



In most cases, the auditor's concerns are sufficiently answered by the management and the auditor is able to sign off the financial statements

## What are key audit matters?

**B**ACK in 2015, the International Auditing and Assurance Standards Board, which sets accounting standards worldwide, approved a suite of new reporting standards.

These new standards came into force for the financial statements for financial periods ended on Dec 15, 2016. That same year, the Malaysian Institute of Accountants (MIA) issued the same set of standards and fully adopted them.

A key enhancement under the new standards is the requirement for auditors to report the key audit matters (KAM) they encountered during the audit process. Previously, KAM were only discussed between those charged with governance – namely, management and the auditors. By including it in the auditors' report, it now becomes available to the general public.

MIA president Datuk Mohammad Faiz Azmi explains that KAM highlights the areas on which auditors spent the most time during the audit. These areas are often complex and require significant judgments to be made by directors.

"The communication of KAM is intended to enhance the information value of the audit report by providing greater insights into the audit of the financial statements of an entity," he tells *FocusM*.

It is important to remember that KAM reporting is not supposed to be construed as a qualified opinion on a company's financials. Mohammad Faiz cautions it is important to move away from the mindset of "if it is in the auditors' report, then there is something wrong" that many investors have.

"An important message to be conveyed is that the auditor provides an opinion on the financial statements as a whole. KAM are addressed in the context of the audit of the financial statements as a whole and the auditor does not provide a separate opinion on these matters," he says.

Communicating KAM does not significantly change the audit process and therefore should not have a substantial impact on audit costs, says Mohammad Faiz.

However, it will require greater interaction between auditors and the senior management. Companies will also require an internal quality control process to review the reports and this may translate into incremental time and costs, he adds.

It is important to see this additional information flow to the capital market as a means to enhance value. "Organisations need to understand the benefits and if they can see that there truly is a benefit, then the organisations will embrace these changes."

# Enhanced audit reports can help investors

- **Facilitates** better engagement between investors and management
- **Helps** investors make more holistic investment decisions

**S**HAREHOLDERS of listed companies are starting to get a better deal from their external auditors.

The new enhanced auditors' report from this year onwards requires auditors to cover a much wider scope and quality. Investors wanting a more holistic view of their company's financials can get them from what is called key audit matters (KAM).

Currently, investors of listed entities pay thousands of ringgit in fees to auditors who comb through a company's financial statements to form a view on the integrity of the statements. If there are outstanding issues, a qualified opinion is issued.

The audit process will usually throw up certain important issues which require more of the auditors' attention – for example issues like goodwill, valuation of financial instruments, the effects of new accounting standards and so on.

In most cases, the auditor's concerns are sufficiently answered by the management and the auditor is able to sign off the financial statements. Nonetheless, there are issues which come up which are material to the



by  
**Stephanie Jacob**



KAM and the audit report needs to be crafted in such a manner that it is informative yet easy to understand, says Lya



We must believe this additional information flow to the capital market will enhance value, says Mohammad Faiz

company's financial performance which investors have a right to know. This will help investors be better-equipped to make good investment decisions.

Malaysian Institute of Accountants president Datuk Mohammad Faiz Azmi explains that "KAM provides information to users of the financial statements on areas where the auditor spent the most effort." (see sidebar for more on KAM).

A minority shareholder who holds stakes in several listed banking and oil and gas stocks says he finds the addition of KAM to the auditor's report to be useful.

He sees the KAM report as a way for regular investors to hone in on issues that are important to a company's health. "A well-articulated KAM provides a good

view on the state of health or ill health of the audited companies and/or the performance of the management," he tells *FocusM*.

Minority Shareholder Watchdog Group (MSWG) general manager Lya Rahman concurs the KAM section of the report has bolstered transparency. "It increases the transparency of the audit process and helps investors better understand the risks embedded in an entity," she tells *FocusM* adding that it helps them to align their investment strategy.

This is especially useful for retail investors who can use the enhanced reporting to gain deeper insight into their investee companies. "Investors want to learn more about what the auditors focused on the most, why they thought it was important and how they addressed the matters in their audit," she says.

This turn allows for a more robust discussion between investors and the management and board of directors, as investors are better-equipped to ask the right questions.

"This is especially for the smaller listed companies where independent information may not be as widely available compared to the bigger listed companies," Lya adds.

The shareholder emphasises that responsible directors and management have a duty to provide an adequate response and explanation to the matters raised in the KAM, preferably during the AGM.

Furthermore, there is the opportunity for companies to benefit from the more detailed reports and from taking the effort to address the issues raised. "Any enlightened board of directors and management will take seriously the contents of KAM which forms an integral part of the independent auditors' report."

"It gives them a chance to explain and market their company to investors and prospective investors," he opines.

## Reports can improve further

Given that this is just the first tranche of enhanced reports since the new requirements came into effect this year, the shareholder believes that there is still room for improvement.

"The investing public should give the independent auditors some time to improve on the quality and effectiveness of KAM," he says.

MSWG's Lya sees the development as positive as she believes it sets a trend towards tailoring the auditors' report with the end-user in mind.

"KAM and the audit report needs to be crafted in such a manner that it is informative yet easy to understand," she says. She hopes auditors will move away from using generic language, jargon or boilerplate report templates.

"This will be the challenge but MSWG believes it is not too large a hurdle to overcome," Lya adds.

*FocusM*