

# **IBRAHIM & COMPANY**

**Certified Public Accountants**



## **International Standard on Auditing (ISA) 701 Communicating Key Audit Matters in the Independent Auditor's Report**

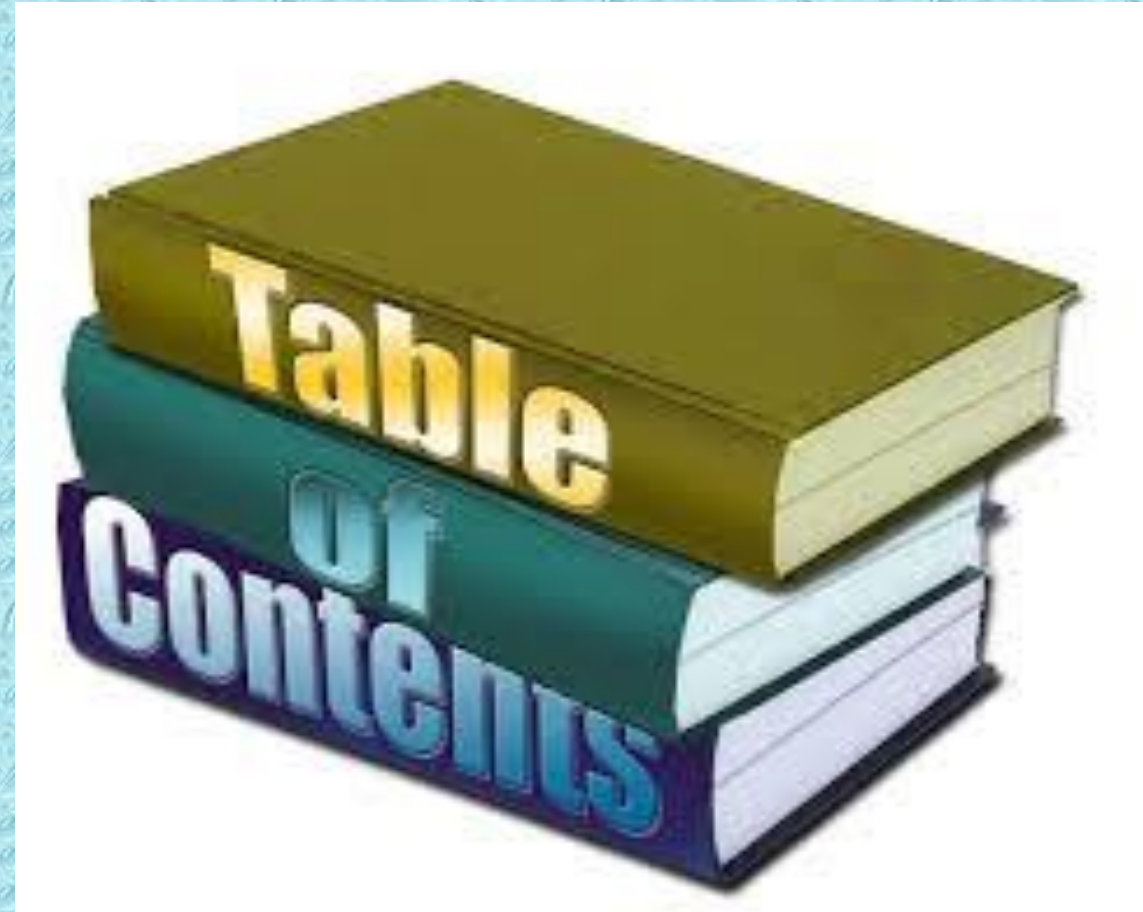
### **Coast Branch Practitioners Forum**

**CPA Ibrahim Mohamed**

**30<sup>th</sup> May 2017**

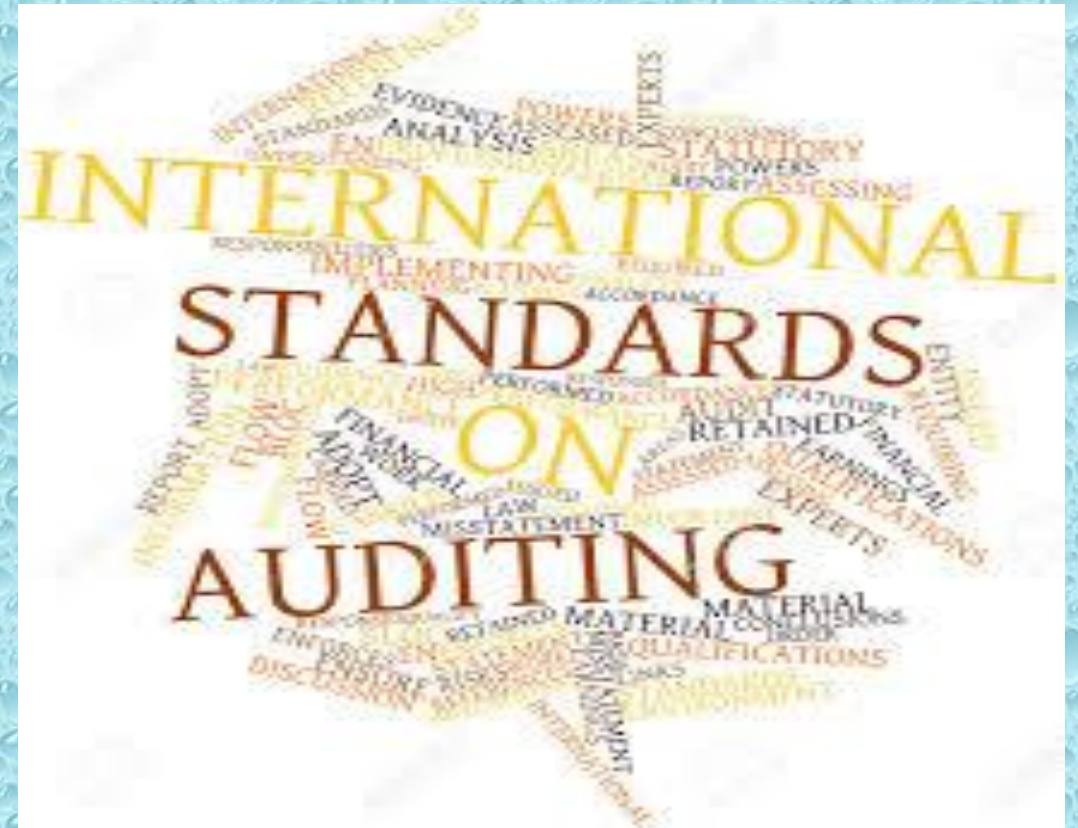
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# Scope of ISA 701

- ❖ The standard deals with the auditor's responsibility to communicate key audit matters in the auditor's report.
- ❖ It provides additional information to users of the financial statements to further engage with management and those charged with governance.
- ❖ The standard was formally adopted by ICPAK in April 2015.





# Definition of Terms

- ❖ Key audit matters (KAMs)- Are those matters that, in the auditor's professional judgment were of most significance in the audit of the financial statement. They are selected from matters communicated with those charged with governance.
- ❖ Those charged with governance – The persons with responsibility for overseeing the strategic direction and the financial reporting process of the entity. May include executive members of a governance board and owner-manager.

# Audit Reports Affected by ISA 701

- ❖ Mandatory for audit of financial statements of listed companies with voluntary application allowed for entities other than listed entities.
- ❖ Applicable to all the deposit taking sacco's as per the Sacco Societies Regulatory Authority (SASRA) guideline dated 21 November 2016.
- ❖ Applicable to all insurance regulated entities as per the Insurance Regulatory Authority dated 26 August 2016.
- ❖ Applicable to all entities regulated by the Capital Market Authority whether listed or non-listed as per its guideline dated 10 November 2016.
- ❖ This ISA is effective for the periods ending on or after 15 December 2016.





# Matters to be Communicated with those charged with governance

- ❖ The responsibilities of the auditor in relation to the financial statement audit.
- ❖ Planned audit scope including the significant risks identified by the auditor and timing of the audit
- ❖ The auditor's view about the accounting policies, estimates and financial statement disclosures.
- ❖ Significant difficulties encountered in obtaining audit evidence.
- ❖ Significant deficiencies in internal control.
- ❖ Auditor independence.



# Nature of Key Audit Matters

- ❖ Areas identified as significant risks specifically in the context of the entity.
- ❖ Areas involving significant auditor judgment.
- ❖ Areas in which the auditor encountered significant difficulty during the audit.
- ❖ Matters that require significant hours by the engagement partner.
- ❖ Involve consultation/evaluation the engagement quality control reviewer.
- ❖ Accounting estimates with high estimation uncertainty.
- ❖ Significant transactions with related parties.
- ❖ Limitations on the group audit.
- ❖ Extensive unexpected effort required to obtain sufficient appropriate audit evidence.
- ❖ Recent economic, accounting, regulatory and other development.
- ❖ Matters giving rise to a modification of the auditor's opinion are by their nature key audit matters.





# Determining Key Audit Matters

**All matters communicated with those charged with governance**

**The determination of the matters that required significant auditor attention in performing the audit**

**The determination of which of those matters were most significant**

**Permission to carve out sensitive matters**



# The number of KAMs in the Audit Report

The number of key audit matters to be included in the auditor's report may be affected by:

- ❖ The size and complexity of the entity.
- ❖ The nature of its business and environment.
- ❖ The facts and circumstances of the audit engagement.
- ❖ ISA 701 doesn't prescribe the number of KAMs that should be reported.
- ❖ KAMs are selected based on the auditor's professional judgment.

The greater the number of key audit matters the less useful the auditor's communication of key matters may be.

Law and regulation may restrict the auditor's communication of certain matters with those charged with governance. In such case the auditor may consider obtaining legal advice.

# Communicating key audit matters

- ❖ Limiting the use of highly technical auditing terms.
- ❖ Auditor to avoid giving original information.
- ❖ Reference is made to relevant disclosures in the financial statements.
- ❖ The auditor describes its effect on the audit.
- ❖ Procedures performed described at a high level and not a detailed description of procedures.
- ❖ Address the specific outcome but avoid the impression that an opinion is express on individual matters.



# Describing KAMs in the Audit Report

<b>Why the matter is considered to be of the most significance</b>	<b>Reference to related disclosures</b>	<b>How the matter was addressed in the audit</b>	<b>Brief overview of procedures performed</b>	<b>Key observation or indication of the outcome of the procedures</b>
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# Top five KAMs most reported in the UK

The UK Financial Reporting Council (FRC) conducted a post-implementation review of KAMs among 150 auditor's reports. The Top five KAMs most reported in the UK were:

- Impairment of assets
- Tax
- Goodwill impairment
- Management override of controls and
- Fraud in revenue recognition



# Example 1

Key audit matter	How our audit addressed the key matter
<b>1. Contingencies relating to tax matters</b> <p>As disclosed in Note 30 (d) to the financial statements, the Group has open tax assessments as it is involved in legal matters with the Kenya Revenue Authority (KRA). The determination of provisions and contingent liabilities arising from the open tax assessments make this a particular area of significant judgement.</p> <p>We focused on management's assessment of the likely outcome and quantification of tax exposures which involves significant judgement.</p> <p>We also considered there to be a risk that the tax disclosures in Notes 12 and 30 (d) to the financial statements, which are significant to the understanding of the Group's tax position may not be adequate.</p>	<p>Our audit procedures included:</p> <ul style="list-style-type: none"><li>• Understanding the process of estimating, recording and reassessing tax provisions and contingencies.</li><li>• Involving our tax specialists to assist in analysing the judgements used to determine provisions for tax matters based on their knowledge and experience of local regulations and practices.</li><li>• Inspecting the correspondence with tax authorities.</li><li>• Inspecting reports on open tax assessments prepared by the company's tax advisors and in-house tax manager and where appropriate, the company's external legal advisers, and other appropriate documentation considered necessary to understand the position and conclusions made by the company. We also obtained external confirmations from legal counsel on significant tax litigation.</li><li>• We also assessed the adequacy of the Group's financial statements disclosures in respect of the tax positions and contingent liabilities.</li></ul>

Source: EY, 2017 – Bamburi Cement Limited

# Example 2

## 2. Contingencies relating to Hima Cement Uganda Limited – Mining Lease

Contingencies in respect of mining lease legal suit are disclosed in Note 30 (c) to the financial statement. Hima Cement Uganda Limited is a material subsidiary of the Group.

Since the ultimate disposition of this suit and the related claims cannot be predicted with certainty, an adverse outcome could have a material adverse effect on the financial position, results of operations and cash flows of the Group.

Significant judgement is required in assessing the likely outcome of the suit and quantification of the obligation to be paid out, if any, in case of an adverse outcome. Hence this was considered a key audit matter.

We also considered that the disclosures on this matter are important in understanding the consolidated financial statements.

Our audit procedures included understanding the Group's processes for the recording and reassessment of contingencies.

We evaluated management's assessment of this suit and its effect, in case of adverse outcome, on the financial position, results of operations and cash flows of the Group and the need for any provision and related disclosures.

Our procedures also included obtaining confirmation from Hima's external legal counsel in order to compare their expert opinion to management's position on measurement and disclosures for the contingencies related to this suit.

We also engaged in periodic meetings with management and the Group's internal legal counsel as well as inspecting correspondence between the involved parties.

We also assessed the adequacy of the Group's disclosures in respect of contingencies.

**Source: EY, 2017 – Bamburi Cement Limited**



# Example 3

Information Technology (IT) systems and controls	
The key audit matter	How the matter was addressed
<p>Effective 12 August 2016, KCB Group PLC upgraded its core banking system from T24 R08 to T24 R14. Due to the inherent risks associated with a system upgrade and the processes around data migration, we identified IT systems and controls over financial reporting as a Key audit matter. There is a risk that automated accounting procedures and related IT dependent manual controls are not designed and operating effectively.</p>	<p>Our audit procedures in this area included, among others:</p> <ul style="list-style-type: none"><li>- Reviewing the data migration process, testing general IT controls around system access and change management and testing controls over computer operations within specific applications which are required to be operating correctly to mitigate the risk of misstatement in the financial statements;</li><li>- With the support of our own IT specialists, testing these controls through examining whether changes made to the systems were appropriately approved, and assessing whether appropriate restrictions were placed on access to core systems through reviewing the permissions and responsibilities of those given that access; and</li><li>- Where we identify the need to perform additional procedures, place reliance on manual compensating controls, such as reconciliations between systems and other information sources or performing additional testing, such as extending the size of our sample sizes, to obtain sufficient appropriate audit evidence over the financial statement balances that were impacted.</li></ul>

Source: KPMG, 2017 – KCB Group PLC

# Example 4

IAS 29 Financial Reporting in Hyperinflationary Economies	
See accounting policy note 3 (c) (ii) – Significant accounting policies; disclosure note 20 – Loss on monetary position and disclosure note 51 – Hyperinflation.	
The key audit matter	How the matter was addressed
<p>The Group has a significant foreign subsidiary in operating in South Sudan. For the financial year ended 31 December 2016, the subsidiary's financial statements were restated for hyperinflationary adjustments in accordance with inflation statistics published by the South Sudan National Bureau of Statistics and the consumer price indices stated by International Monetary Fund classified South Sudan which classified South Sudan as a hyperinflationary economy for the year ended 31 December 2016.</p> <p>We have considered hyperinflationary adjustments as a key audit matter due to the complex calculations and disclosures involved in re-statement of financial statements to conform to the requirements of International Accounting Standard ("IAS") 29, Financial Reporting in Hyperinflationary Economies. The standard requires significant judgments to be made by Directors in determination of whether an economy is hyperinflationary.</p>	<p>Our audit procedures in this area included, among others:</p> <ul style="list-style-type: none"><li>- Assessing and testing for the indicators of hyperinflation on the South Sudan economy as well as judgments and assumptions made by the Directors during the application of the requirements of IAS 29. This included comparing the assumptions used to externally available industry, financial and economic data;</li><li>- Inspecting and validating the source of data used in the workings provided by the management by verifying the Consumer Price Index ('CPI') and inflation rates provided against those published by the South Sudan National Bureau of Statistics and the International Monetary Fund; and</li><li>- Assessing whether disclosures in the consolidated financial statements appropriately reflect the effects of the applying IAS 29 requirements.</li></ul>

Source: KPMG, 2017 – KCB Group PLC

Questions  
Answers  
Comments

**Thank You!**