

Audit Quality Assurance Workshop – Central Rift Branch

Auditors opinion reports and Key Audit
Matters,

Presentation by:
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INTRODUCTION



Terms used

Pervasive- This is a term used in the context of misstatement to describe the effects on the financial statements of misstatements or the possible effects on the financial statements. Pervasive effects on the financial statements are those that, in the auditor's Judgment:

- 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;
- In relation to disclosures, are fundamental to users' understanding of the financial statements.

Modified opinion – A qualified opinion, an adverse opinion or a disclaimer of opinion.



AUDIT OPINION REPORT

ISA 700, ISA 705,

ISA 700 (Revised): Forming an opinion and reporting on financial statements

In order to form an opinion, the auditor shall conclude as to whether he 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:

- Whether sufficient appropriate audit evidence has been obtained (ISA 330);
- Whether uncorrected misstatements are material, individually or in aggregate (ISA 450);
- Qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.

REPORTING



- The audit report represents the only visible output produced by the auditor. It is very important that the opinion given is appropriate in the circumstances.
- An incorrect opinion can have devastating consequences for the auditor due to professional liability.

Elements of audit reports



Title

Addressee

Opinion

Basis of opinion

Going concern
(where
applicable)

Key audit
matters (where
applicable)

Other
informati
on

Management's
responsibilities

Auditor's
responsibilities

Other reporting
responsibilities

Auditor's
signature

Auditor's
address

Report date

Audit report Format

ISA 700 (Revised)

1.Independent Auditor's Report

To the shareholders of...

2.Report on the audit of the Financial Statements

3.Opinion

4.Basis for opinion

5.Material uncertainties relating to going concern (where applicable)

6.Key audit matters (where applicable)

7.Other information

8.Responsibilities of management and TCWG for the financial statements

9.Auditor's responsibilities for the audit of the financial statements

10.Report on the audit of the financial statements

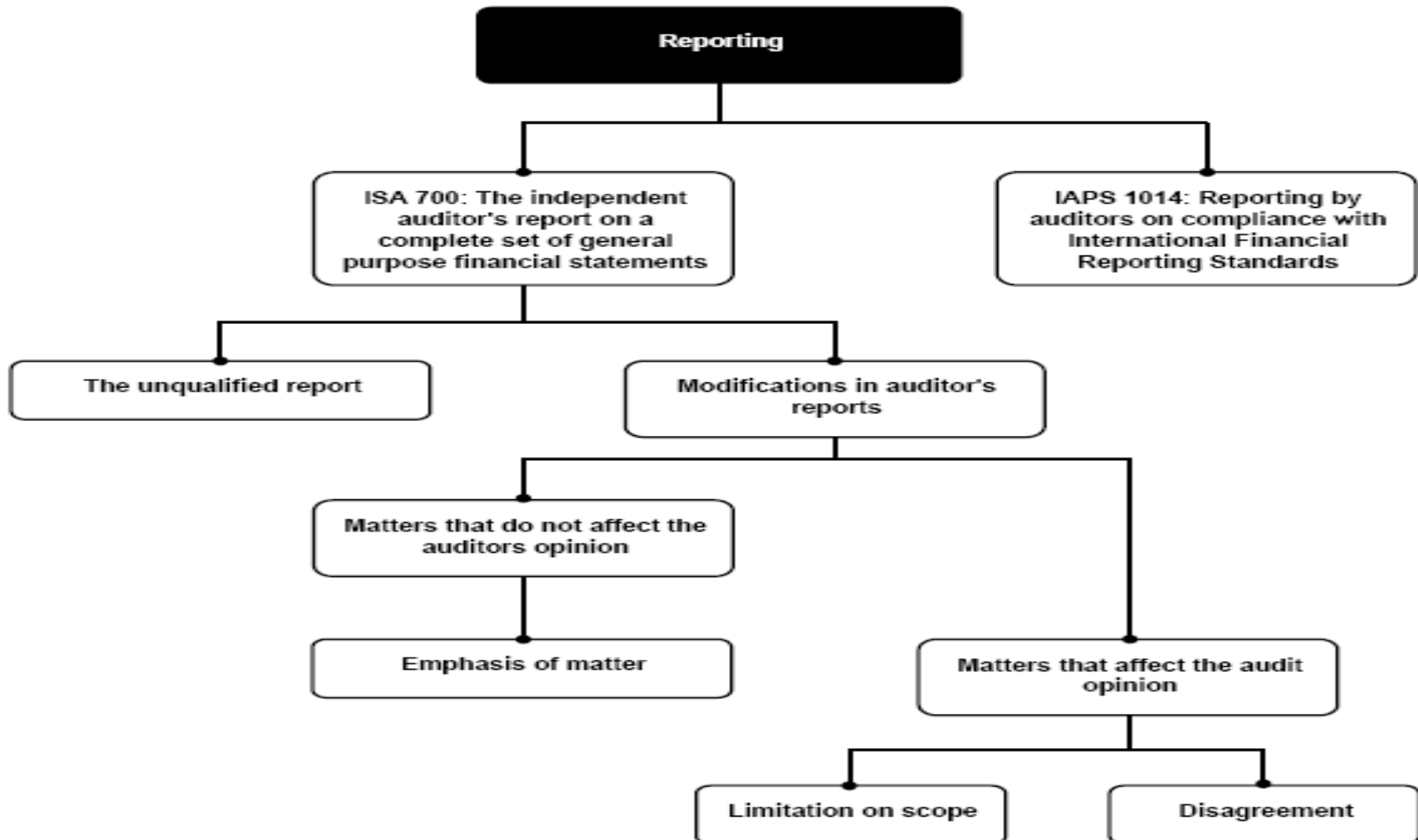
11.Name of engagement partner (where applicable)

12.Signature

13.Address

14.Date

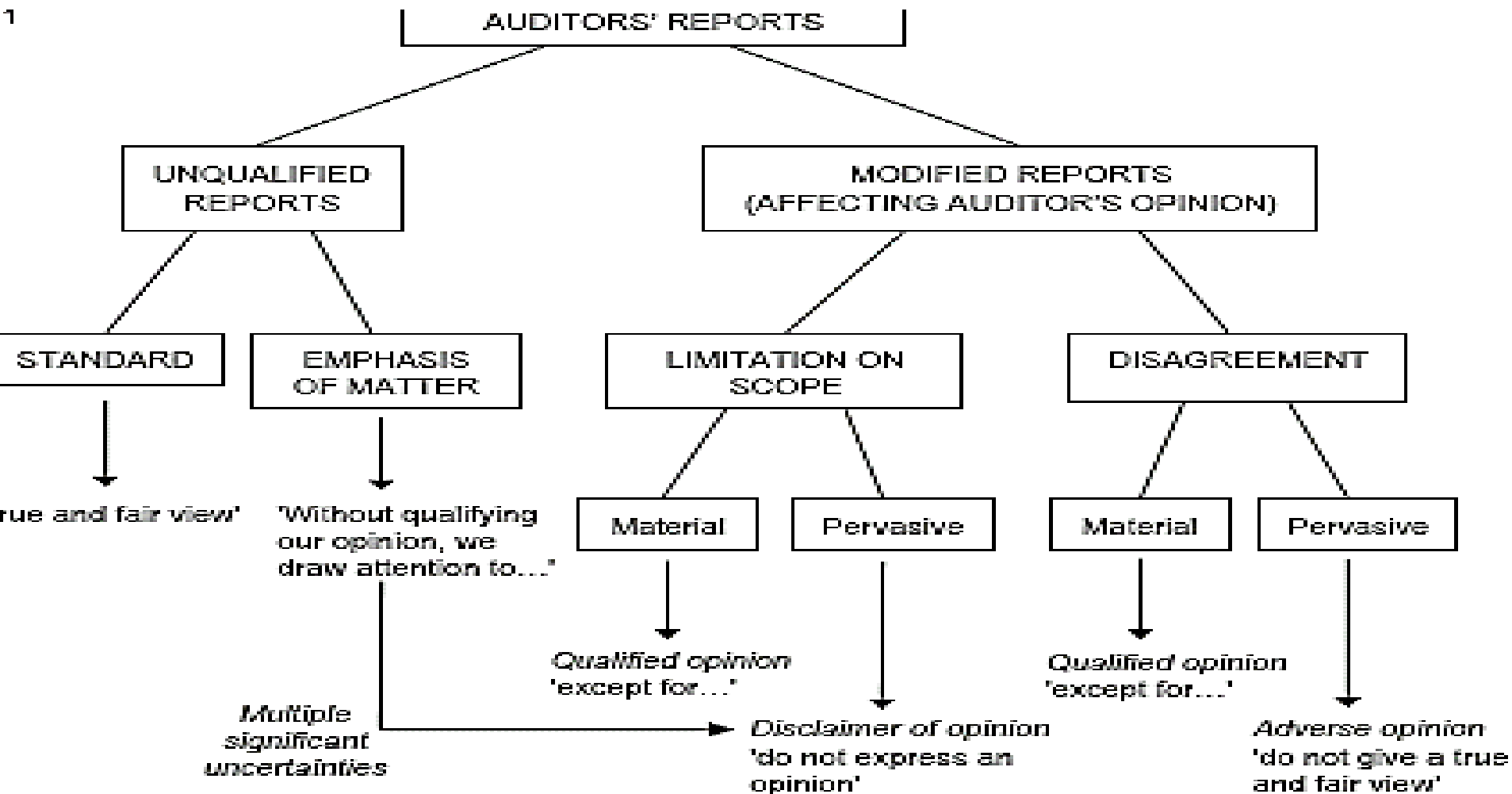
REPORTING OVERVIEW



Overview 2



1



Unmodified opinion with other communication



ISA 706: Emphasis of Matter paragraphs and Other Matter paragraphs

In the auditor's opinion it may be necessary to draw users' attention to matters presented with the financial statements or other information in the annual report that are of such importance and fundamental to users' understanding of either the financial statements themselves or the rest of the audit itself.

Draws users' attention to issues within the financial statements which are appropriately presented and disclosed in the financial statements but are fundamental to users' understanding of the financial statements such as

- An uncertainty relating to the future outcome of exceptional litigation or regulatory action.
- A significant subsequent event that occurs between the date of the financial Statements and the date of the auditor's report.
- Early application (where permitted) of a new accounting standard that has 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

ISA 705: MODIFICATION OF AUDIT OPINION



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

Pervasive effects on the financial statements are those that in the auditor's judgement:



Reason deemed pervasive	Example
1. Are not confined to specific elements accounts or items of the financial statements	No depreciation has been provided on PPE, a receivable balance consisting half of total receivables is irrecoverable and has not been provided and trade payables have been significantly understated
2. If so confined, represent or could represent a substantial proportion of the financial statements	A house building company has included all houses it has constructed in the year as non-current assets rather than inventory. The value constitutes 90% of total assets
3. fundamental to users' understanding of the financial statements In relation to disclosures, are	There has been material uncertainty in respect of going concern which has not been adequately disclosed

Qualified opinion

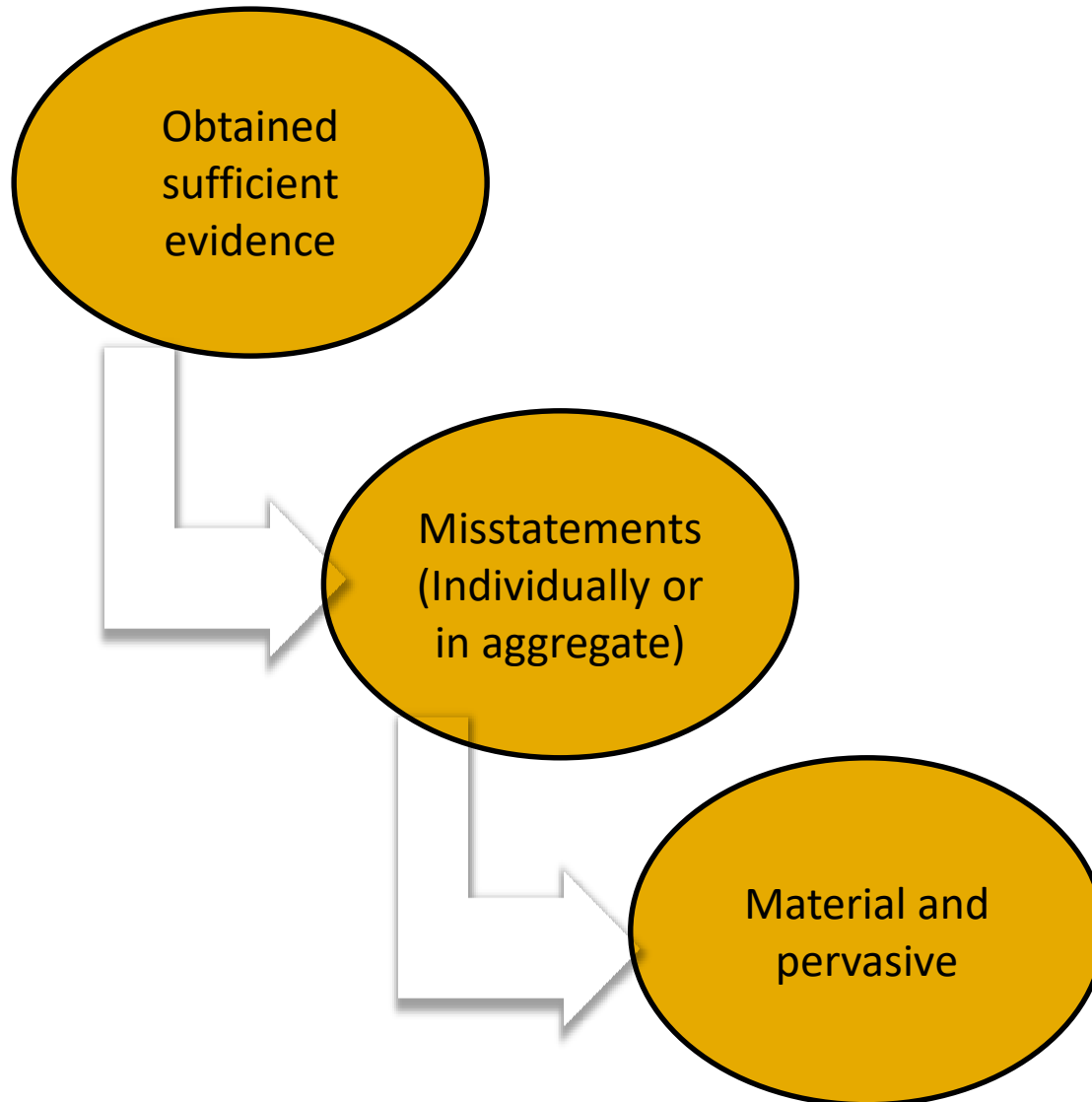


Material but not pervasive

- Appropriateness of accounting policies
- Application of selected accounting policies
- Appropriateness and adequacy of disclosures in the financial statements

- Circumstances beyond the entity's control (e.g. records destroyed)
- Circumstances relating to the nature and timing of the auditor's work (e.g. auditor being appointed after physical inventory count)
- Limitations imposed by management (e.g. mgmt. denying access for external confirmations)

Adverse opinion



Disclaimer of opinion



Auditor cannot obtain sufficient and appropriate evidence- Possible effects of the financial statement if any could be both material and pervasive

The opinion must also be disclaimed in situations involving multiple uncertainties when 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.

Basis of opinion



When the auditor modifies the audit opinion, the auditor shall amend the heading 'Basis for Opinion' to:

- 'Basis for Qualified Opinion',
- 'Basis for Adverse Opinion' or
- 'Basis for Disclaimer of Opinion'

Within this section, include a description of the matter giving rise to the modification.

- 1.If there is a material misstatement that relates to specific amounts in the financial statements, the auditor shall include in the Basis for Opinion section a **description** and quantification of the financial effects of the misstatement unless impracticable. If it is **not practicable** to quantify the financial effects, the auditor shall so state in this section.
2. If there is a material misstatement that relates to narrative disclosures, the auditor shall include in the Basis for Opinion section an explanation of how the disclosures are misstated.
- 3.If there is a material misstatement that relates to the non-disclosure of information required to be disclosed, the auditor shall **discuss with TCWG**, **describe** in the Basis for Opinion section the nature of the omitted information and unless prohibited by law or regulation, **include the omitted disclosures**, provided it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information

Sample of Audit Report



INDEPENDENT AUDITOR'S REPORT

To, The ABC Private Limited

Report on the Audit of the Standalone Financial Statements

Opinion

We have audited the accompanying standalone financial statements of ABC Private Limited ("the Company"), which comprise the balance sheet as at 31st March 2019, the statement of Profit and Loss, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information. In our opinion and to the best of our information and according to the explanations given to us, the previously mentioned standalone financial statements give the information required by the Act, in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as at March 31, 2019. Its loss, changes in equity and its cash flows for the year ended on that date.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the financial statements section of our report. We are independent of the company in accordance with the International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants (Parts A and B) (IESBA Code) and other independence requirements applicable to performing audits of financial statements in Kenya. We have fulfilled our other ethical responsibilities in accordance with the IESBA Code and in accordance with other ethical requirements applicable to performing audits in Kenya. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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

Report Continue...



Key Audit Matters	Auditors response and procedures
Provisioning towards Major Maintenance expense	
Project highway for which it has to carry out periodic major maintenance resurfacing expenses as required under the concession agreement. The estimation of the likely amount to be incurred and the timing thereof involves calculation and judgement for assessing the provision towards resurfacing (as per IAS 37). Considering the amount and estimation involved, the same is considered as Key Audit Matter	The estimation made by the management have been verified compliance of the requirements of concession agreement, checking of arithmetical accuracy, verifying the underlying assumptions and comparison with earlier years assumption etc. to check any material inconsistencies. Based on audit procedures carried, we have not come across any material variations.

Information Other than the Financial Statements and Auditor's Report Thereon

The company's Board of Directors is responsible for the other information. The other information comprises the information included in the Annual Report, but does not include the financial statements and our auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information; we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the directors for the Financial Statements

The directors are responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act, 2015, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with International Standards on Auditing will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or taken together, they could reasonably be expected to influence the economic decisions of users taken based on these financial statements.

As part of an audit in accordance with International Standards on Auditing, we exercise professional judgement and maintain professional scepticism throughout the audit. We also

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on
- the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit. The engagement partner responsible for the audit resulting in this independent auditor's report was Certified Public

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Mbaya & Associate

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Nairobi Kenya

Partner

Certified Public Accountants (Kenya)



3st December 2019



KEY AUDIT MATTER

ISA 701

Effective from December 2016

Key Audit matter



Definition:

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

- **Significant Audit risks:**
Areas of risks of material misstatement
- **Significant judgmental areas in the financial statement:** Accounting Estimates with high estimation uncertainty
- **Significant events or transaction during the year:** with the effects on the financial statements

KEY AUDIT MATTER



Key audit matters (KAM) were developed by the International Auditing and Assurance Standards Board (IAASB) to respond to the challenge from stakeholders to improve the transparency and clarity of audit reports. A revised suite of auditor reporting standards were issued in 2015 with an effective date of December 2016

For many years, investors have been saying they want audit reports to give more detail about the audit process. They were of the view that more contextual information about the audit would help investors differentiate better between companies that had received 'clean' audit reports

Common Significant areas



Going Concern
assessment

Revenue recognition

Effective of new
accounting standard

Impairment of
assets

Business combination
and accounting
impact

Disposal of
business unit

Provision for
contingencies

Deferred Taxation

Goodwill impairment

Valuation of
financial
instruments

Communicating key audit matters



Auditor's communication with those charge with governance should be the starting point to determine the key audit matter

The number of key audit matter will vary depending with the size and complexity of the entity and the nature of its business environment

The importance of communicating key audit matters



- Provides additional information to users of the financial statements to assist them 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
- Assist users of the financial statements in understanding the entity and areas of significant management judgment in the audited financial statements; as such, matters are areas of focus in performing the audit.
- Provide users of the financial statements a basis to further engage with management and those charged with governance about certain matters relating to the entity and the audited financial statements.

Sensitive matter: Not part of KAM



ISA 701 allows for the possibility, in extremely rare circumstances , that the auditor might decide not to communicate a matter when:

- Laws or regulations preclude a disclosure such as a matter that may prejudice an investigation of illegal act
- Adverse consequences on the entity are expected to outweigh the public interest benefits of communication
- This is a complex decision and involve significant auditor judgment. Accordingly, the auditor may consider it appropriate to obtain legal advice

KAM: WHAT TO STATE



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

- Why the matter was considered to be one of the most significance in the audit
- How the matter was addressed in the audit: Auditors approach and overview of the procedures performed with an indication of an outcome
- Reference to the related disclosures.

Key points to note in this area



- Should be specific to the entity- Avoid generic and standardized language
- Does not imply that the matter has been appropriately resolved in the audit: Key audit matter is not audit qualification
- Key audit matter is not a substitute for the disclosure in the financial statements
- Does not imply discrete opinions on separate elements of the financial statement

Key point to note continue...



- Key Audit matter does not change the audit scope nor does it change the scope of those charged with governance and the management in relation to financial statements
- KAM only intend to highlight “through the eye of the auditor” matters of most significance
- Will provide users of the financial statements a basis to further engage with management and the with the auditors
- Will require enhanced communication between the auditor and audit committee

Example: Goodwill



[Reason why this matter is a KAM] Under IFRSs, the Group is required to annually test the amount of goodwill for impairment. This annual impairment test was significant to our audit because the balance of XX as of 31 December 20X9 is material to the financial statements. In addition, management's assessment process is complex and highly judgmental and is based on assumptions, specifically [describe certain assumptions], which are affected by expected future market or economic conditions, particularly those in [name of country or geographic area].

[How a KAM was addressed in the audit] 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.

[Refer to the related disclosures] The Company's disclosures about goodwill are included in Note X, which specifically explains that small changes in the key assumptions used could give rise to an impairment of the goodwill balance in the future



ANY QUESTION?

THANK YOU.