinion... (remaining words are the same as illustrated in the opinion paragraph - example 1 above).

*"Without qualifying our opinion we draw attention to Note X in the financial statements. The Company incurred a net loss of xxx during the year ended December 31, 20X1 and, as of that date, the Company's current liabilities exceeded its current assets by xxx and its total liabilities exceeded its total assets by xxx. These factors, along with other matters as set forth in Note X, raise substantial doubt that the Company will be able to continue as a going concern."*

**Note:** The auditor is not precluded from expressing a disclaimer of opinion for a going concern uncertainty.

#### **Ex 4: Qualified Audit Report - Limitation on scope**

"We have audited... (remaining words are the same as illustrated in the introductory paragraph - Example 1 above).

Except as discussed in the following paragraph, we conducted our audit in accordance with ... (remaining words are the same as illustrated in the scope paragraph -Example 1 above)

*We did not observe the counting of the physical inventories as of December 31, 20X1, since that date was prior to the time we were initially engaged as auditors for the Company. Owing to the nature of the Company's records,; we were unable to satisfy ourselves as to inventory quantities by other audit procedures.*

*In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to satisfy ourselves as to physical inventory qualities, the financial statements give a true and ... (remaining words are the same as illustrated in the opinion paragraph - Example 1 above)."*

#### **Example 5: Disclaimer of Opinion - Limitation on scope**

*"We were engaged to audit the accompanying balance sheet of the ABC Company as of December 31, 20X1, and the related statements of income and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. (Omit the sentence stating the responsibility of the auditor).*

*(The paragraph discussing the scope of the audit would either be omitted or amended according to the circumstances.)*

*(Add a paragraph discussing the scope limitation as follows:)*

*We were not able to observe all physical inventories and confirm accounts receivable due to limitations placed on the scope of our work by the company.*

*Because of the significance of the matters discussed in the preceding paragraph, we do not express an opinion on the financial statements.*

#### **Example 6: Qualified Audit Report - Disagreement on accounting policies due to inappropriate accounting method**

"We have audited... (remaining words are the same as illustrated in the introductory paragraph - Example 1 above).

We conducted our audit in accordance with ... (remaining words are the same as illustrated in the scope paragraph - Example 1 above).

*As discussed in Note X to the financial statements, no depreciation has been provided in the financial statements which practice, in our opinion, is not in accordance with International Accounting Standards. The provision for the year ended December 31, 20X1, should be xxx based on the straight-line method of depreciation using annual rates of 5% for the building and 20% for the equipment. Accordingly, the fixed assets should be reduced by accumulated depreciation of xxx and the loss for the year and accumulated deficit should be increased by xxx and xxx, respectively.*

*In our opinion, except for the effect on the financial statement of the matter referred to in the preceding paragraph, the financial statements give a true and ... (remaining words are the same as illustrated in the opinion paragraph - Example 1 above)."*

### **Example 7: Qualified Audit Report - Disagreement on accounting policies due to inadequate disclosure**

*"We have audited ... (remaining words are the same as illustrated in the introductory paragraph - Example 1 above).*

*We conducted our audit in accordance with ... (remaining words are the same as illustrated in the scope paragraph - Example 1 above).*

*On January 15, 20X2, the Company issued debentures in the amount of xxx for the purpose of financing plant expansion. The debenture agreement restricts the payment of future cash dividends to earnings after December 31, 20X1. In our opinion, disclosure of this information is required by International Accounting Standards and the Companies Act.*

*In our opinion, except for the omission of the information included in the preceding paragraph, the financial statements give a true and ... (remaining words are the same as illustrated in the opinion paragraph - Example 1 above).*

### **Example 8: Adverse Audit Report - Disagreement on accounting policies due to inadequate disclosure**

*"We have audited ... (remaining words are the same as illustrated in the introductory paragraph - Example 1 above).*

*We Conducted our audit in accordance with ... (remaining words same as illustrated in the scope paragraph - Example 1 - above).*

*In our opinion, because of the effects of the matters discussed in the preceding paragraph(s), the financial statements do not give a true fair view of (or do not 'present fairly') the financial position of the Company as of December 31, 20X1, and of the results of its operations and its cash flows for the year then ended in accordance with International Accounting Standards and do not comply with the Companies Act.*