Grant Thornton
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Future of audit: The transformed auditor's report

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Contents

Introduction

Financial statements audited by an independent auditor and in accordance with the auditing standards inspire confidence. An important element of this process is the auditor's report which communicates the auditor's opinion on the financial statements. However, the effectiveness of these reports has been limited by the boilerplate reporting language and lack of useful information for the stakeholders.

The International Auditing and Assurance Standards Board (IAASB), acknowledging the criticality of auditor reporting to the value of financial statement audit and the audit profession, issued new and revised auditor reporting standards in January 2015. These standards are aimed at modifying the design of the report to accommodate evolving national financial reporting regimes, while communicating common and essential content. These standards are effective for audits of financial statements for periods ending on or after 15 December 2016.

The Standards on Auditing (SAs) in India, which now find their place in the Companies Act, 2013, are largely consistent with the International Standards on Auditing (ISAs). The Institute of Chartered Accountants of India (ICAI) has made corresponding changes and issued the new and revised standards on the same lines as the IAASB. Most of the revised standards are applicable for audits of financial statements for periods beginning on or after 1 April 2018. The ICAI has also issued an Implementation Guide to SA 701 in February 2018 (communicating the key audit matters (KAMs) in the independent auditor's report). The Implementation Guide includes focused and detailed guidance on issues relating to KAMs as well as frequently asked questions. In May 2018, the ICAI also issued the revised edition of "Implementation Guide on Reporting Standards (Revised SA 700, Revised 705 and Revised 706)" to align the same to the revised standards.

This publication delves into the transformed auditor's report and takes a look at what has changed. It includes experiences of companies from around the world, particularly around the concept of reporting KAMs. It also addresses some common questions that audit committees and Boards may have on the new auditor's report.

The transformed report – form and content

The contents of the auditor's report have been reordered, with the audit opinion finding its place right at the beginning of the report, followed by the basis for opinion paragraph. It also includes a new section relating to going concern.

1

Independent Auditor's Report

- To (the addressee)

Opinion/Qualified Opinion

- **What has been audited:** We have audited the financial statements of (Name of the Company) ('the Company'), which comprise the balance sheet as at ...
- **What is the opinion:** In our opinion and to the best of our information ...

2

New Requirement

Basis for Opinion

- **Modification:** Description of the matter(s) that gives rise to modification
- **How was the audit conducted:** We conducted our audit in accordance with Standards on Auditing ...
- **Statement regarding independence:** We are independent of the Company in accordance with the ethical requirements issued by the Institute of Chartered Accountants of India ('ICAI Code'), and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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More Elaborate

Auditor's Responsibilities for the Audit of the Financial Statements

- **Objectives of the auditor:** 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.
- **Statement regarding level of assurance:** Reasonable assurance is a high level of assurance, but is not ...
- **Exercise of professional judgement:** As part of an audit in accordance with SAs, we exercised professional judgement and maintained professional skepticism throughout the audit ...
- **Misstatement:** We identified and assessed the risks of material misstatement of financial statements ...
- **Internal controls:** We obtained an understanding of internal control relevant to the audit . . .
- **Accounting policies:** We evaluated the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management
- **Going concern assessment:** We concluded on the appropriateness of management's use of the going concern basis of accounting ...
- **Overall evaluation of financial statements:** We evaluated the overall presentation, structure and content of the financial statements ...
- **Communication with those charged with governance:** We communicated with those charged with governance regarding ...

New Requirement

Material Uncertainty Related to Going Concern

- This section is used where events or conditions which may cast significant doubt on the entity's ability to continue as a going concern have been identified and a material uncertainty exists

3

Emphasis of Matter(s)

- Used when the auditor considers it necessary to draw user's attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to user's understanding of the financial statements

4

5

Key Audit Matters

New Requirement

- **What were the most significant matters in current year's audit:** KAMs are those matters that, in our professional judgment ...
- Description of each key audit matter

More Elaborate

Responsibilities of Management for the Financial Statements

- **Preparation of financial statements:** Management is responsible for the preparation of the financial statements that give a true and fair view in accordance with …
- **Going concern assessment:** In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern ...
- **Identifying who is responsible for oversight of financial reporting process:** Those charged with governance are responsible for overseeing the Company's financial reporting process

7

6

Other Information

New Requirement

- **Who is responsible:** Management is responsible for...
- **What is other information:** The other information comprises ...
- **Statement regarding auditor's opinion:** Our opinion on the financial statements does not cover the other information ...
- **Description of auditor's responsibility:** Our responsibility is to read the other information and ...
- **New reporting requirement:** Based on the work we have performed on the other information obtained prior to ...

Other Matter Paragraph

Used when the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, are relevant to user's understanding of audit, the auditor's responsibility or the auditor's report.

9

Report on Other Legal and Regulatory requirements

This section deals with the other reporting responsibilities in the auditor's report that are in addition to those under the SAs. [For example: reporting as per Companies (Auditor's Report) Order, 2016 as per section 143(11) of the Companies Act, 2013 and the additional reporting requirements specified under section 143(3).]

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Summary of new and revised standards

Standards	Changes/new requirements	Effective for audits of financial statements for periods beginning on or after
SA 700 (Revised), Forming an Opinion and Reporting on Financial Statements	Overarching revision to establish the new reporting requirements, including the new structure of the auditor's report	01 April 2018
SA 701, Communicating Key Audit Matters in the Independent Auditor's Report	New standard which deals with the auditor's responsibility to communicate KAMs in the auditor's report; intended to address both the auditor's judgement on what to communicate in the auditor's report and the form and content of such communication (discussed further in the following section)	01 April 2018
SA 705 (Revised), Modifications to the Opinion in the Independent Auditor's Report	Revised to clarify the impact of the new reporting requirements while expressing a modified opinion	01 April 2018
SA 706 (Revised), Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report	Revised to explain the relationship between the Emphasis of Matter(s) and Other Matter paragraphs and the KAMs	01 April 2018
SA 260 (Revised), Communication with Those Charged with Governance	The amendments primarily address the conforming changes on account of SA 701; however, there are certain improvements to the standard as well such as communicating the use of an auditor's expert and providing further examples of significant matters that need to be discussed with the management	01 April 2017 *
SA 570 (Revised), Going Concern	Requires a separate section to be included in the auditor's report when the auditor concludes that a material uncertainty related to going concern exists and it has been adequately disclosed in the financial statements	01 April 2017 *
SA 720 (Revised), The Auditor's Responsibilities relating to Other Information	New mandatory reporting requirement in line with the changes in SA 700 (Revised) on other information included in the entity's annual report	01 April 2018
Related conforming amendments to SA 210, 220, 230, 510, 540, 600 and 710		

*While these standards have been amended in the context of the new reporting standards, their impact on the audits of the financial statements for periods beginning on or after 01 April 2017 should be carefully assessed to determine the impact of any changes that are unrelated to the new and revised standards.

Understanding Key Audit Matters (KAMs)

The requirement that has been at the centre of almost every deliberation on the transformed auditor's report is that of KAMs. This section takes a look at what KAMs are, how they are identified and how they have been reported in countries where the revised auditor's reporting standards are already applicable.

KAMs 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. They are selected from the matters communicated to those charged with governance (TCWG).

How are KAMs identified ?

All matters communicated to those charged with governance →

Matters that required "significant auditor attention" (taking into account areas of higher assessed risk, significant auditor judgments, and significant events or transactions) →

Matters which were of "most significance" to the audit →

KAMs to be described in the auditor's report

SA 260 (Revised) Communication with Those Charged with Governance gives guidance on the matters which are required to be communicated with TCWG.

The areas that require significant auditor attention are areas of higher assessed risks of material misstatement, or identified significant risks; areas that involved significant management judgement, including accounting estimates that have been identified as having a high estimation uncertainty; and significant events or transactions that occurred during the year.

The auditor will need to exercise considerable judgement in identifying KAMs. SA 701 does observe that professional judgement will be needed to determine which and how many KAMs to include in the audit report.

Communicating KAMs in the auditor's report is not:

- a substitute for disclosures in the financial statements
- a substitute for expressing a modified opinion when required as per SA 705 (Revised)
- a substitute for reporting in accordance with SA 570 (Revised)
- a separate opinion on individual matters

The description of KAMs in the auditor's report will include a reference to the related disclosure(s), if any, in the financial statements and is expected to 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.

KAMs need to be communicated in the auditor's report on financial statements of listed entities in accordance with the new SA 701. KAMs may also be included if:

- **a law or regulation** requires KAMs for audits of entities other than listed entities
- auditors **voluntarily**, or at the request of the management or TCWG, decide to communicate KAMs in the auditor's report for entities other than listed entities

The IAASB and, consequently, the ICAI have recognised that there may be situations when a KAM cannot be included in the auditor's report. This could be on account of a law or regulation precluding public disclosure about the matter. It could also happen, in extremely rare circumstances, where the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

However, the second exception will not apply if the entity has publicly disclosed information about the matter.

> The number of KAMs communicated in the auditor's report may be affected by the complexity of the entity, the nature of the entity's business and environment, and the facts and circumstances of the audit engagement. It is envisaged that there will be at least one KAM for an audit of a listed entity.
>
> At the same time, a lengthy list of KAMs will be contrary to the notion of such matters being those of most significance in the audit.

Examples of KAMs

The following examples have been extracted from the annual reports of the respective companies and pertain to different countries.

A) Annual report of Sanderson Group Plc for 30 September 2018 (United Kingdom)

Key Audit Matter - Group	How the matter was addressed in the audit - Group
Risk 2 - Valuation of newly acquired goodwill and intangibles During the year, the Group acquired the entire share capital of Anisa Consolidated Holdings Limited (ACH). This acquisition has had a material impact on the financial statements, resulting in the recognition of goodwill and intangible assets on consolidation of ACH into the group. The group measures goodwill at the acquisition date as being the fair value of consideration transferred less the net recognised fair value amount of identifiable assets acquired and liabilities assumed. Goodwill of £6.2 million was recognised as a result. On initial recognition, the assets and liabilities acquired in a business combination are included in the consolidated balance sheet at their fair values, which are also used as the basis for subsequent measurement in accordance with the group accounting policies. Determining the fair value of certain assets and liabilities requires judgement to be exercised by the directors, particularly in respect to capturing liabilities not previously recognised in the financial statements of ACH. Intangible assets acquired in a business combination are deemed to have a cost to the Group equal to their fair value at the acquisition date. Intangible assets of £7.2 million were recognised as a result of the acquisition of ACH. These intangibles were valued using input from a third-party valuation expert, based on discounted cash flow forecasts, which require judgement by the directors around key assumptions such as revenue growth, discount rates, brand royalty rates, customer attrition and long-term growth rates. Due to the significant financial statement impact of the acquisition, as well as the high level of estimation required in determining the appropriate accounting treatment, we identified the valuation of newly acquired goodwill and intangibles as a significant risk, which was one of the most significant assessed risks of material misstatement.	Our audit work included, but was not restricted to: • documenting our understanding of the management's process for evaluating the accounting treatment to be applied to the ACH acquisition and assessing the design effectiveness of relevant controls • reperforming the management's calculation of the fair value of the consideration transferred less the net recognised amount of identifiable assets acquired and liabilities assumed • using our internal valuation specialist to evaluate and challenge the assumptions used, including discount rates and growth rates, and forecast future trading performance applied in the calculation of the fair value of the intangibles recognised • testing the completeness and accuracy of the data used in the of the acquisition of ACH • testing significant fair value adjustments made to the assets and liabilities acquired and challenging the management's assumptions in the value in use assigned to certain assets. The group's accounting policy on acquisition accounting is shown in note 3 and related disclosures are included in note 18. **Key observations** Based on our audit work, we found that the assumptions and judgements used in the management's accounting treatment of the ACH business combination were reasonable. We found no errors in the underlying calculations.

B) Annual report of Tesco Plc for the year ended 24 February 2018 (United Kingdom)

Key audit matter description	How the scope of our audit responded to the key audit matter	Key observations
Inventory valuation As described in Note 1 (Accounting policies, judgements and estimates) and Note 15 (Inventories), the group carries inventory at the lower of cost and fair value less costs to sell using the weighted average cost basis. As at 24 February 2018, the group held inventories of £2,263 million (2016/17: £2,301 million). The group provides for obsolescence based on forecast inventory usage. This methodology relies upon assumptions made in determining appropriate provisioning percentages to apply to inventory balances.	We obtained a detailed understanding and evaluated the design and implementation of controls that the group has established in relation to inventory valuation. We obtained assurance over the appropriateness of the management's assumptions applied in calculating the value of inventory provisions by: • critically assessing the group's inventory provisioning policy, with specific consideration given to aged inventory (in particular for non-food and general merchandising products) as well as stock turn calculations, including the impact of seasonality • verifying the value of a sample of inventory items to confirm whether they are held at the lower of cost and net realisable value, through comparison to vendor invoices and sales prices • using data analytics to identify unusual inventory usage characteristics, completing assumption tolerance testing and recalculating the provision in totality based on the group's policy • reviewing the historical accuracy of inventory provisioning with reference to inventory write-offs during the year in relation to stock loss or other inventory adjustments	We concur that the total level of provision is within an acceptable range.

C) Annual report of Singapore Airlines Limited for year ended 31 March 2018

Accuracy of passenger revenue

Refer to note2(t) 'Revenue' and note3(c) 'Passenger revenue recognition' for the relevant accounting policy and a discussion of significant accounting estimates

Key Audit Matter	How the matter was addressed in the audit
Passenger revenue is not recorded immediately on sale of flight tickets but is deferred to be recorded at a later time as revenue in the profit and loss account when a passenger is flown. Such deferred revenue is presented on the statement of financial position as sales in advance of carriage and is measured based on the sales price to the customer, net of discounts and rebates. Flight tickets sold often involve multiple flight sectors and partner airlines. The amount of revenue to be recognised for each flight as it is flown relies on complex internal IT systems that handle large volumes of transaction data and includes the exchange of information with industry systems and partner airlines. As a result of the complexity in determining on flight date the revenue to be recognised for flown flights, this is a key focus area in our audit.	To check the accuracy of the revenue recorded by the passenger revenue systems, we tested the relevant computer system controls, these being the user access, programme change controls and application controls over internal passenger revenue systems. Our tests of these controls were designed to determine whether these key computer systems controls operated as they are designed, and are protected from tampering of data or software logic that would result in inaccurate accounting information relating to passenger revenue. Computer system controls were tested selectively; these included those relating to the completeness of transfers of data between systems, ticket validation to identify data errors and the assignment of ticket prices to each flight. Key manual controls were also tested to assess the appropriateness of the treatment applied to exceptions and reconciliations of the group's records with the outputs from shared industry systems and partner airlines. We also visited Singapore Airlines' stations in Tokyo, Surabaya and Singapore as well as SilkAir's stations in Surabaya and Singapore to test the effectiveness of key controls in the passenger revenue accounting process at those locations.

Findings

No significant exceptions were noted in our testing of the IT and manual controls. Our site visits found the key controls to be operating as designed.

Expectations from the transformed reports

The overall expectation from the transformed reports is to improve audit quality or users' perception of audit quality. Audit quality has been at the forefront of all discussions relating to the reliability of financial statements, and the IAASB has taken significant steps in addressing concerns relating to it.

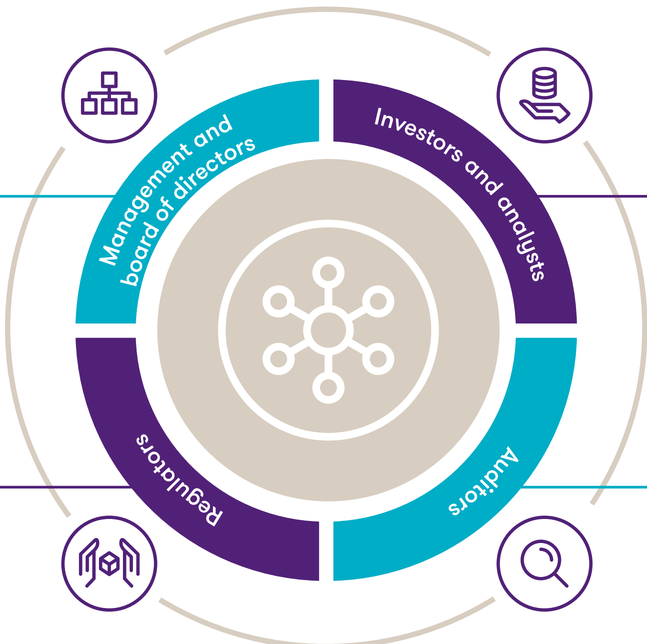
Specifically, the IAASB expects the transformed reports to:

- enhance the communicative value of the reports to the users
- enhance transparency to facilitate users of financial statements in understanding significant judgements made by the auditor in forming his/her opinion on the financial statements, since they are directly related to areas of significant management judgement in preparing the financial statements
- increase robust communication between TCWG, management and the auditor, particularly regarding KAMs
- increase attention of management and TCWG to the disclosures in the financial statements referred to in the auditor's report
- increase professional scepticism of the auditor in areas where KAMs are identified

How does it impact stakeholders?

- Increased communication between auditors and TCWG
- Increased attention to disclosures in the financial statements

- Meaningful information leading to better data for decision-making
- Tailor-made and relevant information as against boilerplate reporting



- Greater transparency
- Better and clear information on significant areas

- Renewed focus on matters to be reported
- Increased professional skepticism
- No change in underlying audit procedures

While the expectations from the standard setters are quite high, the new report does require a substantial change in the mindset of all concerned — including the management, TCWG and auditors.

Auditors will need to, among other things, manage their risks while improving audit quality. Therefore, they will need to be innovative, use new and emerging technologies such as data analytics, and adopt practices which help in delivering an insightful report.

From an ongoing perspective, there may not be a drastic change in the reporting from one year to the next unless there are significant events, transactions or circumstances which affect the entity. This leads to the apprehension that even these reports may eventually end up being boiler-plate. However, the intent of the standard is to make the reporting specific to the entity, to the year and to the issues of that particular year. Ultimately, the idea is that the auditor's report should not be just a tick-in-the-box exercise; rather, it should provide an insight into the audit process and the conclusions drawn.

Experience from other countries

The overall response

The new auditor's report has already been effective in several countries, including China, Australia, Singapore, Malaysia and certain countries in Europe. The UK was one of the first countries to roll out these requirements. The UK's Financial Reporting Council (FRC), in its review of the second year of extended auditor's reports[1], received feedback that investors welcomed extended auditor reporting and greatly valued the enhanced information it provided. The Public Company Accounting Oversight Board (PCAOB) has also adopted a corresponding auditing standard on the same lines. Its requirements are expected to apply in a phased manner, with the first phase being applicable for audits for fiscal years ending on or after 15 December 2017. [The requirements relating to reporting critical audit matters (CAMs), which correspond to KAM, will take effect in a staggered manner begining from audits for fiscal years ending on or after 30 June 2019.]

The FRC's survey of extended auditor's reports issued in the first year confirmed that auditors in the UK **'appeared not only to have met the new requirements but in many cases had made, sometimes quite radical, further changes to auditor's reports going beyond the changes required by the FRC. A particular conclusion of the Survey was that each of the audit firms had adopted different approaches to the extended auditor's report and had, therefore, been innovative in different ways'[2]**. The innovations included disclosure of the materiality benchmark used, disclosure of the magnitude of unadjusted differences being reported to the Audit Committee, reporting of detailed audit findings with respect to identified risks, experimentation with detailed broader explanation of the audit scoping process and presentation of the auditor's reports through the use of diagrams and graphs.

The reports which have earned the greatest praise from investors this year are carefully structured with the end user in mind, and signpost key information. They also include clear, concise and transparent disclosures about risk, scope and materiality, as well as the critical areas where professional judgement and assumptions have been addressed — UK FRC (January 2016)

A similar study[3] on the first-year experience with the enhanced auditor reporting in Singapore found that the reports not only brought about insightful disclosures by the auditors but also led to positive behavioural changes among various stakeholders in the financial reporting ecosystems. The findings included the expected increase in audit committee deliberations, investors using the reports to identify significant accounting and auditing issues as well as management adding more disclosures in line with the KAMs reported.

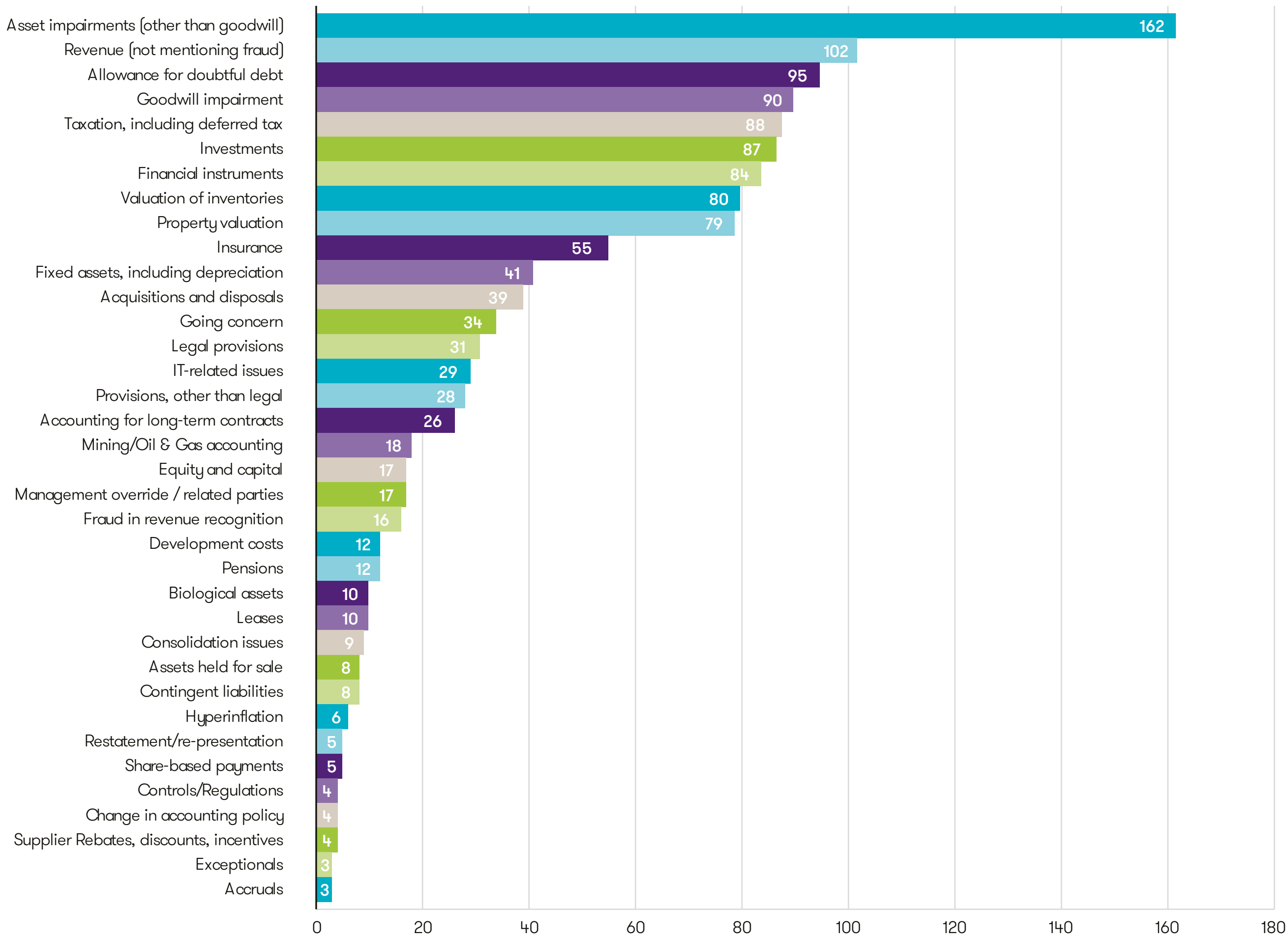
1. Extended auditor's reports: A further review of experience - released in January 2016
2. Extended auditor's reports: A review of experience in the first year – released in March 2015
3. Embracing Transparency, Enhancing Value: A first-year review of the enhanced auditor's report in Singapore – A study conducted by Accounting and Corporate Regulatory Authority (ACRA), Association of Chartered Certified Accountants (ACCA), Institute of Singapore Chartered Accountants (ISCA) and Nanyang Technological University (NTU).

Reporting KAMs

The UK's Association of Chartered Certified Accountants (ACCA) analysed 1,321 KAMs reported across 560 audit reports in 11 countries (Brazil, Cyprus, Kenya, Nigeria, Oman, Romania, South Africa, the UAE and Zimbabwe) to evaluate the first-year implementation of the new standards[4]. The key finding from this study was that the benefits of KAMs went beyond better information for investors to encompass improved governance, better audit quality and enhanced corporate reporting.

The finding relating to subject matters covered is quite interesting and asset impairment seems to be by far the most reported KAM across these reports, followed by revenue, doubtful debts, goodwill impairment and taxation. These feature as significant risk areas in most audits, and it is not surprising to see them in this list.

Fig 1: Subject matters covered by KAMs*

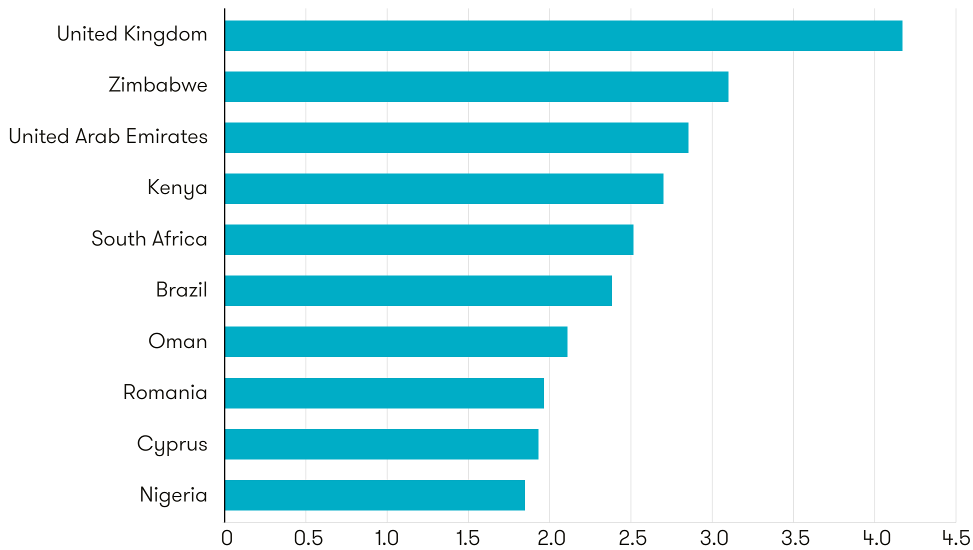


*Source: Key audit matters: unlocking the secrets of the audit – released in March 2018 by ACCA

4. Key audit matters: unlocking the secrets of the audit – released in March 2018 by ACCA

It appears that the auditors in the UK had a lot more to say than their counterparts in other countries. Apart from the countries covered in Figure 2, auditors in Singapore reported an average of 2.3 KAMs[5] in the first year of implementation, while it was 2.09 in Malaysia[6] and an average of 3 in Australia and New Zealand[7].

Fig 2: Average number of KAMs per company , in the sample countries*



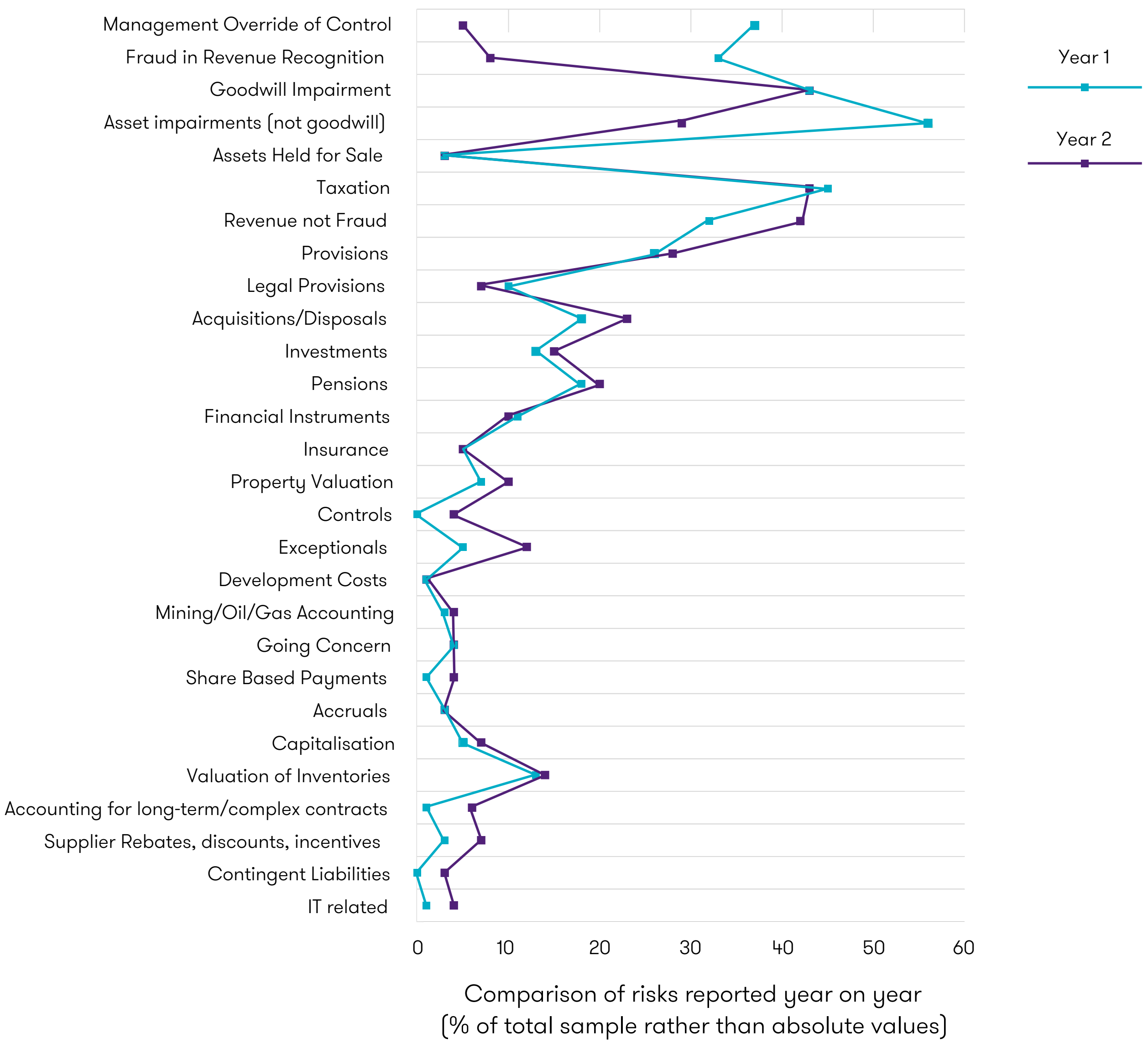
*Source: Report published by Association of Chartered Certified Accountants (ACCA)

5. Embracing Transparency, Enhancing Value: A first year review of the enhanced auditor's report in Singapore – study conducted by Accounting and Corporate Regulatory Authority (ACRA), Association of Chartered Certified Accountants (ACCA), Institute of Singapore Chartered Accountants (ISCA) and Nanyang Technological University (NTU)
6. Enhanced Auditors' Report: A review of first-year implementation experience in Malaysia – Study conducted by The Securities Commission Malaysia (SC)'s Audit Oversight Board (AOB), the Malaysian Institute of Accountants (MIA) and the Association of Chartered Certified Accountants (ACCA) released in January 2018
7. September 2017 edition of APlus, magazine published by Hong Kong Institute of Certified Public Accountants

In terms of progressive improvements from one year to the next, the study by FRC in the UK covered 153 audit reports in year one and 278 audit reports in year two and uncovered some interesting insights.

Figure 3 below shows the change in the number of KAMs communicated in each area of financial statements. The study also shows that the language used in KAMs by all the audit firms has evolved from being generic to entity-specific/granular in significantly more cases than it was in year 1.

Figure 3: The change in the number of KAMs from Year 1 to Year 2



Source: Extended auditor's reports: A further review of experince - released in January 2016 by FRC

KAM reporting has also thrown up some interesting data points. For example, in New Zealand, 44% (39) of the auditor's report surveyed referenced using auditors' experts or specialists. The most common specialists to be used in the audit were in-house valuation specialists[8].

In Malaysia, the results of the first-year review[9] signal that companies and audit committees may need to raise their own expectations of the enhanced auditor's report. Investors and audit committee members saw room for general improvement in KAMs on top of the matters covered in the survey. Investors in the UK[10] would welcome, among other things, clearer explanations of the level and quality of assurance derived from component audit teams. The learnings and expectations from the future indicate that there is a reasonable level of acceptance and in most cases a positive response from the stakeholders. They also indicate that the new reports have been able to generate and sustain a high level of interest.

Our views

While the new reporting requirements require auditors to consider the risks involved, they also offer an opportunity for demonstrating innovation and audit quality. We expect the new reporting standards to drive a significant change in reporting as seen globally and get streamlined over a period of time. Auditors and management are likely to be apprehensive of what is eventually covered in the auditor's report and its likely impact. To ensure effective implementation, it is essential that the auditors, management and audit committees, begin to understand and assess these requirements at the earliest.

8. Key Audit Matters: A stock take of the first year in New Zealand (November 2017) issued by New Zealand's External Reporting Board (XRB) and Financial Markets Authority (FMA)
9. Enhanced Auditors' Report: A review of first-year implementation experience in Malaysia – Study conducted by The Securities Commission Malaysia (SC)'s Audit Oversight Board (AOB), the Malaysian Institute of Accountants (MIA) and the Association of Chartered Certified Accountants (ACCA) released in January 2018
10. Extended auditor's reports: A further review of experience - released in January 2016

Frequently Asked Questions

In this section, we have tried to answer some of the most common questions and address concerns around the new requirements, especially for the board of directors and the audit committee while considering their oversight responsibilities over the management and audit respectively.

1. Does the new auditor's report impact the responsibilities of the management and TCWG?

The SAs issued by the AASB of the ICAI are not binding on the management or TCWG. The new requirements in the auditing standards, therefore, do not directly impose any requirements on them.

However, the KAMs are intended to draw the attention of the users of the financial statements to the matters that were of most significance to the audit. These would generally be matters that involved substantial judgement from the management, followed by high level of judgement/focus from auditors and TCWG, in discharging their duties. The KAMs may also serve as a base for the investors and other stakeholders to initiate conversations with the management.

The management and TCWG will need to pay greater attention to the relevant disclosures in the financial statements to which reference is made in the auditor's report, as that is one of the expected outcomes of this entire revamp of standards by IAASB.

The management, TCWG and the auditor now need to have an ongoing dialogue throughout the audit process, starting with the planning phase, about the most likely candidates for KAMs. Audit committees will also benefit from seeing a draft of the auditor's report as early as possible to understand what the auditor intends to say about the matters, the reasons for identifying those matters and how the matters were addressed in the audit.

The experience in the UK and other countries has shown that requiring auditors to communicate KAMs enhances communications about those matters between the auditor and the audit committee, and increases attention by management and the audit committee to the disclosures referred to in the auditor's report.

2. Will the new auditor's report improve audit quality?

The new audit report may not add to the current audit procedures. However, it is likely, as also evidenced from the experience around the world, that the need to elaborate the audit approach and describe what was most significant in the audit will improve audit quality.

Also, given the current regulatory landscape in India, auditors are expected to apply enhanced professional scepticism while dealing with the significant areas of audit knowing that these areas will be communicated in the audit report and subject to scrutiny by public.

Auditors may also have to reconsider some of the assessments done by the management, evaluate the adequacy and relevance of the work done during the audit, enhance documentation and certainly increase the quantity and quality of communications with the management and TCWG.

3. Will KAMs be entity-specific in all cases or eventually reduce to boilerplate language in the following years?

KAMs are meant to be specific to the entity and the audit that was performed. Therefore, SA 701 includes a judgment-based decision-making framework to help auditors make that determination. This framework was developed to focus auditors on areas of interest for investors and other users — in particular, areas of the financial statements that involved the most significant or complex judgments by management and areas of auditor focus in accordance with the risk-based approach in the SAs.

However, the specifics of the description are left to the judgment of the auditor. The auditing standards require neither a lengthy description of the auditor's procedures nor an indication of the outcome of the procedures or a conclusion on the matter.

The objective of requiring this reporting will not be met if the KAMs are boilerplate. Even globally, the stakeholders are not interested in boilerplate, bland wording. They want specific information about the issues that the auditors focused on which were significant areas of judgement or those matters where they had the most robust discussions with TCWG (being the audit committees in most cases).

4. Will auditors report all or most matters discussed with TCWG as KAMs to cushion the audit reporting responsibilities?

The determination of KAMs involves auditor judgement about the relative importance of matters that required significant auditor attention. As stated earlier, the auditing standards do not prescribe or limit the number of matters to be reported as KAMs. It may be affected by the complexity of the entity, the nature of the entity's business and environment, and the facts and circumstances of the audit engagement.

In general, the greater the number of matters initially determined to be KAMs, the more the auditor may need to reconsider whether each of these matters meets the definition of a KAM. To reiterate, lengthy lists of KAMs are in fact contrary to the notion of such matters being of most significance in the audit.

While the average number of KAMs reported across various countries is varied, it is expected that for a listed entity there would be at least one matter that received significant audit focus and discussion with the audit committee. In extremely rare situations, the auditor might not identify any KAMs, in which case the auditor's report will need to indicate that there were no KAMs to communicate.

6. Will KAMs be used by investors and other stakeholders for assessing the management's performance?

This question itself indicates the importance of educating investors and other stakeholders on KAMs. The IAASB, in all its communications on KAMs, has clarified the responsibilities of auditors as well as those of the management and TCWG. Communicating KAMs does not change the auditor's underlying responsibilities in accordance with ISAs (or SAs) to conduct a thorough risk assessment, design and perform procedures that are appropriate to respond to those risks, and form an opinion based on the audit evidence obtained. Nor does it change the responsibilities of the management and TCWG for the preparation and presentation of the financial statements, including ensuring appropriate disclosures in accordance with the applicable financial reporting framework. KAMs are meant to explain what took up most of the auditor's time in the current year's audit and what the auditor did with respect to those matters. KAMs are meant to provide an insight into the audit process and not into the management's performance.

7. Is the auditor taking on a management role when communicating KAMs?

KAM is not a replacement of, or supplement to, the information included in the financial statements by the management. The auditor's responsibility has always included consideration of the adequacy and appropriateness of disclosures in forming an opinion on the financial statements. Communicating KAMs, therefore, is not intended to 'fill the gaps' for disclosures which could be incomplete or missing.

Further, the standards clearly prohibit the auditor from communicating 'original information' about the entity in the auditor's report as well as from duplicating the management's disclosures. The ideal KAMs need to refer and leverage relevant disclosures in the financial statements in explaining why the auditor considered that matter to be one of most significance and how the matter was addressed in the audit.

As seen globally, the impact of the new requirements is not limited to the auditor's report. There have been obvious improvements in disclosures elsewhere in the annual report or financial statements relating to the issues reported as KAM so that the auditor does not end up revealing any new information about the company's affairs.

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