

- Forming an audit opinion
- Communication of Key Audit Matters

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Presentation outline

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4. What is new?
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Introductory examples

- Audit report in 2006 – KP1
- Audit report in 2015 – PAL, HEL, QAL, CAL
- Effect of NOCLAR

Why is the change important



- Audit report is a key deliverable addressing the output of the audit process.
- Financial statements users need more informative report
- Auditors to provide more relevant information to users

Why is the change important (continued)



- Enhanced reporting will influence the value of the financial statement audit
- Increase transparency in the reporting
- It will ensure continued relevance of the auditing profession.

Key benefits according to IAASB



- Increased informational value of the auditor's report.
- Enhanced communications between investors and the auditor,
- Enhanced communication between the auditor and those charged with governance

Key benefits according to IAASB (continued)



- Increased attention by management to the disclosures in the financial statements to which reference is made in the auditor's report
- Renewed focus of the auditor on matters to be communicated in the auditor's report, which could indirectly result in an increase in professional skepticism.

What is new?

- **Dichotomy** - between listed and non listed entities.
Mandatory for audits of financial statements of listed entities, voluntarily application allowed for entities other than listed entities.
- **New KAM section** - to communicate key audit matters (KAM). KAM are those matters that, in the auditor's judgment, were of most significance in the audit of the current period financial statements.

What is new? contd.



- **Name of engagement Partner** - Disclosure of the name of the engagement partner.
- **Other changes** for all entities – see next slide.

What is new? contd.



Changes affecting all entities:-

- a) Report layout
- b) Going concern
- c) Auditor's independence
- d) Auditor's responsibilities

Report layout



- Opinion section required to be presented first.
- Basis for Opinion section comes second
- Typical layout
 - Title and addressee
 - Report of audit of the financial statements
 - Opinion
 - Basis for opinion
 - Key Audit Matters

Report layout (cont'd)



- Other information
- Responsibility of the directors for the financial statements
- Auditor's responsibility for the for the audit of the financial statements
- Report on other legal and regulatory requirements
- Engagement partner name and number
- Signature
- Place where registered
- Date

Note: Exemption to this format only if regulation prescribes otherwise

Going concern – ISA 570

- Enhanced auditor reporting on going concern
- Includes more description of the respective responsibilities of management and the auditor for going concern
- A separate section when a material uncertainty exists and is adequately disclosed, under the heading “Material Uncertainty Related to Going Concern”

Going concern – ISA 570 (continued)



- New requirement to challenge adequacy of disclosures for “close calls” in view of the applicable financial reporting framework when events or conditions are identified that may cast significant doubt on an entity’s ability to continue as a going concern

Auditor's independence



- Affirmative statement about the auditor's independence and fulfillment of relevant ethical responsibilities, with disclosure of the jurisdiction of origin of those requirements or reference to the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants.

Auditor's responsibilities

- Enhanced description of the auditor's responsibilities and key features of an audit. Certain components of the description of the auditor's responsibilities may be presented in an appendix to the auditor's report or, where law, regulation or national auditing standards expressly permit, by reference in the auditor's report to a website of an appropriate authority.

Key concepts to note



- a) Pervasive
- b) Key Audit Matters (KAM)
- c) Emphasis of matter
- d) Adverse opinion
- e) Disclaimer of opinion

Pervasive

Pervasive effect are those that in the auditors judgement:

- Are not confined to specific elements, accounts or items of the financial statements;
- If so confined, represent or could represent a substantial proportion of the financial statements; or
- In relation to disclosures, are fundamental to users' understanding of the financial statements

Pervasive cont.

Pervasiveness is a matter that confuses many new auditors as, it is a matter that requires professional judgment. In this case the judgment is whether the matter is isolated to specific components of the financial statements, or whether the matter pervades many elements of the financial statements, rendering them unreliable as a whole.

Pervasive cont.

The bottom line is that if the auditor believes that the financial statements may be relied upon in some part for decision making then the matter is material and not pervasive. If, however, they believe the financial statements should not be relied upon at all for making decisions then the matter is pervasive.

Example: Related parties (Spreading widely),
Inventories (confined but pervasive)

Emphasis of matter

EOM is rarely dealt with satisfactorily by some auditors. This is mainly because some auditors believe that EOM is linked to modifications of the opinion. This is not the case: EOM and modified opinions are separate matters.

EOM – A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

Form of a modified audit opinion



- a) Circumstances leading to modified opinion
- b) Qualified opinion
- c) Adverse opinion
- d) Disclaimer of opinion
- e) Decision matrix

Circumstances leading to modification



The auditor shall modify the opinion in the auditor's report when:

- The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or
- The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

Decision matrix

Nature of matter	Auditors judgement on pervasiveness	
	Material but not pervasive	Material and pervasive
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

Qualified opinion

The auditor shall express a qualified opinion when:

- The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
- The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

Adverse

- The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.



Disclaimer

The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

Which ISAs are changing? Contd.



- Forming an opinion and reporting on financial statements (ISA 700 Revised)
- Modified audit report (ISA 705 Revised)
- Emphasis of matter and other matters (ISA 706 Revised)
- Going concern (ISA 570 revised)
- Key Audit Matters (ISA 701 Revised)
- Auditors responsibility on other information (ISA 720 Revised)

Other considerations:

- Communication with those charged with Governance (ISA 260)
- Other ISAs changed for conformity.

ISA 700 Revised

Objectives of an auditor are:

- i. To form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and
- ii. To express clearly that opinion through writing.

The auditor shall form an opinion on whether the financial statements are prepared, in all material respect, in accordance with the applicable financial reporting framework.

ISA 700 contd. (Forming an opinion)



In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion shall take into account:

- i. The auditor conclusion in accordance with ISA 330, whether sufficient appropriate evidence has been obtained
- ii. The auditors conclusion in accordance with ISA 450 whether uncorrected misstatements are material, individually or in aggregate; and
- iii. The financial statements have been presented in all material respect in accordance with the requirements of the applicable framework

ISA 700 contd. (Format of an audit report)



- Title (clearly indicate it is the report of the independent auditor)
- Addressee (The auditors report shall be addressed as appropriate)
- Auditors opinion
- Basis of opinion (state the audit was conducted in accordance with ISAs, Refer to section in the audit report that describes the auditors responsibilities, include a statement that the auditor is independent of the entity, state whether audit evidence was sufficient and appropriate)
- Going concern (to report in accordance with ISA 570)
- Key Audit Matters (for listed entities and certain regulated entities, proposed ISA 701)
- Other information (to report in accordance with ISA 720)
- Responsibilities for the financial statements

ISA 700 contd. (Format of an audit report (contd))



- Auditors responsibilities for the financial statements
- Other reporting responsibilities
- Name of engagement (required for listed companies in rare circumstances such disclosure is reasonably expected to lead to a significant security threat)
- Auditors address
- Date of the auditors report

ISA 705 revised

Objectives of the auditor is to express an appropriately modified opinion on the financial statements that is necessary when:

- i. The auditor concludes, based on audit evidence, that the financial statements as a whole are not free from material misstatements; or
- ii. The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement

ISA 706 - Emphasis of Matter



The objective of the auditor, having formed an opinion on the financial statements, is to draw users' attention, when in the auditor's judgment it is necessary to do so, by way of clear additional communication in the auditor's report, to:

- i. A matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users' understanding of the financial statements; or
- ii. As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

ISA 706 Examples of circumstances requiring emphasis of matter



- an uncertainty relating to the future outcome of exceptional litigation or regulatory action.
- A new accounting standard (for example, a new International Financial Reporting Standard) that is not yet effective but is expected to have a material effect on the financial statements
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.
- A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.

ISA 720 Other matters paragraph



- Other matter' paragraphs are used to refer to matters that have not been disclosed in the financial statements that the auditor believes are significant to user understanding. One usage of these paragraphs is where the auditor concludes that there is a material inconsistency between the audited financial statements and the other (unaudited) information contained within the annual report and accounts, as required by ISA 720, The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements.

ISA 701 Key Audit Matters



- Key audit matters - 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. (ISA 260)

ISA 701 Determining Key Audit Matters



The auditor shall determine which of the matters communicated with those charged with governance are the key audit matters. In making this determination, the auditor shall take into account areas of significant auditor attention in performing the audit, including:

- Areas identified as significant risks in accordance with ISA 315 (Revised)
- Areas in which the auditor encountered significant difficulty during the audit, including with respect to obtaining sufficient appropriate audit evidence.
- Circumstances that required significant modification of the auditor's planned approach to the audit, including as a result of the identification of a significant deficiency in internal control.

ISA 701 Communication of Key Audit Matters



- The auditor shall communicate the key audit matters determined in accordance with paragraph 8 in a separate section of the auditor's report under the heading "Key Audit Matters."



Any
questions??