

Key Audit Matters

Auditor's report snapshot

6 July 2017

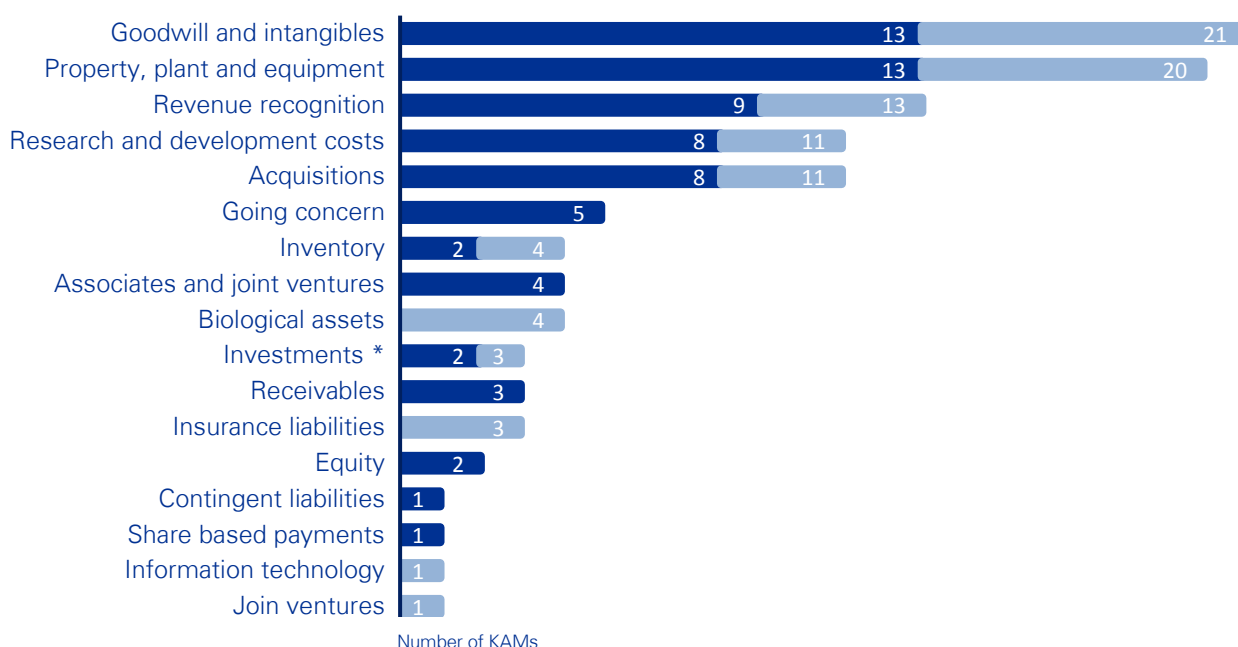


March 2017 was the second significant period end where NZX listed entities had to issue new style audit reports including Key Audit Matters (KAMs). This snapshot provides insights into those KAMs and emerging trends in the new style reporting. Below are the themes from the 58* entities listed on the NZX which had year-ends in the first quarter of 2017 that reported KAMs.

Reports by industry



KAMs by topic



The above dark blue bars show the number of KAMs reported in audit reports released since January 2017. The light blue bars show the cumulative KAMs reported in the audit reports that have been released to the NZX since December 2016.

* Included in the 58 entities were 23 individual unit trusts, all with the same manager and auditor. All 23 unit trusts reported one KAM each, which related to the valuation of Investments. To avoid skewing the results of this analysis, these funds and their related KAMs have been grouped together and treated as one entity.

With 36* March balance date audit reports released, the top 5 Key Audit Matter topics represented 71 percent of all KAMs communicated.

KAM topic

Goodwill and Intangibles



Observations

- Consistent with the December snapshot, KAMs relating to Goodwill and Intangibles remain the most reported KAM.
- However unlike December, no Financial Services (FS) entities reported Goodwill and Intangibles as a KAM. Instead, Corporates reported this as a KAM for the first time. Infrastructure, Government and Health (IGH) continued to include this KAM.
- Out of the 13 KAMs on goodwill and intangibles, 6 specifically cited the use of valuation experts when describing how the KAM was addressed.
- While this continues to be the most reported KAM in audit reports published to date, do not default to thinking it is always considered a KAM. KAMs are defined as those matters that, in the auditor's professional judgment, were of *most significance*. This consideration is therefore relative to the audit for a particular year.

KAM topic

Property, Plant and Equipment (PPE)



Observations

- As with Goodwill and Intangibles, PPE remains to be one of the most reported KAMs in audit reports to date.
- The majority of PPE KAMs for the March period relate to the valuation of investment properties (7 out of 13). This is a change from December where the majority of PPE KAMs related to the valuation of Land and Buildings.
- See the deep dive below on the valuation of investment properties.

KAM topic

Revenue Recognition

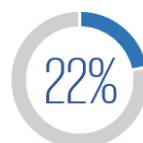


Observations

- Revenue recognition continues to be reported across a range of industries, with FS being the only industry that did not include Revenue Recognition as a KAM.
- One of the KAMs relating to Revenue Recognition was in response to the early adoption of IFRS 15 – Revenue from Contracts with Customers. When this standard becomes mandatory, we expect to see an increase in KAMs relating to Revenue Recognition.

KAM topic

Acquisitions



Observations

- March 2017 was the first period where Acquisitions made it into our top KAMs analysis and was reported across four of the five industries for the March period.
- Included in the eight acquisition KAMs are one restructuring and two demerger scenarios.
- Five of these KAMs included discussion around the effort required to determine whether the accounting treatment was correct.

KAM topic

Research and Development Costs (R & D Costs)



Observations

- As with Acquisitions, this is also the first time R & D Costs were one of the top reported KAMs. KAMs relating to R & D Costs and Acquisitions replace KAMs relating to Biological Assets in the top five when compared to December.
- This was reported across the IGH, Technology, Media and Telecommunications (TMT) and Corporates industries. One common theme amongst all entities that had this KAM was how central technology was to their business, with most of these KAMs relating to the capitalization of software development costs.

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Deep dive – Investment Properties

With seven KAMs on the valuation of investment properties, this gives us the opportunity to look more closely at this KAM in particular. The types of properties included in this KAM varied between retail, office, industrial and retirement villages.

- Three of the seven KAMs stated the entities policies of obtaining a valuation from an independent valuer. Two of those had a policy to engage valuers every year, the other had a policy to engage valuers every two years.
- All properties appear to have had an independent valuation performed in the current year, with the exception of one. This one KAM included four properties that were subject to a sale and purchase agreement with a deferred settlement date.
- Two KAMs specifically stated that the valuers were rotated so that no valuer performs the same property valuation for more than three consecutive years.
- One KAM discussed the impact of the recent earthquakes.
- Three KAMs stated that the auditors met with the valuers to better understand the methodology, discuss and challenge the assumptions used.

Other key statistics



Included materiality



Included Scoping



Included Findings



Average pages per report



Average KAMs per report

Other observations on the auditor's report

- Of the 36* new style audit reports reviewed, there was one audit report with no KAMs. The reason cited for not reporting any KAMs was that due to the simple nature of the Company's operations, it was determined that there were no KAMs to report. This provides the first example of ISA (NZ) 701, paragraph A59, which states that in certain limited circumstances (e.g. entities with very limited operations) the auditor may determine that there are no KAMs to report. Whilst this is meant to occur in rare circumstances, we do expect to see this occur more in the future when the requirements to include KAMs is applied to a wider range of entities.
- This was also the first time that a new style audit report included a *Material Uncertainty Related to Going Concern* (MURGC). This is the new name for an Emphasis of Matter related to going concern. Three entities included a MURGC. ISA (NZ) 706 highlights the subtle difference between matters which are considered to require significant auditor attention (i.e. KAMs) and matters which, in the auditor's judgement, are fundamental to the users' understanding of the financial statements. This creates an interesting situation where matters which are material to the financial statements are not disclosed as a KAM as a MURGC discusses the reason for the uncertainty, but not how the auditor addressed the issue.

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- Included in the 58 entities within the March period were two entities that had early adopted the new style audit reports in previous years, making this their second time to report KAMs. Of the two, one reported different KAMs than in the previous year, highlighting that auditors determination of matters *requiring significant attention* is determined individually for each audit.
- There were a number of KAM topics included in the March 2017 period that were not reported on in December. These were Contingent liabilities, Equity, Going concern, Receivables and Share based payments. These represents the fact that there were significantly more entities reporting KAMs at March when compared to December.

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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