

SA 701 Communicating Key Audit matters in the independent Auditor's report

This article aims to explain the concept of Key Audit matters that are part of new Auditor's report.

SA 701 deals with the Auditor's responsibility to communicate key Audit matters in the Auditor's report. It is intended for addressing both the judgement of an Auditor as to what is required to be communicated in Audit report and the content and form of such communication. The purpose of communicating key audit matters is to enhance the communicative value of the auditor's report.

This SA applies to audits of complete sets of general purpose financial statements of listed entities and circumstances when the auditor otherwise decides to communicate key audit matters in the auditor's report. This SA also applies when the auditor is required by law or regulation to communicate key audit matters in the auditor's report.

This SA is effective for audits of financial statements for periods beginning on or after April 1, 2018

Purpose of introduction of SA:

- ❖ To enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed.
- ❖ Provides basis to further engage enquiry with management.

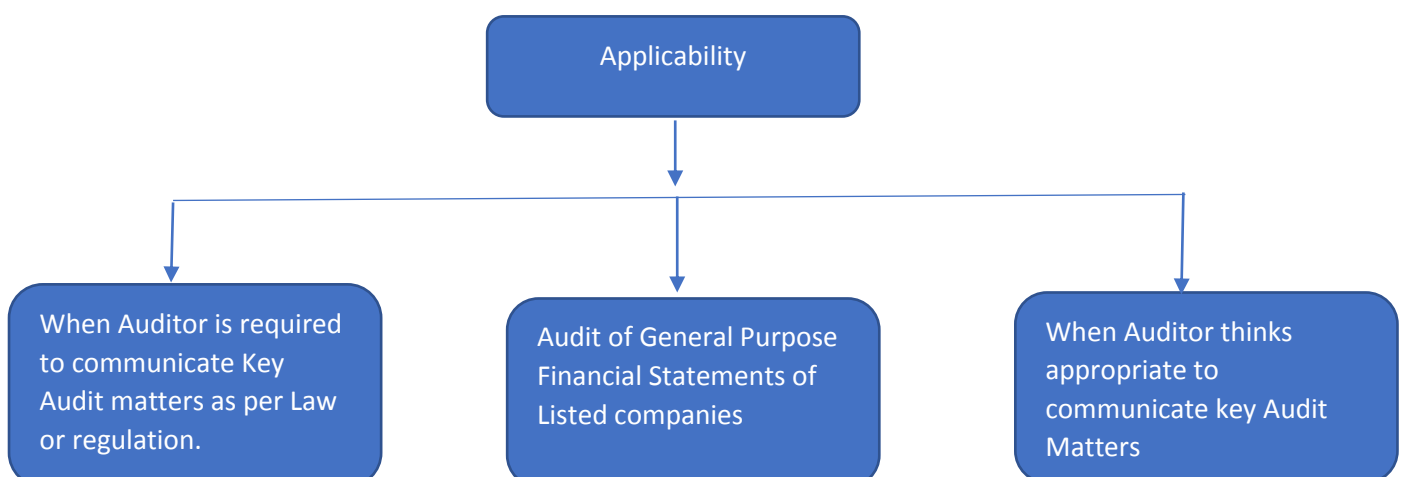
Key Audit matter (KAM):

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.

Scope of the standard:

- ❖ Deals with the auditor's responsibility to communicate key audit matters in the auditor's report.
- ❖ It is intended to address both the auditor's judgment as to what to communicate in the auditor's report and the form and content of such communication.

Applicability:



Note:

This SA is effective for audit of financial statements for periods beginning on or after April 1, 2018.

Determination of Key audit matters:

The following matters are to be considered while determining key Audit matters:

- ❖ Matters which involves significant Auditor's judgement while conducting Audit.
- ❖ Matters which Involves difficulty in obtaining sufficient and appropriate Audit evidences.
- ❖ Those areas where significant deficiencies were found in the Internal controls.
- ❖ Those matters which makes Auditor difficult in performing Audit.
- ❖ Matters which are identified as significant risk.
- ❖ Circumstances required significant modifications in Audit plan.

It can be explained with the help of a diagram:



These are the matters to be discussed with those charged with governance.

Out of the matters discussed with those charged with governance this traingle represents the KAM.

Communication:

Communication of Key Audit matter **is not:**

- ❖ A substitute for disclosure in FS that Financial reporting framework requires management to make.
- ❖ A substitute for modified opinion required by the circumstances as per SA 705.
- ❖ A substitute for reporting as per SA 750 when material uncertainty exists relating to events that may cast significant doubt on entity's ability to continue a going concern.

- ❖ A separate opinion on individual matters.

Reporting:

Audit report shall state that:

- ❖ KAM are those matters which are in Auditor's judgement were of the most significant in Audit.
- ❖ KAM are selected from matters communicated with TCWG, but not intended to represent all matters discussed.
- ❖ The Auditor's procedures relating to these matters were designed in context of the Audit of financial statements as a whole.
- ❖ The Auditor's opinion is not modified with respect to any of the Key Audit Matter and Auditor doesn't express an opinion on these individual matters.

Disclosure:

- ❖ Describe each Key Audit Matter under appropriate subheading.
 - For example, if the KAM is on debtors, then Auditor must state in report that Key Audit Matter - Debtors.
- ❖ Explanation as to why item considered significant and its effect on the Audit.
- ❖ A reference to related disclosure in financial statements.

Exceptions:

- ❖ Law or regulation precludes public disclosure about the matter; or
- ❖ 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.

Documentation:

The Auditor shall include in the Audit documentation:

- ❖ The matters that required significant Auditor attention as determined in accordance with SA, and the rationale for the Auditor's determination as to whether or not each of these matters is a KAM.
- ❖ Where applicable, the rationale for the auditor's determination that there are no key audit matters to communicate in the auditor's report or that the only key audit matters to communicate are those matters addressed by paragraph 15; 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.

If there are no Key Audit matters found during the Audit:

- ❖ Document the rationale that there are no key Audit matter to report.

- ❖ Communicate this conclusion with TCWG.
- ❖ Report expressly in the report after defining KAM, that the Auditor has determined that there are no such key Audit matters to report.
- ❖ Discuss this conclusion with quality control review (if any).

Example of Key Audit Matter (KAM):

KCB group financial report:

- ❖ Effective 12-8-17 KCB group upgraded its core banking system from T24R08 to T24R14
- ❖ Due to inherent risks associated with the system upgrade and 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.

How the matter was addressed:

- ❖ Our Audit procedure in this area included among others, 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 management in the FS.
- ❖ With the help 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 permissions and responsibility of those given that access and where we identified the need to perform additional procedures place reliance on manual controls such as reconciliations between systems and other information sources or performing addition testing such as extending the size of our samples to obtain appropriate audit evidence for the financial statement balances that were impacted.

Difference between Other matter paragraph, Emphasis of matter paragraph and Key audit matter:

<i>Other matter paragraph</i>	<i>Emphasis of matter paragraph</i>	<i>Key Audit matter</i>
It is a paragraph included in the Auditor's report that refers to a matter other than those presented or disclosed in the financial report that, in the Auditor's judgement, is relevant to users understanding of the Audit.	It is 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 judgement, is of such importance that it is fundamental to users understanding of financial statements.	These are the matters that provides additional information to users of the financial statements to assist them in understanding those matters that, in the Auditor's professional judgement, were of most significant in the Audit of the financial statements.

Amendments in related Standards:

- ❖ Auditor shall report the matter in separate section of going concern as per SA 570.

- ❖ SA 700 - disclosure shall be made unless law and regulation precludes public disclosure about the matter or when adverse consequences of doing so would reasonably be expected.
- ❖ SA 705 – When Auditor disclaims an opinion of FS, the Auditor’s report shall not include KAM.
- ❖ SA 706 – The Auditor shall include EMP provided that Auditor is not required to modify his opinion as a result of those matters.
 - ✓ Matter not determined as KAM as per SA 701.

Conclusion:

As SA 701 intends to disclose the most significant matters in the Independent Auditor’s report, it will help the users of the financial statements to focus on those matters and make decisions accordingly. It also helps the Auditor to express those matters which he thinks that it is useful for the decision making of the users of the financial statements.