

INFORMATION SHEET FOR AUDIT COMMITTEES ON KEY AUDIT MATTERS



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The auditor's report – the principal communication from the auditor to users of the audited financial statements – has been revolutionised.

This represents one of the biggest changes in auditor reporting in decades. The most revolutionary change is the requirement for auditors to report on key audit matters (KAM). This is initially for listed entities in Australia and listed issuers in New Zealand, but further roll-out is expected. Although the changes are not effective until 31 December 2016 year ends some companies and their auditors have already elected to report in accordance with the new requirements.

"Never before in the history of auditing have we seen such a revolutionary change that will significantly improve the value of audit. We encourage innovation so that audit reports are insightful and unique, and we challenge our markets and regulators to support and embrace these differences."

Lee White FCA,
CEO, Chartered Accountants Australia and New Zealand

What are KAM?

KAM are defined as "those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial statements of the current period." These will be a subset of the matters communicated to the audit committee, and may include:

- Areas of higher assessed risks of material misstatements or significant risks (ie risks requiring special audit consideration)
- Significant auditor judgements relating to areas of significant management judgement
- The effect of significant events or transactions on the audit

A matter that is determined to be a KAM is usually fundamental to users' understanding of the financial statements, the overall outcome of the audit, the auditor's responsibilities or the auditor's report. The concept of matters of most significance applies within the context of the entity and the specific audit engagement that was performed. As a result, a range of matters may be reported as KAM.

How many KAM should there be?

There is no requirement for any specific number of KAM. It is expected that the number will vary between entities, even for those entities in the same industry, and even for the same entity year on year. Since the concept of KAM is relative it is envisaged that there will always be at least one for each audit, except in rare circumstances. In addition, a matter that is included as a KAM in one period does not automatically become one in the following period.

Does the order of KAM mean anything?

There is no requirement for a specific ordering of KAM. They may be organised in order of relative importance, based on the auditor's judgement, or they may correspond to the order in which matters are disclosed in the financial statements.

How will KAM be reported?

KAM will be presented in a separate section of the audit report, with an appropriate subheading and an introductory paragraph. Some auditors have also chosen to include their materiality figure however this is not compulsory. An illustrative example of what the KAM section in an audit report might look like is provided below.

Key Audit Matters

Key audit matters are those matters that, in our professional judgement, 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.

Name of key audit matter

Why, in the auditor's professional judgement, the matter was one of the most significant in the audit of the financial statements of the current period:

- Significant risks
- Significant judgements or estimations
- Significant events or transactions

How the matter was addressed in the audit:

- Aspects of the auditor's response or approach
- A brief overview of procedures performed
- An indication of the outcome of the audit procedures
- Key observations with respect to the matter

Reference to the related disclosure(s), if any

What if the matter is not disclosed in the financial statements?

KAM only need to include a reference to a related disclosure in the financial statements if there is one. Financial statement disclosures are determined by the applicable accounting standards. You might find that a matter to which a KAM relates is not required to be disclosed in the financial statements. If it is disclosed in the financial statements, then the description of KAM should not just reiterate what is in the written in the disclosure.

Can we have a say in how KAM are reported?

The auditor is likely to develop a preliminary view at the planning stage of which matters are likely to be KAM, which they will communicate to the audit committee. They may even provide a draft KAM section for review and feedback. The auditor will likely be receptive to feedback on specific wording, but ultimately KAM are reported within the auditor's report so they have the final say on what is included. The final determination of KAM is based on the results of the full audit, and initial assessments of what matters are KAM may change throughout the audit process. As a result, the audit committee are likely to have final discussions about KAM with the auditor at the conclusion of the audit.

Will KAM contain original information?

As a general rule, KAM will not provide any information about the entity that has not otherwise been made publicly available by the entity. Rather than providing original information, the necessary additional information should be disclosed by the entity in the first instance if practicable.

Conclusion

As the new requirements are implemented, there is likely to be an element of experimentation and innovation. The opportunity to do this should be embraced, and diversity in approach is certainly encouraged. Flexibility has specifically been allowed to avoid the use of 'boilerplate' communications. The level of detail to include is a matter of professional judgement. As a result, KAM are likely to vary in wording, tone and depth.

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