KAM: THE MATTERS THAT MATTER - EMBRACING THE SPIRIT OF THE NEW REQUIREMENTS

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About this publication

This publication has been developed to help practitioners understand and effectively implement the new auditing standard; ASA/ISA (NZ) 701 *Communicating Key Audit Matters in the Independent Auditor's Report*.

Key audit matters (KAM) will be required in audit reports for listed entities in Australia and listed issuers in New Zealand for periods ending on or after 15 December 2016.

This guidance is intended to be read in conjunction with the auditing standards and provides helpful examples only.

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Never before in the history of auditing have we seen such a **REVOLUTIONARY CHANGE THAT WILL SIGNIFICANTLY IMPROVE THE VALUE OF AUDIT.** We encourage innovation so that audit **reports are insightful and unique**, and we challenge our markets and regulators to support and **embrace these differences**.

LEE WHITE FCA
CEO, CHARTERED ACCOUNTANTS AUSTRALIA AND NEW ZEALAND

HOW TO IDENTIFY KAM

WHAT ARE KAM?

KAM are defined 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.

HOW ARE KAM DETERMINED?

The matters communicated with those charged with governance (TCWG) is the starting point. The judgement-based decision-making framework is a two-step process, beginning first with the narrowing of matters to those that required significant auditor attention and then a further narrowing of matters to those of most significance.

FIGURE 1: KAM JUDGEMENT-BASED DECISION-MAKING FRAMEWORK

MATTERS COMMUNICATED WITH TCWG

When determining matters to communicate with TCWG you should always consider:

- Areas of higher assessed risks of material misstatements or significant risks (ie risks requiring special audit consideration)
- Significant auditor judgements relating to areas of significant management judgement
- The effect on the audit of significant events or transactions

There are various standards that require specific communications with TCWG, for example:

- ASA/ISA (NZ) 550 *Related parties* – significant matters arising during the audit in connection with the entity's related parties.
- ASA/ISA (NZ) 600 *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)* – various matters such as an overview of the nature of the group engagement team's planned involvement in the work to be performed by the component auditors on the financial information of significant components.
- ASA/ISA (NZ) 220 *Quality Control for an Audit of Financial Statements* – difficult or contentious matters, for example; a technical matter where the auditor consulted with others outside the firm.

MATTERS REQUIRING SIGNIFICANT ATTENTION

The concept of significant auditor attention recognises that an audit is risk-based. For a particular account balance, class of transactions or disclosure, the higher an assessed risk of material misstatement at the assertion level, the more judgment is often involved. In designing audit procedures, you are required to obtain more persuasive audit evidence, so you may increase the quantity of the evidence, or obtain evidence that is more relevant or reliable. For example, you may place more emphasis on obtaining third party evidence or by obtaining corroborating evidence from a number of independent sources.

MATTERS OF MOST SIGNIFICANCE

How to determine matters of most significance

The concept of matters of most significance is applicable in the context of the entity and the audit that was performed. In determining the relative significance of a matter communicated with TCWG and whether such a matter is a KAM, the following considerations may be particularly relevant:

- Matters which involved the most communication with TCWG
- Matters determined to be important to the users of the financial statements (eg breach of loan covenants)
- Where management's selection of an appropriate accounting policy was complex or involved subjectivity (eg forestry valuation)
- Whether there are any misstatements identified that related to the matter
- Matters which required the most audit effort (eg areas where you spent most of your time during the audit)
- Areas where there have been difficulties in applying audit procedures, evaluating the results of those procedures, or obtaining relevant and reliable evidence, in particular as judgments become more subjective (eg financial instruments in level 3 of the fair value hierarchy)
- Areas affected by a severe control deficiency or breakdown.

How many there should be

The requirements do not specify how many KAM should be reported. It is expected that the number of KAM will vary between entities, even for those entities in the same industry, and even for the same entity year on year. Determining the number of KAM to be included in the audit report may be affected by the:

- Size and complexity of the entity
- Nature of the business environment
- Facts and circumstances of the audit engagement.

If it is determined that there are no KAM to communicate, then this should be explicitly stated in the audit report.

Year on year considerations

A matter that is included as a KAM in one period does not automatically become a KAM in the following period. While it will be useful to consider whether a prior year KAM should still be a KAM in the current period, ultimately KAM for each period depend on what matters are considered of most significance for that period.

What a KAM is not

A KAM is not:

- A substitute for disclosures in the financial statements
- A substitute for a modified opinion
- A substitute for reporting a material uncertainty related to going concern
- A separate opinion on individual matters
- An implication that a matter has not been resolved by the auditor.

EXCEPTIONS FOR REPORTING KAM

Since the concept of KAM is linked to the relative importance of matters, it is envisaged that there will be at least one KAM for an audit, except in rare situations. These situations are listed in the standard[1]. Also, KAM are not reported if there is a disclaimer of opinion.

DOCUMENTATION OF KAM IN THE AUDIT FILE

The same principles apply from ASA/ISA (NZ) 230 *Documentation*; the audit file documentation must be sufficient to enable an experienced auditor, having no previous connection with the audit, to understand, among other things, significant professional judgements. You will need to document on the audit file professional judgements about:

- Why a matter that required significant auditor attention is, or is not, a KAM
- If there are no KAM, the rationale why
- When a matter was determined to be a KAM during the audit process, but it was not communicated in the audit report.

There is no requirement to document the rationale why matters communicated to TCWG were not matters that required significant auditor attention.

1. Para. 14 of ASA/ISA (NZ) 701

HOW TO WRITE KAM

WRITING KAM

The description of KAM should provide a succinct and balanced explanation to enable intended users to understand why the matter was one of most significance in the audit and how the matter was addressed in the audit. KAM should be entity-specific, audit-specific and avoid standardised, overly technical words and jargon.

As the new requirements are implemented, there is likely to be an element of experimentation and innovation. This opportunity should be embraced, and diversity in approach is certainly encouraged. As a result, KAM will vary in wording, tone and depth.

When KAM are communicated, they must be presented in a separate section of the audit report. Each KAM must have an appropriate subheading and the following introductory paragraph must be included:

KEY AUDIT MATTERS

Key audit matters are those that, in our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

The description of KAM must always include:

- Why the matter is considered a KAM
- How the matter was addressed in the audit
- Reference to the related disclosure(s), if any.

WHY THE MATTER IS CONSIDERED A KAM

Explaining the factors that led you to concluding that a particular matter required significant auditor attention and was of most significance in the audit is likely to be of interest to intended users. The description may make reference to principle considerations such as:

- Economic conditions that affected the auditor's ability to obtain audit evidence, for example illiquid markets for certain financial instruments
- New or emerging accounting policies, for example entity-specific or industry-specific matters on which the engagement team consulted within the firm
- Changes in the entity's strategy or business model that had a material effect on the financial statements.

EXAMPLE:

COCHLEAR LIMITED Y/E
30 JUNE 2015

Patent dispute provision $21.3 million

The patent dispute provision relates to a specific claim that has been made against the Consolidated Entity. We focused on this area as a key audit matter due to the amounts involved being material as well as the inherent uncertainty in the application of the measurement aspects of accounting standards to determine the amount, if any, to be provided for and the disclosures to be made in respect of this matter.

The description of KAM should not be a mere reiteration of what is disclosed in the financial statements. Here is an extract from Cochlear's *Note 5.4 Provisions* to illustrate that the KAM is not a duplication of the disclosure.

PATENT DISPUTE

In a trial of the patent infringement lawsuit by the Alfred E. Mann Foundation for Scientific Research and Advanced Bionics LLC in January 2014, a Jury found that Cochlear Limited and its US subsidiary Cochlear Americas infringed four claims across two patents, the infringement was wilful and awarded United States dollars (USD) 131,216,325 in damages.

On 1 April 2015, a Judge in the United States District Court in Los Angeles, California held that three of the four patent claims were invalid and Cochlear's infringement of the remaining claim was not wilful. The Judge overturned the damages awarded because three of the four claims were held to be invalid. On 21 April 2015, the Court entered Judgment on liability only and stayed a new trial on damages pending the outcome of the appeal by all parties from the Judgment to the United States Court of Appeals for the Federal Circuit.

As the patents have expired, the Judgment will not disrupt Cochlear's business or customers in the United States.

The directors have obtained external advice and are of the opinion that the facts and the law do not support the Court's decision on infringement of the one remaining claim.

The nature of the above legal process is such that final future outcomes are uncertain.

The directors have made judgements and assumptions relating to their best estimate of the outcome of this litigation and actual outcomes may differ from the estimated liability.

A provision was expensed in the half year ended 31 December 2013 in relation to this dispute. No additional amount has been provided since that initial provision. For the purpose of determining this provision, Cochlear considered its independent damages expert's assessment prepared for the trial to estimate the liability that could result from the dispute.

HOW THE MATTER WAS ADDRESSED IN THE AUDIT

The description of how the matter was addressed in the audit may include:

- Aspects of the auditor's response or approach
- A brief overview of procedures performed
- An indication of the outcome of the audit procedures
- Key observations with respect to the matter.

Flexibility has specifically been allowed to avoid the use of "boilerplate" communications. The standard allows flexibility to describe more broadly how the matter was addressed in the audit rather than specifically requiring a description of the auditor's response, findings or procedures. The level of detail to include is a matter of professional judgement.

REFERENCE TO THE RELATED DISCLOSURE(S)

As well as referencing the related disclosure, you may wish to draw attention to specific aspects of the disclosure.

EXAMPLE:
ASX LIMITED Y/E 30 JUNE 2015

Refer to page 40 (Consolidated balance sheet) and page 54 note C1 for details of management's impairment test and assumptions.

EXAMPLE:
DOWNER EDI LIMITED Y/E 30 JUNE 2015

Our procedures included, amongst others

- We assessed management's determination of the Group's CGUs based on our understanding of the nature of the Group's business and the economic environment in which the segments operate. We also analysed the internal reporting of the Group to assess how earnings streams are monitored and reported;
- We evaluated management's process regarding valuation of the Group's goodwill assets to determine any asset impairments. We tested controls were being performed, such as the preparation and review of forecasts. These forecasts take into consideration the impacts of the sector specific challenges that the Group faces;
- We challenged the Group's assumptions and estimates used to determine the recoverable value of its assets, including those relating to forecast revenue, cost, capital expenditure, discount rates and foreign exchange rates by adjusting for future events and corroborating the key market related assumptions to external data;
- We checked the mathematical accuracy of the cash flow models and agreed relevant data to the latest forecasts;
- We assessed the historical accuracy of forecasting of the Group;
- We performed sensitivity analysis in two main areas. These included the discount rate and terminal growth assumptions on the CGUs with a higher risk of impairment; and
- We also assessed whether assumptions, such as working capital and capital spend, had been determined and applied consistently across the Group.

INTERACTION WITH OTHER PARTS OF THE AUDIT REPORT

INTERACTION WITH SIGNIFICANT RISKS

Areas of significant management judgements and unusual transactions may often be identified as significant risks. Significant risks are often areas that require significant auditor attention. However, this may not be the case for all significant risks. For example; ASA/ISA (NZ) 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* requires the fraud risk of management override of controls to be a significant risk in all audits, but this may not require significant auditor attention in a particular year compared to other issues.

RELATIONSHIP WITH MODIFIED OPINIONS

MODIFIED OPINION	KAM
QUALIFIED	Include the usual KAM section; AND Reference the Basis for Qualified Opinion in the KAM section. "In addition to the matter described in the Basis for Qualified Opinion section, we have determined the matters described below to be the key audit matters to be communicated in our report." [Description of each key audit matter]
ADVERSE	Include the usual KAM section; AND Reference the Basis for Adverse Opinion in the KAM section. "In addition to the matter described in the Basis for Adverse Opinion section, we have determined the matters described below to be the key audit matters to be communicated in our report." [Description of each key audit matter]
DISCLAIMER	There must not be a KAM section.

INTERACTION WITH GOING CONCERN

Matters related to going concern may be determined to be KAM. A material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern is, by its nature, a KAM. Emphasis of Matter paragraphs are no longer to be used for communications around going concern.

The following table outlines the reporting for each type of going concern issue.

If the use of the going concern basis of accounting is inappropriate	• An adverse opinion • A description of this circumstance in the *Basis for Adverse Opinion* section • Reference the *Basis for Adverse Opinion* in the KAM section
When the use of the going concern basis of accounting is appropriate but a material uncertainty exists related to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern and disclosures in the financial statements are adequate	• An unmodified opinion • A section with a new required heading *Material Uncertainty Related to Going Concern*, with a reference to the note in the financial statements that describes the material uncertainty, and a statement that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter. • Reference the *Material Uncertainty Related to Going Concern* in the KAM section "In addition to the matter described in the Material Uncertainty Related to Going Concern section we have determined the matters described below to be the key audit matters to be communicated in our report." [Description of each key audit matter]
When the use of the going concern basis of accounting is appropriate but a material uncertainty exists related to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern and disclosures in the financial statements are inadequate or omitted	• A qualified or adverse opinion as appropriate • A description of this circumstance in the *Basis for Qualified/Adverse Opinion* section • Reference the *Basis for Qualified/Adverse Opinion* in the KAM section
When the use of the going concern basis of accounting is appropriate but events or conditions were identified that may cast doubt on the entity's ability to continue as a going concern but, based on the audit evidence obtained the auditor concludes that no material uncertainty exists[2]	• An unmodified opinion • Report as a KAM

2. This is otherwise known as a "close call"

RELATIONSHIP WITH OTHER PARAGRAPHS

PARAGRAPH	DEFINITION
EMPHASIS OF MATTER	Used to draw users' attention to a matter disclosed in the financial statements that is fundamental to users' understanding of the financial statements.
OTHER MATTER	Used to draw users' attention to a matter other than those disclosed in the financial statements that is relevant to users' understanding of the audit, the auditor's responsibilities or the audit report.

A matter that is determined to be KAM is usually fundamental to users' understanding of the financial statements, the audit, the auditor's responsibilities or the auditor's report. Therefore it may also meet the definition of an Emphasis of Matter or an Other Matter. If this is the case, then the matter is a KAM as opposed to an Emphasis of Matter or Other Matter.

In summary, Emphasis of Matter and Other Matter paragraphs still exist, but should not be used for a matter that is a KAM.

There may be a matter that is not determined to be a KAM (ie because it did not require significant auditor attention), but is fundamental to users' understanding of the financial statements, the audit, the auditor's responsibilities or the auditor's report (for example a subsequent event). If it is considered necessary to draw users' attention to such a matter, the matter is included in an Emphasis of Matter or Other Matter paragraph as appropriate.

The KAM section in the audit report does not have to reference the Emphasis of Matter or Other Matter paragraph. An Emphasis of Matter paragraph may be presented either directly before or after the KAM section, depending on the relative significance of the information in each. When a KAM section is presented in the auditor's report and an Other Matter paragraph is also considered necessary, you may add further context to the heading "Other Matter", such as "Other Matter – Scope of the Audit", to differentiate the Other Matter paragraph from the KAM section.

PRACTICAL TIPS

WHEN TO CONSIDER

It may be advantageous to develop a preliminary view at the planning stage of which matters are likely to be KAM and communicate these to the audit committee at the initial planning meeting. However, the final determination of KAM is based on the results of the audit, therefore the assessment of what matters are KAM may change throughout the audit. Therefore you may have further discussions about KAM with the audit committee when communicating audit findings.

You may find it useful to provide the audit committee with draft KAM at the planning stage of the audit to focus their minds from the very start of the process. This also prepares for easier discussions at the end of the audit when timing is tight, and it can also help initiate discussions on things that may have changed during the audit. In summary it acts as a valuable tool to assist the audit committee's understanding.

WHAT ORDER

There is no requirement for a specific ordering of KAM. They may be organised in order of relative importance, based on the auditor's judgement, or may correspond to the order in which matters are disclosed in the financial statements.

NO RELATED DISCLOSURES

You might find that a matter to which a KAM relates is not disclosed in the financial statements. That is acceptable because the description of a KAM only needs to include a reference to a related disclosure if there is one. By way of example; applicable accounting standards may not require the disclosure of the implementation of a new IT system in the notes to the financial statements.

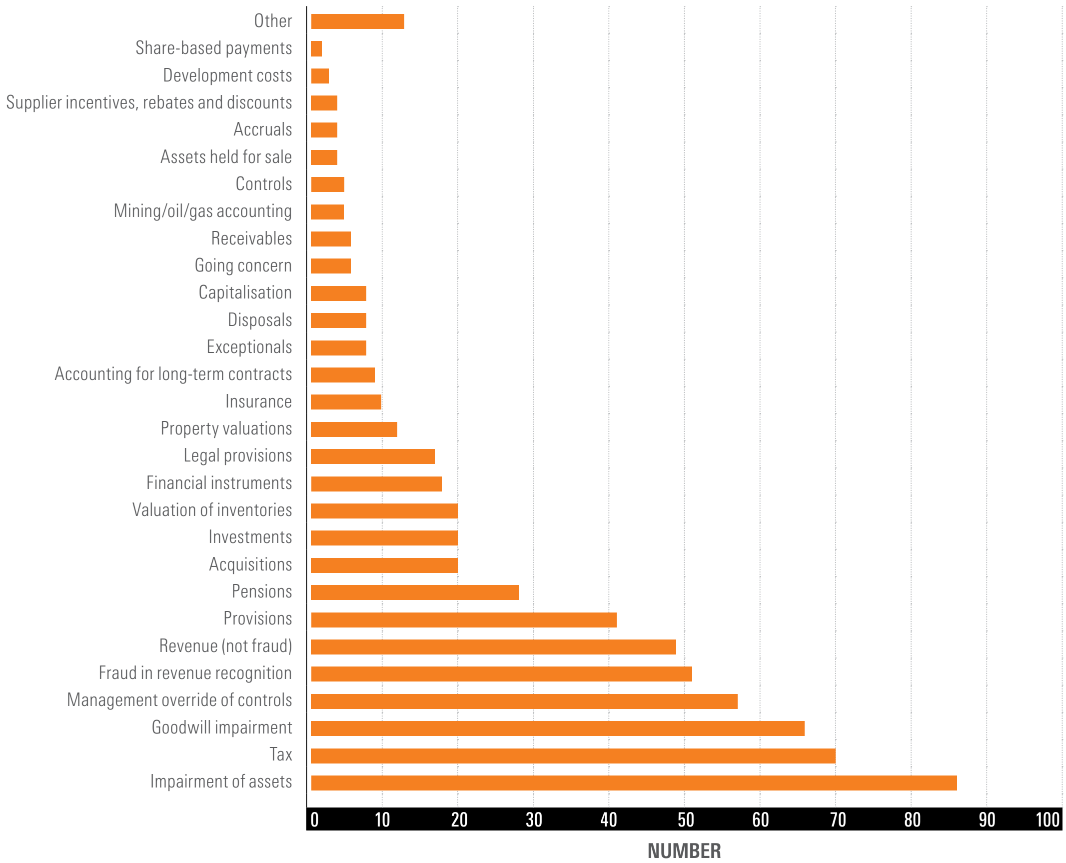
As a general rule, KAM would not provide original information, which is any information about the entity that has not otherwise been made publicly available by the entity. Rather than providing original information, management or TCWG should be encouraged to disclose the necessary additional information, however it is acknowledged that there may be situations where this is not practicable.

COMMON KAM

Similar new auditor reporting requirements have already been implemented in the UK. Between July and September 2014 the UK Financial Reporting Council (FRC) carried out a detailed analysis of 153 audit reports that had been published at that time. Between them they included 650 matters, which included a broad range of topics and are shown in the graph on page 14[3].

3. SOURCE: Extended Auditor's Reports: A Review of Experience in the First Year. UK Financial Reporting Council (March 2015)

FIGURE 2: ANALYSIS OF REPORTED MATTERS



SPECIFIC ISSUES FOR RESOURCE ENTITIES

Mining activities begin with the exploration and evaluation of an area of interest. If the exploration and evaluation is successful, a mine can be developed, and commercial mining production can commence. The phases before production begins can be prolonged and expensive. The appropriate accounting treatment for this investment is essential.

There are a number of issues that are unique to the mining industry, and the debate about specific guidance continues. Therefore applying accounting standards in this industry will be a continual challenge. We can look to the UK for examples of KAM.

EXPLORATION AND EVALUATION EXPENDITURES

Exploration and evaluation expenditures are defined as "expenditures incurred by an entity in connection with the exploration for and evaluation of mineral resources before the technical feasibility and commercial viability of extracting a mineral resource are demonstrable". They include:

- Acquisition of rights to explore
- Topographical, geological, geochemical and geophysical studies
- Exploratory drilling
- Trenching
- Sampling
- Activities in relation to evaluating the technical feasibility and commercial viability of extracting a mineral resource.

The accounting treatment of exploration and evaluation expenditures (capitalising or expensing) can have a significant impact on the financial statements and reported financial results. This is particularly so for entities at the exploration stage with no production activities.

In determining whether an exploration and evaluation asset should be recognised or not there are some considerations to be made. By way of example; whether the rights to tenure of the area of interest are current; and whether the exploration and evaluation expenditures are expected to be recouped, either through successful development and exploitation or through sale.

As exploration and evaluation expenditures are often made in the hope (rather than the expectation) that there will be future economic benefits, it is difficult for an entity to demonstrate that the recovery of exploration and evaluation expenditures is probable. A feasibility study may be needed before the entity can demonstrate that future economic benefits are probable.

The following is a fictitious example to illustrate an exploration and evaluation expenditures KAM:

MINING LTD Y/E 31 DECEMBER 2016

Exploration and evaluation expenditures

The company has incurred significant exploration and evaluation expenditures which have been capitalised. As the carrying value of exploration and evaluation expenditures represents a significant asset of the company, we considered it necessary to assess whether facts and circumstances existed to suggest that the carrying amount of this asset may exceed its recoverable amount. As a result, the asset was required to be assessed for impairment.

In doing so, we carried out the following work in accordance with the guidance set out in AASB *6 Exploration for and Evaluation of Mineral Resources*:

- We obtained evidence that the company has valid rights to explore in the areas represented by the capitalised exploration and evaluation expenditures by obtaining independent searches of a sample of the company's tenement holdings;
- We enquired with management and reviewed budgets to ensure that substantive expenditure on further exploration for and evaluation of the mineral resources in the company's areas of interest were planned;
- We enquired with management, reviewed announcements made and reviewed minutes of directors' meetings to ensure that the company had not decided to discontinue activities in any of its areas of interest;
- We enquired with management to ensure that the company had not decided to proceed with development of a specific area of interest, yet the carrying amount of the exploration and evaluation asset was unlikely to be recovered in full from successful development or sale.

Note 12 to the financial statements contains the accounting policy and disclosures in relation to exploration and evaluation expenditures.

IMPAIRMENT OF MINING PROPERTIES

Due to the depressed nature of many commodity prices, the increasing costs of mining operations, and the other constantly changing variables that form part of mine plans, an impairment review of mine properties for significant mining operations would be a common KAM.

EXAMPLE:
ASIA RESOURCE MINERALS PLC Y/E 31 DECEMBER 2014

Assessment of carrying value of mining properties

This balance is material and its value is highly sensitive to changes in the global thermal coal market. In 2014 thermal coal prices continued to decline which increased the risk of impairment of the Group's mining properties. As part of their annual impairment review management prepared an analysis of the recoverable amount of the PT Berau cash generating unit which was based on a 'fair value less costs to sell' model.

The basis of the valuation model was management's Life of Mine Plan which was independently reviewed by third party mining experts. The valuation model also includes a number of judgmental estimates and assumptions.

We tested the integrity of management's impairment model and identified the most judgemental assumptions. We tested management's commodity price assumptions (thermal coal and fuel), against third party bank and broker forecasts and found that they fell within a reasonable range and in line with market views. We evaluated management's assumption about the future sales recovery rates against the Newcastle thermal coal benchmark and found it to be supportable based on the historical rates of recovery. We tested the discount rate applied, to establish whether it was appropriately derived from market data including risk free rate and inflation assumptions and consistent with the approach adopted by a typical market participant. We agreed management's production assumptions to the latest Board approved Life of Mine production plans and budgets and found no material differences. We assessed the competence and the independence of experts used by management to review the Life of Mine Plan and were satisfied with their objectivity and expertise. We obtained sufficient evidence to support other key inputs into the model, such as contractor costs and capital expenditure assumptions, and, where appropriate, corroborated these assumptions by reviewing signed contracts or approved budgets. We re-performed the sensitivity analysis prepared by management to ascertain the extent to which a change in key assumptions (production volumes, coal and fuel prices and discount rate) would result in impairment. We concur with management's analysis as disclosed in the financial statements.

Refer to Note 2 for the directors' disclosures of the related accounting policies, Note 3 for critical accounting judgements and estimates and Note 13 for detailed disclosures.

GOING CONCERN

Consider an entity in the mining industry in the exploration stage. It has the following attributes:

- Has planned levels of exploration spending that exceed its cash balance;
- Expects that future capital raising will provide the necessary funding;
- Does not have material current or non-current liabilities; and
- Has minimal contractual commitments other than payments required to maintain its exploration property and permit rights.

If it becomes difficult to raise financing in the capital markets, the entity can take the following actions until financing is possible:

- Slow its rate of exploration activity and associated spending to a level that can be sustained for a significant period of time based on its existing financial resources; or
- Defer exploration spending to the level necessary to keep its exploration property and permit rights, and reduce its operational spending to a level that enables it to "keep the lights on" for a significant period of time.

The entity does not intend to curtail its operations permanently nor does it intend to pursue liquidation. Rather, it is pursuing additional financing to continue its activities.

It's easy to see how an entity that does not have sufficient funds and faces significant uncertainty about its ability to raise funds may have a material uncertainty related to going concern.

ADAPTED EXAMPLE*
NEW WORLD RESOURCES PLC Y/E 31 DECEMBER 2014

Material Uncertainty Related to Going Concern

In forming our opinion on the financial statements, which is not modified, we have considered the adequacy of the disclosures made in Note 2 to the consolidated financial statements concerning the Group's and the Company's ability to continue as a going concern. The Group is currently cash flow negative and the current low coal price environment has placed significant pressure on the Group's liquidity position, and also on its solvency, resulting in the Group having net liabilities of EUR 160 million at 31 December 2014. The Directors completed a capital restructuring during the year, which is expected to provide sufficient cash for a period of 12 months from its completion. However, in the event of unexpected production or other operating issues, or further deterioration in coal prices, the Group could be in breach of the minimum available cash requirement for the Super Senior Credit Facility, which is set at EUR 40 million and is first tested as at 31 October 2015. In those circumstances the Group could run out of cash in the fourth quarter of 2015 and all of the remaining debt of the Group could become immediately repayable.

These conditions, along with other matters explained in Note 2 to the consolidated financial statements, indicate the existence of a material uncertainty which may cast significant doubt as to the Group's and the Company's ability to continue as a going concern. The financial statements do not include the adjustments that would result if the Group and Company were unable to continue as a going concern.

* This example has been adapted from an Emphasis of Matter paragraph.

However, the nature of the business and the entity's stage in the business life cycle may require a different approach to assessing going concern. The only time when going concern can be a KAM is when the use of the going concern basis of accounting is appropriate but there is a close call.

EXAMPLE:

AVOCET MINING PLC Y/E 31 DECEMBER 2014

Going concern assessment

The accounts are prepared on a going concern basis in accordance with IAS 1 *Presentation of Financial Statements* and as the directors' assessment of the group's ability to continue as a going concern can be highly judgemental, we identified going concern as a significant risk requiring special audit consideration.

Our audit work included, but was not restricted to, the following:

- An evaluation of the directors' assessment of the group's ability to continue as a going concern. In particular, we reviewed cash flow forecasts for the period to the end of the life of mine plan, performing sensitivity analysis to assess the risk of a breach of covenants, and reviewing and challenging the directors' assumptions, including future sales of gold and the expected market gold price;
- Reviewed documentation in place in respect of discussions with third parties in relation to funding and developing the Tri-K asset;
- An evaluation of the directors' plans for future actions in relation to its going concern assessment, taking into account any relevant events subsequent to the year-end through discussion with the Audit Committee and agreeing the additional funding from Elliott Management.

The group's assessment of going concern is included in note 1 to the financial statements. As noted in the *Report on Corporate Governance* on page 37, the Audit Committee also considered the liquidity and going concern of the group as one of the key areas of risk and judgement relevant to the group for the year.

SPECIFIC ISSUES FOR SMALLER ENTITIES

For smaller entities it may not be so immediately apparent what the KAM are, especially if the entity is not complex, and it is not a high-risk audit engagement. Therefore determining KAM for smaller entities comes with its own unique challenges.

If an entity has limited operations, it is possible for there to be no KAM. However, because the concept of KAM is relative as opposed to absolute, it is likely there will always be at least one KAM.

Smaller entities may not have any significant risks except the mandatory risk of management override of controls and the reputable presumption of risk of fraud in revenue recognition. But this does not automatically mean these are the only KAM, or there are no KAM. It is important to remember that KAM are broader than "significant risks"; KAM may just be areas where you spent most of your time during the audit.

Again we can look to the UK for examples of KAM for smaller entities, and see that they are not necessary related to areas of significant risk, judgement or complexity.

EXAMPLE 1:

CITY OF LONDON GROUP PLC Y/E 31 MARCH 2014

Revenue = £5.556m,
Performance materiality = £107k

Recognition of revenue

Overstatement of revenue is considered to be a significant audit risk as it is the key driver of returns to investors.

We evaluated and tested the controls relating to revenue recognition. Analytical procedures were performed linking the revenue recorded during the year to the receivable balance at the year end. Further substantive tests were performed checking the receipt of interest payments to the bank statements. The cut-off around the year end was tested to check income is recognised in the correct accounting period.

The accounting policy for revenue is outlined in note 2.20, and a breakdown of revenue is presented in note 4.

EXAMPLE 2:
HIDONG ESTATE PLC Y/E 31 MARCH 2015

Income = RM 443k, Overall materiality = RM 117k

Carrying amount of cash and listed investments

The Company's portfolio of cash and listed investments makes up 99.6% of total assets (by value) and is considered to be the key driver of operations and performance results. We do not consider cash or listed investments to be at high risk of significant misstatement, or to be subject to a significant level of judgement because they comprise liquid and, in the case of the listed investments, quoted, investments. However, due to their materiality in the context of the financial statements as a whole, they are considered to be the area which had the greatest effect on our overall audit strategy and allocation of resources in planning and completing our audit.

Our procedures over the existence, completeness and valuation of the Company's portfolio of cash and listed investments included, but were not limited to:

- documenting and assessing the processes and controls in place to record investment transactions and to value the portfolio;
- agreeing the valuation of 100% of listed investments to externally quoted prices; and
- agreeing 100% of cash and listed investment holdings to independently received third party confirmations.

Refer to page 10 (Audit Committee section of Report of Directors), page 24 (accounting policy) and pages 20 to 32 (financial disclosures).

EXAMPLE 3:
ASSOCIATED BRITISH ENGINEERING PLC Y/E 31 MARCH 2015

Revenue = £2.6m, Performance materiality = £16k

Inventory valuation and existence

British Polar Engines Limited holds a significant amount of inventory which is used for the manufacture and supply of diesel engines and spare parts, as well as associated repair works. Inventory may be held for long periods of time before utilisation making it vulnerable to obsolescence or theft. This could result in an overstatement of the value of inventory if the historical cost is higher than the net realisable value. Furthermore, the assessment and application of inventory provisions are subject to significant management judgement. We have therefore identified inventory existence and valuation as an area requiring particular audit attention.

Our audit work included, but was not restricted to, the attendance of the inventory count at the year end and the assessment of the adequacy of controls over the existence of inventory. We also tested a sample of stock items to ensure they were held at the lower of cost and net realisable value, and evaluated management judgement with regards to the application of provisions to inventory lines.

The group's accounting policies in respect of inventory are in included in the group accounting policies and disclosures are included in note 12 to the group financial statements.

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