

XYZ INSTITUTE OF AUDITING & ASSURANCE

Assignment on Auditing, Assurance and Services

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Assignment Title: : Auditing, Assurance & Services

Due Date : 17th of May 2018

Date of Submission : 17th of May 2018

Word Length : 2500

Executive Summary

As said in an interview by a Cyprus auditor "Auditors are not trying to hide anything, and the fact that KAMs (Key audit matters) are now disclosed in audit report makes more transparent the matter they had in mind in the prior year as well."

For years, it has been criticized that the audit reports that come from the company's audit firms provide very little information for the investor. An investor wants to see his money grows with the risk that is ascertained to him and he expects audit reports from the audit firms to provide that certainty. If the investor is not able to understand the major threat to the company that he is planning to invest, his reward will not match the risk and reward principle.

The concept of a KAM was borne out of investor demand for more detail on the audit process: more contextual information to help investors differentiate between a large number of companies that receive clean audit reports. With new auditing standard "**ASA 701 Communicating Key Audit Matters in the Independent Auditor's Report**" the auditors require to set out those matter in the audit report "that was of most significance in the audit of the financial statements" conducted by him. Due to the introduction of this auditing standard, there will be a comprehensive change in the existing audit report format. However, as of now, ASA 701 is applicable only to the listed companies.

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Definition

As Per ASA 701 the Key Audit matter means "those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial report of the current period. Key audit matters are selected from matters communicated with those charged with governance."

"(Auditing & Assurance Standards Board,2015. [online] Available at: http://www.auasb.gov.au/admin/file/content102/c3/ASA_701_2015.pdf"

Introduction

KAM are those matters which according to the auditor's professional judgment, requires significant attention while performing the audit. KAM are selected from matters which are communicated to the management or those charged with governance and can be determined by taking into account areas of high risk, auditor professional judgment. KAM can be few of the things which affect the company in its revenue, market value, or its existence in term of going concern. KAM can be different based on the industry it is operating or its location. Few common KAMs are revenue recognition, goodwill, and intangibles, Loans and receivables, Investment valuation, taxation etc. But each industry or specifically each company could have its unique key audit matters as per the professional judgment of the auditor. i.e., Investment valuation can be a significant KAM for an infrastructure company but not that significant for a technology company.

The AUASB have issued the Auditing Standard ASA 701 Communicating Key Audit Matters in the Independent Auditor's Report. The main features of this standard include :

- Making mandatory the communication of KAM in the auditor's report for the audit of listed companies.
- How the auditor need to determine the KAM;
- How the auditor is to decide individual KAM;
- In which circumstances the matter identified as KAM is not communicated in the auditor's report; and
- Requirement of audit document relating to KAM.

Case Study

Taking my research forward in the given topic, I went through the annual report of few of the companies listed in ASX Top 100 for the year 2017, i.e. Asx Limited (Financial Sector) , Aurizon holdings limited (Industrial Sector), Bank of Queensland (Financials Sector), Commonwealth bank (Financials Sector), and Ramsay Health care (Health Care Sector). All sectors could have their unique key audit matters based on the professional judgment of the auditors. Few common KAM for all industries might be goodwill and intangibles, or revenue recognition, or it can be investment valuation.

"[online] Available at: <https://www.asx100list.com/>"

In my research, I have selected healthcare industries as it is one of the booming industries in today's scenario and covers market cap weight of 8.87% of the Top 100 ASX listed companies and it is one of the hot favorites for the investors. Healthcare industry is the fourth largest contributor to nations GDP is a good industry to look at. Healthcare Industry operates through a chain of networks and involves a lot of manpower resources and technology. Also, healthcare industry is a trust-based industry and mainly driven by its goodwill in the market. So, healthcare industry could have a lot of Key Audit Matters that a investor would be interested in. In my research, I deeply went through the Annual report of the companies which are qualified in ASX Top 100 list and are operating in healthcare sector. The companies I found in the list are:

1. **Ansell Limited (ANN)** "(annual report 2017 [online] Available at: <http://sc-cdn-prod.azureedge.net/-/media/Corporate/MainWebsite/About/Investor-Center/Annual-Report-2017/Ansell-Annual-Report-2017-FINAL.PDF?la=en&modified=20170823225606>)"
2. **Cochlear Limited (COH)** "(annual report 2017 [online] Available at: https://www.cochlear.com/b0dffcb0-9826-4c99-9d58-ad7a760bddac/en_corporate_cochlear_annualreport2017_1.78mb.pdf?MOD=AJPERES&pp;CONVERT_TO=url&CACHEID=ROOTWORKSPACE-b0dffcb0-9826-4c99-9d58-ad7a760bddac-ITJByF)"
3. **CSL Limited (CSL)** "(annual report 2017 [online] Available at: [http://annualreport.csl.com.au/docs/802/1/CSL_AR17%20\(secured\).pdf](http://annualreport.csl.com.au/docs/802/1/CSL_AR17%20(secured).pdf))"
4. **Health scope Limited (HSO)** "(annual report 2017 [online] Available at: http://healthscope.com.au/application/files/3715/0344/5418/HS_Annual%20Report%20FY17_v15_FA_low.pdf)"

Key Audit Matters in annual return 2017 for :

1. Ansell Limited

Ansell Limited is well known for its surgical gloves and other surgical instruments which are used in the healthcare industry. The company has major shares of its asset in the form of goodwill and brand names (approx 40%). As one of the key strategies of the company is organic growth through new product development and new products have the inherent uncertainty of the performances which increases the risk of impairment. Also, Ansell Limited operate in worldwide tax environment in different countries and jurisdictions. The structure of the company reflects the nature of its operations which is mainly driven by acquisitions and mergers. Acquisitions and mergers are always being a tax litigated issue.

So the key audit matter here which are identified here are:

- Valuation of goodwill and brand name of the company; and
- Taxation issues.

Valuation of goodwill and brand names

Identification as KAM

Valuation of goodwill and brand names are always based on assumptions. These assumptions should be substantiated by the performances and result of the company. Auditing a forward looking assumption is always complex for auditors. The key assumptions in valuation of goodwill through cash flow model includes forecasting revenue growth rate, in particular growth rate from newly launched product, terminal growth rate and discount rates. These assumptions are purely based on management judgement which is very difficult to audit and hence valuation of goodwill is of great significance in the audit process and can be identified as KAM.

How the matter to be addressed in audit

As valuation of goodwill is a KAM for Ansell Ltd the auditor should address this issue by auditing the prior period cash flows forecasts of the company taking into considerations the significant judgements made by the management. For this purpose the auditor may involve valuation specialists for assessing the reasonableness of the discount rate taken by the management.

Taxation

Identification as KAM

Ansell Limited is operating in number of tax jurisdictions and each jurisdiction has its own tax complexities and different taxing rules. Moreover the company is also involved in the cross border arrangements with its group companies which would also need to be seen from the angle of transfer pricing which requires a huge compliances and transparency.

How the matter to be addressed in audit

The auditors shall address this issue by considering tax advice from external tax advisors or tax advisors from different tax jurisdictions. Auditors may also assess the completeness of the tax provisions by communicating from the tax authorities, including the status of recent and current tax authority audit and enquiries or from the outcomes of previous tax audits by the local tax authorities.

2.. Cochlear Limited

Cochlear limited is a medical device company that design, manufactures and supplies devices like hearing implantable. The company sells its product all over the world to different type of customers and collection of trade receivable is always a important factor for the company. Moreover to keep up with the evolving medical industry the company is constantly evolving new products which are of different designs and shapes and each comes with a warranty period which is different for each product. Ascertaining the warranty cost and that for its global business is itself a complex task. This year company have also made a huge investment in acquiring Sycle LLC and it is one of the significant transaction of the company in the year.

So the key audit matter here which are identified here are:

- Recoverability of trade receivables,
- warranty provisions, and
- Business acquisition.

Recoverability of trade receivables

Identification as KAM

Recoverability of trade receivables was considered a key audit matter due to the reason that company has wide range of individual customers which are in different geographic location and company makes credit sales to many of its customers. While going through the accounts it was observed that some customers have higher sales outstanding considering the company's average which is a significant risk.

How the matter to be addressed in audit

The auditor shall address the issue by testing key control process including credit account application approvals and credit limit assessments, and assessing the recoverability of a sample of outstanding trade receivable balances across different geographical area and comparing it to the other companies in the trade.

Warranty Provisions

Identification as KAM

The warranty provision was considered a key audit matter due to the estimation of uncertainty inherent in the Consolidated Entity's key assumptions applied. As the company

has acquired Sycle LLC this year and Sycle LLC has sold its product under warranty in prior years. As there is no certainty of the warranty claims it can be considered a significant KAM.

How the matter to be addressed in the audit

The auditor shall address the issue by obtaining an understanding of the evolving product portfolio, each product's warrantable period and history of failure rates, and different attributes that impacted in making key assumptions in the calculation of warranty provisions.

Business Acquisition

Identification as KAM

The company has acquired Sycle LLC this year and which cost company a significant investment and it is one of the single largest transaction of the company in the year involving amount of US\$ 79.5 million. The size of this transaction has a pervasive impact on the financial statements and hence it is identified as KAM.

How the matter to be addressed in the audit

The auditor shall address the issue by reading the purchase agreement signed and other associated side agrrements related to the acquisition to understand the term and conditon implied while entring into the arrangement. The auditor shall also take help from the valuation sepcialist to determine the justification of considertion paid for acquisition.

3. CSL Limited

CSL limited is a company which is engaged in the activity of research, development, manufacturing and marketing of pharmaceutical specially biopharmaceuticals. The company has a major share of its asset in the form of inventory. Being in the pharmaceutical industry the company's inventory have limited rack life of its product and there are great chances that the inventory can realize less than the net realizable value expected by the mangement.

So the key audit matter here which are identified here is:

Valuation of Inventory

Valuation of Inventory

Identification as KAM

The accounting for inventories is complex as the company has to follow the strict guidelines regarding the quality and efficacy of the product due to the nature of product. Due to this there is always a chance that the inventory could be valued at greater amount than what is actually recoverable. Moreover the inventories are spread in different geographical location. So it makes the audit process very complex in determining the reliability of provisions for obsolescence made against the inventory.

How the matter to be addressed in the audit

The auditor shall assess the carrying value of the inventory, including costing and provision for obsolescence and net realizable value. Auditor shall also assess the provision for obsolescence as whether the provision justify the known quality issues and commercial consideration in accordance to Australian Accounting Standards, and consistent application from prior periods.

4. Health Scope Limited

Health scope limited is in the business of operating private hospitals, medical centres and international pathology centres. The company have mainly business in Australia. The company has many hospitals and Geelong Private Hospital is also one of the venture of the company. Due to the continuous competitive pressure in the local area of Geelong Private Hospital the financial position of the hospital has declined over the years.

So the key audit matter here which are identified here is:

Carrying Value of the Geelong Private Limited

Carrying Value of the Geelong Private Limited

Identification as KAM

Due to the financial performance of Geelong Private hospital the management undertook the impairment assessment for the hospital and recognized the impairment loss of \$ 11.5 million in relation to the plant and machinery that cannot be transferred to the other sites. It can be identified as KAM due to the judgement of management required to determine the recoverable amount.

How the matter to be addressed in the audit

The auditor shall obtain an understanding of management's process to assess the recoverable amount and about the market condition and future cash flows. The auditor should also use his professional judgement to see if the asset transferable as per management is actually transferable or not.

Conclusion

From above discussions it can be said that ASA 701 Communicating Key Audit Matters in the independent Auditor's Report is very useful to the investors as it makes auditors to disclose the transactions which are assessed to higher risk or any event which would have high impact on company's ability to continue as Going Concern It will require auditors judgement to determine whether the transaction is of most significance and how the auditor have dealt with the transaction. It will give a clear cut idea of the company's current position and whether the assumptions made by the management are practical or not.

ASA 701 will provide more transparency in the audit report and help the investors to decide whether to invest in the company or not.

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