KPMG

Key Audit Matters

Auditor’s report snapshot 28 March 2017

Our third auditor’s report snapshot[1], provides insights and observations on Key Audit Matters from 56 entities in the ASX 500[2] with 31 December 2016 year ends. Key Audit Matters (KAMs) are those matters that required significant auditor attention in performing the audit, and are communicated in auditor’s reports of listed entities[3].

Reports by industry

ENR	Financial	TMT	Corporates	IGH
21	12	13	7	3
Energy & Natural Resources	Financial Services	Technology, Media & Telecommunications		Infrastructure, Government & Health

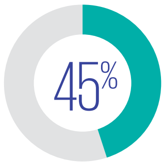
KAMs by industry sector

	ENR	Financial	TMT	Corporates	IGH	Total
Goodwill and intangibles	2	5	10	6	2	**25**
Revenue		5	4	2	2	**13**
Acquisitions	1	1	7	3	1	**13**
Taxation	6	2	4			**12**
Provisions	8	1		1		**10**
Exploration & Evaluation	10					**10**
Other non-current assets	7			3		**10**
Other	2	3	4			**9**
Inventory	5	2	1	1		**9**
Investments	2	3	1		2	**8**
Other liabilities	2	4		2		**8**
Going concern related	7					**7**
Property investment		5				**5**
Hedging/Derivatives		3			2	**5**
PPE	4					**4**
Interest bearing liabilities		2		1		**3**
Expenses			1		1	**2**
Other current assets	1			1		**2**
Total	**57**	**36**	**32**	**20**	**10**	**155**

With 56 audit reports released[2], the top 4 Key Audit Matter (KAM)[3] topics represent over 40 percent of all KAMs communicated.

KAM topic

Goodwill and Intangibles



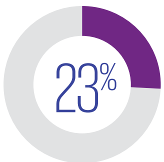
Industry sector

Observations

- The most common KAM relates to carrying value assessments or impairment of Goodwill and Intangibles.
- Over 70 percent of entities present it as the first KAM, giving it prominence and significance.
- Technology, Media and Telecommunications (TMT) and Corporate sector entities are almost twice as likely as Financial Services (FS) entities to include this KAM, with an approximate 80 percent inclusion rate.
- Common reasons cited as driving the greater auditor attention include the significance of the balances, the requirement to test goodwill annually for impairment, and the significant judgment associated with forward-looking estimations in valuation models. These assessments can be particularly challenging in sectors experiencing constrained economic conditions.

KAM topic

Acquisitions



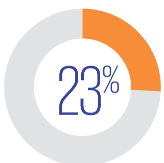
Industry sector

Observations

- Over half of all Acquisition KAMs arise in the TMT sector, and in 54 percent of all TMT audit reports reviewed. Second is the Corporates sector, making up nearly a quarter of all acquisition KAMs, and figuring in 43 percent of Corporates audit reports.
- This is likely reflective of the increasing consolidation and globalisation activity, combined with rapid innovation, impacting these sectors. We note the link to the prior observation, in these same sectors, of KAMs for impairment of Goodwill and Intangibles from previous acquisitions.
- Auditors are focused on the significant judgments associated with separately identifying intangibles and fair valuing assets acquired. These assessments involve estimates of future performance expectations and attract greater auditor effort as the entities often do not have the benefit of historical experience operating the acquired business.

KAM topic

Revenue



Industry sector

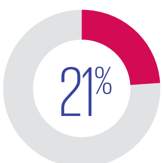
Real Estate

Observations

- 42 percent of entities in the FS sector reported a KAM on Revenue, primarily resulting from the audit effort applied to assessing stage of completion estimations common in real estate industry revenue recognition policies.
- We expect Revenue KAMs to increase as entities adopt AASB 15 *Revenue from contracts with customers*. Incremental audit attention will be applied addressing the significant developments in entities accounting and reporting for revenue, and its pervasiveness to their financial report.

KAM topic

Taxation



Industry sector

Observations

- Half of all Taxation KAMs feature in the Energy and Natural Resources (ENR) sector. Specific auditor focus is assessing recognition and recoverability of deferred tax assets, featuring in 42 percent of Taxation KAMs. Other reasons cited by auditors are foreign tax jurisdictional matters and the operation of the petroleum resources rent tax. Tax specialist assistance is often sought by auditors in these circumstances.

Energy & Natural Resources (ENR) industry sector deep-dive

1. Almost 40 percent of audit reports analysed are for entities in the ENR sector, the largest overall sector represented, including Oil & Gas.
2. 38 percent included KAMs on provisions – all relating to the challenge auditing estimations of remediation and restoration obligations, which may be many years into the future.
3. The prevalence of KAMs on the assessment of Exploration & Evaluation capitalised expenditure is expected with 60 percent from the Oil & Gas sub-sector.
4. Taxation KAMs feature in nearly one-third of entities.
5. One third of ENR entities communicate going concern in their audit report. Seven KAMs relate to going concern type matters with a focus on funding. While the auditor has not concluded there is a material uncertainty related to going concern, the movements in commodity prices and assessing the impact to the financial performance and position of the entity, attracted additional audit effort. Two auditors highlight a Material Uncertainty Related Related to Going Concern[4] in their auditor's report.
6. Other common KAMs include valuation of inventory (mainly ore stockpiles) and impairment of other non-current assets. Stockpiling for longer, in the hope the commodity prices increase, can lead to additional valuation concerns for auditor focus.

Comparison to previous auditor's report snapshots

	Observed in 30 September 2016 Series 2 snapshot	Status now	Comment
Number of enhanced audit reports	18	56	– All 18 reports reviewed in our previous snapshot voluntarily adopted the new auditing standard communicating KAMs, ahead of the required timetable.
Number of KAMs	**Low 1 High 7 Average 3**	**Low 1 High 5 Average 2.8**	– Eight auditors reported the KAM low of one, compared to one previously – Six auditors reported the KAM high of five, compared to one reporting the previous high of 7 – We note no correlation of higher market capitalisation to the highest number of KAMs, and no industry sector has a significantly different average number of KAMs. – This variability is a positive indicator auditors are tailoring the selection of KAMs to the conduct of their audit of that client, without influence of absolute size or profile of the entity.
Nature and headlines of KAMs	**Bespoke to the audit of the entity**	**Bespoke to the audit of the entity**	– Few KAMs were selected for complex accounting matters, such as financial instruments, without consideration as to their contextual relevance to the financial report, such as significance and risk of error. We see this as a positive indicator auditors are selecting KAMs based on their relative audit effort, which may not equate directly to matters of traditional accounting complexity. – We expect the wide-scale adoption of the new accounting standards, such as AASB 16 *Leases* and AASB 15 *Revenue from contracts with customers*, to feature in future KAMs given the additional audit effort applied for these significant developments in financial reporting measurement and presentation.
Taxation KAMs	3	12	– We previously predicted a greater number of KAMs related to taxation arrangements given the complexity in the Australian taxation system and calls for transparency, and this appears to be occurring.

Other observations on the auditor's report

1. Three audit reports included a Material Uncertainty Related to Going Concern[4]. None included Emphasis of Matter or Other Matter[5] sections. No auditor excluded KAMs due to law or regulation precluding such disclosure or based on an assessment the disclosure would cause adverse consequences outweighing the public interest benefits[6].

2. Gone are the days of the historical two page auditor's report! The average length of enhanced auditor' reports was 5.3 pages. The increase in length is influenced by a number of factors:

   – The inclusion of KAMs.

   – One firm reporting materiality and scoping applied in their Australian audits. This is not contemplated in the Australian Auditing Standards (ASAs) and ISA equivalents, however is a requirement of UK auditing standards. The most common materiality applied is 5 percent of adjusted profit before tax.

   – Most firms have not taken advantage of the option[7] of removing standardised text from the auditor's responsibilities section and cross referring to the full descriptions contained on the website of the Australian Auditing and Assurance Standards Board. This adds approximately one extra page to the length of the auditor's report.

The implementation of KAMs is the biggest change to auditing standards and the audit report since the introduction of the clarity standards in 2004.

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.

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1. Series 1 Auditor's Report Snapshot issued on 31 August 2016 highlighted our observations from 16 enhanced audit reports published for 30 June 2016 audits, adopting early the requirements of ASA 701 *Communicating Key Audit Matters in the Independent Auditor's Report*. Series 2 Auditor's Report Snapshot issued on 30 September 2016 updated Series 1 for further early adopters and trends exhibited thereon.
2. Based on auditor's reports KPMG viewed between 1 January and 28 March 2017 of ASX 500 with 31 December 2016 year ends applying exclusively the Australian auditing standards.
3. Key Audit Matters (KAMs) are those matters that required significant auditor attention in performing the audit, ASA 701 *Communicating Key Audit Matters in the Independent Auditor's Report*, as issued by the Australian Auditing and Assurance Standards Board. ASA 701 is operative for the audits of general purpose financial reports of listed entities with years ended on or after 15 December 2016. Enhanced audit reports are those including Key Audit Matters. The description of the KAM addresses why the matter was considered to be a key audit matter and how the matter was addressed in the audit.
4. Material uncertainty related to going concern determined by reference to conditions or events assessed in accordance with ASA 570 *Going Concern*.
5. Emphasis of matter or Other matter paragraphs determined by reference to ASA 706 *Emphasis of matter paragraphs* and *Other matter paragraphs in the Independent Auditor's Report*.
6. ASA 701 paragraph 14 exclusion criteria.
7. The ASAs allow these descriptions to be included in the body of the auditor's report, within an appendix to the auditor's report, or by a specific reference within the auditor's report to the location of such a description on a website of an appropriate authority.