

S.L. CHHAJED & CO. LLP

CHARTERED ACCOUNTANTS

SA 701 Communicating Key Audit Matters in the Independent Auditor's Report

➤ COMMUNICATING KAM IN THE INDEPENDENT AUDITOR'S REPORT

Applicability:

- This SA is applicable for audits of financial statements for periods beginning on or after April 1, 2018.
- This SA applies to audit of complete set of FS of:
 - Listed Entities
 - Unlisted Entities:
 - a) When Auditor is required by Law or Regulation, or
 - b) When Auditor decides to communicate KAM in his report

➤ OBJECTIVE:

- Intention of SA 701 is to address both the auditor's judgement:
 - as to what to communicate in the auditor's report as KAM
 - the form and content of such communication.
- The purpose of communicating KAM is to enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed.
- It also helps intended users in understanding the entity and areas of significant management judgment.

➤ KEY AUDIT MATTERS (KAM):

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.
- Communicating KAM is not substitute of:
 - Disclosures in the financial statements
 - Expressing a modified opinion as per SA 705
 - Reporting as per SA 570 when a material uncertainty exists regarding Going Concern
 - A separate opinion on individual matters i.e., Emphasis of matter paragraph and other matter paragraph as per SA 706.

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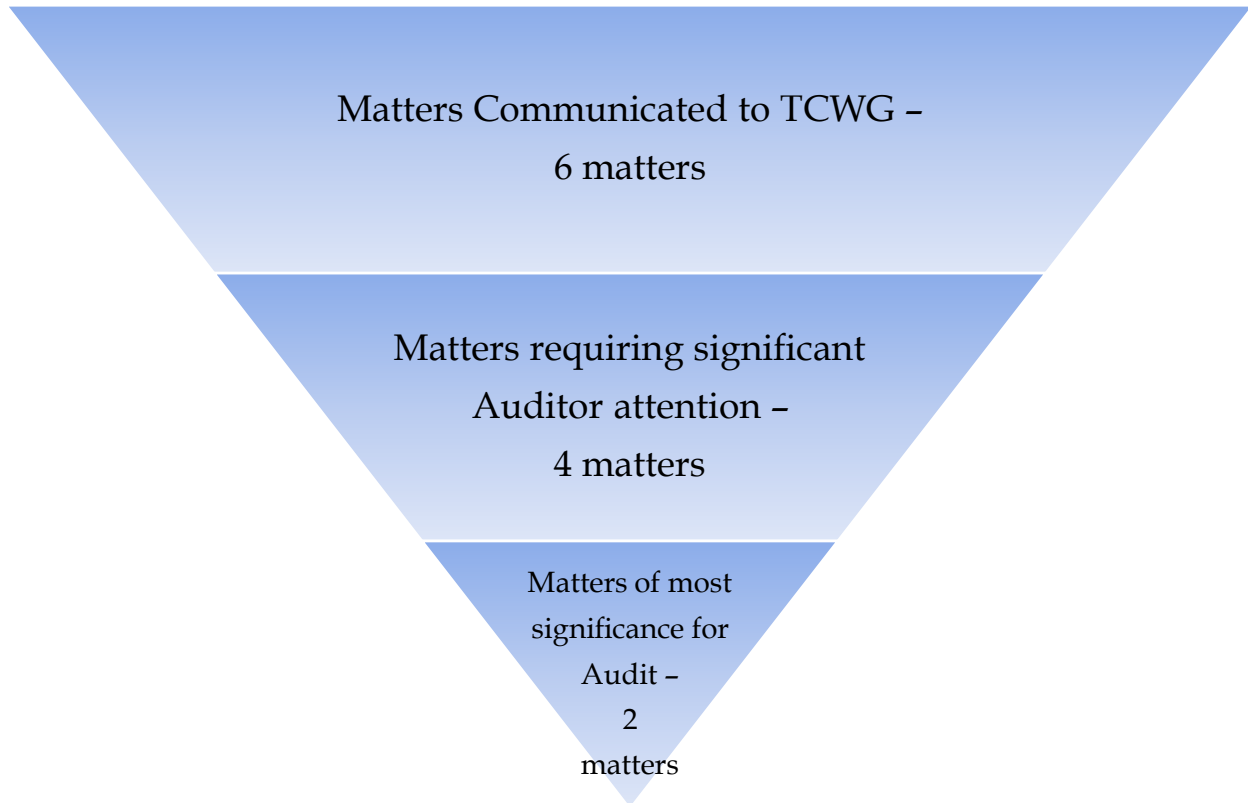
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➤ **DETERMINING KEY AUDIT MATTERS -FUNNEL APPROACH:**



- KAM are selected from Matter communicated with TCWG, but not representing all the matters.
- In making the determination, the Auditor shall take into account the following:
 - a) Area of higher assessed risk of material misstatement or significant risks identified in accordance with SA 315.
 - b) Significant auditor judgements relating to areas in FS that involved significant management judgement including accounting estimates that have been identified as having high estimation uncertainty.
 - c) The effect on the audit of significant events or transactions that occurred during the period.

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- Matters that required significant auditor attention:
 - The concept of significant auditor attention recognizes that an audit is risk based and focuses on identifying and assessing the risk of material misstatement of FS, designing and performing audit procedures responsive to those risks and obtaining audit evidence that is sufficient and appropriate to provide a basis for the auditor opinion.
 - Accordingly matters that pose challenges to the auditor in obtaining sufficient appropriate audit evidence or pose challenges to the auditor in forming an opinion may be particularly relevant in the auditor's determination of KAM.
 - Areas of significant auditor attention often relate to areas of complexity and significant management judgement in the FS and therefore often involve difficult or complex auditor judgements.

Matters of most significance:

- The consideration relevant to determining relative significance of a matter communicated with TCWG and whether such a matter is a KAM include:
 - Importance of the matters to intended users' understanding of FS as a whole and its materiality, in particular.
 - Nature of underlying accounting policy relating to the matter or complexity or subjectivity involved in management's selection of appropriate policy compared to the other entity within the industry.
 - Nature and extent of audit efforts needed to address the matter.
 - Nature and severity of difficulties in applying audit procedures, evaluating the results of those procedures and obtaining reliable and relevant evidence to based the auditor opinion as the auditor's judgement become more subjective.
 - Severity of control deficiencies identified relevant to the matter.

Determining which and how many, of those matters that required significant auditor attention were of most significance in the audit of FS of current period is a matter of professional judgement.

COMMUNICATING KAM:

- Before reporting a matter in KAM, auditor shall communicate with TCWG the list of matters identified as KAM & document those matters.
- Auditor shall describe in his report in a separate section using an appropriate subheading under the heading "Key Audit Matters" after the heading "Basis for opinion" (qualified / adverse) and "EOM" (if any) but before "Other Matter" para (if any).

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- Report shall state:
 - Definition of KAM.
 - KAM are selected from Matters communicated with TCWG, but not representing all the matters.
 - These matters were addressed in the context of the audit of financial statements as a whole.
 - Auditor does not provide a separate opinion on those matters.

- Description of Individual KAM – A matter of Professional Judgement:
The report shall include a reference to related disclosure, if any in the FS and shall address:
 - i. Why the matter was considered as most significance in the audit and therefore determined to be a KAM
 - ii. How the matter was addressed

- Circumstances of determining a matter to be a KAM is Not required to be communicated in the Auditor’s Report.
- Interaction between Descriptions of KAM or other elements required to be Included in the Auditor’s Report e.g., where a Qualified opinion is given, Auditor may give statement that except matter stated in Basis for Qualified Opinion Para there is no KAM.
- Form and Content of the KAM Section in Other Circumstances:
If there is no KAM to be communicated then the auditor shall include a statement to this effect in a separate section of the auditor’s report under the heading “Key Audit Matters.”

- In order for intended users to understand the significance of KAM in the context of audit of FS as a whole, as well as the relationship between KAM and other elements of the auditor’s report, including the auditor’s opinion, care may be necessary so that language used in the description of a KAM:
 - Does not imply that the matter has not been appropriately resolved by the auditor in forming the opinion on the FS.
 - Relates the matter directly to the specific circumstances of the entity, while avoiding generic or standardized language.
 - Takes into account how the matter is addressed in the related disclosure(s) in the FS, if any.
 - Does not contain or imply discrete opinions on separate elements of the FS.

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➤ **INTERPLAY BETWEEN EOM & KAM:**

- KAM is not a substitute for EOM
- Auditor should not use EOM para to highlight the matter which is reported under KAM.
- A matter that is not determined to be a KAM because it did not require significant auditor attention, but in the auditor judgement it is fundamental to user's understanding of FS (E.g., Subsequent Events), such matter can be included in EOM para.

➤ **DOCUMENTATION:**

Audit Documentation shall Include:

- The matters that required significant auditor attention whether or not each of these matters is a KAM
- auditor's determination that there are no KAM or are already addressed as per applicable SA.
- auditor's determination not to communicate in the auditor's report a matter determined to be a KAM.
- If no KAM found, auditor
 - Will document the reasons for not finding KAM.
 - Communicate with TCWG
 - Report expressly mentioning that no KAM found
 - Discuss with quality control reviewer, where there is such requirement

➤ **AREAS WHICH CAN BE CONSIDERED FOR REPORTING AS KAM:**

Some Examples	
➤ Impairment of Goodwill & Intangible Asset	➤ Valuation of Investment Property
➤ Valuation of Inventory	➤ Impairment of PPE
➤ Provisions & Obligations	➤ Valuation of Complex Financial Instruments
➤ Recognition & Valuation of Claims & Litigations	➤ Material Uncertainty with reference to going concern
➤ Business Restructuring	➤ Uncertain Tax Position

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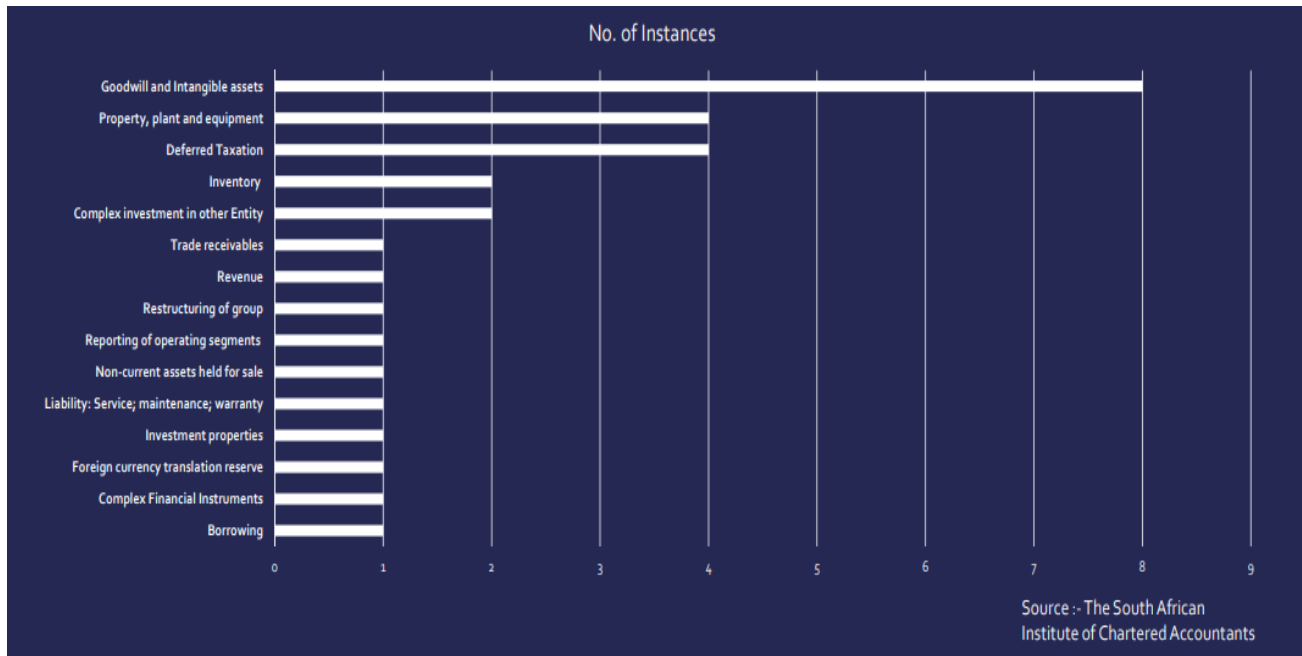
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➤ **CASE STUDY ON ADOPTION OF SA 701 IN SOUTH AFRICA**
(BASED ON THE AUDIT OF 9 ENTITIES BY BIG 4)
SUMMARY OF DIFFERENT KAM REPORTED



➤ **ILLUSTRATION OF KAM REPORTING:**

Description of Key Audit Matter:

The availability of sufficient funding and the testing of whether the company will be able to continue meeting its obligations under the financing covenants are important for the going concern assumption and, as such, are significant aspects of our audit. This test or assessment is largely based on the expectations of and the estimates made by management. The expectations and estimates can be influenced by subjective elements such as estimated future cash flows, forecasted results and margins from operations. Estimates are based on assumptions, including expectations regarding future developments in the economy and the market.

Description of Auditor's Response:

We have used our own internal experts in evaluating the assumptions and forecasts made by management in the 2017 Budget and the 2018-2019 Mid-Term Plan. We have specifically devoted attention to the assumptions made with respect to the future value added, the results and the cash flows in order to assess the company's ability to continue meeting its payment obligations and its obligations under the financing covenants in the year ahead.

For notes on the going concern assumption and financing requirements, see the Going concern principle section on page xx and notes xx and xx of the financial statements respectively.

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