A close-up photograph of a person's hand holding a silver ballpoint pen, poised to write on a white document. The document has some faint, illegible text on it. The background is a soft-focus green wall. A yellow text box is overlaid on the top right of the image.

**Western India Regional Council (WIRC)
Audit Conclusion and Reporting
SA 700, 701, 705, 706 and 720**

**Speaker – CA Hemal Shah
June 19, 2019**

Agenda

Key changes in SA 700, 705 and 706

New And Revised Auditor Reporting Standards

Key changes in audit report in nutshell and Changes in audit report structure

SA 701- Communicating Key Audit Matters in the Independent Auditor's Report

- ▶ Key Drivers Which Have Led To The Change
- ▶ How To Identify KAM
- ▶ Key Insights From Those Countries That Have Implemented KAM So Far
- ▶ KAM Practical Considerations
- ▶ How To Write KAM
- ▶ Interaction With Other Parts Of Audit Report
- ▶ Documentation Considerations
- ▶ Examples

SA 720 (Revised) – The Auditor's Responsibilities relating to Other Information

- ▶ Objective and Scope
- ▶ What Does The Change Mean
- ▶ Consideration of the Other Information
- ▶ Responding requirements

New And Revised Auditor Reporting Standards

New and Revised SAs	Description of changes
SA 700 (Revised), Forming an Opinion and Reporting on Financial Statements	Revisions to establish new required reporting elements
SA 701, Communicating Key Audit Matters in the Independent Auditor's Report	New Standard to establish requirements and guidance in for the auditor's determination and communication of Key Audit Matters (KAMs) .
SA 705 (Revised), Modification of the Opinion in the Independent Auditor's Report	Clarification of how the new reporting requirements are affected when expressing a modified opinion
SA 706 (Revised), Communication with Those Charged with Governance(TCWG)	Required auditor communication with TCWG will now include the significant risks identified by the auditor and the circumstances that required significant modification of the auditor's planned approach to the audit, KAM etc
SA 720 (Revised), The Auditor's Responsibilities Relating to Other Information	Auditor is required to read and consider the Other Information to ascertain cases material inconsistency between Other information and auditors knowledge obtained in the audit.

Key Changes In Audit Report In A Nutshell

Existing format of audit report	Key changes
<ul style="list-style-type: none">q Audit Report commences with management responsibility on financial statements.q No separate reference in Basis for Opinion paragraph. Indirect reference to compliance with independence requirements contained in Auditor's Responsibility paragraph, wherein it was stated that "we comply with ethical requirements".q Management's Responsibility for the financial statements paragraph used to convey the responsibility of Company's Board of Directors w.r.t preparation of financial statements and related matters.	<ul style="list-style-type: none">q Audit report will start with audit opinion.q New Basis for Opinion paragraph to follow the audit opinion and will state that the auditor is independent of the entity being audited in accordance with the Code of Ethics issues by (ICAI) together with the ethical requirements that are relevant to the audit of the financial statements under the provisions of the Companies Act, 2013 and the Rules thereunder, and the auditor has fulfilled ethical responsibilities in accordance with these requirements and the Code of Ethics.q Management's Responsibility for the financial statements paragraph to continue to convey the responsibility of Company's Board of Directors w.r.t to preparation of financial statements and to state management is responsible for assessing the entity's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.q Explicit requirement to stated that Board of Directors are also responsible for overseeing the entity's financial reporting process.

Key Changes In Audit Report In A Nutshell

Existing format of audit report	Key changes
<ul style="list-style-type: none">q Auditor's Responsibility paragraph used to convey that audit was planned and performed to obtain reasonable assurance about whether the financial statement are free from material misstatement. q Further, Auditor's Responsibility paragraph used to convey that procedures selected depended on auditor's judgment, including assessment of risk of material misstatement of financial statements, whether due to fraud or error. In making those assessments, the auditor considers internal financial control relevant to the Company's preparation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances. q Audit report does not require reporting of KAM.	<ul style="list-style-type: none">q Auditor's Responsibility paragraph reworded and states to state that the objective is to obtain reasonable assurance about whether the financial statements as a whole, are free from material misstatement, whether due to fraud or error AND defines what is reasonable assurance. Paragraph also states that "Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements." q The reworded paragraph excludes the wording related to procedures and auditor's judgment as aforementioned. q Auditors of listed companies must report the KAM.

Auditors' Report: Changes in Report Structure

Earlier Structure of Auditor's Report: Report on the Financial Statements

- ▶ Title: Independent Auditor's Report
- ▶ Addressee: As per Engagement terms
- ▶ Subtitle: Report on the FS
- ▶ Introductory Paragraph: To mention
 - ▶ Whose FS are audited and period covered
 - ▶ Title of each statement in FS
 - ▶ Refer summary of significant accounting policies and explanatory information
- ▶ Management's Responsibility for the Financial Statements
- ▶ Auditor's Responsibility
- ▶ Basis for modified opinion, if any
- ▶ Auditor's Opinion
- ▶ Emphasis of Matter
- ▶ Other Matters
- ▶ Subtitle: Report on Other Legal and Regulatory Requirements
- ▶ Signature
- ▶ Date
- ▶ Place

Revised Structure of Auditor's Report: Report on the Audit of Financial Statements

- ▶ Title: Independent Auditor's Report
- ▶ Addressee: As per Engagement terms
- ▶ Subtitle: Report on the Audit of the FS
- ▶ Opinion: Including information to be mentioned in introductory paragraph before
 - ▶ **Basis for Opinion**
 - ▶ Emphasis of Matter
 - ▶ **Key Audit Matters**
 - ▶ Responsibilities of Management and **Those Charged with Governance** for the Financial Statements
 - ▶ Auditor's Responsibilities for the Audit of the Financial Statements - **enhanced**
- ▶ Other matter
- ▶ **Subtitle: Report on Other Legal and Regulatory Requirements***
- ▶ Signature
- ▶ Date
- ▶ Place

* Additional reporting on managerial remuneration u/s 143(3) in addition to reporting on CARO

SA 701 – Communicating Key Audit Matters in the Independent Auditor's Report



Key Drivers Which Have Led To The Change

Outsiders wanted ways to focus the attention of management and directors and the audit committee members on the big problems. If a company has big risks, or problems, regulators want to know that auditors have focused their Reporting on these issues which tells us that the auditor focused on these issues during the audit.

Jim Sylph, Co-Chair of IAASB's Auditor Reporting Implementation Task Force

The auditor's opinion is valued, and users want to hear more from the auditor -more pertinent, and more tailored information about the specific audit performed on an entity's financial statements. There is symbolic value in the current audit report, but little communicative value- and the users see the potential for the auditor to provide more value and more transparency. So now is the time to lay the foundation for the auditor's report of the future.

Prof Arnold Schilder, Chairman IAASB

Financial crisis led investors, regulators and other stakeholders to ask whether Auditors, Directors and Audit committee were:

- ∅ Having the right conversations; and
- ∅ Addressing the risks appropriately when necessary and
- ∅ Wanted an insight into the above

SA 701 - Scope

Scope of SA - 701

- Applies to audits of complete sets of general purpose financial statements of listed entities
- Circumstances when the auditor otherwise decides to communicate KAMs in the auditor's report.

This SA also applies when the auditor is required by law or regulation to communicate key audit matters in the auditor's report.

SA 701 V/s SA 570

A matter giving rise to a modified opinion in accordance with SA 705 (Revised), or a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with SA 570 (Revised), are by their nature key audit matters.

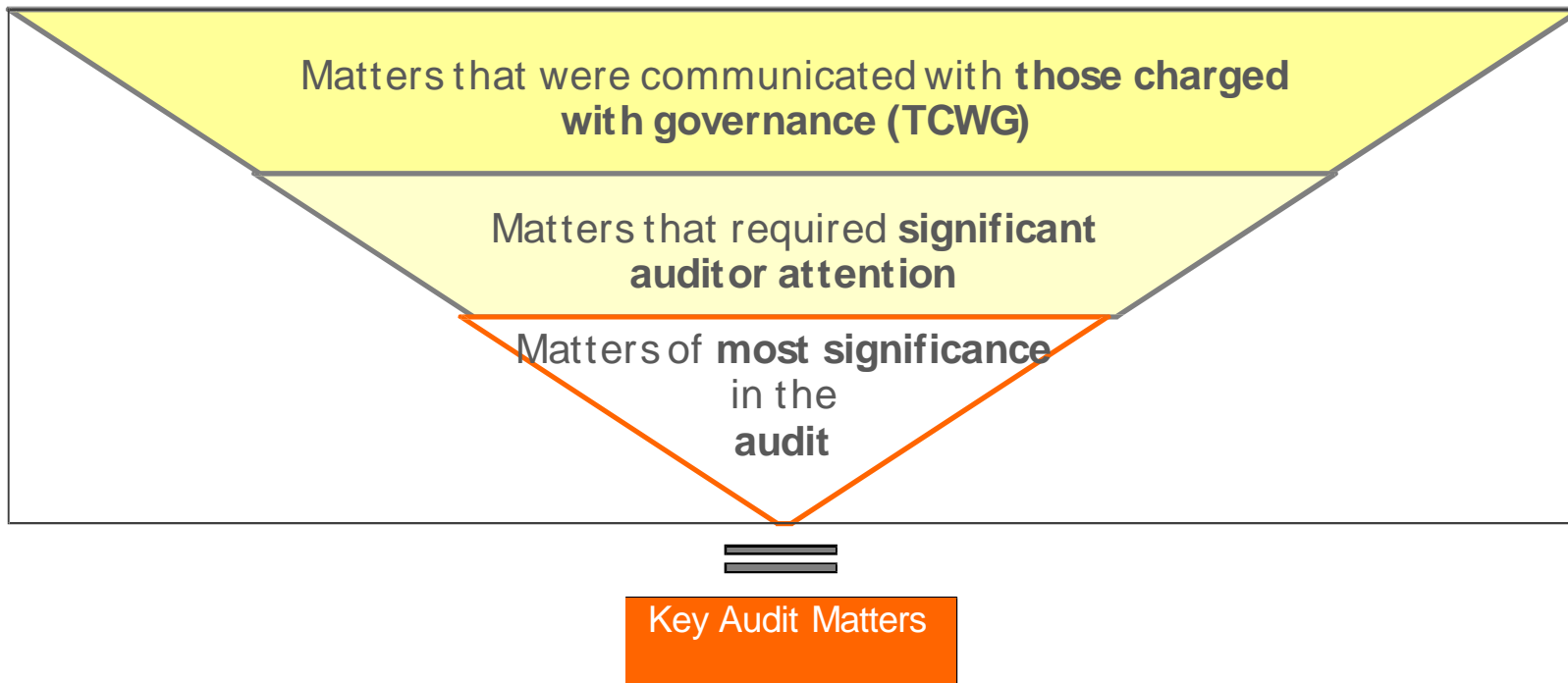
However, in such circumstances, these matters shall not be described in the Key Audit Matters

Rather, the auditor shall:

- (a) Report on these matter(s) in accordance with the applicable SA(s); and
- (b) Include a reference to the Basis for Qualified (Adverse) Opinion or the Material Uncertainty Related to Going Concern section(s) in the Key Audit Matters section.

How To Identify KAM

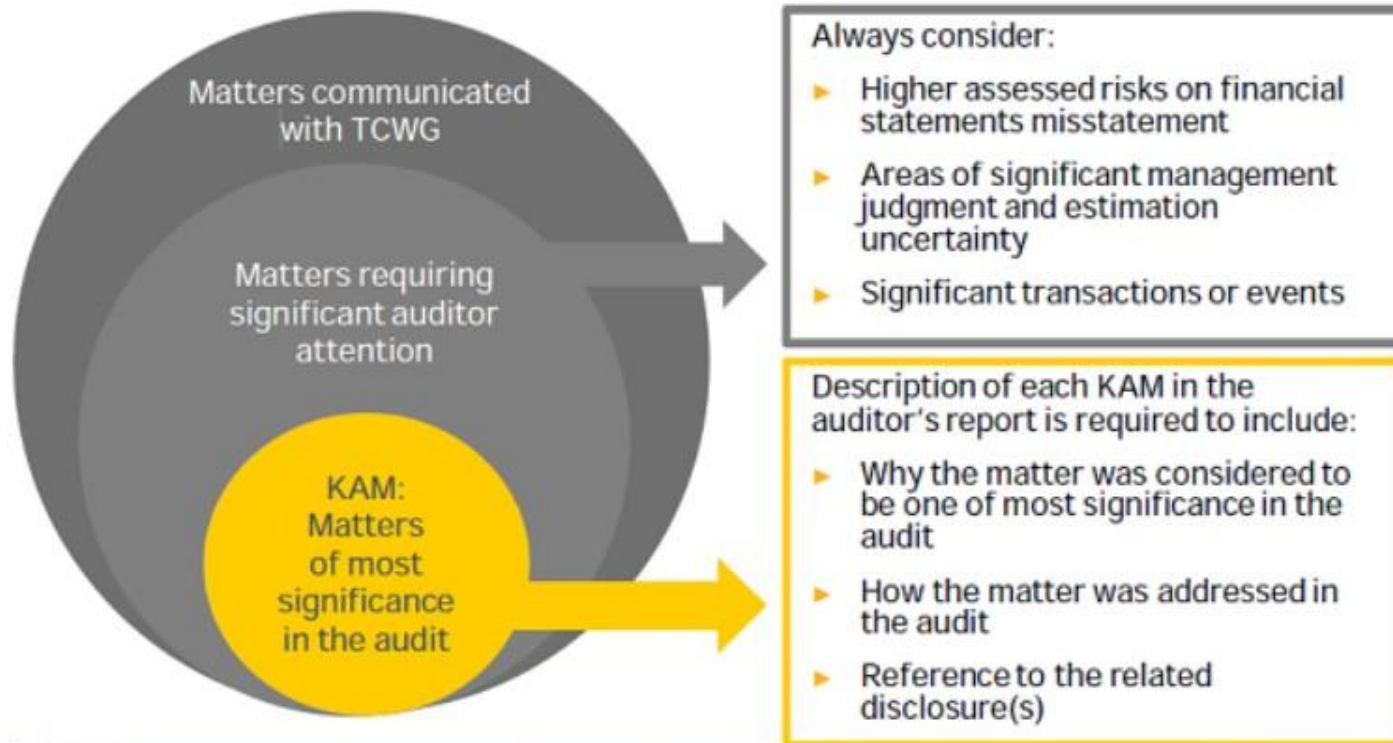
- ▶ KAM are defined as those matters that, in the **auditor's professional judgment**, were of **most significance** in the audit of the financial statements of the current period



How To Identify KAM

- ▶ KAM are defined 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

Determination of Key Audit Matter (KAM)



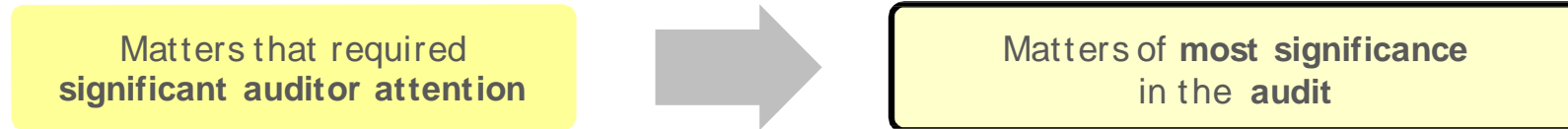
How To Identify KAM



The auditor will always consider

- § Areas of higher assessed risks of material misstatements or significant risks (i.e. risks requiring special audit consideration)
- § Significant auditor judgments relating to areas of significant management judgment (e.g., complex accounting estimates)
- § Effect on the audit of significant events or transactions

How To Identify KAM



KAM are determined by the auditor's consideration of the:

- § Matters which involved most communication with TCWG
- § Matters determined to be important to the users of financial statements
- § Where management's selection of an appropriate accounting policy was complex or involved subjectivity
- § Whether there were any misstatements identified that related to the matter
- § Matters which required most audit effort
- § Areas where there have been difficulties in applying audit procedures, evaluating the results of those procedures, and obtaining relevant and reliable evidence
- § Areas affected by a severe control deficiency relevant to the matter (if any)
- § Whether there were any misstatements identified that related to the matter

Key Audit Matters

International Experience

- ▶ Being adopted in more than **110 countries**
- ▶ Earlier adoption in a number of countries – UK, Netherlands, South Africa, Australia
- ▶ **Challenges identified**
 - ▶ Management time involved
 - ▶ Disclosure of sensitive information
 - ▶ Board collaboration

AUSTRALIA

Top 5 KAM topics:

- ▶ Goodwill (and related CGU assets such as intangibles and PPE)
- ▶ Revenue
- ▶ Taxation
- ▶ Acquisitions
- ▶ Inventory

UNITED KINGDOM

Top 5 KAM topics:

- ▶ Revenue Recognition
- ▶ Estimates
- ▶ Taxation
- ▶ Goodwill (and related CGU assets such as intangibles and PPE)
- ▶ Valuation of financial instruments

KAM Sector wise insights

Based on survey of auditor's report of 128 entities between 01 July and 19 September 2017 of ASX 200 with June 30, 2017 year ends applying exclusively the Australian auditing standards. (Source: Key audit matters, Auditor's report snapshot September 20, 2017, KPMG Publication)

Particulars	Consumer & Retail	Other Corporates	Real Estate	Financial	Energy & Natural Resources	Infrastructure, Government & Health	Total
Goodwill (and related CGU assets)	11	28	5	11	7	18	80
Revenue	6	13	6	4	4	4	37
Taxation	1	5	2	2	10	6	26
Acquisitions	10	9	2	-	1	3	25
Inventory	8	5	5	-	5	1	24
Provisions	2	4	-	5	10	1	22
Property investments	-	-	17	1	-	2	20
Receivables & allowances	6	3	1	3	4	2	19
Investment in related entities	-	6	2	1	3	2	14
Investments	-	1	-	13	-	-	14
Insurance related	-	-	-	11	-	1	12
PPE & finite life intangibles	4	4	-	1	1	2	12

KAM Sector wise insights

Cont..

Particulars	Consumer & Retail	Other Corporates	Real Estate	Financial	Energy & Natural Resources	Infrastructure, Government & Health	Total
Exploration & Evaluation	-	1	-	-	10	-	11
Financial instruments	-	-	3	2	3	1	9
Other	2	2	1	3	-	1	9
Disposals & assets held for sale	3	3	-	-	1	1	8
Interest bearing liabilities	-	3	1	-	1	1	6
IT systems	2	2	-	2	-	-	6
Trade & other payables	-	3	-	-	2	1	6
Expenses	-	1	-	3	-	-	4
Going concern related	-	-	-	-	-	-	-
Total	55	93	45	62	62	47	364

Key Insights From Those Countries That Have Implemented KAM So Far

United Kingdom

- **Conciseness**

Investors value information particularly highly when it is presented in a **concise way**. Auditors are expected to convey granular information about highly technical matters in a concise and easy to understand way.

Average word count in the risk sections of extended auditor's reports

Firm		Deloitte	EY	KPMG	PwC	Others
Average word count	(All)	893	971	992	1,557	787
Average word count	(FTSE 100)	972	1,046	1,205	1,858	1,256

Number of KAMs

Depends upon the nature and complexities, however, lengthy lists of key audit matters may be contrary to the notion of such matters being those of most significance in the audit.

KAM Practical Considerations

- ▶ Applicability
 - ▶ Interim financial statements / Regulation 33 or 52 of LODR
 - ▶ Tax financial statements
 - ▶ Unlisted entities
 - ▶ In process of getting listed
 - ▶ Early adoption
- ▶ Can an item be KAM if there is no relevant disclosures required in the financial statements?
- ▶ Can KAM be different for different years?
 - Impact of comparative data?
- ▶ How many number of KAMs to be reported?
 - ▶ Can there be no KAM?
- ▶ Circumstances in which KAM is not reported
- ▶ Should conclusion be provided for every KAM?
- ▶ Order of KAMs
- ▶ KAM on CFS
- ▶ KAM in case of Joint audit
- ▶ Interplay between EOM (Emphasis of matter) and KAM (Key Audit Matters)

How To Write KAM

What is included in the Description?

- ü The description always includes
 - **Why the matter is considered to be a KAM**
 - Economic conditions that affect auditor’s ability to obtain audit evidence, eg: illiquid markets for certain financial instruments.
 - New/emerging accounting policies
 - Changes in the entity’s strategy or business model that had a material effect on the financial statements.

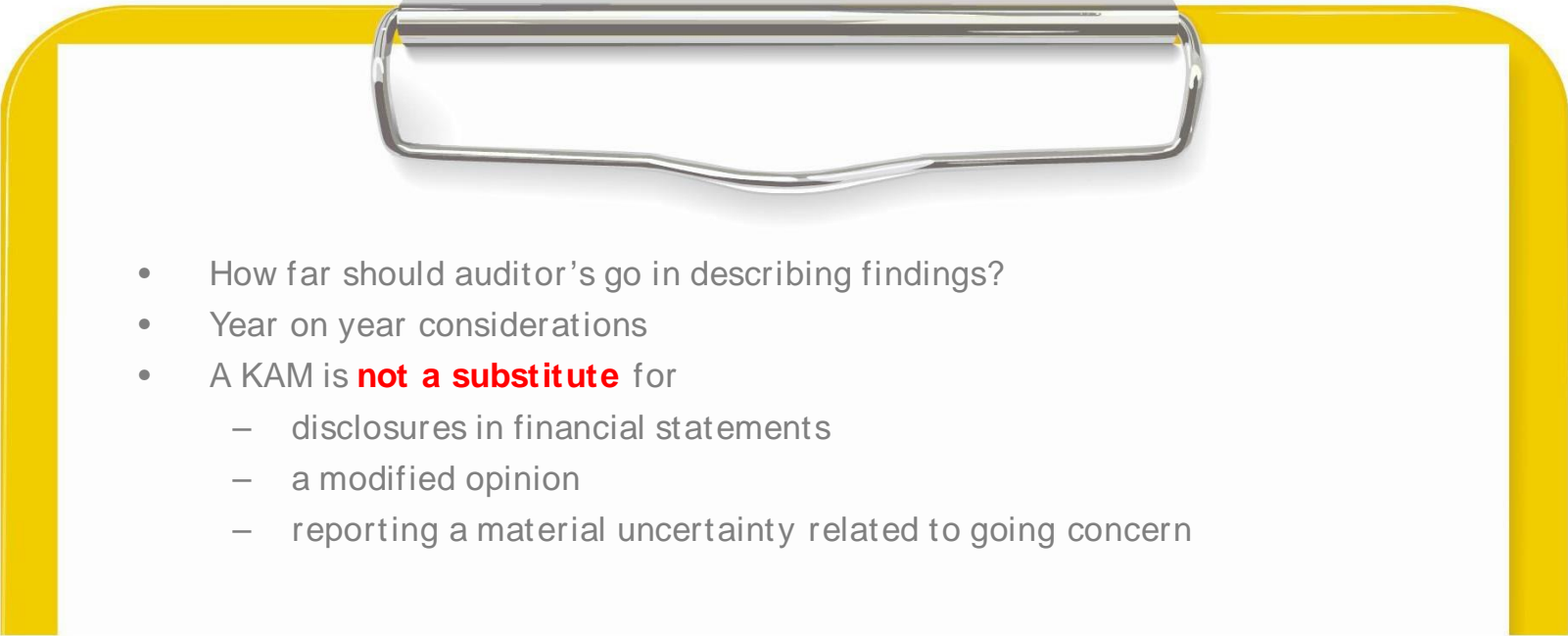
Examples:

- 1) Goodwill – Annual impairment test is material and assessment is judgemental and complex
- 2) Valuation of Financial Instruments – Based on entity developed internal model
- 3) Effects of New Accounting Standards (Ind AS 110, 111 and 112) – Complex structure and contractual agreements
- 4) Valuation of Defined Benefit Pension Assets and Liabilities – Valuations and subjective judgements
- 5) Revenue recognition – Complex commercial arrangement

- **How the matter was addressed in the audit**
 - Aspects of the auditor’s approach or response.
 - Brief overview of procedures performed.
 - Indication of the outcome of the auditor’s procedures/ Key observations
- **Reference to the related disclosure(s), if any**

How To Write KAM

- ü KAM should be entity-specific and avoid standardized or overly technical language
- ü Description of a KAM should not
 - Imply that the matter has not been appropriately resolved by the auditor in forming the opinion on the financial statements
 - Contain or imply discrete opinions on separate elements of the financial statements (a “piecemeal opinion”)

- 
- How far should auditor’s go in describing findings?
 - Year on year considerations
 - A KAM is **not a substitute** for
 - disclosures in financial statements
 - a modified opinion
 - reporting a material uncertainty related to going concern

Matters to be considered by the auditor in determining KAMs

Significant risks

- (a) Whether it is a fraud risk
- (b) Whether the risk relates to major changes in developments that impact the entity
- (c) Whether the risk arises from complexity of transactions
- (d) Whether there are significant related party transactions
- (e) Whether measurements of amounts included in the financial statements involve high level of subjectivity or measurement uncertainty
- (f) Whether the risk involves significant events or transactions that are outside the normal course of business or appear to be unusual in nature

Matters to be considered by the auditor in determining KAMs

Significant judgements

- (a) Allowance for doubtful accounts
- (b) Inventory obsolescence
- (c) Warranty obligations
- (d) Depreciation method used or useful life of assets
- (e) Provision against carrying amounts of investments
- (f) Financial obligations or costs arising from litigations
- (g) Complex financial instruments that are not traded in open market
- (h) Share based payments
- (i) Property or equipment held for disposal
- (j) Goodwill, intangible assets or liabilities acquired in business combination
- (k) Transactions involving non-monetary exchange

How To Write KAM

INFOSYS March 31, 2019

Key audit matter

How our audit addressed the key audit matter

Evaluation of uncertain tax positions

The Company has material uncertain tax positions including matters under dispute which involves significant judgment to determine the possible outcome of these disputes.

Refer Notes 1.4b and 2.22 to the Standalone Financial Statements

Principal Audit Procedures:

Obtained details of completed tax assessments and demands for the year ended March 31, 2019 from management. We involved our internal experts to challenge the management's underlying assumptions in estimating the tax provision and the possible outcome of the disputes. Our internal experts also considered legal precedence and other rulings in evaluating management's position on these uncertain tax positions. Additionally, we considered the effect of new information in respect of uncertain tax positions as at April 1, 2018 to evaluate whether any change was required to management's position on these uncertainties.

How To Write KAM

INFOSYS March 31, 2019

Key audit matter

How our audit addressed the key audit matter

Accuracy of recognition, measurement, presentation and disclosures of revenues and other related balances in view of adoption of Ind AS 115 “Revenue from Contracts with Customers” (new revenue accounting standard)

The application of the new revenue accounting standard involves certain key judgements relating to identification of distinct performance obligations, determination of transaction price of the identified performance obligations, the appropriateness of the basis used to measure revenue recognised over a period.

Principal Audit Procedures:

- § Selected a sample of continuing and new contracts and performed the following procedures:
- Read, analysed and identified the distinct performance obligations in these contracts.
 - Compared these performance obligations with that identified and recorded by the Company.
 - Considered the terms of the contracts to determine the transaction price including any variable consideration to verify the transaction price used to compute revenue and to test the basis of estimation of the variable consideration.
 - Samples in respect of revenue recorded for time and material contracts were tested using a combination of approved time sheets including customer acceptances, subsequent invoicing and historical trend of collections and disputes.
 - In respect of samples relating to fixed price contracts, progress towards satisfaction of performance obligation used to compute recorded revenue was verified with actual and estimated efforts from the time recording and budgeting systems. We also tested the access and change management controls relating to these systems.

How To Write KAM

INFOSYS March 31, 2019

Key audit matter

How our audit addressed the key audit matter

Accuracy of recognition, measurement, presentation and disclosures of revenues and other related balances in view of adoption of Ind AS 115 “Revenue from Contracts with Customers” (new revenue accounting standard)

Additionally, new revenue accounting standard contains disclosures which involves collation of information in respect of disaggregated revenue and periods over which the remaining performance obligations will be satisfied subsequent to the balance sheet date.

Refer Notes 1.4a and 2.16 to the Standalone Financial Statements

Principal Audit Procedures:

We assessed the Company’s process to identify the impact of adoption of the new revenue accounting standard. Our audit approach consisted testing of the design and operating effectiveness of the internal controls and substantive testing as follows:

- § Evaluated the design of internal controls relating to implementation of the new revenue accounting standard.
- § Selected a sample of continuing and new contracts, and tested the operating effectiveness of the internal control, relating to identification of the distinct performance obligations and determination of transaction price. We carried out a combination of procedures involving enquiry and observation, reperformance and inspection of evidence in respect of operation of these controls.
- § Tested the relevant information technology systems’ access and change management controls relating to contracts and related information used in recording and disclosing revenue in accordance with the new revenue accounting standard.

How To Write KAM

NOVARTIS AG 2018

Key audit matter

How our audit addressed the key audit matter

Carrying value of Alcon goodwill

The Group has goodwill of USD 35.3 billion at December 31, 2018, of which USD 8.9 billion relates to Alcon. The assessment of the carrying value of the goodwill balances is dependent on the estimation of future cash flows. In particular, those assessments and judgments made to support the carrying value of the goodwill allocated to the Alcon Division were critical, given the performance of the business in prior years, which led the Group to initiate a turnaround plan, followed by the ongoing strategic review.

Refer to “Note 1. Significant accounting policies” (pages F-6 to F-15) and “Note 10. Goodwill and intangible assets” (pages F-37 to F-39).

- § We assessed and tested the design and operating effectiveness of the Group’s controls over the assessment of the carrying value of Alcon goodwill and concluded that these operate effectively. We tested, with the support of our valuation specialists, the Alcon goodwill carrying value as at December 31, 2018. We also challenged management to substantiate their key assumptions including growth rate in the cash flow projections during the forecast period and the terminal growth rate assumption. We also evaluated management’s intention and ability to execute their strategic initiatives and evaluated the reasonableness of the discount rate applied to those future cash flows.
- § We assessed management’s sensitivity analysis around key estimates to quantify the downside changes in assumptions that could result in an impairment and the disclosures included in “Note 10. Goodwill and intangible assets” (pages F-37 to F-39) of the Annual Report. In conjunction with the intended spin-off of Alcon, management provided a range of estimate for the valuation of the business that indicates the value of the goodwill is not impaired.
- § Finally, we did not identify any material differences between management cash flow forecasts from last year and the actual results reached this year. As a result of our procedures, as discussed with the Audit and Compliance Committee, we determined that the conclusions reached by management with regard to the carrying value of Alcon goodwill were reasonable and supportable.

How To Write KAM

NOVARTIS AG 2018

Key audit matter

How our audit addressed the key audit matter

Carrying value of the Innovative Medicines division intangible assets other than goodwill, including newly acquired intangible assets

The Group has intangible assets in its Innovative Medicines division other than goodwill totalling USD 26.0 billion at December 31, 2018, comprising research and development acquired, currently marketed products, and other intangible assets. The Group recognized specific impairments of intangible assets in its Innovative Medicines division other than goodwill of USD 592 million during the year. In 2018, the Group entered into significant transactions, including the acquisitions of Advanced Accelerator Applications S.A., AveXis, Inc. and Endocyte, Inc. The related purchase price allocations resulted in the identification and recognition of a fair value of USD 12.5 billion in newly acquired intangible assets, excluding goodwill. The assessment of the carrying values of intangible assets is dependent on future cash flows. The assessments of carrying values performed by the Group contain a number of significant judgments and estimates such as scientific success, revenue growth, the success of new product launches, profit margins and discount rates.

- § We assessed and tested the design and operating effectiveness of the Group's controls over the assessment of the carrying value of intangible assets other than goodwill and concluded that these operate effectively, specifically in respect to the identification of impairment triggering events.
- § We assessed and tested the design and operating effectiveness of the Group's controls over the identification and the valuation of intangible assets acquired in a business combination. We utilized a risk-based approach to select certain significant intangible assets to test the carrying value calculations and assess the key assumptions. For the currently marketed products, these assumptions specifically included pricing, market size and share, and competitive environment assumptions.
- § Finally, we did not identify any material differences between management cash flow forecasts from last year and the actual results reached this year.

How To Write KAM

NOVARTIS AG 2018

Key audit matter

How our audit addressed the key audit matter

Carrying value of the Innovative Medicines division intangible assets other than goodwill, including newly acquired intangible assets

The carrying value assessments of the following intangible assets include the most significant risk and highest level of judgment:

- Certain currently marketed products that have performed below management's expectation or were, in our view, at a greater risk of impairment
- Currently marketed products recognized as intangible assets in the purchase price allocation
- Products in development, as the assessment of their carrying value is challenging due to management being required to make judgments both as to the probability of scientific success and regulatory approval of the developments across indications, as well as the probability of commercial success of the subsequent product launches

Refer to "Note 1. Significant accounting policies" (pages F-6 to F-15), "Note 10. Goodwill and intangible assets" (pages F-37 to F-39), "Note 2. Significant transactions in 2018" (pages F-16 to F-18) and "Note 23. Acquisitions of business" (page F-57).

- § For selected currently marketed products and products in development, with the support of our valuation specialists, we considered third-party sources to challenge expected future revenues due to actions by competitors or due to changes in relevant markets.
- § Furthermore, for products in development, we also considered key scientific developments.
- § We performed our own sensitivity analysis around these key estimates to ascertain the extent of change in those assumptions that either individually or collectively would be required for the intangible assets tested to be impaired.
- § As a result of our procedures, we did not propose any adjustments to the amount of impairment recognized in 2018 or to the value of intangible assets recognized in the purchase price allocations. For intangible assets other than goodwill where management determined that no impairment was required, we found that the assessments made by management were based upon reasonable assumptions, consistently applied.

How To Write KAM

NOVARTIS AG 2018

Key audit matter

How our audit addressed the key audit matter

Rebates, discounts and sales returns

Commencing in 2018, the Group has applied IFRS 15 “Revenue from Contracts with Customers”. The Group distributes its products primarily through wholesale distributors. In many cases the ultimate net selling prices are determined based on government mandated rebates as well as contractual arrangements that the Group has with the ultimate patient’s insurer or other payment program. Under IFRS 15, revenue is recognized when control has passed to the customer, which is usually upon shipment to the distributor. The transaction price is the amount of consideration an entity expects to be entitled to from a customer in exchange for providing the goods or services. IFRS15 requires an entity to estimate the amount of variable consideration to which it will be entitled to the extent that such amount is not highly probable to reverse. Variable consideration may include rebates, discounts and sales returns. The estimate depends on contract terms and regulation, historical experience, as well as forecasts of sales volumes by sales channel.

§ We performed procedures to assess the design and operating effectiveness of the controls related to the recording of rebates, discounts and sales returns, and the estimation of related period-end reserves. We obtained management’s calculations for the respective estimates and performed one or more of the following procedures on each of them: developed an independent expectation of the reserve and/or tested management’s estimation process to assess the reasonableness of the recorded reserve balances, performed retrospective reviews, and assessed subsequent events. We also performed testing of credits issued and payments made throughout the year, reviewed related contracts, and performed procedures to validate contractual terms and inventory levels of significant customers and wholesalers. We did not identify any material differences between our expectations and the accruals, and we found the judgments

How To Write KAM

NOVARTIS AG 2018

Key audit matter

How our audit addressed the key audit matter

Rebates, discounts and sales returns

Additionally, the dispensing of the product to the patient and the final determination of the net selling price may be several months later. This key audit matter is focused on the valuation and accuracy of the accruals for rebates, discounts and sales returns recognized at the year-end because, specifically for US Medicaid and Medicare or similar programs, the estimation processes involves large volumes of data, requires significant judgment, and contains risk of management bias. The provision reported as of December 31, 2018, for revenue deductions related to rebates, discounts, allowances and sales returns amounted to USD 5.3 billion.

Refer to “Note 21. Provisions and other current liabilities” (pages F-53 and F-55).

- § For selected currently marketed products and products in development, with the support of our valuation specialists, we considered third-party sources to challenge expected future revenues due to actions by competitors or due to changes in relevant markets.
- § Furthermore, for products in development, we also considered key scientific developments.
- § We performed our own sensitivity analysis around these key estimates to ascertain the extent of change in those assumptions that either individually or collectively would be required for the intangible assets tested to be impaired.
- § As a result of our procedures, we did not propose any adjustments to the amount of impairment recognized in 2018 or to the value of intangible assets recognized in the purchase price allocations. For intangible assets other than goodwill where management determined that no impairment was required, we found that the assessments made by management were based upon reasonable assumptions, consistently applied.

Illustrations of KAM points

1) Hindustan Unilever Limited

- Revenue recognition
- Provisions for taxation, litigation and other significant provisions
- Assessment of contingent liabilities relating to litigations and claims

2) Asian Paints Limited

- Revenue recognition
- Discounts and incentives
- Capital work-in-progress/ Property Plant and Equipment (PPE)
- System upgradation

3) HDFC Bank Limited

- Identification of Non-performing advances and provisioning of advances
- Evaluation of open tax litigations (Direct and Indirect tax)
- Information Technology (IT) Systems and Controls

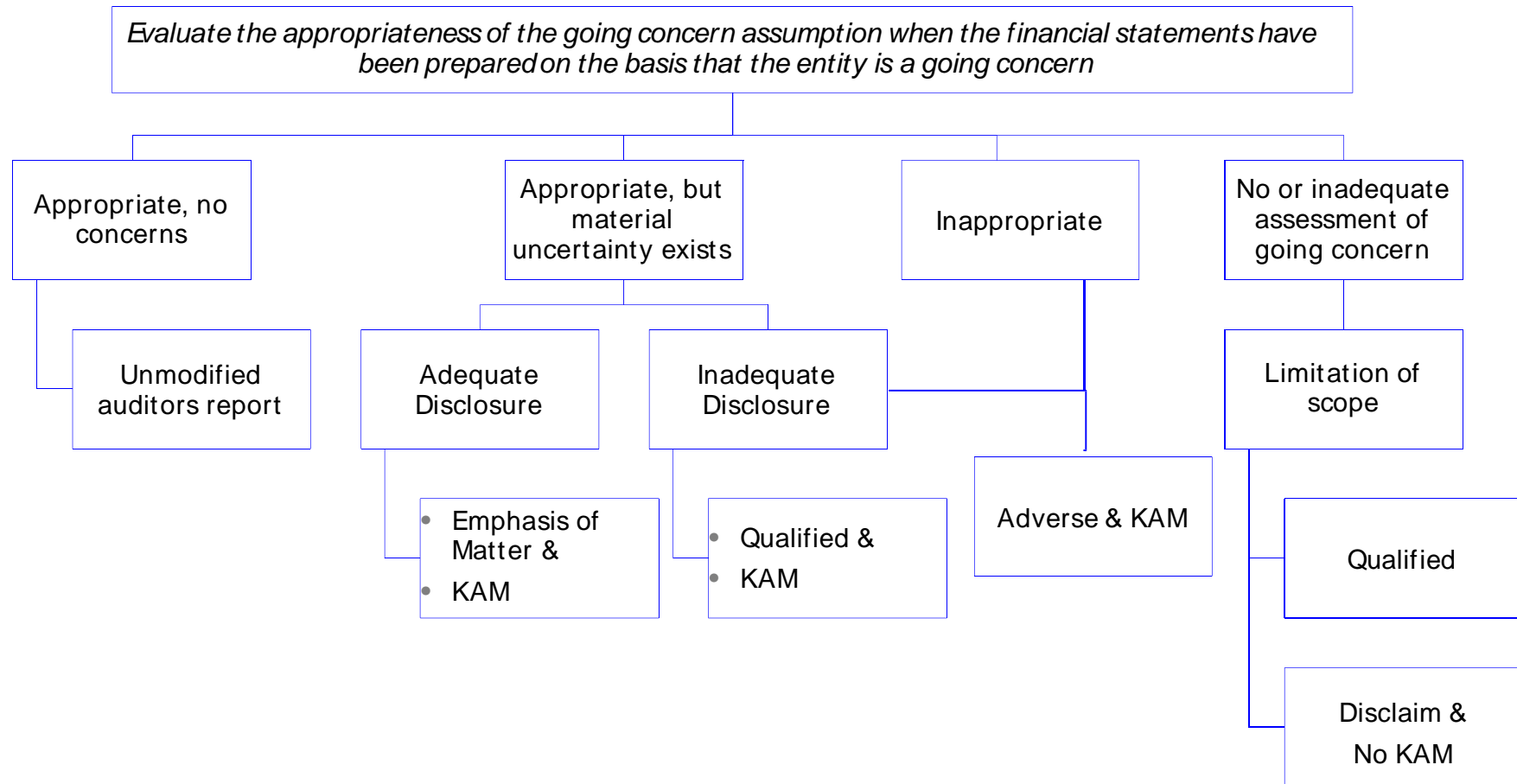
4) Tata Consultancy Services Limited (TCS)

- Revenue recognition – Fixed price development contracts
- Adoption of Ind AS 115 – Revenue from Contracts with Customers
- Evaluation of uncertain tax positions

Interaction With Other Parts Of Audit Report

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”
Adverse	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 Adverse Opinion section, we have determined the matters described below to be the key audit matters to be communicated in our report”
Disclaimer	There must not be a KAM section

Interaction With Going Concern



KAM Documentation Considerations

- § SA 701 requires the auditor to document the professional judgments made about
 - Why a matter that required significant auditor attention is or is not a KAM
 - If there are no KAM, the rationale why
 - Where, applicable, why a matter determined to be a KAM is not communicated

What Does The Change Mean

FOR DIRECTORS/ AUDIT COMMITTEE

- ▶ More proactive engagement with the auditors and improved discussions with the auditors, to ensure that investors receive relevant and well described information that is consistent across all communication in the annual report.
- ▶ Sharing with the public what used to be closed door information will require an even sharper focus. Early action is required to ensure that the first revised auditor's reports go well in 2019.
- ▶ Risk that audit committee may be challenged by shareholders, regarding adequacy of disclosures in financial statements after reading the KAM.

FOR AUDITOR

- ▶ It is the auditor's report, but management and audit committee are keenly interested
 - Discussions on the audit report may lead management to decide to enhance or change their disclosures too.
- ▶ Getting the key audit matters right is a very challenging task
 - Being precise about particular areas of focus is difficult to articulate.
- ▶ Anticipate the time involved
 - Engage early with stakeholders to finalise in time.

SA 720 (Revised) – The Auditor's Responsibilities relating to Other Information



Objective and Scope

Objective:

Auditor is required to read and consider the Other Information to ascertain cases where:

There is a **material inconsistency** between the Other Information and the financial statements; (or)

There is a **material inconsistency** between the Other Information and the auditor's knowledge obtained in the audit.

Material inconsistency identified by the auditor may indicate that there is:

material misstatement of the financial statements (or)

material misstatement of the Other information

Either of the above may:

undermine the credibility of the financial statements and the auditor's report thereon.

Inappropriately influence the economic decisions of the users for whom the auditor's report is prepared.

Scope:

Auditor's responsibilities under this SA do not constitute an assurance engagement or impose an obligation on the auditor to obtain assurance about the Other Information.

Meaning of Other Information

Financial or non-financial information (other than financial statements and the auditor's report thereon) included in an entity's annual report.

Depending on the applicable law, regulation or custom, one or more of the following documents may form part of the annual report

- Director's Report
- Management Discussion and Analysis
- Corporate Governance Statement/reports
- Chairman's Statement
- Business Responsibility Report

Following are **not 'Other Information'** within the scope SA 720 (Revised)

- Separate industry report or regulatory reports (for eg: capital adequacy reports), such as may be prepared in the banking, insurance and pension industries.
- Sustainability reports.
- Corporate Social Responsibility (CSR) Report
- Diversity and equal opportunity reports.
- Product responsibility reports.
- Labour practices and working condition reports.
- Human rights reports.
- Other regulatory filings with the Government agencies such as Registrar of Companies.

SA 720 (Revised) **does not apply** to preliminary announcements of financial information or securities offering documents, including prospectuses.

Appendix 1 to SA 720 (Revised) contains examples of amounts/ other items that may be included in the Other Information.

Appendix 1- Examples of Amounts or Other Items that May Be Included in the Other Information

The following are examples of amounts and other items that may be included in other information. This list is not intended to be exhaustive.

Amounts

- (a) Items in a summary of key financial results, such as net income, earnings per share, dividends, sales and other operating revenues, and purchases and operating expenses.
- (b) Selected operating data, such as income from continuing operations by major operating area, or sales by geographical segment or product line.
- (c) Special items, such as asset dispositions, litigation provisions, asset impairments, tax adjustments, environmental remediation provisions, and restructuring and reorganization expenses.
- (d) Liquidity and capital resource information, such as cash, cash equivalents and marketable securities; dividends; and debt, capital lease and minority interest obligations.
- (e) Capital expenditures by segment or division.
- (f) Amounts involved in, and related financial effects of, off-balance sheet arrangements.
- (g) Amounts involved in guarantees, contractual obligations, legal or environmental claims, and other contingencies.
- (h) Financial measures or ratios, such as gross margin, return on average capital employed, return on average shareholders' equity, current ratio, interest coverage ratio and debt ratio. Some of these may be directly reconcilable to the financial statements.

Appendix 1- Examples of Amounts or Other Items that May Be Included in the Other Information

Other Items

- (a) Explanations of critical accounting estimates and related assumptions.
- (b) Identification of related parties and descriptions of transactions with them.
- (c) Articulation of the entity's policies or approach to manage commodity, foreign exchange or interest rate risks, such as through the use of forward contracts, interest rate swaps, or other financial instruments.
- (d) Descriptions of the nature of off-balance sheet arrangements.
- (e) Descriptions of guarantees, indemnifications, contractual obligations, litigation or environmental liability cases, and other contingencies, including management's qualitative assessments of the entity's related exposures.
- (f) Descriptions of changes in legal or regulatory requirements, such as new tax or environmental regulations, that have materially impacted the entity's operations or fiscal position, or will have a material impact on the entity's future financial prospects.
- (g) Management's qualitative assessments of the impacts of new financial reporting standards that have come into effect during the period, or will come into effect in the following period, on the entity's financial results, financial position and cash flows.
- (h) General descriptions of the business environment and outlook.
- (i) Overview of strategy.
- (j) Descriptions of trends in market prices of key commodities or raw materials.
- (k) Contrasts of supply, demand and regulatory circumstances between geographic regions.
- (l) Explanations of specific factors influencing the entity's profitability in specific segments.

Obtaining of Other Information

Other information may include amounts or other items that are intended to be the same as, to summarize, or to provide greater detail about, the amounts or other items in the financial statements. Examples of such amounts or other items may include:

- Tables, charts or graphs containing extracts of the financial statements.
- A disclosure providing greater detail about a balance or account shown in the financial statements, such as “Revenue for 20X1 comprised Rs. XXX million from product X and Rs. YYY million from product Y.”
- Descriptions of the financial results, such as “Total research and development expense was Rs. XXX in 20X1.”

The auditor’s knowledge obtained in the audit may also include **matters that are prospective in nature**. Such matters may include, for example, business prospects and future cash flows that the auditor considered when evaluating the assumptions used by management in performing impairment tests on intangible assets such as goodwill, or when evaluating management’s assessment of the entity’s ability to continue as a going concern.

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Obtaining of Other Information

- Determining the document(s) that comprises the **annual report is often clear based on law, regulation or custom**. In many cases, management or those charged with governance may have customarily issued a package of documents that together comprise the annual report, or may have committed to do so. In some cases, however, it may not be clear which document(s) is or comprises the annual report. In such cases, the timing and purpose of the documents (and for whom they are intended) are matters that may be relevant to the auditor's determination of which document(s) is or comprises the annual report. (A11)
- When the **annual report is translated into other languages pursuant to law or regulation** (such as may occur when an entity voluntarily or is required by the relevant law or regulation to translate the annual report into another language), or when multiple "annual reports" are prepared under different legislation (for example, when an entity is listed in more than one jurisdictions), consideration may need to be given as to whether one, or more than one of the "annual reports" form part of the other information. Local law or regulation may provide further guidance in this respect. (A12)
- There may be circumstances when, at the date of the auditor's report, the entity is considering the development of a document that may be part of the entity's annual report (for example, a voluntary report to stakeholders) but management is unable to confirm to the auditor the purpose or timing of such a document. If the auditor is unable to ascertain the purpose or timing of such a document, the document is not considered other information for purposes of this SA. (A17)

Procedures to be performed

Determining the nature and extent of procedures is a matter of professional judgment, recognizing that the auditor's responsibilities under this SA do not constitute an assurance engagement on the other information

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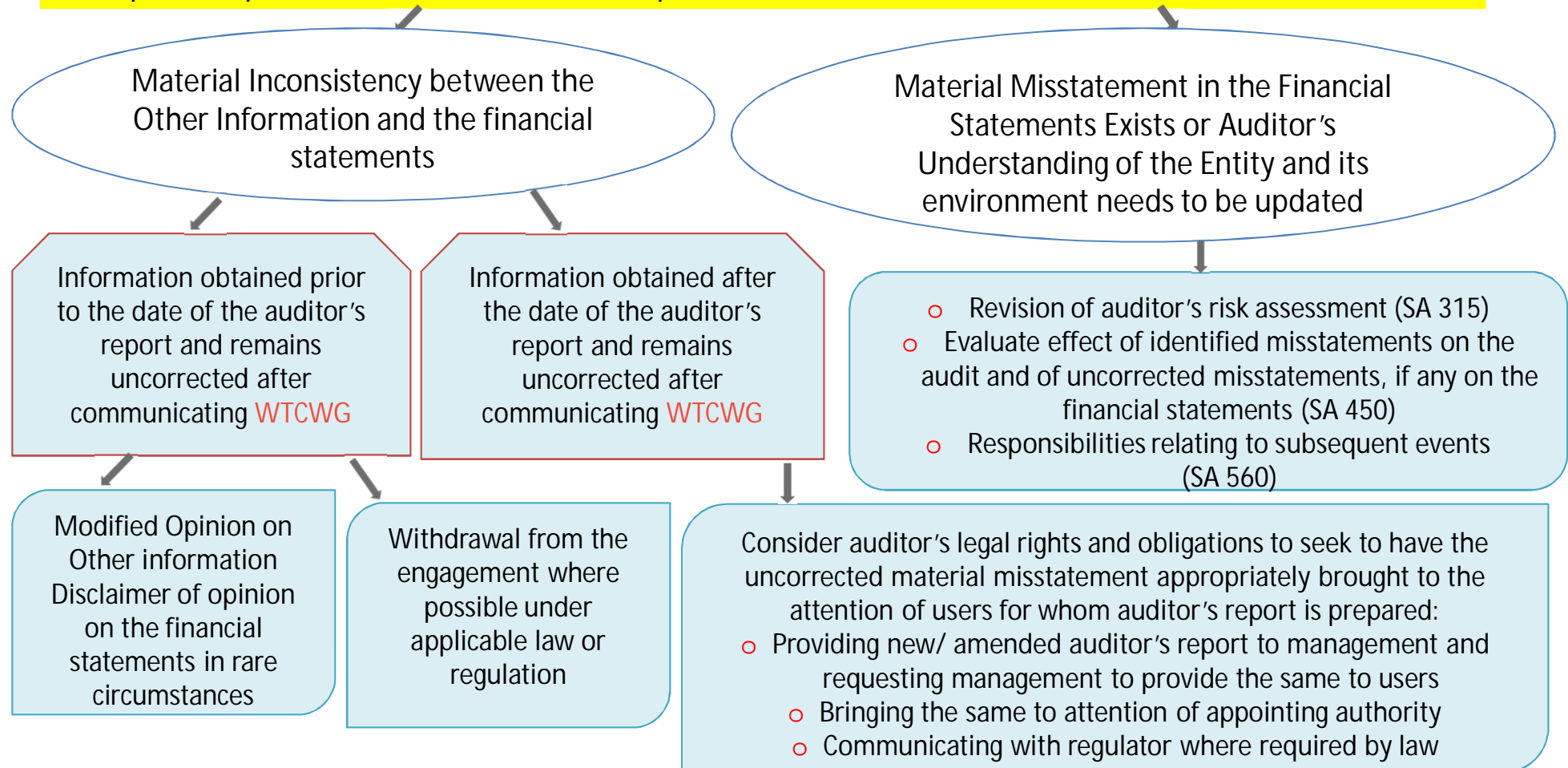
Examples of such procedures include:

- For information that is intended to be the same as information in the financial statements, comparing the information to the financial statements.
- For information intended to convey the same meaning as disclosures in the financial statements, comparing the words used and considering the significance of differences in wording used and whether such differences imply different meanings.
- Obtaining a reconciliation between an amount within the other information and the financial statements from management, comparing items in the reconciliation to the financial statements and the other information; and checking whether the calculations within the reconciliation are arithmetically accurate.

Reading and Considering the Other Information

Reading the Other Information*

* Make appropriate arrangement with management of Company to obtain information in a timely manner and if possible prior to the date of auditor's report.



Reporting requirement w.r.t. Other Information

Listed entity:

Auditor's report shall include a separate section with a heading 'Other Information':

If any Other Information is received after the auditor's report date, it would need to be identified and stated separately.

Other Information:

The Company's Board of Director is responsible for the other information. The other information comprises the Director's Report (but does not include the standalone Ind AS financial statements and our auditor's report thereon), which we obtained prior to the date of this auditor's report, and the Chairman's Statement, which is expected to be made available to us after that date.

Unlisted entity:

Auditor's report shall include a separate section with a heading 'Other Information':

If any Other Information is received before the auditor's report date, it would need to be identified and stated separately.

Other Information:

The Company's Board of Director is responsible for the other information. The other information obtained at the date of this auditor's report is information included in the Director's Report, Chairman's Statement (but does not include the standalone Ind AS financial statements and our auditor's report thereon).

Illustrative - Reporting under SA 720 (Revised)

Other Information

The Company's Board of Directors is responsible for the other information. The other information comprises the information included in the Annual report, but does not include the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the [standalone] Ind AS financial statements, our responsibility is to read the other information and, in doing so, consider whether such other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Reporting requirement w.r.t. Other Information

Auditor has obtained all of the Other Information prior to the date of the auditor's report and the matter giving rise to the qualified opinion on the consolidated financial statements also affects the Other Information:

Other Information:

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

As described in the 'Basis for Qualified Opinion' section above, we were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC's investment in XYZ as at March 31, ____ . Accordingly, we are unable to conclude whether or not the other information is materially misstated with respect to this matter.

Other Key Considerations:

When some/all of the document(s) determined as having Other Information will not be available until after the date of auditor's report, request management to provide a written representation that the final version of the document(s) will be provided to the auditor when available and prior to its issuance by the entity, such that the auditor can complete the procedures required by SA 720 (Revised).

The group auditor may request the management of the group to require the concerned component auditor to validate that part of the Other Information included in the annual report of the group that relates to the respective component.

Auditor's Responsibilities relating to Other Information

The auditor shall:

- (a) Determine, through discussion with management, which document(s) comprises the annual report, and the entity's planned manner and timing of the issuance of such document(s);
- (b) Make appropriate arrangements with management to obtain in a timely manner and, if possible, prior to the date of the auditor's report, the final version of the document(s) comprising the annual report;
- (c) When some or all of the document(s) determined in (a) will not be available until after the date of the auditor's report, request management to provide a written representation that the final version of the document(s) will be provided to the auditor when available, and prior to its issuance by the entity, such that the auditor can complete the procedures required by this SA.

Thank you

