Introducing the new auditor’s report

IPEC – 16 June 2016

“The introduction of Key Audit Matters for listed entities is a significant enhancement that will change not only the auditor's report, but more broadly the quality of financial reporting – and therefore the informative value to investors and other key stakeholders."

Linda de Beer, IAASB Consultative Advisory Group (CAG) Chair

Why is change necessary?

- **Improved auditor communications – increased focus on investors and other key stakeholders, more relevant and decision-useful information**

- **Evolving world. More complex business. Increased judgement and uncertainty.**

- **Corporate failures**

- **Increased distrust in the board and the auditors**
  - **Pressure on auditor independence (rotation, non-audit services)**

- **Information generation**

The expected benefits

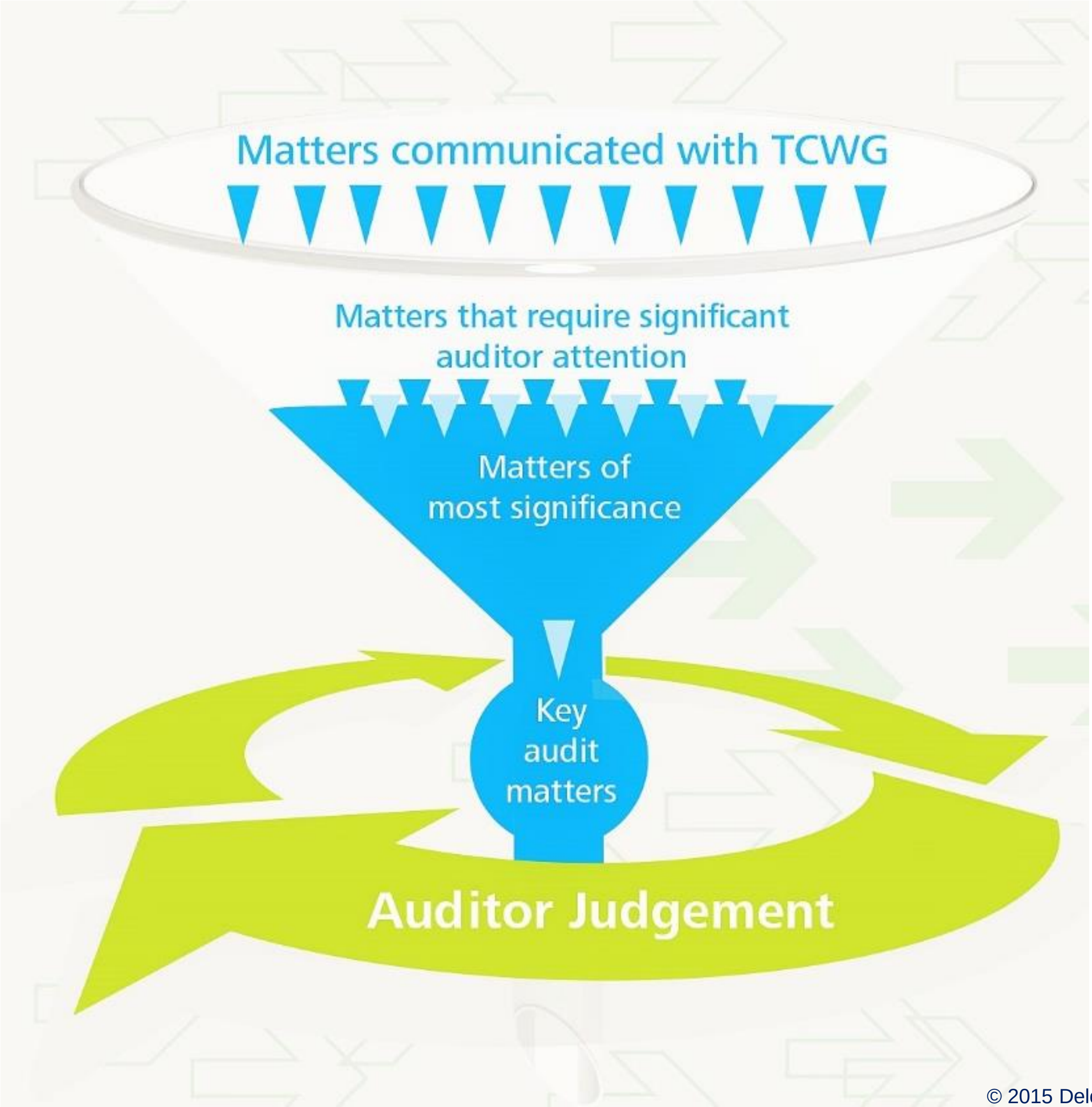
Transparency into the audit and discussions with TCWG	**Improves trust**
Relevant, entity specific information	**Improves interest in the audit report and enhances credibility of audit**
Comparability – industries and audit firms	**Better understanding, more robust**
Enhanced communicative value – TCWG and users	**Industry insights, evaluate audit quality across firms**
Improved disclosures – audit quality and quality of financial reporting	**Increased focus on disclosures in the FS, commentary by TCWG and auditor's response to KAM**

Overview of the changes

Listed entities only

Key Audit Matters	New section to communicate key audit matters (KAM), including our audit response to the KAM. KAM are those matters that were of most significance in the audit of the current period financial statements
Name of partner	Disclosure of the name of the engagement partner
Opinion first	Opinion section required to be presented first, followed by the Basis for Opinion section, unless national laws or regulations prescribe otherwise
Going concern	• Description of the responsibilities for going concern • Separate section when a disclosed material uncertainty exists • Need to challenge adequacy of disclosures for "close calls“
Independence	Affirmative statement about the auditor’s independence and fulfillment of relevant ethical responsibilities
Responsibilities	Enhanced description of the responsibilities of the auditor and key features of an audit

Key Audit Matters (KAM)
The process for identifying KAMs



Key Audit Matters (cont.)
The auditor’s description of the KAM

Credit risk remains a significant challenge affecting the country’s financial services sector as evidenced by the increasing non-performing receivables. Consequently, there is risk of non-recoverability of Insurance receivables primarily due to generally low liquidity and business performance constraints within the economy. Further to this, the recoverability of receivables from expired policies susceptible a particularly high risk of non-recovery due to:

Why this it is a KAM/ reference to related disclosure

Key Audit Matters (cont.)
The auditor's description of the KAM

How the matter was addressed in the audit

In evaluating the valuation of Insurance receivables, we performed the following procedures:

- Reviewed the documentation evidencing the performance of credit assessments on existing and potential customers in accordance with the policies, procedures, and applicable laws.
- Tested recoverability of Insurance receivables through confirmation of balances with customers, and analysed customer payment trends for both the current year and the period just after year-end.

We concluded that the Insurance receivables were reasonable extent, accurately valued.

Key Audit Matters (cont.)
Intended purpose

What Key Audit Matters are	What Key Audit Matters are NOT
• The auditor's perspective on a few key matters of most importance to the audit • Relevant, entity and period specific • Insights and transparency into the audit and the discussions with management/ TCWG	• Matters of most importance to the financial statements • Discrete opinions on each matter • A replacement for management's lack of commentary or disclosure • A list of all significant risks • Commentary on management's performance or the relative aggressiveness or conservatism in management's accounting policies or judgments

Common Key Audit Matters in Insurance

COMMON KAM

1) Valuation of insurance contracts and insurance contracts for account of policyholders including the design and application of complex valuation models and the economic and actuarial assumptions that support the calculation.
2) Incurred But Not Reported is an estimate and subjective to bias.(Uncertainties in policyholder claims and litigation)
3) Investment held by the insurance company - Fair valuation may be difficult in the event that the investment are not in tradeable equities or debt instruments, e.g. property investments
4) Valuation and recoverability of other assets e.g. insurance receivables given the generally liquidity situation in the country. (Determination of Gross Written Premium)

The UK Experience

- UK has had reformed reports for 3 years
- Requirements slightly different from IAASB, but principles are similar. The UK requires:
  - Focus on significant risks only
  - Commentary on materiality
  - Indicate scope of audit, which includes group scoping
  - Audit committee also required to comment on risks
  - Management required to comment on critical judgements formed and key estimates made

The UK Experience (cont.)
Commentary on risks – key observations

Commended

- ✔ Explanation of the complexities of the underlying matter e.g. pricing mechanisms for revenue, choice of accounting policy
- ✔ Inclusion of auditor's view on whether estimates were cautious or optimistic
- ✔ Inclusion of auditor's procedures and results of procedures
- ✔ Identification of weaknesses in internal control

Criticised

- ✘ No specific details e.g. standard wording
- ✘ Discussion of risks highlighted elsewhere in the annual report
- ✘ Including "standard" risks in every report e.g. revenue recognition and management override of controls
- ✘ Talking in "auditor code"

This highlights what users are looking for

CHALLENGES IN IMPLEMENTATION

- Independence and objectivity of report as report is now product of discussion with Board and Management. Auditor’s ownership of report compromised.

- Going concern disclosure e.g. material uncertainty may affect investor confidence. (E.g matters on recapitalisation and ability to meet the capitalisation requirements).

- Identifying key stakeholders

- Risk of disclosure of competitor sensitive information (e.g. customer concentration

- Perception management between the audited company and auditors (Risk of perceived provision of negative information)

- Inconsistencies could be noted in computations for key balances such as insurance liabilities

- Inclusion of auditor’s view on whether estimates were cautious or optimistic.

Impact on the audit committee and management

What matters could potentially be KAMs?

- Is the accounting treatment correct?
- Is there a history of errors?
- Are we satisfied with how management is currently addressing these matters (e.g. no deficiencies in internal control)?
- Do the disclosures include all information relevant to users and will the disclosures support the auditor's description of the KAM?

Impact on audit committee meetings

- Timing to accommodate audit process and deliberations on KAMs
- Evaluate independence of the auditor

Impact on the audit committee and management (cont.)

Going concern

- What is management's process for evaluating going concern, what are the controls? Consider if these are good enough.
- Do the disclosures include all information relevant to users?
  - NB: Expanded disclosures in "close call" situations

Other information

- What is included in other information for the entity?
- When will the other information be available to the auditor?
- Is it consistent with the financial statements?

Global comparison

Proposed changes	IAASB	United Kingdom	European Union	PAAB (Zimbabwe)
Effective date	Dec 2016	Oct 2013	June 2017	• Dec 2016 • "Dry run" Dec 2015
KAM/ CAM/ risks	Only listed entities	Certain listed entities	Public interest entities	Public interest entities
Materiality		Certain listed entities		
Scope of audit		Certain listed entities		Public interest entities
Going concern	All entities if material uncertainty exists			Public interest entities
Ethics/ independence	All entities	Certain listed entities	Public interest entities	Public interest entities
Other information	All entities	Certain listed entities		Public interest entities
Identify partner	Only listed entities	Certain listed entities		Public interest entities
Years served		Disclosure by the board	Public interest entities	