AN ANALYSIS OF THE NATURE OF KEY AUDIT MATTERS AS DISCLOSED BY THE AUDITORS OF THE TOP 40 LISTED ENTITIES ON THE JSE

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ABSTRACT

The audit report is the primary document through which auditors communicate their opinion on the fair presentation of financial statements to users. The new audit report format, which came into effect in 2016, introduces a number of changes. One of the most important changes is the requirement that all public entities disclose items that are deemed of greatest significance in the audit, namely, Key Audit Matters. Through these changes, the new audit report format seeks to address the audit expectation gap.

The purpose of this study was to analyse whether the top 40 listed entities on the Johannesburg Stock Exchange disclosed Key Audit Matters according to the new reporting standards and to determine the nature of these items. Using a content analysis methodology, the findings revealed that 130 Key Audit Matters were raised by the study population and that the three disclosure requirements of the new reporting standards were met, namely, (i) why the matter was considered to be of most significance in the audit and therefore deemed a Key Audit Matter, (ii) how the matter was addressed in the audit and (iii) whether reference was made to the related disclosure, if any, in the financial statements.

Study limitations were noted and recommendations on addressing the issue were provided.

KEY WORDS

Audit opinion

Audit report

Auditor reporting standards

Disclosure requirements

Key Audit Matter

JSE top 40 entities

LIST OF ABBREVIATIONS

IAASB	International Auditing and Assurance Standards Board
ISA	International Standards of Auditing
JSE	Johannesburg Stock Exchange
SAICA	South African Institute of Chartered Accountants

INTRODUCTION

Trust and ethics are core values underpinning the auditing profession. Accordingly, the users of financial statements place significant value on the auditors' opinion regarding the fair presentation of financial statements. This premise is echoed by Tahinakis and Samarinas (2016), who assert that as a matter of principle, the auditing process must ensure trust. This is confirmed by Verhoef (2011), who observes that auditing is built on a firm foundation of strong ethical values. The South African Institute of Chartered Accountants (hereafter "SAICA") (2015) notes that the audit report is a primary communication tool used by auditors to communicate their opinion to users of financial statements. Consequently, this report is expected to convey a degree of trust, through sound professional judgment, as to the financial statements of an entity (Loghin, 2017). Thus, the audit report should provide trustworthy, external confirmation as to the fair presentation of financial statements.

The role of auditors and audit reports has come under increasing scrutiny, especially since the 2008 financial crisis. Bédard, Gonthier-Besacier and Schatt (2014) confirm that, following the recent financial crisis, the role of the auditor has been questioned, especially the fact that audit reports are highly standardised and information content is low. This criticism is echoed by Jermakowicz, Epstein and Ramamoorti (2018), who note the increased focus on audit reports since the economic downturn and the resultant calls for auditors to provide more detailed reporting (Bédard *et al*., 2014). The International Auditing and Assurance Standards Board (hereafter "IAASB"), as the standard setting body, responded to this request by issuing a new audit report format (Pratt, 2013; Boolaky & Quick, 2016). This led to the introduction of the Key Audit Matters requirement which is expected to have the greatest impact of the format (Bester, 2015). De Laurell and Burbage (2014) observe that this format should improve the transparency of financial reporting while Botha and Hoogwerf (2016) indicate that it should increase the relevance and value of the audit report to users of financial statements. Given the shareholders' need for accurate and reliable reporting, disclosing Key Audit Matters should further enhance auditor reporting and improving communication and by provide the auditor's viewpoint on the financial statement.

The structure of this paper is summarised as follows: the next section expresses the research problem, followed by a literature review focusing on the new audit report format, and specifically on Key Audit Matters. This is followed by the research design and the empirical study and findings. Lastly, a conclusion and further possible research opportunities are identified.

PROBLEM STATEMENT / RESEARCH QUESTION

The previous audit report format had significant shortcomings in conveying the auditors' findings to readers, and accordingly, a new audit report format was deemed essential to better communicate the auditors' findings to users. This resulted in the IAASB issuing a new set of audit reporting standards in 2016. One of the main changes to the old format was the introduction of Key Audit Matters. As the new reporting standards were only issued in 2016, only limited research has been done on Key Audit Matters, an important facet of the new format. Hence, the overarching research problem of this study is an investigation into how auditors of the top 40 listed entities on the Johannesburg Stock Exchange (hereafter "JSE") disclose Key Audit Matters according to the new reporting standards, as well as identifying the nature of the matters disclosed.

In order to address the overall research question, the following sub-questions are formulated:

- What is the number of Key Audit Matters disclosed in the audit reports?
- What is the nature of the Key Audit Matters disclosed in the audit reports?
- Were the disclosure requirements applicable to Key Audit Matters in line with the International Auditing Standard (IAS) 701?

LITERATURE REVIEW

The literature review focuses on audit reporting, the need for change and the new report format with specific focus on Key Audit Matters

Audit reporting

When an audit is performed, the auditor verifies, recalculates and obtains comfort that the balances in the financial statements are a fair reflection of the financial state of the entity. Acevedo (2005) explains that auditing is a process whereby the auditor confirms the information reported by management in the financial statements of the entity. This definition is corroborated by Boolaky and Quick (2016), who note that an audit is a professional opinion on whether the financial statements of an entity provide a true and fair view. Lee, Ali and Bien (2009) confirm that an audit adds credibility to financial statements.

The purpose of an audit, according to the International Standards of Auditing (hereafter "ISA") ISA 200 (SAICA, 2017: 80), is to:

> …enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material aspects, in accordance with an applicable financial reporting framework. An audit provides assurance on and credibility of the financial statements. Following an audit, the auditor communicates their opinion on the financial statements to the users of the financial statements through an audit report.

An audit report is the primary communication tool used by auditors to communicate their opinion to users of financial statements (Chong & Pflugrath, 2008). This serves to enhance the credibility of financial statements (Asare & Wright, 2012). Ali Eid (2014:144) indicates that "financial statement users rely on the audit report to provide assurance on the entity's financial statements". Users also rely on the audit report to assist them in their decision-making. This view is echoed by Whitehouse (2015) who states that adequate communication by the auditor provides users of financial statements with transparency and assists in making sound decisions. Tahinakis and Samarinas (2016) observe that investors' decisions are impacted by the information that validates financial statements.

The audit report provides users of financial statements with assurance as to the financial statements and assists in decision-making. It is therefore important that the users of financial statements have a thorough understanding of the concept of the audit report. The following definition by Alkhatib and Marji (2012:1342) effectively summarises an audit and an audit report:

> The auditor's report is an independent examination and expression of opinion on the financial statements of an entity's annual reports. The objective of an audit is to independently verify the contents and the preparation of the entity's financial statements according to the standards, legislations, regulations and requirements.

The audit report thus provides assurance on financial statements, allowing users to rely on the audited statements. In this way, it offers trustworthy, external confirmation of the financial statements.

Need for change

As stated by Court (2016:549), "we are not operating simply in a state of change, but rather a revolution on how everything is done". Given the rapid pace of change in the workplace, auditors need to respond to these changes in order to stay relevant. According to Marsh, Fischer and Montondon (2013), auditors must be forward-thinking if they are to adapt to these changes. This is reiterated by Smith (2016), who maintains that auditors must evolve and adapt to the rapidly changing marketplace.

This section focuses on the two main reasons for the need to change the format of the old audit report, namely, (i) the audit expectation gap and (ii) the limitations of the previous audit report format.

Audit expectation gap

An audit expectation gap is explained by Marx (2008:xli) as the "difference in opinion and fact as to the duties and responsibilities of the different parties concerned in a transaction or function". The audit expectation gap has been widely researched and can further be defined as follows:

- The difference between the view of the auditor and the users of financial statements as to the level of assurance obtained from the audit process (Bédard, Sutton, Arnold & Phillips, 2012);
- With the change in expectations, the response of the accounting profession also changes, but not at the same pace. Thus, there is always a time delay between the changing expectations of the users and the response by the profession (Saha & Baruah, 2008); and
- A gap between the users' perception of the responsibility of the auditor and what the auditor actually accomplished in their mission, according to their engagements and auditing standards (Kiss, Fülöp & Cordoş, 2015).

From the discussion above, it can be seen that the audit expectation gap refers to the differing expectations between what auditors do, and what the users of financial statements think the auditors should do. Literature points to the audit expectation gap as one of the main reasons for adopting the new audit report format, namely:

- There are three key ways to reduce the gap: extended audit reports, extended responsibilities and education (Köse & Erdoğan, 2015);

- The auditor expectation information gap arises due to the limited information provided in the previous auditor's report (de Beer, 2015); and
- An expanded audit report can be used as a way of reducing the audit expectation gap (Lee *et al*., 2009).

Limitations of the previous audit report format

The limitations of the previous audit format were an additional reason driving the need for change. Lazarevska and Trpeska (2016) highlight the fact that users of financial statements require more information that relates specifically to the audit of the entity. Mock, Bédard, Coram, Davis, Espahbodi and Warne (2013) found that even though users of financial statements considered the previous audit report as useful, they nonetheless desired more information, including more detail on the audit process, the level of assurance as well as entity-specific information.

The frustration with this limited amount of information is encapsulated by Jamal and Sunder (2013:1) who state that a"uditors' 'boilerplate' pass or fail reports reveal little of the fine-grained understanding they gain about the inner workings of their clients, including internal controls, accounting policies, disclosure and governance". This view is corroborated by de Beer (2015), who reiterates that the auditor, after performing an in-depth audit and giving an opinion on the financial statements, possesses a wealth of information about the entity. The simple pass or fail opinion gave no insight into the entity and users of financial statements thus called for more relevant, company-specific information in the auditor's report (de Beer, 2015).

Auditors use standardised language to communicate their pass or fail opinion. Cordoş and Fülöp (2015) concur that auditors are not only criticised for failing to explain how conclusions are reached, but also for using standardised language when communicating their opinion. The end result is the reduced value of the audit opinion in the report.

Simnett and Huggins (2014) explain that the reason for the previous standardised format was to allow for the comparison of reports across entities. However, this view is now being challenged by users of financial statements. This is supported by Mock *et al.* (2013) who point out that users of financial statements accord little value to the current audit report precisely because of its standardised language. This notion is supported by Coram, Mock, Turner and Gray (2011). Accordingly, there have been calls for auditors to provide more detailed reports (Bédard *et al*., 2014). The new report format is expected to decrease the information gap while at the same time increasing the communication power of the audit report (Lazarevska & Trpeska, 2016).

New format of the audit report

The new and revised audit reporting standards were released by the IAASB in January 2015 (IAASB, 2016a). These new standards aimed to be more informative, allowing auditors to provide information which is of greater relevance to users (IAASB, 2015a).

Segal (2017) emphasises that auditors need to provide more detailed information and to substantiate their findings by highlighting procedures followed and assumptions made. The new and revised standards, viewed as critical to the relevance of audits (IAASB, 2015a), aim to enhance auditor reporting within the existing scope of the audit, without expanding the auditor's work effort (de Beer, 2015). These standards became applicable to the period ending on or after 15 December 2016 (SAICA, 2015).

The new and revised reporting standards changed the audit report significantly (Bédard *et al.*, 2016). The purpose of these standards is to enhance the report for users of financial statements (IAASB, 2018); they are viewed as critical to the relevance of audits (IAASB, 2015a). Lazarevska and Trpeska (2016) anticipate that the new look of the audit report should add value to the audit. In addition to providing a pass or fail opinion, the new report also provides insights into the audit process and the auditors' perspective which is considered important (IAASB, 2016a). These changes to the format of the audit report were the most significant development in recent auditing history (SAICA, 2015).

The changes that should reduce the audit expectation gap and overcome the limitations inherent in the previous report format are as follows: (i) the conclusion and basis for the conclusion are presented first in the audit report, (ii) the basis for the conclusion describes why the fail or pass opinion was issued, and (iii) Key Audit Matters are included to convey the auditor's viewpoint. Key Audit Matters are discussed in detail below.

Key Audit Matters

Of all the changes in the auditor's report, Key Audit Matters are expected to have the greatest impact (Bester, 2015). Communicating Key Audit Matters does not change the auditor's underlying responsibilities in terms of the ISAs or the responsibilities of those charged with governance. Instead, Key Audit Matters can be considered as highlighting matters of greatest significance in the audit (IAASB, 2016a), in other words, conveying what was seen 'through the eyes of the auditor'. (IAASB, 2015b). Communicating Key Audit Matters allows users of financial statements to further engage with management and those charged with governance (IAASB, 2015a). It also provides users with a roadmap to navigate through the financial statements and focus on matters highlighted by the auditors (Sirois, Bédard & Bera, 2014).

A new auditing standard, ISA 701 (Communicating Key Audit Matters in the Independent Auditor's Report), was issued to guide the reporting (de Beer, 2015; IAASB, 2015b). ISA 701 indicates that this standard applies to (i) audits of complete sets of general-purpose financial statements of listed entities, (ii) circumstances when the auditor otherwise decides to communicate Key Audit Matters in the audit report and (iii) instances where the auditor is required by law or regulation (SAICA, 2017). The IAASB (2016c) indicates that the definition of listed entities in ISA 220 should be used when determining which entities are listed. ISA 220 defines these as entities "whose shares, stock or debt are quoted or listed in a recognised stock exchange, or are marketed under the regulations of a recognised stock exchange or other equivalent body" (SAICA, 2017).

Definition

Key Audit Matters are defined in ISA 701 as:

> …those matters that, in the auditor's professional judgement, 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 (SAICA, 2017:776).

The IAASB summarises the decision-making process in the diagram below:

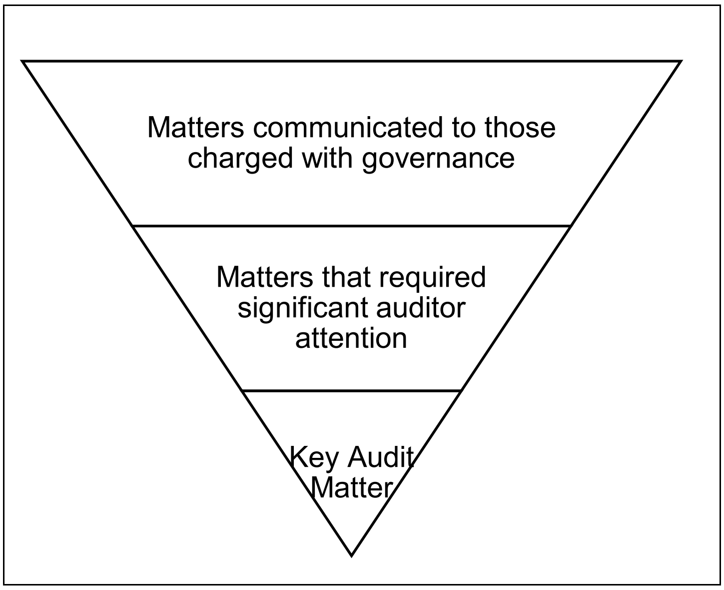

FIGURE 1: Key Audit Matter decision-making framework
***Source**: IAASB (2016b)*

ISA 701 stipulates that to determine a Key Audit Matter, three criteria should be considered. Firstly, it needs to be established whether the matter is communicated to those charged with governance. This refers to a smaller number of matters that were communicated to those charged with governance, based on the auditor's judgement (SAICA, 2017).

Secondly, a Key Audit Matter is considered as such if it is deemed to require significant audit attention (SAICA, 2017). In determining matters that require additional attention, the auditor needs to take the following into account (SAICA, 2017):

(i) **Areas of higher assessed risk of material misstatement or significant risks.** Significant risks are defined in ISA 315 as "an identified and assessed risk of material misstatement that, in the auditor's judgement, requires special audit consideration" (SAICA, 2017:283);

(ii) **Significant auditor judgement applied to areas in the financial statements.** Significant auditor judgement includes estimates that have been identified as having high uncertainty, critical accounting policies and critical accounting estimates and related disclosures (SAICA, 2017);

(iii) **The effect of significant events or transactions that occurred during the period.** These are deemed to be any events or transactions which had a significant effect on the financial statements or the audit. These may be areas that required significant auditor attention and may be identified as a significant risk. Such events can include economic, accounting, regulatory, industry or other developments (SAICA, 2017); and

(iv) Further indicators of matters that require significant auditor attention include events or transactions that pose challenges to the auditor in obtaining sufficient, appropriate audit evidence and areas of high complexity (SAICA, 2017).

Thirdly, a Key Audit Matter is considered as such if it is deemed to be of significance during the audit. ISA 701 provides guidance in this regard:

- The importance of the matter to intended users' understanding of the financial statements as a whole;
- The nature of the underlying accounting policy or the complexity of subjectivity involved compared to other entities within the same industry;
- The nature and materiality of correct and accumulated uncorrected misstatements due to fraud or error;
- The nature and extent of audit effort needed to address the matter, including the extent of specialised skills or knowledge required and the nature of consultations outside the engagement team;
- Nature and severity of difficulties in applying audit procedures, evaluation the results of the procedures and obtaining relevant and reliable evidence on which to base the auditor's opinion;
- The impact of control deficiencies identified that relate to the Key Audit Matter; and
- Whether the matter involved a number of separate but related auditing considerations (SAICA, 2017).

Misconceptions about Key Audit Matters

Leen and Seng (2015) report in the *Business Times* that Key Audit Matters could be misconstrued in three ways. These misconceptions are supported by literature and are discussed below:

(i) Key Audit Matters are not a substitute for management's disclosures. It is still management's responsibility to ensure adequate disclosure is made in the financial statements (Leen & Seng, 2015; SAICA, 2017);

(ii) Key Audit Matters are not a separate audit opinion on individual Key Audit Matters. Only one audit opinion on the financial statements should be issued (Leen & Seng, 2015; SAICA, 2017); and

(iii) Key Audit Matters are not a substitute for expressing a modified opinion or reporting on an entity's ability to continue operating as a going concern (Leen & Seng, 2015; SAICA, 2017). Key Audit Matters can be disclosed even when an auditor concludes that the financial statements are free from material misstatement (Lennox, Schmidt & Thompson, 2018). A disclosed Key Audit Matter does not necessarily indicate that the matter has not been appropriately resolved when forming the audit opinion (SAICA, 2017).

Communication of Key Audit Matters

Once Key Audit Matters have been identified, it is of the utmost importance that they be communicated to users of financial statements. Key Audit Matters should be described using a separate section in the audit report entitled 'Key Audit Matters' (SAICA, 2017). Placing a separate Key Audit Matters section in close proximity to the auditor's places the information in a prominent position (SAICA, 2017).

ISA 701 provides guidance on the disclosure of Key Audit Matters which should include three sections, namely:

(i) **Why the matter was considered to be one of most significance in the audit and therefore determined to be a Key Audit Matter** (IAASB, 2015a; SAICA, 2017).

A description of individual Key Audit Matters should explain to the users of financial statements why the matter was considered to be of particular significance in the audit. Technical jargon should be kept to a minimum to ensure users with a reasonable knowledge can understand the matter (SAICA, 2017);

(ii) **How the matter was addressed in the audit** (IAASB, 2015a; SAICA, 2017).

The amount of detail to describe how the Key Audit Matter was addressed during the audit is a matter of professional judgement. ISA 701 provides guidance on what the auditor could include, namely:

- "Aspects of the auditor's response or approach that were most relevant to the matter or specific to the assessed risk of material misstatement;
- A brief overview of procedures performed;
- An indication of the outcome of the auditor's procedures; or
- Key observations with respect to the matter

Or some combination of these elements" (SAICA 2017:792)

(iii) **Reference to the related disclosure(s), if any** (IAASB, 2015a; SAICA, 2017).

RESEARCH METHOD

Research design and method

Zikmund, Babin, Carr and Griffin (2010:657) note that a research design is "a master plan that specifies the methods and procedures for collecting and analyzing the needed information". The research objective, which is derived from the research problem, determines the type of design that will be chosen. One of the types of research design is cross-sectional design. This type of design is defined as "a study in which various segments of a population are sampled and data are collected at a single moment in time" (Zikmund et al., 2010:650). This is reiterated by Bryman, Bell, Hirschsohn, Dos Santos, Du Toit, Masenge, van Aardt and Wagner (2014:105) who explain that "cross-sectional design involves the collection of data on more than one case and at a single point in time". Bryman *et al.* (2014) further highlight that a cross-sectional design has the following characteristics: (i) more than one case is examined, (ii) at a single point in time, (iii) with quantitative or qualitative data, (iv) the results indicating patterns of association. The research design chosen for this study is a cross-sectional one as (i) the audit reports for the top 40 listed entities are being examined, (ii) from the latest reports that were uploaded on the entities' websites between 16 June 2018 and 16 July 2018 when the reports were downloaded, (iii) quantitative and qualitative data was used and (iv) the aim of the study was to examine the relationship between Key Audit Matters.

Broadly speaking, there are two types of studies: empirical and non-empirical (Mouton, 2014). Kumar (2005) explains that an empirical study should produce 'hard evidence' based on the information collected by the researcher. Conclusions can then be drawn from that evidence. The type of study chosen for this research was empirical. This approach was deemed best-suited to analysing existing data, namely, the disclosure of Key Audit Matters in the audit reports of the JSE top 40 listed entities.

Content analysis is one of many research methods (Mouton, 2014). This particular method, which is applied in the present study, was deemed appropriate as it involves the objective, systematic and quantitative description of the information gathered (Zikmund, 2003). Two prominent characteristics of content analysis are described below:

(i) Content analysis is the process of breaking content up into conceptual parts (Wilson, 2011). Chu (2015) highlights that this method requires the systematic and objective analysis of data. In this study, content was obtained and analysed based on information derived from the literature review. This information ensured the logical grouping of data in the control sheet.

(ii) Content can come from various sources, including books, manuscripts or drawings. This type of analysis requires the close scrutiny of documents or records (Hofstee, 2006). In this study, content consisted of existing data, namely, the disclosures in the management and audit reports of the JSE top 40 listed entities.

Research methodology

Content analysis, as a research method, can be used both quantitatively and qualitatively (Mouton, 2014). The combination of qualitative and quantitative methods is referred to as 'mixed methods' (Pole, 2007).

Qualitative analysis has been described as non-numerical data or data that has not been quantified (Saunders, Lewis & Thornhill, 2012). It can also be written data that is obtained from the researcher's own understanding and insights (de Villiers & Fouché, 2015). The aim of qualitative analysis is to provide a detailed description of the data (Glogowska, 2011).

Quantitative analysis, on the other hand, refers to numerical data or data that has been quantified (Saunders *et al.*, 2012). This type of analysis starts with a predetermined hypothesis and a predetermined code to test the hypothesis. The results are then described using statistics (Wilson, 2011). Quantitative analysis involves obtaining evidence, usually in a numeric format, statistically analysing the data and then drawing conclusions (de Villiers & Fouché, 2015).

Mixed methods research combines both qualitative and quantitative methods (Glogowska, 2011), either concurrently or sequentially (Saunders *et al.*, 2012). Using a mixed methods approach has a significant advantage insofar as one method builds on the strengths of the other, thereby neutralising the limitations of using either methodology alone (Pole, 2007).

In this study, a control sheet was designed to conduct the content analysis. The analysed data was then interpreted based on the literature review. Accordingly, both qualitative and quantitative methods were used, resulting in a mixed methods approach.

Research instrument

A research instrument refers to the tool that is used to gather the information for the study (Hofstee, 2006). The research instrument used in this study was a control sheet containing elements informed by the literature review. The control sheet assisted in measuring the audit reports against these elements.

The reliability and validity of the control sheet was enhanced through discussions with other academics and the updating of the control sheet after further research. The analysis was performed by the researcher and the coding accuracy was verified by an independent academic.

Data collection

Although Key Audit Matters should be disclosed by all entities listed on the JSE (SAICA, 2017), the population selected for the empirical study consisted only of the JSE top 40 listed entities. These were selected because:

- The JSE is currently the largest exchange in Africa and is ranked the nineteenth largest in the world by market capitalisation (JSE, 2018a). On 2 July 2018, the JSE top 40 listed entities represented 83% market share of the total market (JSE, 2018c) (see Annexure A (JSE, 2018b));
- They are the largest listed entities ranked by market capitalisation and therefore the largest listed entities in South Africa; and
- All listed entities are required to disclose Key Audit Matters and it can reasonably be expected that Key Audit Matters will be disclosed by the JSE top 40 entities.

The most recent audit reports of the top 40 listed entities were obtained from their websites and analysed between 16 June 2018 and 16 July 2018. The latest available report for each entity was included in the population. These reports were easily obtained as they are available on each company's website and it was not necessary to make contact with any of the entities. A desktop analysis was therefore performed.

Research control

A 100% response rate was achieved and all the control sheets were completed for the 40 companies in the population.

TABLE 1: Response rate for the control sheets used in the content analysis

	Content analysis control sheets of the JSE top 40 listed entities' audit reports	
	Number	Percentage
Completed and usable control sheets	40	100%
Control sheets used	40	100%

Source: Control sheet (own calculation)

EMPIRICAL FINDINGS

A control sheet containing three elements was designed based on the literature reviewed. These three elements are: (i) number of Key Audit Matters disclosed in the audit report, (ii) nature of Key Audit Matters disclosed in the audit report and (iii) disclosure requirements of Key Audit Matters in the audit report. The control sheet was completed for the full population. The results of this testing are presented below.

Number of Key Audit Matters disclosed in the audit report

Objective of the analysis

The objective of this element was to determine how many Key Audit Matters were identified for each entity. Key Audit Matters were defined in the previous section. The literature review stresses that Key Audit Matters should be disclosed by all listed entities. As the population consisted of all entities listed on the JSE, it could reasonably be expected that Key Audit Matters would be disclosed or at least considered in the audit reports of all the entities in the population.

Findings and deductions

The analysis indicated that Key Audit Matters were disclosed in all the audit reports examined. This observation is in line with expectations as all the entities examined are listed and identifying and disclosing Key Audit Matters is compulsory for all listed companies. The number of Key Audit Matters disclosed in the reports ranged from one to seven. In the population, a total of 130 Key Audit Matters was disclosed, which is an average of 3.25 per entity. The majority (63%) of reports disclosed three or less Key Audit Matters.

TABLE 2: Element 1 – Number of Key Audit Matters disclosed in the audit report

Number of Key Audit Matters issued per audit report	Number of audit reports	Number of Key Audit Matters raised	Number of Key Audit Matters as a percentage of all Key Audit Matters
1.1 1 Key Audit Matter	4	4	3%
1.2 2 Key Audit Matters	9	18	14%
1.3 3 Key Audit Matters	12	36	28%
1.4 4 Key Audit Matters	8	32	25%
1.5 5 Key Audit Matters	3	15	11%
1.6 6 Key Audit Matters	3	18	14%
1.7 7 Key Audit Matters	1	7	5%
	40	130	100%

Source: Control sheet (own calculation)

Nature of Key Audit Matters disclosed in the audit report

Objective of the analysis

The objective of this element was to determine the nature of Key Audit Matters which were disclosed in the audit reports. The literature review highlighted the need for a new audit report format and it was noted that the shortcomings of the previous format included the audit expectation gap, the lack of communication and the use of standardised language. The disclosure of Key Audit Matters is expected to improve communication to users of financial statements, specifically on matters of particular significance in the audit, thereby giving an indication of the auditor's viewpoint.

Findings and deductions

The analysis indicates that the Key Audit Matters that were identified could be classified into various categories as follows: 15% related to taxation, deferred tax, accounting for taxes or uncertain tax provisions while 11% related to goodwill and other intangible assets – impairment and valuation. Of the 130 Key Audit Matters, 37 (28%) could not be allocated to any of the categories above. These items include specific entity acquisitions, employee benefits and foreign exchange risks.

TABLE 3: Element 2 – Nature of Key Audit Matters disclosed in the audit report

	Nature of Key Audit Matter disclosed	Numbers	Percentage
2.1	Taxation, deferred tax, accounting for taxes and uncertain tax provisions	19	15%
2.2	Goodwill and other intangible assets – impairment and valuation	14	11%
2.3	Nature and valuation of financial instruments	9	7%
2.4	Impairment, recoverability and provision for trade receivables	8	6%
2.5	Valuation and inventory provision	7	5%
2.6	Accounting and impairment of equity accounted investments	7	5%
2.7	Insurance contract liabilities	5	4%
2.8	Revenue recognition	5	4%
2.9	Valuation of investment properties	5	4%
2.10	Accounting and impairment for business combinations	5	4%
2.11	Asset valuation	5	4%
2.12	Rehabilitation provision	3	2%
2.13	Assessment of impairment of computer software intangible assets	1	1%
2.14	Other	37	28%
		130	100%

Source: Control sheet (own calculation)

The words most commonly used in the title of each Key Audit Matter were identified. There was no direct correlation between these words and the nature of the Matter, as shown in Table 4 below. Thus, one word could relate to various classifications, for example, ‘valuation’ would be included in sections 2.2, 2.3, 2.5, 2.9, 2.11 and possibly in 2.13 in Table 3 above. The words used 10 times or more were ‘valuation’ (27 times), ‘impairment’ (26 times), ‘assets’ (18 times), ‘accounting’ (17 times), ‘goodwill’ (15 times), ‘investment’ (13 times) and ‘liabilities’ (10 times).

FIGURE 2: **Element 3 – Analysis of top 100 words used in Key Audit Matter titles**

Source: Author’s construction

Disclosure requirements of Key Audit Matters in the audit report

Objective of the analysis

The objective of this element was to determine whether the disclosure requirements, as stipulated in ISA 701, were met. All the audit reports were based on the new format and all contained Key Audit Matters. It could therefore be reasonably expected that the detail disclosed regarding Key Audit Matters would meet the requirements of ISA 701. This is important as the new audit report is expected to address the shortcomings of the previous format and assist the reader in seeing the audit through the eyes of the auditor.

Findings and deductions

The analysis indicates that for all Key Audit Matters raised, the following was disclosed: (i) why the matter was considered to be of particular significance and therefore deemed to be a Key Audit Matter, (ii) how the matter was addressed and (iii) reference was made to the related disclosure(s), if any. This observation was expected since disclosing these items is a requirement of ISA 701.

TABLE 4: Element 3 – Disclosure requirements of Key Audit Matters in the audit report

Disclosure of Key Audit Matters	Number		Percentage		Total
	Yes	No	Yes	No	
3.1 Why the matter was considered to be of significance in the audit and therefore determined to be a Key Audit Matter	130	0	100%	0%	130
3.2 How the matter was addressed in the audit. Some items that may be described include: • Aspects of the auditor's response or approach that were most relevant to the matter or specific to the assessed risk of material misstatement; • A brief overview of procedures performed; • An indication of the outcome of the auditor's procedures; or • Key observations with respect to the matter	130	0	100%	0%	130
3.3 Reference to the related disclosure(s), if any.	130	0	100%	0%	130

Source: Control sheet (own calculation)

The literature review highlighted the need for a new audit report format and it was noted that the shortcomings of the previous format included the audit expectation gap, the lack of communication and the use of standardised language. The disclosure of Key Audit Matters is expected to improve communication to users of financial statements, specifically on matters of particular significance in the audit, thereby giving an indication of the auditor's viewpoint. The disclosure of Key Audit Matters was expected to address the shortcomings of the previous report, namely, limited communication, and should assist the end user in seeing the company 'through the eyes of the auditor'.

Summative observations

Included in the audit reports of the study population, i.e. the top 40 entities listed on the JSE, on average, 3.25 Key Audit Matters were raised per entity, which amounted to 130 Matters in total. For all these Matters, the disclosure requirements per ISA 701 were met, namely, (i) why the matter was considered to be of most significance and therefore deemed to be a Key Audit Matter, (ii) how the matter was addressed and (iii) reference was made to the related disclosure(s), if any. Key Audit Matters improve communication to users of financial statements and provide the auditor's viewpoint on the financial statements, highlighting the items which were deemed the most important in the audit. It can thus reasonably be concluded that there was detailed disclosure (as per ISA 701) for the items which were most significant in the audit.

CONCLUSION

Deductions

Auditors use the audit opinion as the main communication tool between themselves and the users of the financial statements. A new audit report format became applicable to all year-ends on or after 15 December 2016. This new format aims to bridge the audit expectation gap and reduce the shortcomings of the previous report format, namely, limited communication and standardised language. An important new element introduced into the new report format was Key Audit Matters.

Based on the literature review and the research methodology, a control sheet was designed and completed for the audit reports of the top 40 listed entities on the JSE which formed the population of the study. The following conclusions were drawn from each element:

- **Element 1: Number of Key Audit Matters disclosed in the audit report**
  Key Audit Matters were disclosed in all the audit reports examined. A total of 130 Key Audit Matters were disclosed, which translates to an average of 3.25 per entity.
- **Element 2: Nature of Key Audit Matters disclosed in the audit report**
  The main themes identified, in 19 Key Audit Matters, related to taxation, deferred tax, accounting for taxes and uncertain tax provision while 14 Key Audit Matters related to goodwill and other intangible assets – impairment and valuation
- **Element 3: Disclosure requirements of Key Audit Matters in the audit report**
  For all Key Audit Matters raised, the disclosure requirements as per ISA 701 were met: (i) why the matter was considered to be of significance in the audit and therefore deemed to be a Key Audit Matter, (ii) how the matter was addressed and (iii) reference to the related disclosure(s), if any.

Areas for future research

The results of the study suggest the following areas for future research:

- An investigation of whether the new audit report format is contributing to closing the audit expectation gap;
- An investigation of whether the previous audit report contributed to audit failures or the financial crisis;
- An investigation of whether the new audit report format is addressing the shortcomings of the previous report format, namely, limited communication and standardised language;
- An analysis on what is raised by the auditor as Key Audit Matters; and
- An investigation of whether there is hesitation to raise Key Audit Matters due to misconceptions of Key Audit Matters by users of financial statements.

Limitations of this study

The scope of this study is limited to the JSE top 40 listed entities as at 2 July 2018 and may therefore not be representative of other entities that are required to disclose Key Audit Matters. According to the ISA 701, these may be other listed entities, entities that are required by law to disclose Key Audit Matters or entities where the auditor decided to communicate Key Audit Matters (SAICA, 2017). A second limitation is the relatively scant literature currently available on the new audit report format and Key Audit Matters as these items only became applicable for the year-end on or after 15 December 2016 (SAICA, 2017). A third limitation is that the study only focused on Key Audit Matters for one year and no comparison was made between different years or different sectors. Lastly, the study focused only on the Key Audit Matters that were raised and did not aim to identify any Key Audit Matters that should have been raised.

Summary

The research problem focused on whether the top 40 listed entities on the JSE disclosed Key Audit Matters according to the new reporting standards. The study examined how the new audit report format was designed to overcome the shortcomings of the previous format. The new format requires the auditor to communicate matters of particular significance in the audit, known as Key Audit Matters. The introduction of Key Audit Matters is considered to be one of the most important changes to the report format.

The empirical content analysis of the top 40 JSE-listed entities found that 130 Key Audit Matters were identified, which is 3.25 per entity. The main theme identified, with 19 Key Audit Matters, related to taxation, deferred tax, accounting for taxes and uncertain tax provision. For all Key Audit Matters raised, the three disclosure requirements as per ISA 701 were met, namely, (i) why the matter was considered to be of most significance in the audit and therefore deemed to be a Key Audit Matter, (ii) how the matter was addressed in the audit and (iii) reference to the related disclosure(s), if any.

Based on the findings of this study, it can be concluded that auditors of the top 40 listed entities in South Africa disclosed the items which were most significant in the audit. Since the new report format was intended to address the shortcomings of the previous format, it can be reasonably accepted that the audit reports of the population are indeed addressing the shortcomings of the previous report.

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ANNEXURE A

Population Used for Content Analysis: List of Top 40 Listed Entities on the Johannesburg Stock Exchange as at 2 July 2018

Number	Code	Name
1	ANH	Anheuser-Busch InBev SA NV
2	BTI	British American Tobacco plc
3	NPN	Naspers Ltd -N-
4	GLN	Glencore plc
5	BIL	BHP Billiton plc
6	CFR	Compagnie Fin Richemont
7	AGL	Anglo American plc
8	FSR	Firstrand Ltd
9	SBK	Standard Bank Group Ltd
10	SOL	Sasol Ltd
11	VOD	Vodacom Group Ltd
12	MTN	MTN Group Ltd
13	S32	South32 Ltd
14	SLM	Sanlam Ltd
15	MNP	Mondi plc
16	OMU	Old Mutual Ltd
17	BGA	Barclays Africa Grp Ltd
18	SHP	Shoprite Holdings Ltd
19	NED	Nedbank Group Ltd
20	APN	Aspen Pharmacare Hldgs Ltd
21	RMH	RMB Holdings Ltd
22	REM	Remgro Ltd

Number	Code	Name
23	CPI	Capitec Bank Hldgs Ltd
24	DSY	Discovery Ltd
25	AMS	Anglo American Plat Ltd
26	KIO	Kumba Iron Ore Ltd
27	BID	BID Corporation Ltd
28	GRT	Growthpoint Prop Ltd
29	HMN	Hammerson plc
30	NRP	NEPI Rockcastle Plc
31	MEI	Mediclinic Int plc
32	INP	Investec plc
33	BVT	Bidvest Ltd
34	TBS	Tiger Brands Ltd
35	RDF	Redefine Properties Ltd
36	MRP	Mr Price Group Ltd
37	SRR	Steinhoff African Rt Ltd
38	WHL	Woolworths Holdings Ltd
39	RMI	Rand Merchant Inv Hldgs Ltd
40	SAP	Sappi Ltd