

AUDIT REPORT FORM & CONTENT

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Facets of Audit opinion



New updates

Revision to existing SA's:

- 700 [Audit report form]
- 705 [Modification to audit opinion]
- 706 [Emphasis of matter & Other Matter]
- 720 [Other information reporting]

New SA included:

- 701 [Key Audit Matters]

Applicable for financial year beginning April 1st, 2018.

Quality Review Board report FY17-18

- ✓ QRB has published its report on findings recently, I have reproduced their findings regarding SA 700 to 720.

Findings:

- i. Failure to provide audit report in specified format.
- ii. Failure to include "Basis for qualified opinion" para in the audit report.
- iii. Inconsistency in other information as defined in SA 720 and financial statement.

SA 700 Revised

The order in which various matters appear in the report is also changed.

Revised order of various matters in the Audit Report:

- Opinion
- Basis for opinion
- Going Concern – if applicable as per SA 570
- Key Audit Matters
- Managements responsibility for standalone / consolidated financial statements
- Auditors Responsibility for audit of the financial statements
- Report on other Legal and Regulatory Requirements

Relevant changes to text of the audit report

Basis for opinion Para

- ✓ Earlier, the basis for opinion paragraph was required only in case of “modified” audit reports. The basis for opinion paragraph now is mandatorily required to be provided in all the audit reports, whether modified or not.
- ✓ Includes a statement that the auditor is **independent** of the entity in accordance with the relevant ethical requirements relating to the audit

Relevant changes to text of the audit report

Auditors responsibility para has the following major changes:

- ✓ Reasonable assurance has been defined:
Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists.
- ✓ Conclude on appropriateness of managements use of going concern assumption
- ✓ Our conclusions are based on the audit evidence obtained **up to the date of our auditor's report**. However, future events or conditions may cause the Company to cease to continue as a going concern.

Relevant changes to text of the audit report

Auditors responsibility para has the following major changes:

- ✓ We are responsible for the direction, supervision and performance of the audit of the financial statements of such entities included in the consolidated financial statements of which we are the independent auditors. For the other entities included in the consolidated financial statements, which have been audited by other auditors, such other auditors remain responsible for the direction, supervision and performance of the audits carried out by them. We remain solely responsible for our audit opinion. – **Applicable for CFS audit report only**
- ✓ Communication with those charged with governance:
We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that **we have complied with relevant ethical requirements regarding independence**, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

Key Audit Matters – SA 701

✓ **Key audit matters:**

Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

✓ **Why disclose?**

- i. To enhance the communicative value of the auditor's report by providing greater transparency about the audit.
- ii. May also provide "intended users" a basis to further engage with management.

Key Audit Matters

- ✓ A major change from the reporting practices till date. It is applicable to audit reports of **listed entities** only.
- ✓ Key Audit Matters[KAM] have to be given under a separate heading in the audit report.
- ✓ Key Audit Matters Not a Substitute for Expressing a Modified Opinion.
- ✓ Prohibited to be given in case a "Disclaimer of opinion" is given in accordance with SA 705, unless required by law or regulation.

Key Audit Matters

✓ Contents of KAM

The reasons for selecting a particular matter as having most significance in the audit and hence as Key Audit Matter is to be mentioned.

How the key audit matter was dealt with in the final audit report is also to be mentioned under this heading.

Reference to related disclosure in the financial statements to be given.

✓ Determining Key Audit Matters

Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315

Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.

The effect on the audit of significant events or transactions that occurred during the period.

How to arrive at KAM

Matters that were communicated with those charged with governance

Matters that required significant auditor attention

Matters of most significance in the audit

Key Audit matters

Communication with those charged with governance

- ✓ The auditor shall communicate with those charged with governance:
 - (a) Those matters the auditor has determined to be the key audit matters; or
 - (b) If applicable, depending on the facts and circumstances of the entity and the audit, the auditor's determination that there are no key audit matters to communicate in the auditor's report.

Circumstances when Key Audit Matter is not communicated

- ✓ A law or regulation precludes public disclosure of the matter.
- ✓ Where an auditor determines that the adverse consequences of the disclosure being a matter not previously disclosed outweighs the public interest benefits of such communication.
- ✓ Where the auditor has dealt with the matter under modified opinion or with reference to going concern assumption, a cross reference to where this is dealt with in the Audit Report to be given under the heading "Key Audit Matters".
- ✓ Where the auditor determines, depending on the facts and circumstances that there are no key audit matters to communicate, it has to be stated specifically.

Issues arising from KAM reporting

- ✓ While this is mandatorily applicable to both standalone and consolidated financial statements of listed entities, it is optional for subsidiaries / joint ventures / associates of such entities if they are not themselves listed entities.
- ✓ The auditor of CFS will have to consider KAM's from CFS perspective where he himself is the auditor of both standalone listed entity and unlisted component and select KAM's accordingly.
- ✓ Where a different auditor of an unlisted subsidiary takes a view that the provisions of SA 701 is not mandatory and hence KAM is not given, auditor of the consolidated entity will be handicapped. This matter will have to be suitably disclosed in the audit report.

Some examples of Key Audit Matters:

- ✓ Certain complex areas relating to revenue recognition.
- ✓ Provisions and contingencies.
- ✓ Taxation Matters (multiple tax jurisdictions, uncertain tax position, deferred tax assets).
- ✓ Assessment of Impairment.
- ✓ I.T. systems and controls particularly when new software like ERP is implemented.

Key audit matters – International experience

Many countries including UK, two gulf countries and some African countries have already implemented this. UK tends to have largest number of KAMs in their audit report.

Top 10 matters reported as KAMs are give below:

- ✓ Asset impairments (other than goodwill)
- ✓ Revenue (not mentioning fraud)
- ✓ Allowance for doubtful debt
- ✓ Goodwill impairment
- ✓ Taxation, including deferred tax
- ✓ Financial instruments
- ✓ Investments
- ✓ Valuation of inventories
- ✓ Property valuation
- ✓ Insurance

KAM from AstraZeneca PLC Audit report

Key audit matter :

Litigation and contingent liabilities

Refer to page 103 (Audit Committee Report), page 143 (Accounting Policies) and page 183 (Note 28) in the Group Financial Statements.

The pharmaceuticals industry is heavily regulated which increases inherent litigation risk. The Group is engaged in a number of legal actions, including patent litigation, product liability, anti-trust and related litigation.

At 31 December 2017, the Group held provisions of \$654 million in respect of legal claims (31 December 2016: \$438 million).

These provisions are based on judgements and accounting estimates made by management in determining the likelihood and magnitude of claims. Accordingly, unexpected adverse outcomes could significantly impact the Group's reported profit and balance sheet position.

KAM from AstraZeneca PLC Audit report

How our audit addressed the key audit matter :

We evaluated the design and tested the operating effectiveness of controls in respect of the determination of the provisions. We determined that the operation of the controls provided us with evidence over the completeness, accuracy and valuation of the provisions.

We read the summary of litigation matters provided by management and held discussions with the Group's legal counsel. We requested legal letters from some of the Group's external legal advisors with respect to the matters included in the summary. Where appropriate we examined correspondence connected with the cases.

For litigation provisions, we tested the calculation of the provisions, assessed the assumptions against third party data, where available and assessed the estimates against historical trends.

We considered management's judgement on the level of provisioning to be appropriate. We also evaluated the appropriateness of the disclosures in Note 19 and Note 28 which we considered appropriate.

Modifications to Audit report – SA 705

Difference between a “qualified opinion” and a “modified opinion”?

Under SA 705 (Revised) there can be three types of “modifications” to an auditor's opinion:

- (a) a “qualified opinion”,
- (b) a “disclaimer of opinion”, or
- (c) an “adverse opinion”.

So, a qualified opinion is one kind of a modified opinion.

Application Matrix for a modified Audit Report

Nature of matter giving rise to modification	Auditor's judgment about the Materiality and Pervasiveness of the Effects or Possible Effects on the financial statements	
	Material but Not Pervasive	Material and Pervasive
Financial Statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

Amendments to the headings for modification of opinion

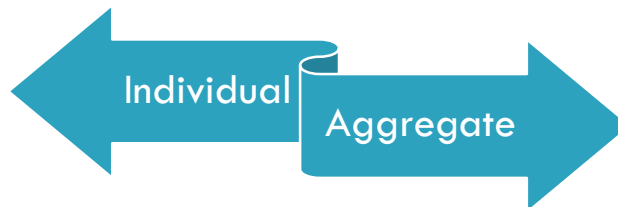
- ✓ When the auditor modifies the audit opinion, the auditor shall use the heading as appropriate, for the Opinion section

Type of opinion	Key words
Qualified Opinion	Except for the effects/possible effects
Adverse Opinion	Significance of the matters
Disclaimer of Opinion	Does not express an opinion

- ✓ The heading "Basis for Opinion" required by paragraph 28 of SA 700 (Revised) to "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate and include a description of the matter giving rise to the modification.

Impact of qualification in audit report

- ✓ If there is a material misstatement of the financial statements that relates to specific amounts in the financial statements (including quantitative disclosures in the notes to the financial statements), the auditor shall include in the Basis for Opinion section a **description** and **quantification** of the financial effects of the misstatement, unless impracticable.



EOM & OM

- ✓ **Emphasis of Matter paragraph [EOM]**– A paragraph included in the auditor’s report that refers to a **matter appropriately presented or disclosed in the financial statements** that, in the auditor’s judgment, is of such importance that it is fundamental to users’ understanding of the financial statements.
 - ✓ report with an appropriate heading that includes the term “Emphasis of Matter”
- ✓ **Other Matter paragraph [OM]**– A paragraph included in the auditor’s report that refers to a matter **other than those presented or disclosed in the financial statements** that, in the auditor’s judgment, is relevant to users’ understanding of the audit, the auditor’s responsibilities or the auditor’s report.
 - ✓ report with an appropriate heading that includes the term “Other Matter”

Exclusions from EOM

An Emphasis of Matter paragraph is not a substitute for:

- ✓ A modified opinion in accordance with SA 705 (Revised) when required by the circumstances of a specific audit engagement;
- ✓ Disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;
- ✓ When SA 701 applies, the matter has been determined to be a key audit matter to be communicated in the auditor's report.
- ✓ **Reporting in accordance with SA 570 (Revised) when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern.**

This is a major change, as going concern related reporting has been covered under SA 570.

Placement of EOM & OM

- ✓ The auditor may consider it necessary to place the paragraph immediately following the Basis of Opinion section to provide appropriate context to the auditor's opinion
- ✓ When a Key Audit Matters section is presented in the auditor's report, an Emphasis of Matter paragraph may be presented either directly before or after the Key Audit Matters section, based on the auditor's judgment

Order of Para's

- ✓ Opinion
- ✓ Basis of opinion
- ✓ Emphasis of matter
- ✓ Key audit matters
- ✓ Other matter
- ✓ Responsibilities of management
- ✓ Auditor's Responsibilities
- ✓ Report on other legal and regulatory

Matters that are usually dealt in EOM & OM

EOM

- Change in significant accounting policy
- A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report
- Impairment test / long term strategic investments
- CFS excludes entities which are fully impaired

OM

- Change in auditor - previous year's figures
- Unaudited accounts of group entities in CFS
- Audit of branches done by other auditors

Common example of OM Para

Other Matter

We did not audit the financial statements/ information..... (number) branches included in the stand alone financial statements of the Company whose financial statements/financial information reflect total assets of Rs. as at 31st March 20XX and the total revenue of Rs. for the year ended on that date, as considered in the standalone financial statements/ information of these branches have been audited by the branch auditors whose reports have been furnished to us, and our opinion in so far as it relates to the amounts and disclosures included in respect of branches, is based solely on the report of such branch auditors.

Our opinion is not modified in respect of these matters.

SA 720 – Other information reporting obligations

What is Other information

Financial or non-financial information (other than financial statements and the auditor's report thereon) included in an entity's annual report.

What to look for

Consider whether there is a material **inconsistency** between the other information and the financial statements including audit evidence and conclusion reached.

Examples of other information

- ✓ Board of directors report
- ✓ Management discussion
- ✓ Corporate governance report
- ✓ Chairman' statement

SA 720 – Other information reporting obligations

Reporting obligations

- ✓ Include a Para titled "Other information".
- ✓ Mention if he have received or not received the "other information" prior to audit report date.
- ✓ Accordingly conclude on the matter, if there is a material inconsistency, we need to state the same.

Report on other legal and regulatory requirements

Matters that are covered under regulatory reporting para:

- ✓ CARO reporting
- ✓ 143(3) including IcoFR.
- ✓ Rule 11 Companies (Audit and Auditors) Rules, 2014

Key Changes to CARO 2016

- ✓ Whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof.
- ✓ Compliance with section 185 & 186 in case of loans, investments and guarantees.
- ✓ Compliance with section 177 & 188 for related party transactions
- ✓ Payment of managerial remuneration in accordance with applicable regulation.
- ✓ Default of payments to "Government" now added.
- ✓ Frauds on the Company by the employees/officers.
- ✓ Non cash transactions with directors compliance u/s 192.
- ✓ Requirement to register under Sec.45-IA of RBI Act, 1934.

Net worth for applicability

- ✓ In case of debit balance of profit and loss, the same shall be netted for computing reserves & surplus. To summarise, total of reserves and surplus as disclosed in the financial statements should be considered in evaluating the threshold.
- ✓ So entities that have PUC higher than 1 crore but with accumulated losses may escape from the CARO reporting, if the net worth is below 1Crore, provided the other limits are not triggered. This is a change from the earlier position that the Guidance note had taken.

143(3) – Specific clauses

Clause (b)

- ✓ Proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him.

Rule 3 of Cos. Accounts Rules, 2014

The books of account and other relevant books and papers maintained in **electronic mode** shall remain accessible in India so as to be usable for subsequent reference.

back-up of the books of account and other books and papers of the company maintained in electronic mode, including at a place outside India, if any, **shall be kept in servers physically located in India on a periodic basis.**

143(3) – Specific clauses

Clause (f)

- ✓ *the observations or comments of the auditors on financial transactions or matters which have any **adverse effect on the functioning** of the company;”*

Guidance from ICAI on reporting

- ✓ The auditor would now have to evaluate the subject matters leading to “**modification**” of the audit report or “**emphasis of matter**” in the auditor’s report to make judgement as to which of them has an adverse effect on the functioning of the company within the overall context of audit of financial statements of the company.

Examples of 143(3)(f) reporting

- ✓ Material uncertainty regarding going concern
- ✓ Material uncertainty regarding the outcome of a litigation

Clause 143(3)(h)

- ✓ any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;"

Guidance from ICAI on reporting

- ✓ The auditor would need to report under clause (h) of section 143(3) any matter that causes a **qualification, adverse remark or disclaimer of opinion** on the financial statements since such matters will or possibly will have an effect on the books of account maintained by the company.

ICAI announcement on Reporting on Components [CFS]

Component	Component is Material to financial statement (Yes / No)	Disclosure in Principal Auditor's Report
Unaudited	No	Optional disclosure [if reported, 'Other Matters']
Audited by another auditor	No	Optional disclosure [if disclosed, 'Other Matters']
Audited by another auditor	Yes	Disclosure to be made in 'Other Matters'
Unaudited	Yes	Report to be modified



Thank You