

# XRB ALERT

## 2020 - 4



## Auditor communication in the COVID-19 environment

HERE WE EXPLAIN THE TOOLS FOR AUDITORS TO USE IN THE AUDITOR'S REPORT TO ENHANCE COMMUNICATION WITH USERS—SPECIFICALLY IN RESPONSE TO THE LIKELY IMPACT OF COVID-19 ON THE AUDITOR'S REPORT.

IN THIS ALERT WE FOCUS ON:

- REPORTING KEY AUDIT MATTERS
  - USE OF EMPHASIS OF MATTER PARAGRAPHS
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- ✓ YOU CAN REFER TO XRB ALERT 1 FOR INFORMATION ON MODIFICATIONS TO THE AUDITOR'S OPINION
  - ✓ YOU CAN REFER TO XRB ALERTS 2 AND 3 FOR INFORMATION SPECIFIC TO GOING CONCERN.

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### DISCLAIMER

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## REPORTING KEY AUDIT MATTERS (KAMS)

### [ISA \(NZ\) 701](#) Communicating Key Audit Matters in the Independent Auditor's Report

The reporting of KAMs responds to calls from users for the auditor to provide more insights about the audit process.

Auditors will consider the impact of COVID-19 when reporting KAMs. The importance of transparent communication is heightened in the current environment to enhance confidence in the audit process and the financial statements.

KAMs provide a basis for users to further engage with the entity.

## WHEN ARE KAMS REPORTED?

Auditors of Financial Market Conduct (FMC) reporting entities considered to have a higher level of public accountability are required to report KAMs in the auditor's report.

The auditor is prohibited from reporting KAMs if the auditor disclaims an opinion.

Auditors may voluntarily communicate KAMs for other entities.

## WHAT SHOULD BE REPORTED AS A KAM?

KAMs provide an opportunity to share the matters that, in the auditor's judgement, were of most significance in the audit of the financial statements.

KAMs are selected from matters communicated with those charged with governance.

The auditor is required to:

- Identify the KAM.
- Refer to related disclosure(s), if any, in the financial statements. This helps the user understand how the entity has addressed the matter.
- Explain why the matter is a KAM.
- Say something about how the KAM was addressed in the audit.

The specifics of the description are left to the judgement of the auditor.

## HOW DOES COVID-19 IMPACT ON THE REPORTING OF KAMS?

Considering the uncertainties regarding future impacts of COVID-19, auditors may address the risk of that uncertainty in KAMs. Additional focus may be needed in determining what and how to report KAMs. The effect on the entity's financial position or performance could significantly impact on the audit procedures undertaken, especially where there are significant management judgements.

New types of KAMs—not previously seen—requiring significant auditor attention may arise due to:

- Difficulty in obtaining audit evidence, e.g. inventory existence.
- Specific events or transactions that impact financial statement items in different ways, give rise to new items or transactions, or unusual or once off transactions may arise, e.g. expected credit losses in assessing doubtful debt provisions due to COVID-19.

KAMs previously reported may be impacted by:

- New responses to how the KAM was addressed, e.g. how the change in the risks caused by COVID-19 has impacted the audit approach.
- Expanded KAMs around disclosures and particular scenarios and sensitivities.
- Re-ordering the KAMs with the most important KAM as the first KAM.
- Repositioning where KAMs are included in the auditor's report.

## WHAT IS NOT REPORTED AS A KAM?

If the auditor includes a Material Uncertainty Related to Going Concern (MURGC) section, this by its very nature is likely to meet the definition of a KAM, however it is not described in the KAM section of the Auditor's Report. Rather a MURGC section is required to communicate this going concern matter that is important to user's understanding of the financial statements in its own section with its own heading<sup>1</sup>.

"Close calls", where the auditor identifies conditions which cast doubt over going concern, but where audit evidence confirms that no material uncertainty exists, may be reflected as a KAM. You can refer to [XRB Alert 1](#) as well as [ISA \(NZ\) 570](#) (Revised) and [ISA \(NZ\) 705](#) (Revised)<sup>2</sup> for more detailed information.

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1 ISA (NZ) 570 (Revised), *Going Concern*, paragraph 22 and A28

2 ISA (NZ) 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*

## USE OF EMPHASIS OF MATTER (EOM) PARAGRAPHS

An auditor may consider it necessary to draw users' attention to specific disclosures in the financial statements, which they consider are so important that it is **fundamental to users' understanding** of the financial statements, by including an EOM paragraph in their auditor's report (refer to [ISA \(NZ\) 706 \(Revised\)](#)<sup>3</sup>).

What is considered "fundamental to users' understanding of the financial statements" is a matter of the auditor's professional judgement and is specific to the entity's circumstances.

The EOM refers to:

- the matter being emphasised;
- where the relevant disclosures can be found in the financial statements; and
- states that the auditor's opinion is not modified in respect of the matter.

Auditors should remain mindful that widespread use of EOM paragraphs may diminish the effectiveness of the communication of such matters.

The placement of EOM paragraphs in the auditor's report depends on the nature of the information to be communicated, and the relative significance of the matter.

An EOM is not used when a matter is already communicated as a KAM or if the audit opinion has been modified

If KAMs are not communicated, the auditor may communicate how COVID-19 impacted the audit using an EOM if appropriate to the circumstances. If KAMs are reported and a matter meets the definition of a KAM and an 'Emphasis of Matter', it is reported as a KAM only. This allows the auditor to include additional information in the description of the KAM.

Auditor judgement is needed in deciding when to use an EOM. It is important that they are not overused.

An EOM is used only where the auditor wants to draw users' attention to a matter they believe is of fundamental importance to the users' understanding of the financial statements.

Examples of circumstances where the auditor might consider it necessary to include an EOM paragraph include:

1. An entity discloses information about the impact of COVID-19, however no MURGC exists. If this matter does not meet the criteria of a KAM, or if KAM reporting is not required, an EOM might be used to highlight the disclosure if the auditor considers the information is fundamental to the users' understanding.
2. A significant subsequent event, and a major catastrophe that has had, or continues to have, a significant effect on the entity's financial position<sup>4</sup>. Going into lock down, and the impact on uncertainty due to COVID-19, between the date of the financial statements and the date of the auditor's report might be an example of a significant subsequent event.

3 ISA (NZ) 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*

4 ISA (NZ) 706 (Revised), paragraph A5

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