

# **New Auditor's Report and Key Audit Matters**

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19 April 2019, Gurugram Branch of NIRC

# Agenda

- 01 Overview

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- 02 Key changes in auditor's report

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- 03 Key audit matters

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- 04 Interplay between key audit matters and other elements in the auditor's report

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- 05 Global experiences

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# Overview

# Summary of changes to the Standards on Auditing (SA)

## SA 700 – Revised with effect from 1 April 2018

- Overarching standard for audit reporting revised to change form and content of Audit Report

## SA 701 – New Standard introduced effective from 1 April 2018

SA 720 – Revised with effect from 1 April 2018

SA 570 – Revised with effect from **1 April 2017**

- New sections in audit report; increased auditor responsibilities

## SA 705 and SA 706 – Revised with effect from 1 April 2018

SA 260 – Revised with effect from **1 April 2017**

- Revised as a result of SA 700 (Revised) and SA 701

## Other conforming amendments

- Conforming amendments made to: SA 210, 220, 230, 510, 540, 600, 710

# Existing report format

- Title: Independent Auditor's Report
- Addressee: As per the engagement terms
- Subtitle: Report on the financial statements
- Introductory paragraph
- Management's responsibility for the financial statements
- Auditor's responsibility
- Basis for modified opinion, if any
- Auditor's opinion
- Emphasis of matter
- Other matter
- Subtitle: Report on other legal and regulatory requirements
- Signature, date and place

# New report format

Title: Independent auditor's report

Addressee: As per the engagement terms

Subtitle: Report on the audit of the financial statements

Opinion

Basis for opinion

Material uncertainty related to going concern (where applicable)

Emphasis of matter

Key audit matters

Other information

Responsibilities of management and those charged with governance

Auditor's responsibilities for the audit of the financial statements

Other matter

Subtitle: Report on other legal and regulatory requirements

Signature, date and place

# Key changes in auditor's report

# Key changes in auditor's report

## Opinion paragraph

### What has changed?

- Opinion paragraph is presented first
- No separate introductory paragraph (included at the beginning of the opinion)

### Opinion

We have audited the standalone financial statements of ABC Company Limited ('the Company'), which comprise the balance sheet as at 31 March 20XX, and 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 which are included the Returns for the year ended on that date audited by the branch auditors of the Company's branches located at (location of branches)].

In our opinion and to the best of our information and according to the explanations given to us, the aforesaid 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 31 March 20XX, and profit/loss, (*changes in equity*) and its cash flows for the year ended on that date.



# Key changes in auditor's report

## Basis for opinion

### What has changed?

- Now mandatory for all reports
- Statement that we conducted audit in accordance with SAs remains the same
- Affirmative statement about auditor's independence

#### Basis for opinion

{State the matter of qualified/adverse opinion}

We conducted our audit in accordance with the Standards on Auditing (SAs) specified under section 143(10) of the Companies Act, 2013. 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 Code of Ethics issued by the Institute of Chartered Accountants of India together with the ethical requirements that are relevant to our audit of the financial statements under the provisions of the Companies Act, 2013 and the Rules thereunder, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our {qualified} opinion.

# Key changes in auditor's report

## Material uncertainty related to going concern

### What has changed?

- New section
- By its nature, such matter is a KAM
- However, needs to be reported under separate section on material uncertainty; not as KAM
- Which means 'how this matter was addressed in the audit' should also be explained

Material uncertainty related to going concern

We draw attention to Note XX in the financial statements, which indicates that the Company incurred a net loss of ZZZ during the year ended December 31, 20X1 and, as of that date, the Company's current liabilities exceeded its total assets by YYY. As stated in Note 6, these events or conditions, along with other matters as set forth in Note XX, indicate that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

# Significant changes introduced by SA 570 (revised)

Reporting responsibilities:

SA 570 (revised)	Erstwhile SA 570
If material uncertainty exists and disclosure is adequate in financial statements: <b>Separate section under the heading ‘Material uncertainty related to going concern’</b>	Emphasis of matter paragraph was required

## Change in auditor’s report:

- Management’s responsibility: assess the appropriateness of going concern basis of accounting
- Auditor’s responsibility: evaluate such management’s assessment

# Significant changes introduced by SA 570 (revised)

A close call situation is where events/conditions are identified that may cast significant doubt on the entity's ability to continue as a going concern but after considering management's plan to deal with these, it is concluded that no material uncertainty exists.

**1. Events/conditions**

**2. Significant doubt on entity's ability to continue as going concern**

**3. Management's plan that mitigate their effect**

**4. Any significant judgement made by management**

# Significant changes introduced by SA 570 (revised)

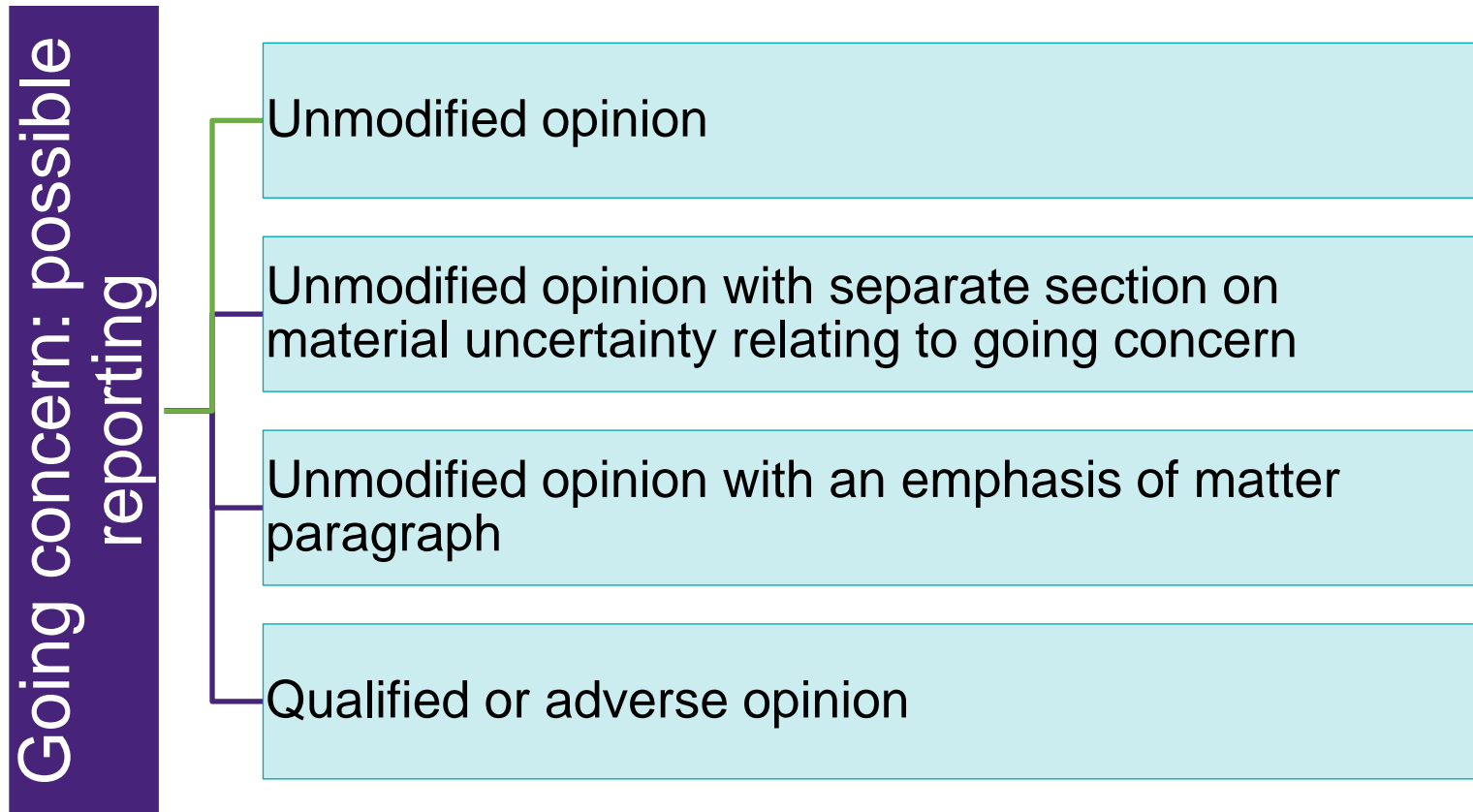
No material uncertainty but events or conditions are identified:

SA 570 (revised)	Erstwhile SA 570
<p>If:</p> <ul style="list-style-type: none"><li>- Events or conditions identified</li><li>- Auditor concludes that no material uncertainty exists</li></ul> <p>Evaluate whether in view of requirements of applicable financial reporting framework, financial statements provide adequate disclosures about such events or conditions.</p>	No similar requirement

**Indian Accounting Standards (Ind AS):** Disclosure of events or conditions required even if no material uncertainty exists

**Indian GAAP:** No specific requirement to disclose events or conditions if no material uncertainty exists  
In case of fair presentation framework, auditor to evaluate if such disclosure is required to achieve fair presentation

# Significant changes introduced by SA 570 (revised)



# Key changes in auditor's report

## Key audit matters

### What has changed?

- New section
- Involves significant judgement and requires considerable time of senior members of the audit team
- The following are by default, a KAM:
  - modification
  - material uncertainty related to going concern

### 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 these matters. In addition to the matters described in the Basis for Qualified Opinion section and Material Uncertainty Related to Going Concern section, we have determined the matters described below to be the key audit matters to be communicated in our report.

[Description of each key audit matter in accordance with SA 701.]

# Key changes in auditor's report

## Information Other than the Financial Statements and Auditor's Report thereon

### What has changed?

- New section
- Does not require an opinion on 'other information'
- New responsibilities in case any material misstatement is identified in other information

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

Management is responsible for the other information. The other information comprises the information included in the X report, but does not include the financial statements and our auditor's report thereon. The X report is expected to be made available to us after the date of this auditor's report.

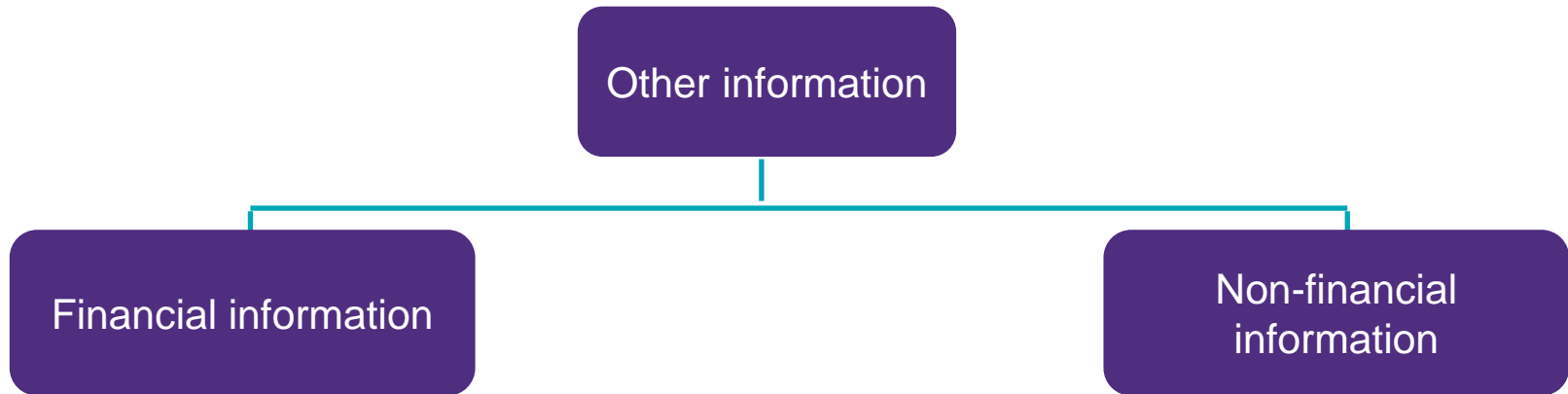
Our opinion on the financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

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

When we read the X report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance and {describe actions applicable in the jurisdiction}.



# SA 720 (Revised), The auditor's responsibilities relating to other information



- Summary of key financial results such as net income, earnings per share, etc.
- Capital expenditure by segment or division
- Amounts involved in guarantees, contractual obligations, legal or environmental claims

- Explanations of critical accounting estimates and related assumptions
- Management's qualitative assessments of impact of new financial reporting standard
- Descriptions of guarantees including management's qualitative assessments

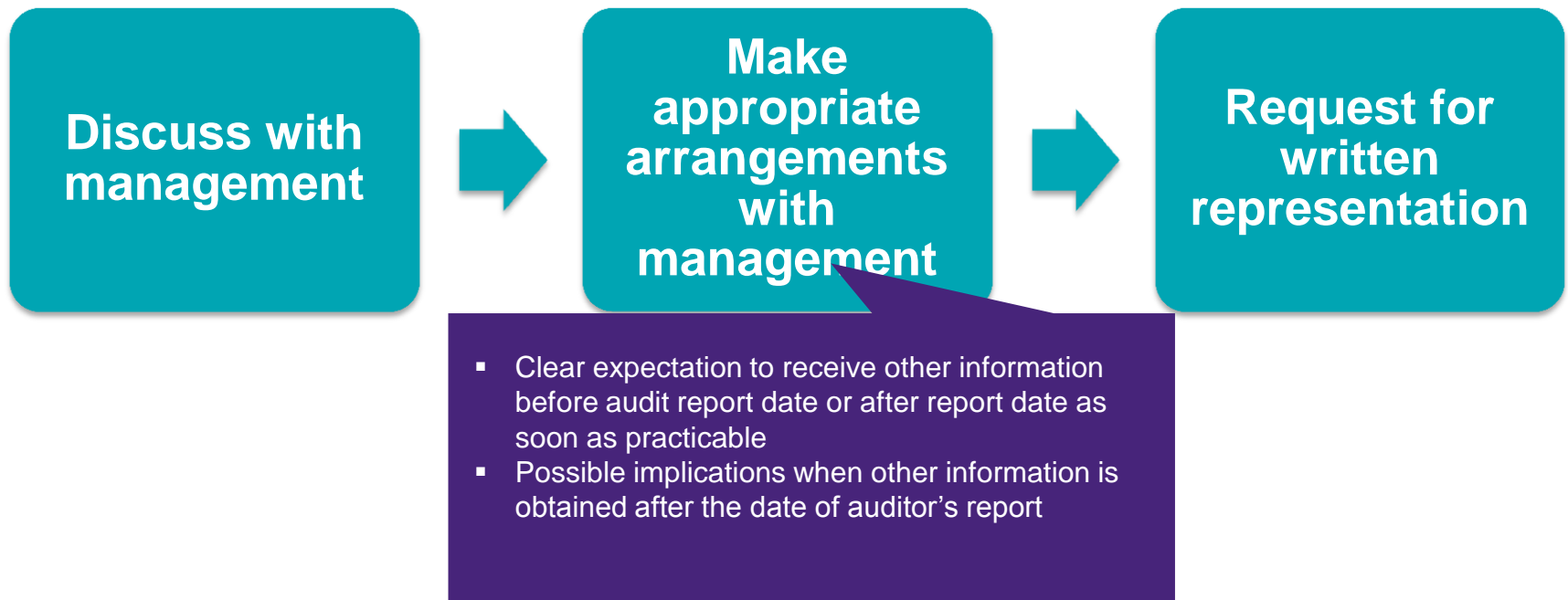
## Does not apply to:

- Preliminary announcements of financial information, or securities offering document
- Disclosures required by financial reporting framework

## Requirements | How do I obtain other information?



# Requirements | How do I obtain other information?



# Requirements | How do I obtain other information?



- All documents that it expects to issue that may comprise other information;
- Financial statements and other information obtained by the auditor prior to audit report date are not materially misstated;
- Where other information not obtained before the date of auditor's report, that management intends to prepare and issue such other information and expected time of issuance.

# Auditor's responsibilities

- **Consider material inconsistencies between:**
  - Other information and financial statements
  - Other information and auditor's knowledge gained during the audit in the context of audit evidence obtained and conclusions reached
- **When material inconsistency appears to exist or other information appears to be materially misstated**
  - Discuss with management to provide support for management's statement
  - If necessary, **perform other procedures** to conclude whether a material misstatement of other information / financial information exists OR whether the auditor's understanding of the entity and its environment needs updation.

# Auditor's responsibilities

## Additional procedures could include:

- Discussions with the management
- Nature and extent of procedures are matters of professional judgement
- Management can consult with legal counsel or management expert

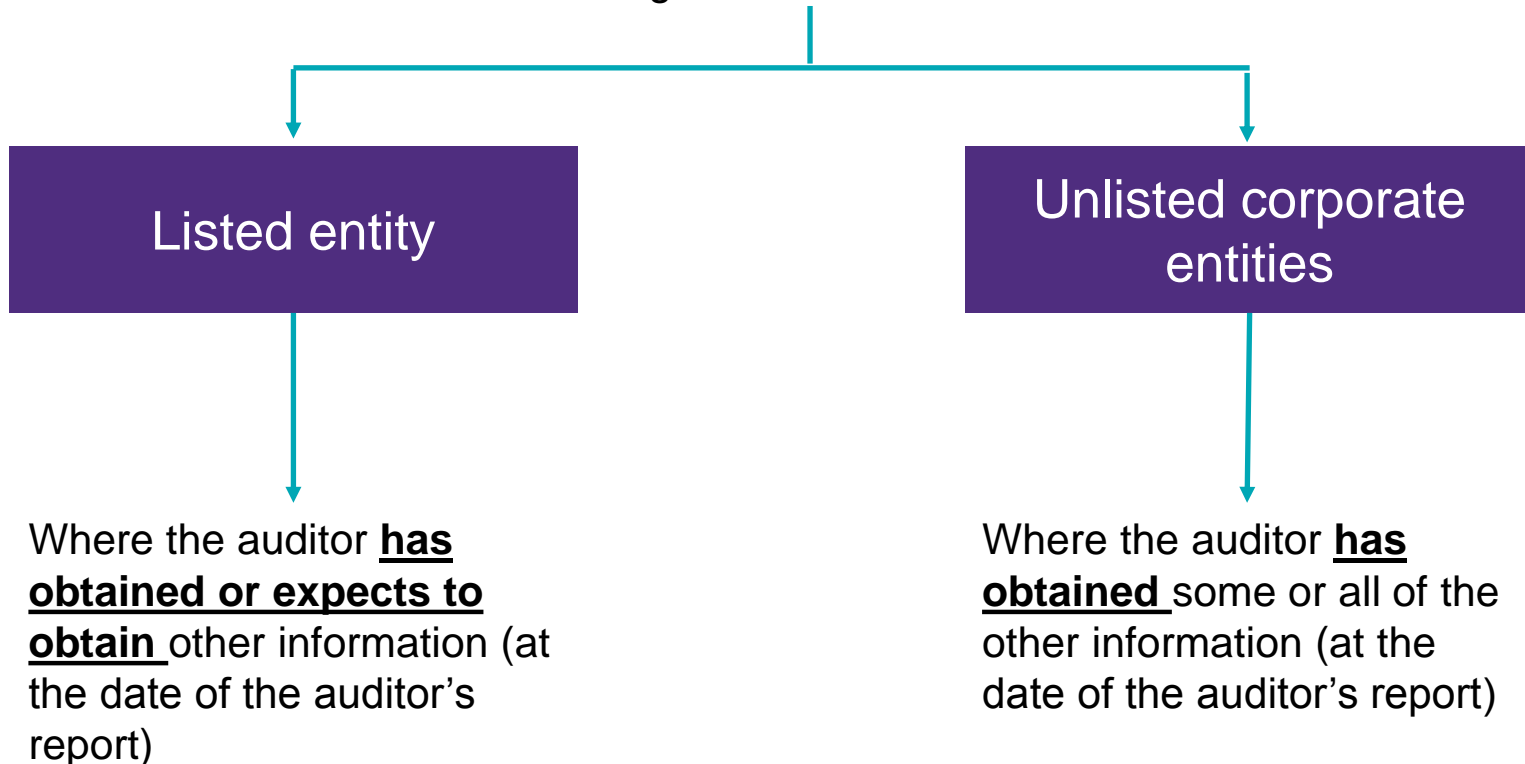
## Actions could include:

- Obtaining evidence from auditor's legal counsel
- Considering implications on auditor's report (if there is limitation of scope imposed by management)
- Withdrawal from audit (where legally possible)

# Reporting responsibilities

Reporting responsibilities do not apply to unlisted non-corporate entities

Separate section with a heading '**Other information**' or other appropriate heading to be included for:



# Key changes in auditor's report

## Emphasis of matter paragraph

### What has changed?

- Include the paragraph with a separate section with an appropriate heading that **includes the term 'Emphasis of Matter'**.
- Placement of KAM, EOM and other matter

## Other matter paragraph

### What has changed?

- No change in requirements for 'other matter' paragraph
- Placement of KAM, EOM and other matter

Emphasis of Matter - Effects of a Fire

We draw attention to Note X of the financial statements, which describes the effects of a fire in the Company's production facilities. Our opinion is not modified in respect of this matter.

Other matter

The financial statements of ABC Company for the year ended 31 March 20X0, were audited by another auditor who expressed an unmodified opinion on those statements on 31 March 20X1.



# Key changes in auditor's report

## Management's responsibility for the financial statements

### What has changed?

- **New paragraph** on management's assessment of going concern of the entity
- Oversight of the financial reporting process
- **Description** may need to be modified to appropriately reflect the particular circumstances, when some but not all of individuals involved in oversight of the financial reporting process are involved in preparing financial statements

### Management's responsibility for the financial statements

The Company's Board of Directors is responsible for the matters stated in section 134(5) of the Companies Act, 2013 ("the Act") with respect to the preparation of these standalone financial statements that give a true and fair view of the financial position, financial performance, (changes in equity) and cash flows of the Company in accordance with the accounting principles generally accepted in India, including the accounting Standards specified under section 133 of the Act. This responsibility also includes maintenance of adequate accounting records in accordance with the provisions of the Act for safeguarding of the assets of the Company and for preventing and detecting frauds and other irregularities; selection and application of appropriate implementation and maintenance of accounting policies; making judgments and estimates that are reasonable and prudent; and design, implementation and maintenance of adequate internal financial controls, that were operating effectively for ensuring the accuracy and completeness of the accounting records, relevant to the preparation and presentation of the financial statement that give a true and fair view and are free from material misstatement, whether due to fraud or error.....

# Key changes in auditor's report

## Auditor's responsibilities for the audit of the financial statements

### What has changed?

- Objectives of the auditor
- Definition of reasonable assurance including materiality
- Misstatements can arise from fraud or error
- Specific reference to section 143(3)(i)
- Evaluating presentation and disclosures
- Conclusion on appropriateness of management's use of going concern basis of accounting
- Location of responsibilities

### 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 SAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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.

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# Key Audit Matters (KAM)

# Key Audit Matters (KAMs)

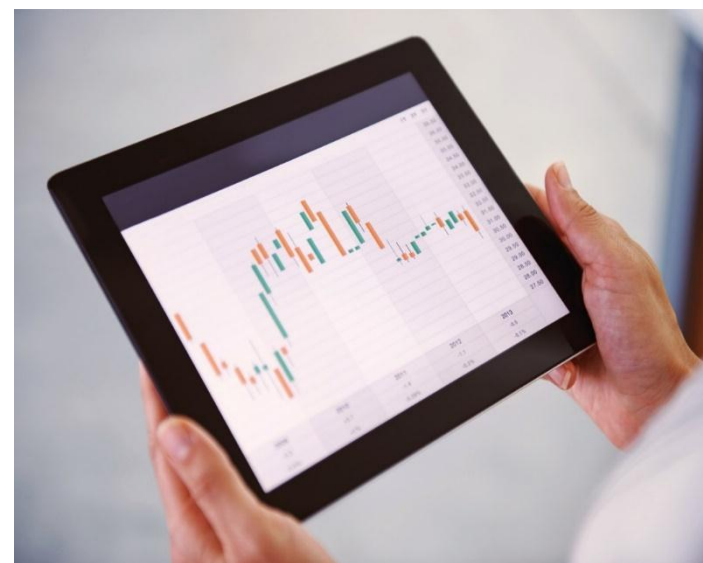
KAMs are the **audit matters** that, in the **auditor's professional judgement**, were of **most significance** in the audit of the financial statements of the current period. KAMs are **selected from matters communicated with** those charged with governance (**TCWG**).

Scope:

- **Listed entities** in accordance with new SA 701.  
**Unless**
  - Law or regulation precludes disclosure
  - Adverse consequences outweigh public interest benefits

KAMs may be included for **other than listed** if;

- Required by **law or regulation**
- Voluntary communication



# Identifying KAMs



- Step 1: Matters communicated to TCWG
- Step 2: Those matters which required **significant auditor attention**
- Step 3: Matters that were **most significant** to the audit

# Identifying KAMs (contd.)

## Matters to be communicated with TCWG

Auditor's responsibilities in relation to financial statements audit

Auditor independence

Planned scope and timing of the audit

Significant findings from the audit

Significant qualitative aspects of entity's accounting practices

Significant difficulties encountered during the audit

Significant matters arising during the audit that were discussed with management

Circumstances affecting form and content of auditor's report

Other significant matters relevant to the oversight of financial reporting process

## Identifying KAMs (contd.)

**Matters requiring significant auditor attention**



- Areas of higher assessed risk of misstatement
- Significant auditor judgements relating to areas involving significant management judgement
- Significant transactions or events

Other matters not disclosed in financial statements may also be considered as requiring significant auditor attention, such as, implementation of new IT system.

# Identifying KAMs (contd.)

**Matters of most significance in the audit**



Nature and extent of communication about matters that required significant auditor attention with TCWG often provides an indication of which matters are of most significance in the audit

Matter of professional judgement



# Required elements of KAMs

## Why?

Why the matter was considered to be one of the most significant in the audit and therefore determined to be a KAM.

## How?

How the matter was addressed in the audit which will be essential summary of the Auditor's response to assessed risks.

## Disclosure

A reference to the related disclosures in the financial statements

# Required elements of KAMs

Why?

Why the matter was considered to be one of the most significant in the audit and therefore determined to be a KAM.

1. Provide insights about factors that led the auditor to conclude the matter as KAM
2. Highlight aspects specific to the entity in order to make description relevant for intended users.
3. Description of KAM that recurs over periods should explain the rationale that why such matter is KAM in current period also

# Required elements of KAMs

How?

How the matter was addressed in the audit which will be essentially a summary of the Auditor's response to assessed risks

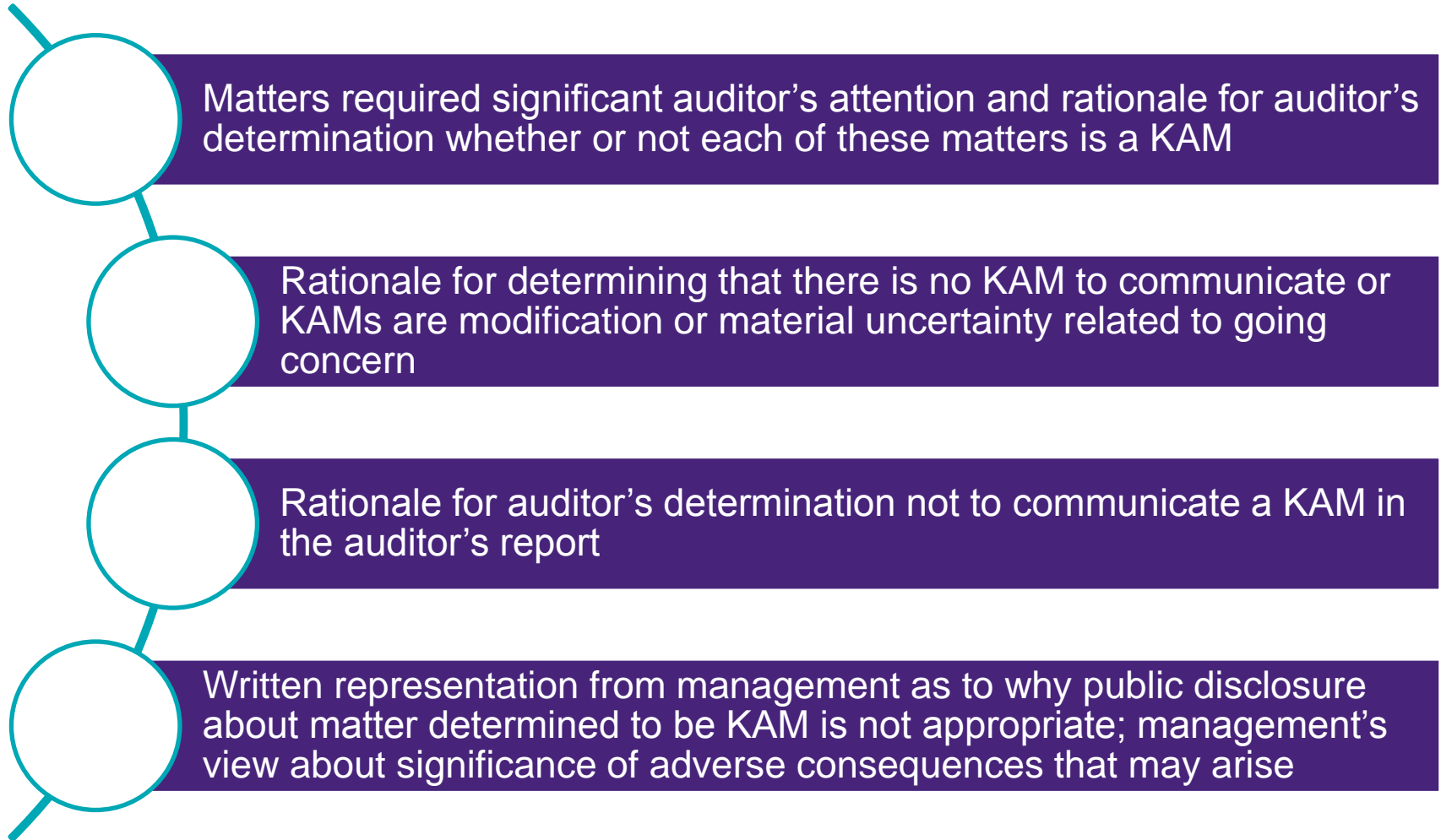
1. How much detail to be provided is a matter of professional judgement.
2. Ensuring non disclosure of 'Original information'.
3. Consider describing following or combination of these elements:
  - Aspect of auditor's response or approach
  - Brief overview of procedures performed
  - Key observations
4. Auditor may make reference to nature and extent of communication with TCWG about KAM.
5. Description of procedures performed for complex areas may be at a high level, rather than including a detailed description.

# Key Audit Matters (KAMs)

## Dealing with significant matters that may not have been publicly disclosed by the entity:

1. It will be in extremely rare circumstances.
2. Such information may be termed as 'sensitive information' and may meet the definition of KAM.
3. Consider complete facts and circumstances, along with discussion with management and the audit committee to understand the management's views about the possible consequences of public disclosure.
4. Encourage management and TCWG to make public disclosure of less sensitive information about the matter.
5. Obtain written representation from management as to why public disclosure is not appropriate, including the management's view about the significance of adverse consequences.
6. Engagement team may consider appropriate to obtain legal advice.

# Documentation



# Interplay between KAM with other elements of audit report

# Interplay between KAM with other elements of audit report

Modification  
– Adverse/  
Qualified  
Opinion

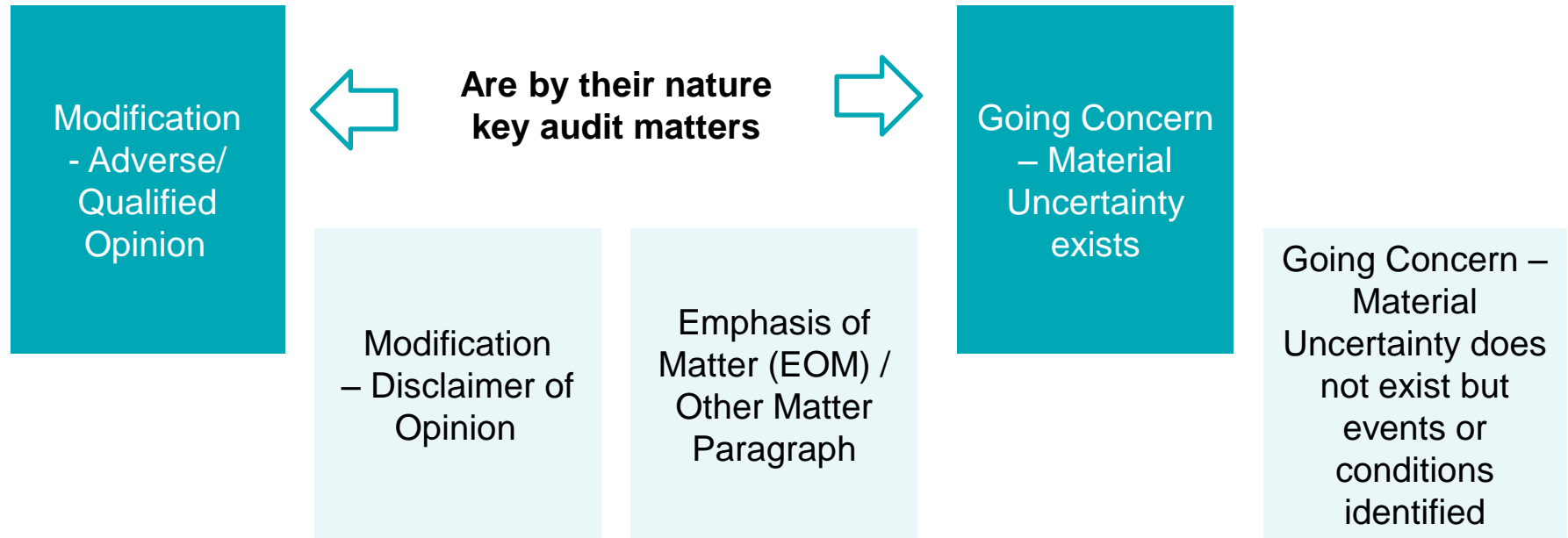
Modification  
– Disclaimer of  
Opinion

Emphasis of  
Matter (EOM) /  
Other Matter  
Paragraph

Going Concern –  
Material  
Uncertainty  
exists

Going Concern –  
Material  
Uncertainty does  
not exist, but  
events or  
conditions  
identified

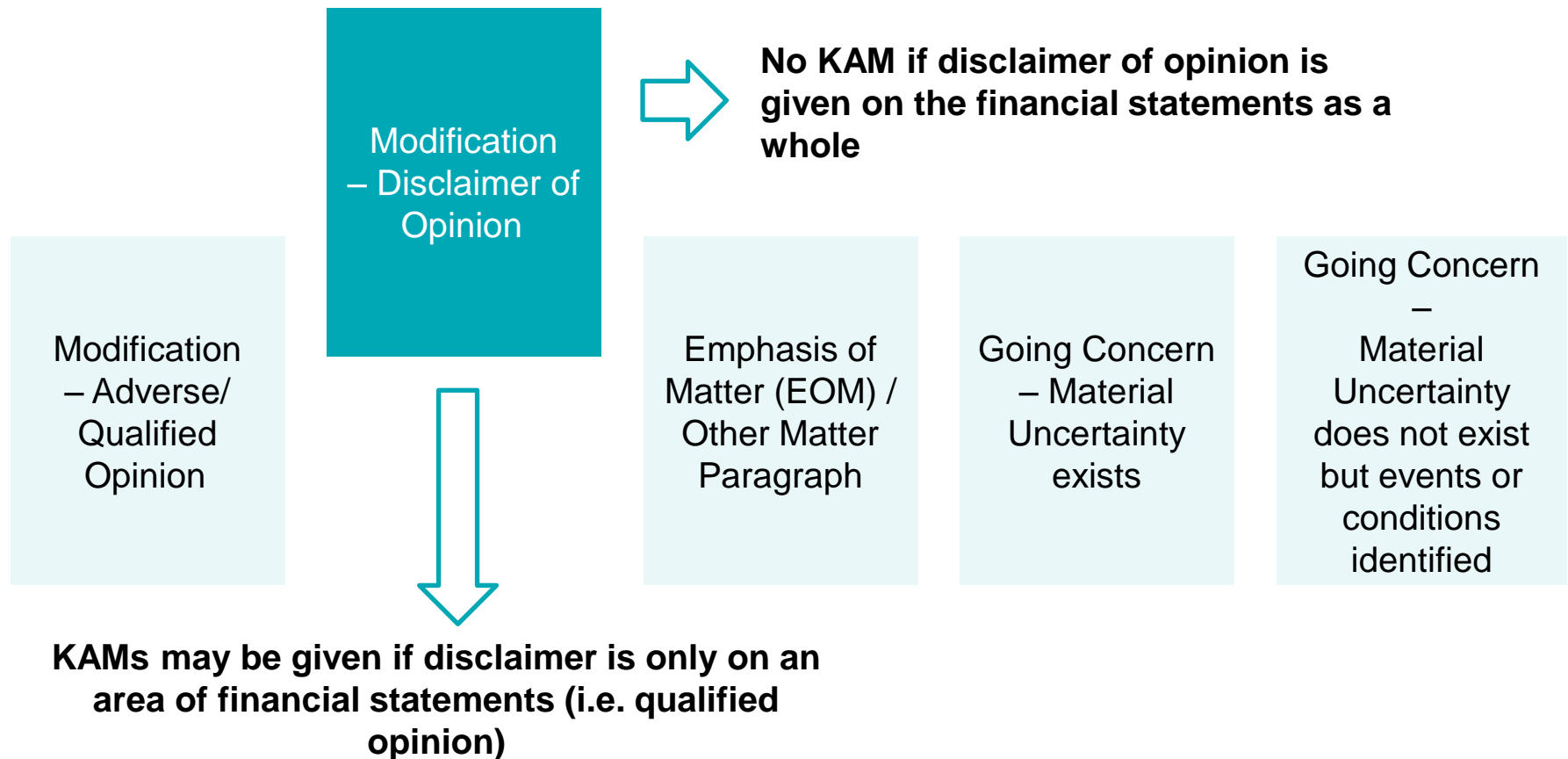
# Interplay between KAM with other elements of audit report



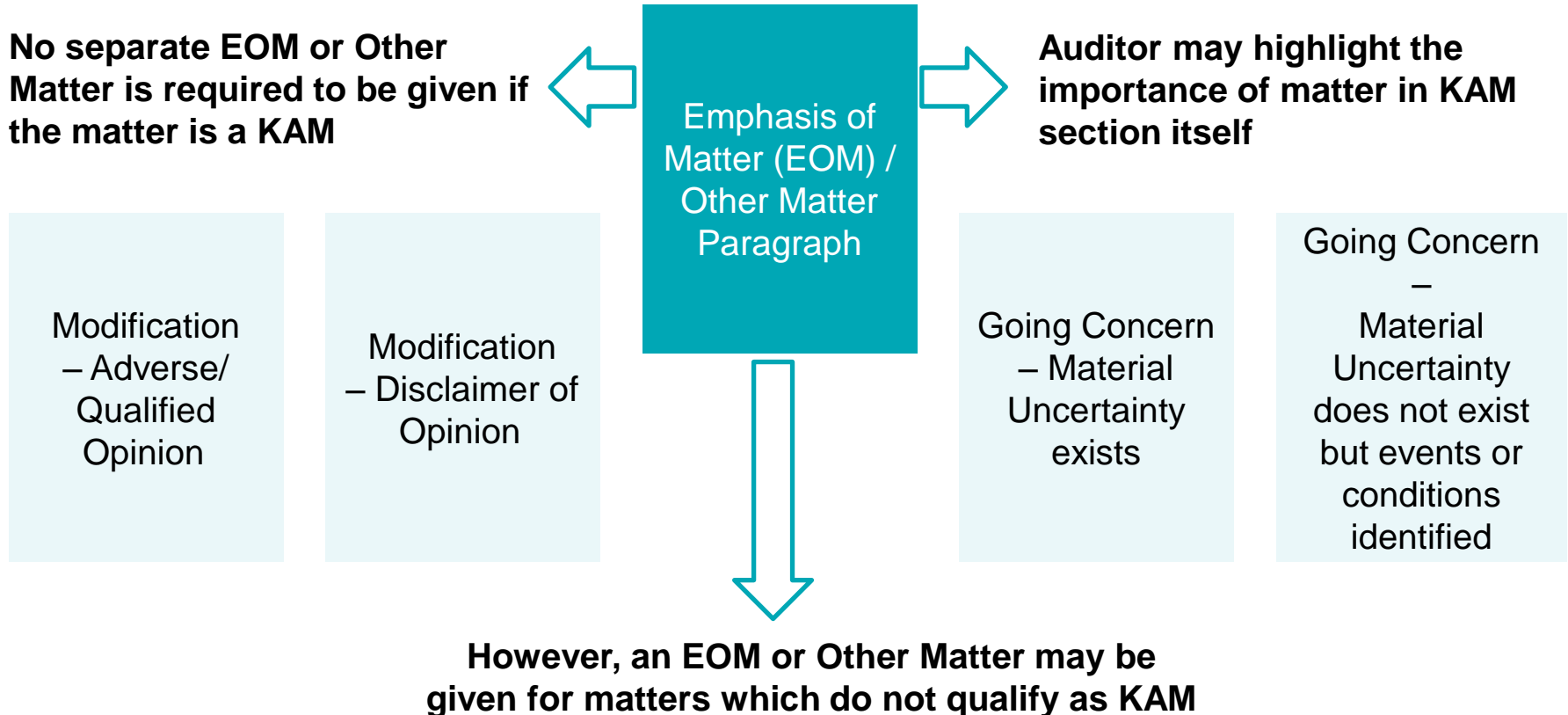
- Not included in KAM section, rather report in accordance with applicable SAs
- Reference to be drawn to above matters in KAM section
- Other KAMs may be given if auditor also determine KAMs in addition to matters which is giving rise to qualified or adverse opinion



# Interplay between KAM with other elements of audit report



# Interplay between KAM with other elements of audit report



# Interplay between KAM with other elements of audit report

- May be considered as a KAM
- May also be fundamental to the understanding of the users of the financial statements
- Under such circumstance, it may be placed as the first matter in KAM section to denote its importance



Going Concern  
–  
Material  
Uncertainty  
does not exist  
but events or  
conditions  
identified



Modification  
– Adverse/  
Qualified  
Opinion

Modification  
– Disclaimer of  
Opinion

Emphasis of  
Matter (EOM) /  
Other Matter  
Paragraph

Going Concern  
– Material  
Uncertainty  
exists

## Description of such key audit matters in the auditor's report

The identified events or conditions disclosed in the financial statements, such as

- substantial operating losses,
- available borrowing facilities and possible debt refinancing, or
- non-compliance with loan agreements, and
- related mitigating factors

# Global experiences

# Audit partner experiences: Challenges faced

As such there was **no precedent to follow**, and **no clear template of good practice**. That is a challenge, but also liberating to some extent. Drafting the audit report was therefore a **time consuming process**, in which one had to strike the **right balance between excessive detail and being over-concise**. We were also very conscious in this case that we needed to write a report in **'plain English'** to make it accessible to the governors, **avoiding jargon** wherever possible.

Striking the **right balance** between giving more colour in the audit report and potentially disclosing more information than what was disclosed by management in the annual report. Also, we needed to let the entity know early on that our audit report would be much longer than in previous years so that when designing their glossy report we were allocated sufficient space.

All of the material being disclosed is in the **same form as that communicated to the audit committee**, which helped. It did take some time to make sure that we clearly **explained what the risk map represented so as to be sure it would not be misunderstood**.

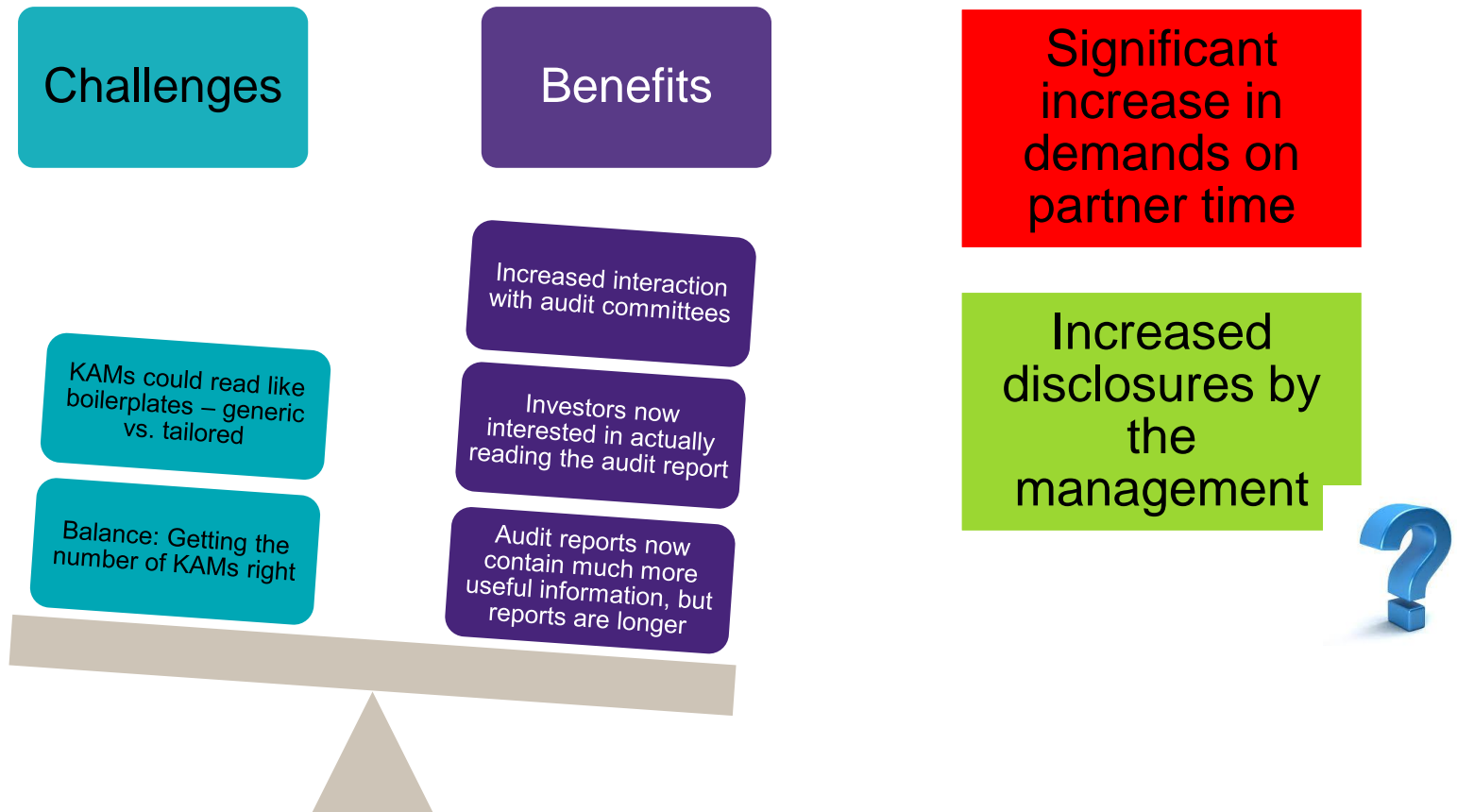
# Audit partner experiences: What worked well

## Marks and Spencers (Best overall report – Investment Association award, UK)

### Audit partner's insights:

- the report looked **visually insightful** – we included a number of charts in the report, such as in relation to materiality and audit scoping;
- we **included findings** against each of the risks, giving an overview of the results of our audit work in the key areas;
- there was **quite a bit of detail in the risk descriptions and responses** that were focused on the specific factors facing the entity;
- for materiality, we **went beyond the requirements of the UK standard** and also disclosed the range of component materialities that we used;
- we also **highlighted key aspects** in each section – for example at the start of the risk section briefly explaining the key risk areas before going into the details.

# Challenges and benefits



# Generic vs. tailored

## Audit Committees

Malaysia: 91% of surveyed audit committee members considered the KAMs to be sufficiently tailored

Singapore: 92% believed that the KAMs were sufficiently tailored to help investors understand the particular concerns of the auditors.

## Investors

Malaysia: Only 45% of surveyed investors considered the KAMs to be sufficiently tailored

Singapore: Only 62% of investors believed KAMs were tailored

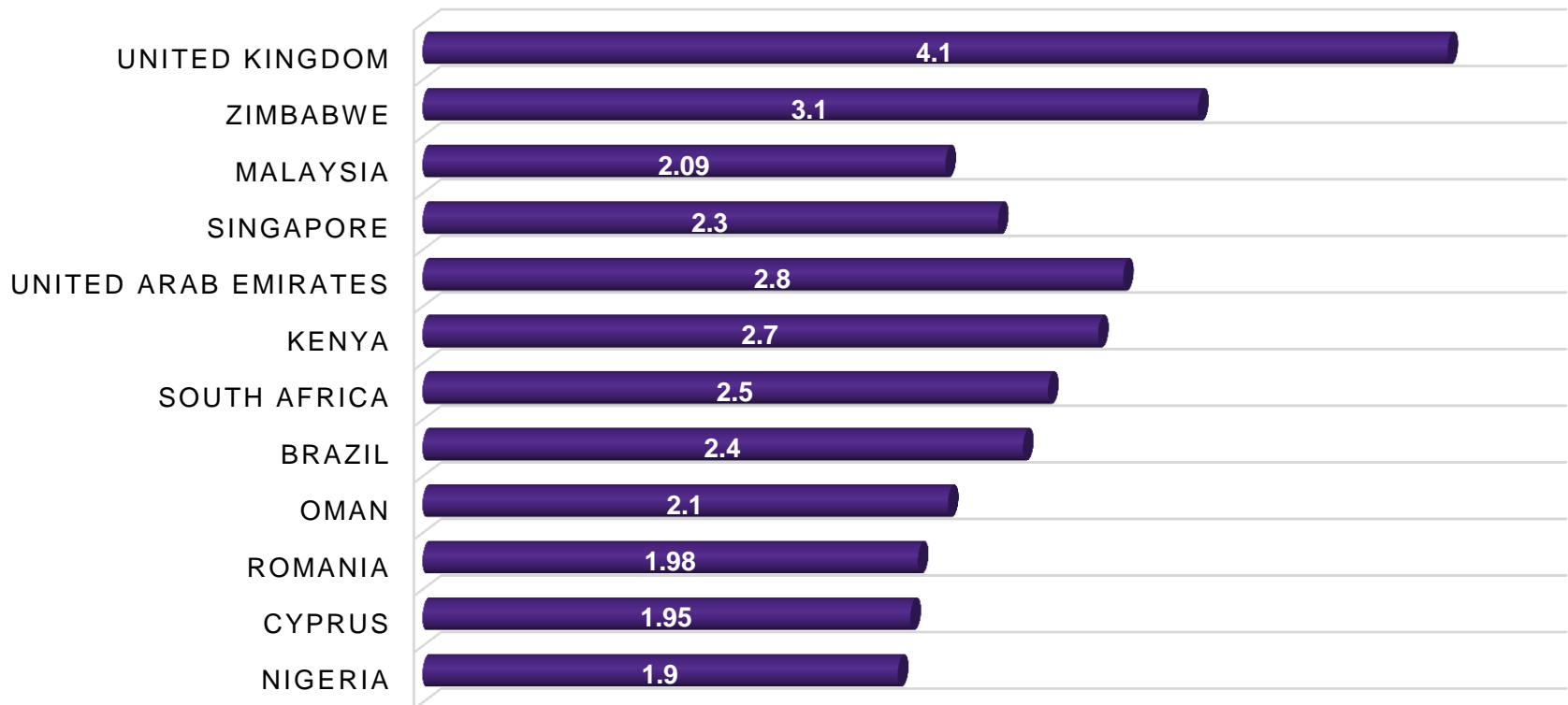
### Likely reason for the divergence:

Audit committees were generally more comfortable with a **neutral description** of the KAM to **not 'alarm' investors** unnecessarily. On the contrary, investors preferred **bolder statements** by the auditors to alert them about underlying risks.

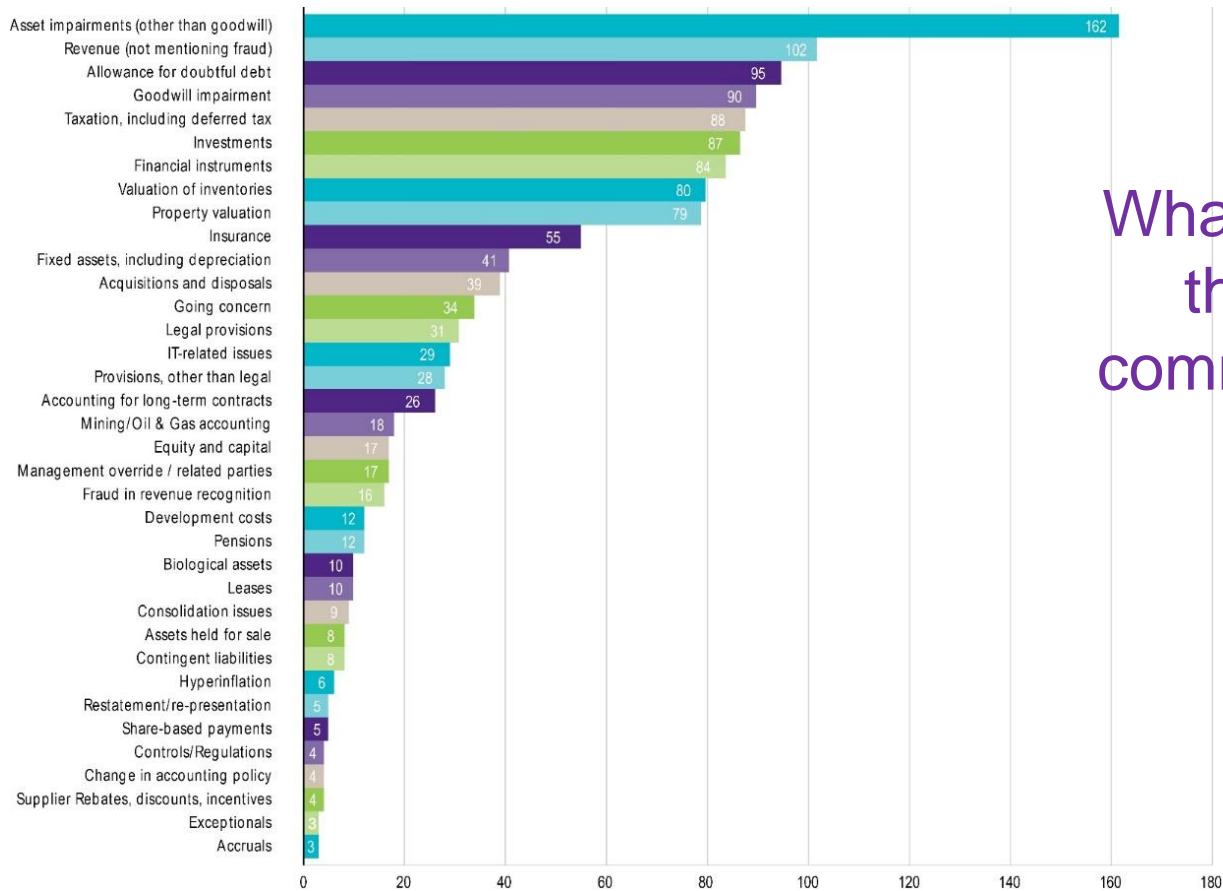


# HOW MANY KAMS

■ Source: Report published by ACCA and Publications on First year review of the enhanced auditor's report in Singapore and Malaysia



# Most common KAMs



What else do you think will be common in India?

**Observations:**

- These were basis a sample of 560 reports across various countries.
- Asset impairment and revenue recognition (non-fraud related) seem to feature in the top 2 if almost every review
- A number of countries reported various related matters and (provisions, financial instruments, PPE, inventories)
- Taxation is another area which has featured quite high in the list



# Adding conclusions/findings

- Optional not mandatory
- If included:
  - Should not suggest a standalone opinion on the associated financial statement items
  - Should aim to help readers understand how they addressed each KAM in the audit.

UK: Overall there has been an increase in the number of auditor's reports including a commentary on findings against key audit risks – up to 20% of overall sample as against 2% in year one.

Malaysia: A total of 70% of the surveyed audit committee members considered it critical or very critical for auditors to voluntarily include conclusions or include conclusions or findings on each KAM. The proportion of investors who considered such discrete conclusions as critical or very critical parts of the EAR is higher (76%). Significantly, the surveyed investors gave this similar importance as the identification of KAMs and even the overall true and fair opinion.

# Getting the KAM right



Indicate knowledge of entity and sector

Specific facts on the entity

Specific assumptions made by management

Benchmarks used by auditors

No use of terms like 'significant' 'usual'

Think from reader's perspective

Ensure description explains 'so what?'

Begin with the end in mind



should not imply - matter not appropriately resolved or is a separate opinion on individual matters

Should not include any new information

Unless modified – the related KAM should not indicate that opinion should have been modified

Do not use the terms, such as inadequate, lack of, inappropriate, in description

No incomplete sentences (even if it is obvious)

**Questions?**