



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

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SA 701

Introduction

- Definition of KAM

- A step by step approach to determining KAM

- Factors to consider at each stage of the process

- Examples of typical KAMs

- Other KAM considerations

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Definition of KAM

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.

Effective date :


This SA - 701 is effective for audits of financial statements for periods beginning on or after
April 1, 2018



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SA Requirements for Communication KAM

The requirement to communicate Key Audit Matters (KAM) in the auditor's report stems with intention to enhance the value of the auditor's report to users by providing greater transparency about the audit that has been performed. The factors that led to the creation of SA 701, also included:

- Establishing a focus on how the KAM affected the auditor's approach to the audit. Particularly those matters that 'kept the auditor awake at night'.
 - Providing for increased focus by management and those charged with governance on their understanding of the entity, related disclosures and those areas that have significant management judgment attached to them, and
 - Encouraging greater engagement between intended users of the financial statements, management and those charged with governance.
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SA Requirements for Communication KAM

Para 11 of SA 701

The auditor shall describe each key audit matter, using an appropriate subheading, in a separate section of the auditor's report under the heading "Key Audit Matters," unless the circumstances in paragraphs 14 or 15 apply.

The introductory language in this section of the auditor's report shall state that: (a) Key audit matters are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements [of the current period]; and

These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters.

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SA Requirements for Communication KAM

Para 13 of SA 701

The description of each key audit matter in the Key Audit Matters section of the auditor's report shall include a reference to the related disclosure(s), if any, in the financial statements and shall address:

- (a) Why the matter was considered to be one of most significance in the audit and therefore determined to be a key audit matter; and
- (b) How the matter was addressed in the audit.

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SA Requirements for Communication KAM

Para 14 of SA 701

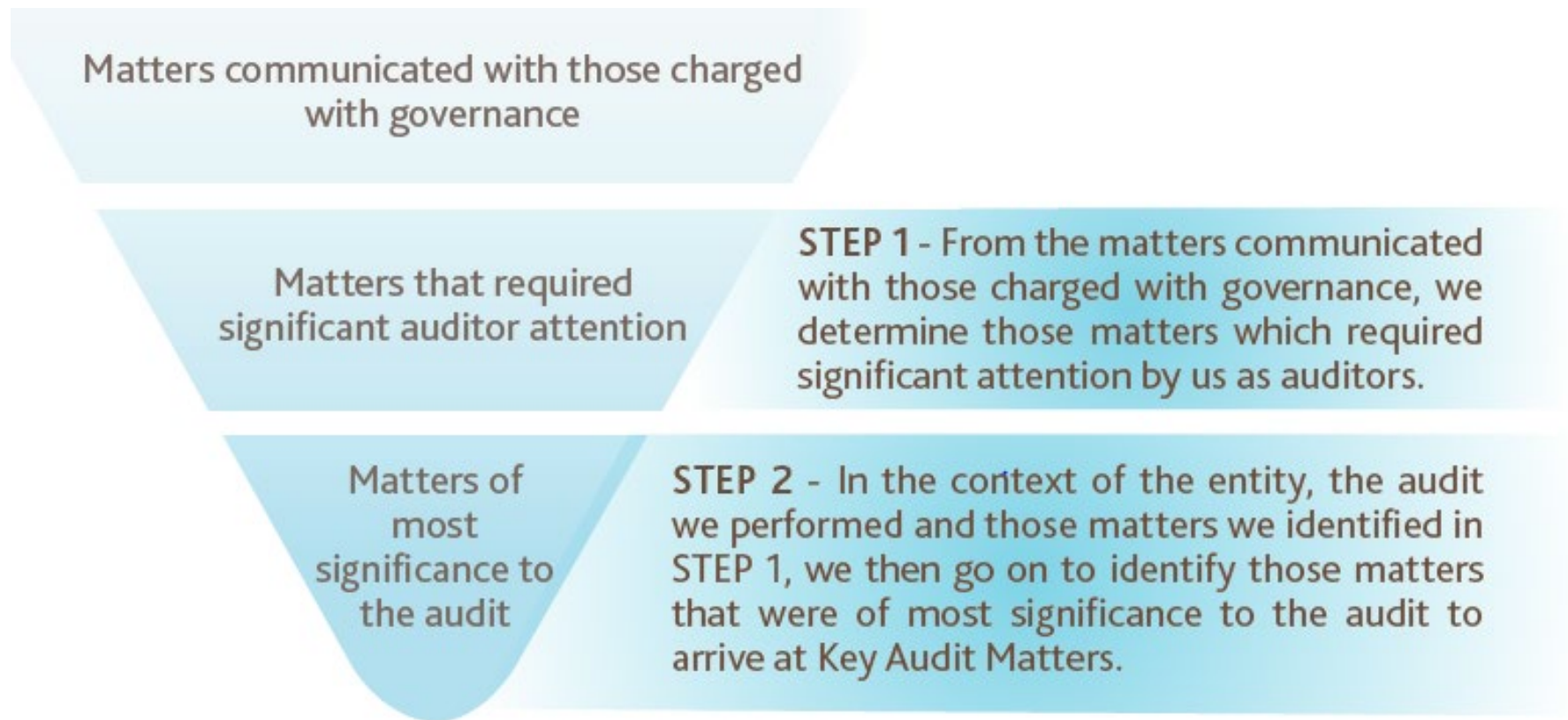
The auditor shall describe each key audit matter in the auditor's report unless:

- a) Law or regulation precludes public disclosure about the matter; or
- b) 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.

Interaction between Descriptions of Key Audit Matters and Other Elements Required to Be Included in the Auditor's Report

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A step by step approach to determining KAM



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Factors to consider at each stage of the process

Decision Stage	Factors to Consider
Matters communicated with those charged with governance	<p>A number of ISAs include requirements that determine the nature, extent and timing of matters to be communicated to those charged with governance.</p> <p>In addition to the requirements outlined in SA 260 - Communication with Those Charged with Governance, Appendix 1 to SA 260 outlines 15 additional SAs (and ISQC 1) which also have communication requirements.</p>

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Factors to consider at each stage of the process

Decision Stage	Factors to Consider
STEP 1 Matters that required significant auditor attention	<p>SA 701 requires engagement teams to take into account three specific types of matters:</p> <ul style="list-style-type: none">a) Areas of higher assessed risk of material misstatement or significant risks identified in accordance with SA 315b) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.c) Significant events or transactions that occurred during the period that had a significant effect on the audit.

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Factors to consider at each stage of the process

Decision Stage	Factors to Consider
<p>STEP 2</p> <p>Matters of most significance to the audit</p>	<p>Factors for consideration when determining those matters that in the judgment of the engagement team were of most significance to the audit may include:</p> <ul style="list-style-type: none"><li data-bbox="595 611 1787 803">• Significance of interactions between engagement teams, management and TOCWG (for example, this might include those matters which required in-depth, frequent or robust discussions).<li data-bbox="595 865 1818 1008">• Importance of the matter to understanding the financial statements as a whole (particularly the impact on investors' and other users' understanding).<li data-bbox="595 1069 1141 1108">• Materiality of the matter.<li data-bbox="595 1169 1586 1258">• Nature and extent of corrected and uncorrected misstatements associated with the matter.

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Factors to consider at each stage of the process

Decision Stage	Factors to Consider
STEP 2 Matters of most significance to the audit	<ul style="list-style-type: none">• Complexity of the accounting policy• Nature and extent of audit effort undertaken by an engagement team to address a particular matter• Difficulty of performing our audit procedures, including:<ul style="list-style-type: none">○ obtaining sufficient appropriate audit evidence○ evaluating the results of our audit procedures○ challenging subjective judgments.• Existence of severe control deficiencies related to the matter.• Matters with multiple audit implications

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Examples of typical KAMs

- Impairment issues regarding intangibles

- Deferred taxation issues (for example, valuation of deferred income tax positions or deferred tax assets)

- Matters connected to restructuring or judgments on acquisition of entities

- Accounting for (pension) provisions

- Accounting for financial instruments

- Valuation of illiquid assets and liabilities

- Valuation of accounts receivable

- Industry-specific accounting treatment

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Examples of typical KAMs

- Significant risks related to fraud in revenue recognition

- Other revenue recognition issues (not fraud)



- Management override of controls

- Insufficient segregation of duties

- Dependency on information technology.

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Other KAM considerations

Identified KAM are... 	Identified KAM are NOT... 
• ... specific to the nature and activities of our client	• ... boilerplate descriptions
• ... relevant and meaningful to users	• ...a discrete opinion for each KAM, or a substitute for a modified opinion or financial statement disclosures
• ...considered from the planning stage onwards ⁴	• ...a substitute for reporting a material uncertainty related to going concern in the auditor's report
	• ...matters unresolved by the auditor

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KAM Writing

Each KAM description must always include :

Step	ISA requirement	Our thought process	Example of KAM content for inclusion in the auditor's report
A	What is the description of the Key Audit Matter?	Statement of fact (usually this will include the title of the KAM)	<i>Impairment of Loans and Investments. The Group's impairment charge represented €67.8 million for the year ending 31 March 2017.</i>
B	Why did the audit focus on this matter?	Explaining our rationale for determining the matter to be one of most significance in our audit (this is a more subjective statement and is based on our professional judgment)	<i>The identification of impairment events and the determination of an impairment charge require the application of significant judgment by management, in particular with respect to the timing, quantity and estimation of future cash flows.</i>
C	What is the reference to the related disclosure?	Statement of fact (this is objective)	<i>See note 7 to the financial statements. The Group's impairment accounting policy is disclosed in note 4 to the financial statements.</i>

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KAM Writing

Illustrative audit key matter :

A

What is the description of the KAM

B

Why did the audit focus on this matter ?

The Group's intangible assets comprised goodwill and product registrations. The carrying amount of the intangible assets and intangible assets under development represents 2.18% of the Group's total assets.

Impairment testing of goodwill

As required by Ind AS - 36 'Impairment of Assets', the Group annually tests the amount of goodwill for impairment where indicators of impairment exist using a discounted cash flow model to estimate the recoverable value. This impairment test is significant to our audit because the assessment process is complex and judgement is based on assumptions such as expected growth rate, expected profitability and future market or economic conditions.

Other intangible assets and intangible assets under development

The Group applies for product registrations in different countries to sell its products. The Group capitalises costs incurred to apply for product registrations. The value of intangible assets was identified as a key audit matter as the Group's annual impairment assessment contains significant judgments involving forecasting and discounting future cash flows. It also involves likelihood of obtaining product registration. The impairment assessment is based on each product registrations value in use. Due to significance and magnitude of the costs capitalised this was considered a key audit matter.

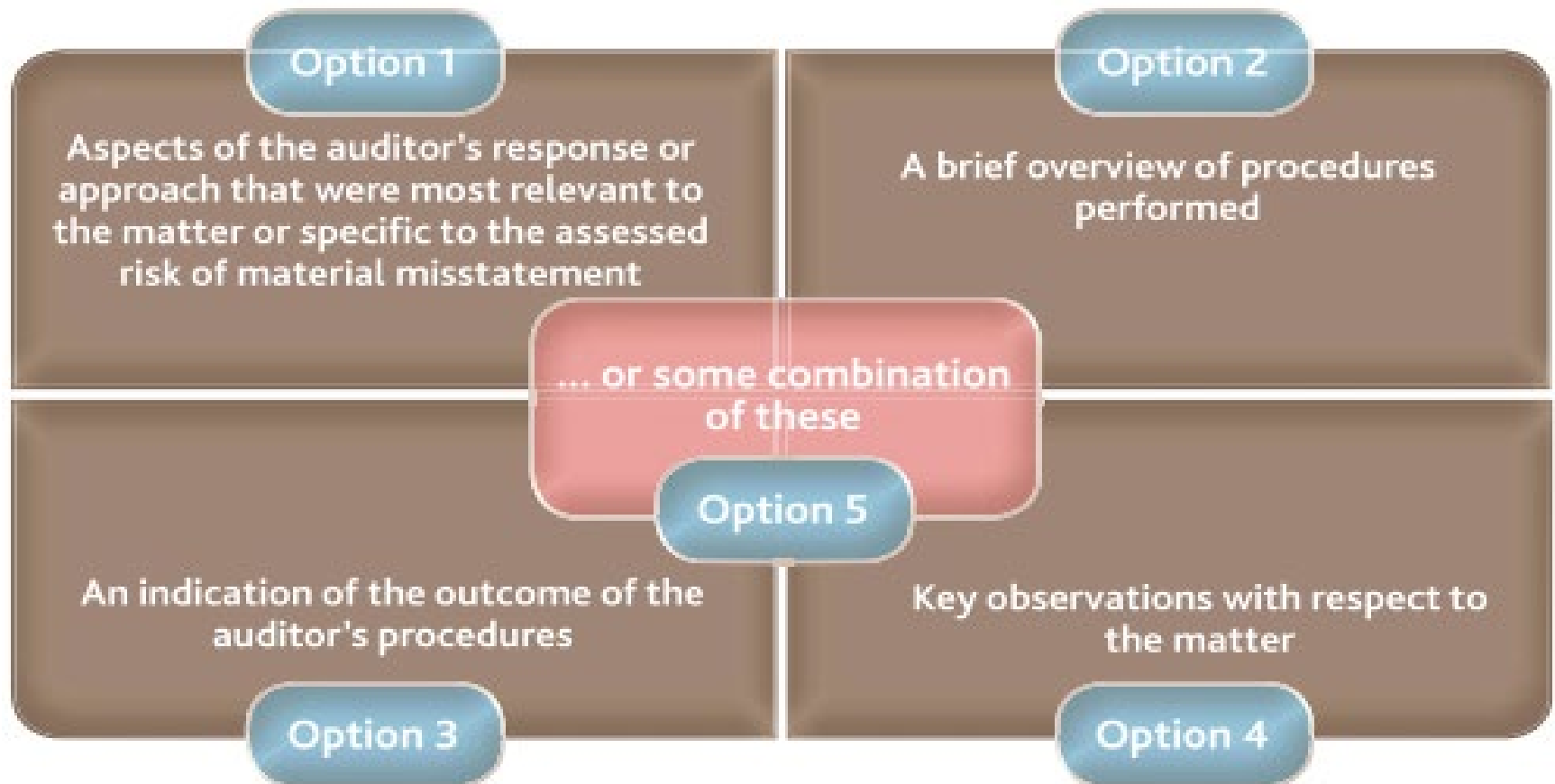
C

What is the reference to the related disclosure ?

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KAM Writing

Describing the audit procedure address KAM



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KAM Writing

Avoiding the appearance of providing an 'opinion' on an item in the KAM :

Key Audit Matter	Description of how the audit addressed the KAM	Wording that could indicate an opinion has been provided
Impairment of Loans and Investments	<i>We are <u>satisfied</u> that the impairment events occurred in the current financial year and with management's decision to impair these assets. We have found the judgments management have made in determining the quantum of the cash flows, which impact the impairment charge, to be <u>appropriate</u>.</i>	Use of the words 'satisfied' and 'appropriate' could imply that the auditor in this instance has resolved the issue and reached a conclusion and as a result, could be interpreted as providing an opinion.
Application of IFRS 10	<i>Overall, we have found management's judgments to be <u>acceptable</u> and have noted that the significant judgments have been <u>appropriately</u> disclosed in note 31 and 32 to the financial statements.</i>	Use of the words 'acceptable' or 'appropriately' provide an indication that the auditor is sharing their view (i.e. giving a potential opinion) on the judgments and significant judgments made by management.
Business Combination	<i>We <u>concur</u> with management's judgments and outcome of their procedures.</i>	Use of the word 'concur' implies agreement and could be interpreted to be an indication of an opinion on the part of the auditor.

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KAM Writing

Other considerations when writing KAM :

Examples of auditor reporting innovations in the context of KAM have included:

- KAM presented using tabular formats
- KAM displayed using graphical approaches (for example year on year comparisons)
- KAM categorised as being either 'recurring' or 'event-driven' risks
- Audit firms disclosing in the KAM section what and how these matters have been reported to the audit committee/ those charged with governance.

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Documentation of KAM :

The SA requires that certain considerations are documented - in line with SA 230, *Audit Documentation*.

Specifically, we have to document:

Our rationale for why we determined that certain matters were KAM, or

If applicable, why we determined there were no KAM, or

If applicable, our rationale for not communicating in the auditor's report a matter that we had determined to be a KAM.

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FAQs

? Which audits is it mandatory to

- Audit of Complete set of General Purpose FS.

? Date of Applicability

- Date of Audit report after April 1, 2018 pertaining to FS for period beginning after April 1, 2018.

? Applicability to Interim Financial Statements (LR)

- NA

? Whether early adoption permissible

- No

? Applicability to Tax FS

- No

? Applicability to listed companies

- Listed status - on reporting date
- Delisted during the year - NA
- Under the listing process - NA
- Securities listed outside India - Applicable

? Applicability to different type of opinion :

- Disclaimer of opinion - PROHIBITED
- Qualified opinion - Applicable
- Adverse opinion - Applicable
- EOM - Applicable (Not a substitute to KAM)

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FAQs

? If no disclosure w.r.t. KAM in FS

- Does not relieve auditor from requirement

? Whether can be different for different years

- Unlikely would be entirely different

? Different entities in same industry

- Possible to have different KAM

? Significant risk = KAM

- No, to be individually evaluated

? All matters communicated to TCWG = KAM

- No, to be individually evaluated

? No KAM

- Yes possible - Disclose the fact

? Only qualification

- Yes possible - Disclose the fact

? Going Concern = KAM

- No - Material uncertainty para

? Order of KAM

- No specific order

? Consol FS

- Parent + Components

? Joint Audit

- Each auditor on their area & Collectively

Reference Documents

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Implementation Guide to
SA 701

Anthology on KAM &
other Reporting in Audit
Reports (SA 701, 705, 706)





THANK YOU