



Key Audit Matters

Auditor's report snapshot

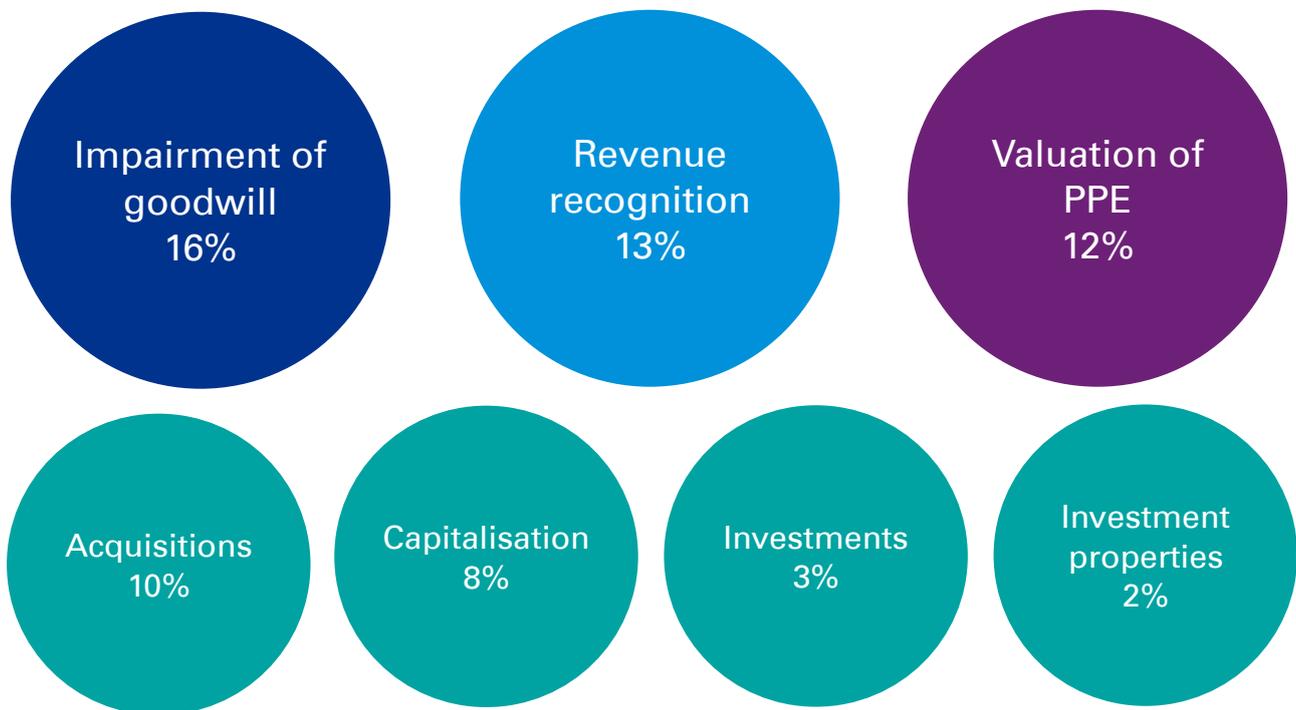
February 2020



We are three years in since Key Audit Matters (KAMs) were required to be reported for NZX Listed Entities and one year in for FMC HPA (Higher level of Public Accountability) entities. This snapshot looks at the trends regarding the new style auditor reporting of NZX Listed Entities and certain FMC HPA entities for the period (financial periods ending October 2018 to September 2019).

Most frequently reported KAMs

To identify and understand the trends, we reviewed 131 audit reports for this snapshot and categorised each KAM into topics. Below are the 7 most frequently reported KAM topics for the period and the percent of total KAMs reported that they represent.



The top three KAM topics have not changed since KAMs became applicable. The next four KAM topics had mixed trends year on year, with significant change being an increase in reporting acquisitions as a KAM. Overall, It is apparent those audit matters that are judgemental, involve estimates, uncertain and/or complex, appropriately, remain the top KAMs disclosed.

Interesting KAM topics

As well as looking at the most frequently reported KAM topics, we have also assessed some of the less frequently reported KAM topics and areas of users' interest:



IT systems

Complex IT systems and controls were highlighted as one of the KAMs of interest in regulators' interview with users.

There have been only six examples relating to IT systems. The common reason cited for why this was reported as a KAM is due to the heavy reliance on complex, automated IT systems and processes.



Taxation

Taxation is a common KAM in overseas jurisdictions including Australia, however taxation continues to appear in only a few NZ audit reports (5 in this period). These NZ examples relate to audit matters around deferred tax assets.

Rare disclosure may be due to the fact that corporate tax in New Zealand is deemed less complex than other jurisdictions, therefore less significant in many audits.

The number of tax related KAMs may increase going forward as NZ IFRIC 23 *Uncertainty over Income Tax Treatments* will take effect from the next reporting period. This interpretation addresses how to recognise and measure current and deferred tax assets and liabilities where there is uncertainty over income tax treatments. As previously mentioned, audit matters that involve judgement and uncertainty are usually disclosed as KAMs as they involve more audit efforts and significance.



Business strategy and model

KAMs linked to the entity's strategic goals or wider macro-economic or environmental factors and non-financial KAMs were highlighted as two of the KAMs of interest in regulators' interviews with users.

Users are increasingly making their decisions based on non-financial metrics and strategic goals of companies. These decisions are generally based on how sustainable a business model is in the long term which is not derived from financial statements or systems.

There were no examples relating to non-financial topics or strategic goals in this period. This is not surprising given there is no requirement of today's auditors to perform due diligence style checks or provide an opinion on areas outside the financial statements. However, as users place more reliance on and demand assurance on such information from the auditors, we may see an expectation for auditors to disclose audit efforts and insights on a wider set of information. We are now seeing KAMs required by regulators in other assurance engagements. Gas and Electricity distribution information disclosures in the energy sector now require KAMs, which illustrates the increasing demand for more details of assurances performed from users. The UK regulator encouraged shareholders to engage with management as an opportunity to raise potential matters that are significant to the users.



Fraud related

There is no precedent KAM on fraud in the market. Whilst fraud is a constant and evolving threat to all types of organisations, and ISA 240 states management is in a unique position to perpetrate fraud, there are still no examples of fraud related KAMs. The procedures performed to address the risk of fraud are likely incorporated into the KAM on revenue, and others..



No KAMs

There was only 1 example where no KAM was disclosed, compared to 3 in the prior period.

While this is permitted under ISA (NZ) 701, the standard highlights that it only happens in extremely rare circumstances (e.g. very limited operations). Given the types of entities who are required to report KAMs, it is unsurprising that there are few in this category.

The new NZ IFRS standards



NZ IFRS 15 *Revenue from Contracts with Customers* and NZ IFRS 9 *Financial Instruments* were effective in the period. Auditing the transition to the new IFRS standards often take considerable effort from auditors.

Interestingly, there were no significant change in the portion of revenue KAMs reported in relation to all the KAMs. This may be due to revenue already requiring considerable effort.



13% of KAMs in 2019

vs.

14% of KAMs in 2018

It is also important to note that transition to these new standards may not result in a material impact on the financial statements, however the auditor could still report this as a KAM as they have spent significant effort in satisfying themselves that there is in fact no material impact.

NZ IFRS 16 *Leases* is effective for reporting periods beginning on or after 1 January 2019. This standard is expected to have significant impact on wide variety of sectors, providing challenges to data gathering, management's judgements and the overall financial reporting . Given complexity and challenges, leases are likely to be a KAM for most entities with large lease arrangements.

Impact for FMC HPA Entities

This was the first year KAMs were mandatory for Financial Market Conduct entities considered to have Higher level of Public Accountability ('FMC HPA Entities'), mostly falling within the Financial Services sector.

Key facts from looking at a sample of KPMG audit report (99 reports) were:

- **Valuation of Investments:** Most reported KAM, almost 50% of all KAMs reported within the sector.
- **Insurance liabilities:** Second most reported KAM, approximately 16% of all KAMs reported within the sector.
- **3.7 pages and 1.6 KAMs:** Average number of pages and KAMs per report are both shorter than averages across all reports and across listed financial services entities. This is likely due to the fact that there are numerous funds which are FMC HPA entities. Audit reports of those entities usually disclose only 1 or 2 KAMs that are core to their operations (e.g. valuation of investments for funds and schemes).
- **Corporates:** FMC HPA corporate entities showed similar trend to listed entities. Top reported KAMs included revenue, inventory, PPE and goodwill. Average number of KAMs was similar however the reports tended to have less pages than listed entities.

¹ Types of entities considered to be FMC HPA Entities can be found at: <https://www.fma.govt.nz/compliance/exemptions/financial-reporting-exemption-information/>

Other key statistics



4.18: Average number of pages per report

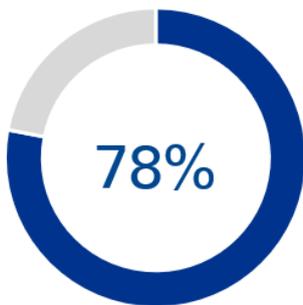


1.88: Average number of KAMs per report

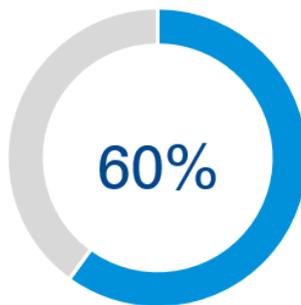


6: Most KAMs reported in any report

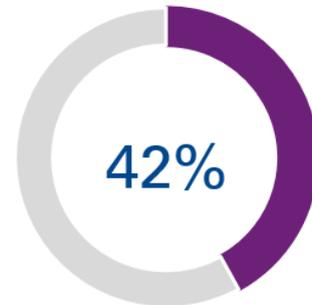
Optional disclosures



Materiality Amount



Materiality Benchmark



Findings

Under ISA (NZ) 701, the inclusion of findings within the audit report is optional and is at the auditor's discretion. The inclusion of materiality in the audit report is not contemplated by ISA (NZ) 701, but is a feature of the equivalent UK standard. The below percentages illustrate how many audit reports including materiality as a dollar amount, the materiality benchmark used, findings and scoping decisions. These figures vary among the Big 4 Accounting Firms. Below are the statistics by firm for the period.

Firm	Materiality (\$)	Materiality (B)	Findings
PwC	100%	100%	80%
KPMG	81%	74%	56%
Deloitte	83%	4%	13%
EY	0%	0%	0%

As shown above, PwC included materiality and findings in every instance, while EY do not include these in any reports. KPMG and Deloitte report on these in some instances.

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