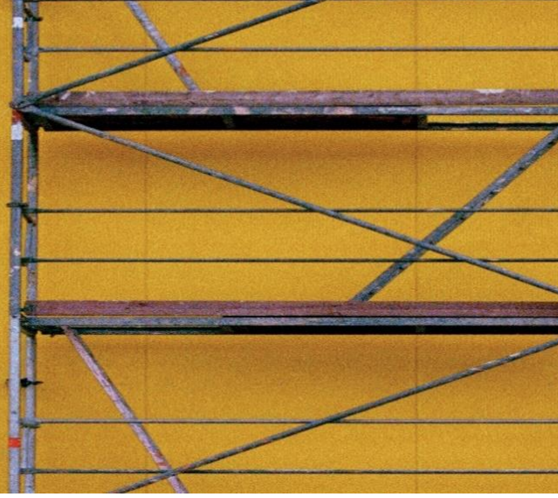


# Key Audit Matters

## Auditor's report snapshot

December 2018

June 2018 was the 19th month that Key Audit Matters (KAMs) were required for NZX Listed Entities. This snapshot looks at the trends regarding the new style auditor reporting for the 19 month period December 2016 to June 2018 (the period), as well as looking at what we expect to see in the future.

## 5 most frequently reported KAMs

To identify and understand the trends in the new style audit reports, we categorise each KAM into topics. Below are the 5 most frequently reported KAM topics for the period  and the percent of total KAMs reported that they represent.

- Property, Plant and Equipment 19%
- Goodwill and Intangibles 18%
- Revenue Recognition 13%
- Acquisitions 7%
- Impairment 5%

This is largely consistent with previous periods, the only changes being Property, Plant and Equipment moving from 2nd to 1st and Impairment moving from 6th to 5th (replacing Capitalised Research and Development Costs). It should be noted that the Property, Plant and Equipment KAM relates to impairment of these assets, whilst the Impairment KAM relates to impairment of other assets. The top 3 KAMs (being Property, Plant and Equipment, Goodwill and Intangibles and Revenue Recognition) make up 50% of all KAMs reported. The remaining 50% are spread over nearly 30 different KAM topics.

## 3 interesting KAM topics

As well as looking at the most frequently reported KAM topics, we thought it would be worth looking at some of the less frequently reported KAM topics. Below are the 3 KAMs / KAM topics that stood out as being of interest.

**Business Operations**

The 30 June 2018 independent auditor's report for Spark New Zealand included a KAM titled "Transition to Agile-at-scale operating model". This KAM focused on Spark's strategic focus, demonstrating that KAMs do not need to be limited to financial statement captions.

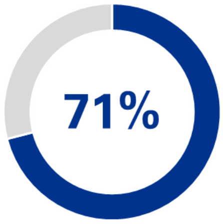
**Information Systems**

There have been 7 KAMs relating to Information Systems. The common reason cited for why this was reported as a KAM is due to the heavy reliance on complex, automated processes. This highlights the impact Information Systems can have for an auditor during an audit.

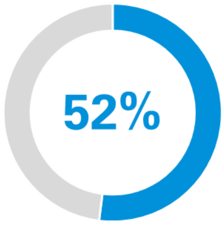
**No KAMs**

Of the 228 reports reviewed by KPMG, 3 did not report any KAMs (excluding reports where the auditor issued a Disclaimer of Opinion). While this is permitted under ISA (NZ) 701, this highlights that it only happens in extremely rare circumstances.

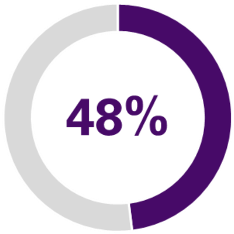
# Optional disclosures



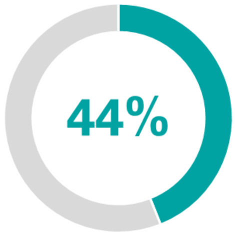

**Materiality Amount**




**Materiality Benchmark**




**Findings**




**Scoping**

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 and scoping in the audit report is not contemplated by ISA (NZ) 701, but is a feature of the equivalent UK standard. At a high level these are the percentage of 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 statics by firm for the latest quarter (April 2018 – June 2018).

| Firm | Materiality ($) | Materiality (B) | Findings | Scoping |
|---|---|---|---|---|
| PwC | 100% | 100% | 94% | 100% |
| KPMG | 85% | 85% | 54% | 15% |
| Deloitte | 88% | 13% | 25% | 0% |
| EY | 0% | 0% | 0% | 0% |

As seen, PwC included materiality, scoping and findings in almost every instance, while EY do not include these in any reports. KPMG and Deloitte report on these in some instances, tailoring these disclosures to be most relevant for each audit.

# Other key statistics

**2.07: Average number of KAMs / report**

**4.25: Average number of pages / report**

**6: Most KAMs reported in any report**

# Year 2 - what we've seen

December 2017 onwards saw most NZX Listed Entities report KAMs for a second time. This raises the question, "what changes occurred between year 1 and year 2?" While there were some movements (mostly to do with KAMs relating to Acquisitions), it appears that most reports remained largely consistent year-on-year.

Unless there are significant changes or new transactions entered into by an entity, we would not expect the KAMs to change much year-on-year. However, while most reports remained consistent, there were instances where the reports did change significantly. For example, the independent auditor's report for Steel and Tube Holdings Limited (Steel and Tube) went from reporting 2 KAMs in 2017 to reporting 5 KAMs in 2018. These changes were due to a number of large events occurring at Steel and Tube and demonstrates that KAMs do need to be reconsidered each year.

# The new IFRS standards

With NZ IFRS 9 *Financial Instruments*, 15 *Revenue from Contracts with Customers* and 16 *Leases* coming into effect within the near future, you may see these as KAMs in 2019. In fact, March 2018 already saw KAMs relating to NZ IFRS 9 and 15 being reported. The reasons cited for including these as KAMs was due to the complexity and judgement involved under both standards.

Given that auditing the transition to these new standards will take considerable effort from auditors, there is a good chance we will see these as a KAM where the transition to these new standards has had a material impact on the financial statements. Whilst not every entity will be impacted by each of the new standards equally, we anticipate at least one of the new standards will have an impact for most clients – if not all three. 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.

# Impact for FMC HPA Entities

KAMs will be required for all Financial Market Conduct Entities considered to have Higher Level of Public Accountability (FMC HPA Entities[1]) with a balance date on or after 31 December 2018. Given a number of FMC HPA Entities fall within the Financial Services sector, now would be a good time to look at that sector as a proxy of what to expect in the future. Below are some key facts relating specifically to the Financial Services industry:

- **Valuation of Investments:** Most reported KAM, appearing in almost 50% of all reports within the sector.
- **Financial Instruments:** Second most reported KAM, with 50% of all Financial Instrument KAMs coming from Financial Services.
- **Impairment (other than Goodwill and Intangibles):** Third most reported KAM, mostly relating to the impairment of loans and finance receivables.
- **4.9 pages:** Average number of pages per report, which is longer than the average across all reports.
- **6 KAMs:** Most KAMs reported in any one report came from a Financial Services entity.

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

# How to get the most from your KAMs

The platform for change was to provide insights to shareholders on the conduct of the audit, previously only viewed by those in the board room. This is an opportunity to promote transparency, provide investors with a better understanding of the audit (and in turn the financial statements) and enhance trust in the marketplace. While the audit report remain the auditor's responsibility, management and directors have a role to play too. So, what can you do to get the most from your KAMs?

- **Engage with your auditors early**

  Experience shows that writing KAMs is a lengthy process, even more so if late edits are made. Engage early with your auditors to avoid any late surprises.
- **Revisit your financials**

  This is also a good time for you to revisit your financial statements to ensure that they are clear and concise. As KAMs often direct users to the note disclosures, why not take this oppourtunity to review your financials to ensure the note disclosures clearly explain the issues at hand and that only the relevant notes are included.
- **Start each year fresh**

  Just because an item was a KAM one year, does not mean it is automatically a KAM the next. KAMs should be tailored to the business and to the current year. Look at your KAMs with a fresh set of eyes each year and ensure that they remain relevant.
- **Think of your user**

  The primary function of KAMs is to increase the financial statements users' understanding. Put yourself in their shoes and ask "would the typical user understand this?" Remember, users might not be as familiar with the auditing process, therefore audit jargon and technical language should be avoided. If you spot this, ask your auditor if there is another way of making their point.

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