



Circular No. 12/2016

November 11, 2016

TO: Chief Executives of Issuers of Securities to the Public

**APPLICATION OF NEW INTERNATIONAL STANDARD ON AUDITING (ISA) NO. 701
– COMMUNICATING KEY AUDIT MATTERS IN THE INDEPENDENT AUDITOR'S
REPORT**

BACKGROUND

In line with the current auditor's reporting standard, auditors have for many years, provided a binary "pass/fail" opinion on a company's financial statements. Either the financial statements fairly present (true and fair view) the company's financial position and operations in accordance with applicable accounting standards, or they do not. While the "traditional approach" remains valuable, many believe it is no longer enough. Auditors have more insights to share, and investors are eager to be informed more on the operations of an entity.

The standard setters on auditing and assurance took note and commenced a consultative project in 2006 as a joint initiative of the International Auditing and Assurance Standards Board (IAASB) and the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) in the form of an academic research to identify, and provide information and insights on user perceptions regarding the financial statement audit and the auditor's report among different classes of financial statement users.

The objective of the project was twofold as indicated below:-

- to appropriately enhance the communicative value and relevance of the auditor's report through proposed revisions to International Standards on Auditing (ISAs) requirements that address its structure and content; and
- to determine whether and how the IAASB's reporting ISAs, in their design, can be modified to accommodate evolving national financial reporting regimes, while at the same time ensuring that common and essential content is being communicated.

Arising from this research and engagements with stakeholders (where several regulators and standard setters responded with measures that would require auditors

to say more), the IAASB approved the following standards and a number of conforming amendments to other standards in January 2015:-

- ∞ *ISA 700 (Revised), Forming an Opinion and Reporting on Financial Statements*
- ∞ ***ISA 701 Communicating Key Audit Matters in the Independent Auditor's Report***
- ∞ *ISA 260 (Revised), Communication with Those Charged with Governance*
- ∞ *ISA 570 (Revised), Going Concern*
- ∞ *ISA 705 (Revised), Modifications to the Opinion in the Independent Auditor's Report*
- ∞ *ISA 706 (Revised), Emphasis of Matter Paragraphs and Other Matter paragraphs in the Independent Auditor's Report*
- ∞ *ISA 720 (Revised), The Auditor's Responsibilities Relating to Other Information*

JURISDICTIONAL APPLICATION

These standards were formally adopted by the Council of the Institute of Certified Public Accountants of Kenya (ICPAK) in April 2015 in accordance with Section 9 (3) of the Accountants Act No. 15 of 2008 which provides that "*The Council shall issue standards of professional practice, including accounting and auditing standards, which shall form the basis of accountancy practice for members of the Institute in the preparation, verification and auditing of financial statements.*" In adopting these standards, the Council noted that whereas ISA 701 was mandatory for listed entities only, certain regulators would require the communication of Key Audit Matters (KAM) in the auditor's report in the public interest. The council further noted that its current mandate was to the members and resolved to engage regulators of public interest entities with the objective of informing them of the new developments and jointly agree on the applicability of ISA 701.

ISA 701 defines KAM as those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. KAM are selected from matters communicated with those charged with governance. ISA 701 is mandatory for audits of complete sets of financial statements of listed entities, with voluntarily application allowed for entities other than listed entities. This ISA also applies when the auditor is required by law or regulation to communicate KAM in the auditor's report.

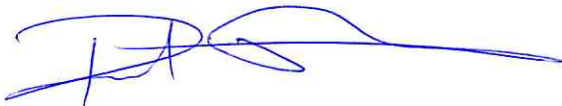
The CMA and the ICPAK have held consultative meetings on the application of ISA 701. The CMA noted that issuers of securities to the public hold assets in a fiduciary capacity for a broad group of outsiders (hold and manage financial resources entrusted to them by clients, customers or members not involved in the management of the entity) and therefore required a greater need for public accountability. There is need for consistency and comparability in the financial reporting and audit of regulated entities to ensure proper understanding and identification of the true and fair position of subject entities by users of annual report and audited financial statements to support informed decision making.

The purpose of this circular is to inform all Issuers of Securities to the Public (whether listed or not): -

1. that *ISA 701 - Communicating Key Audit Matters in the Independent Auditor's Report* is applicable to all such entities whether listed or non-listed and become effective for audits of financial statements for periods ending on or after December 15, 2016.
2. that early application is encouraged;
3. that the CMA and ICPAK will require that a key audit matters section is included in the report of the independent auditor;
that the entities engage with the Authority on any significant issues which may negatively impact on their business whenever they encounter such issues.

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