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Key Audit Matters

CONTRIBUTORS

- Dusan Ecim (University of the Witwatersrand)
- Warren Maroun (University of the Witwatersrand)
- Alan Duboisee de Ricquebourg (University of Leeds)

Queries and comments can be directed to Dusan Ecim (dusan.ecim@wits.ac.za)

This research will be relevant for standard-setters, regulators and users of audit reports interested in how ISA 701 is being implemented and the state of KAM disclosures in an emerging economy.

An analysis of KAM disclosures, trends and insights in South African audit reports between 2017 – 2020

Purpose of this report

One of the most recent developments in auditing is the publication of ISA 701[1] by the International Auditing and Assurance Standards Board (IAASB) which requires auditors to report 'key audit matters' (KAMs). These are the 'matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period' [1, para 8]. The standard is effective for financial years ending on or after 15 December 2016.

ISA 701 has been adopted by regulators in, inter alia, the U.K, the EU, South Africa, Hong Kong, China, Australia and New Zealand [2]. KAMs are intended to reduce information asymmetry and are, in part, a response to the audit expectation gap [3]. Providing details on the most significant issues encountered during an audit, and how they were managed, allows users of financial statements to understand how audits are conducted and to assess the risks inherent in their investments more effectively [4]. Empirical evidence on the impact and importance of KAMs is mixed but the expanded reporting required by IAS 701 should result in more informative audit reports and bolster confidence in underlying assurance processes [5]. Research on KAMs in a South African context has been growing [see 6, 7] and a practitioner-focused report adds to the practical understanding of trends in KAM reporting.

This report analyses the KAM disclosures, trends and insights in South African audit reports. A detailed account is provided of the number of KAMs being disclosed and the themes/issues which they cover. Variations in KAM disclosures among industries, audit firms and over time are also considered. This is done using hand-collected data from the 1 424 audit reports of 356 JSE-listed entities between 2017 – 2020. The period of review ensures that KAMs are considered from the earliest full financial year when all companies report on KAMs (2017) to the most recently available published financial statements at the date of preparing this report (2020). The period covered, and the fact that all listed companies were considered to the extent practical, provides a large sample for examining KAM reporting in South Africa.

[1] ISA 701: Communicating Key Audit Matters in the Independent Auditor's Report.

Background

ISA 701 follows a principles-based approach for determining KAMs. 'Key audit matters are selected from matters communicated with those charged with governance' [1, para 8]. When evaluating if an issue reported to a governing body is also a KAM, the auditor considers:

(1) the risk of material misstatement,

(2) whether or not **significant estimates** and judgements are involved and

(3) any significant events and transactions which have taken place during the reporting period [1, para 9].

After KAMs have been identified, they are described in a separate section of the auditor's report [1, para 11]. This includes an explanation of why each matter was of most significance for executing the audit and how it was addressed [1, para 13]. If there are no KAMs, this is clearly stated in the audit report [1, para 16].

KAM disclosures enhance the transparency of the audit process [8, 9]. This allows those charged with governance and other stakeholders to understand how auditors approach key areas in an audit [10]. Increased auditor scrutiny should lead to more conservative decision-making, better application of financial controls and more reliable reporting to investors [8, 10].

The process of identifying KAMs also facilitates discussions between the auditor and those charged with governance which can enhance audit quality because of a more rigorous risk identification and response process [3, 10]. This may lead to a reduction in the audit expectation gap as users of audit reports obtain a better understanding of the audit function [3].

ISA 701 also gives rise to several challenges. Evidence on the value relevance of the information content of KAMs to stakeholders is mixed, with studies finding that stakeholders may be informed of financial risks through other mediums before KAMs are reported [11]. KAMs may also be misunderstood as areas of concern by the public who do not distinguish between problems, frauds or misstatements on the one hand and significant risk areas which require additional audit work on the other [12]. Added to this is that KAMs can be difficult for non-experts to read and understand because of the complex auditing jargon used [3, 10]. KAM disclosures may also increase the threat of auditor litigation and lead to audit fee recoverability problems [see 3, 13]. There is also no guarantee that the KAMs disclosed in an audit report are accurate and complete [10]. The perception of what is a "key matter" is subjective resulting in inconsistent disclosures [3, 14]. It is important to understand the KAM determination process as this can impact how the benefits from KAM disclosures are derived and how any challenges can be met and solved.

KAM determinants

Certain client and auditor features impact the KAM determination process. The determination of what constitutes a KAM is a function of an auditor's professional judgement, materiality of the underlying matter and time-based considerations [3]. Various client and auditor features may, though, be predictors of the number, type and style of KAMs reported. Refer to **Figure 1**.

Prior studies have focused on KAM determinants in specific jurisdictions. The findings of these studies may not always hold true across other jurisdictions but they provide a useful reference point to understand which factors may impact the number and types of KAMs being disclosed. Starting with client features, the complexity of the business and operations gears the auditors' risk assessment at the overall financial statement level and the assertion level for specific transactions or balances [15]. Client complexity can be impacted by entity size, firm profitability, industry category, geographical location and the number of components in the group structure [2, 14].

More complex accounting subject matters (such as revenue, goodwill, impairments, intangible assets and provisions) which also make use of estimates, increase the application of professional judgement and the level of audit risk leading to additional KAM disclosure [14-16]. Similarly, entities with volatile share prices, high leveraging, loss-making positions or which have more assets on their balance sheets tend to report a greater number of KAMs [17].

Turning to auditor characteristics, the "Big 4" (Deloitte, EY, PwC and KPMG) report more KAMs than smaller audit firms do possibly because the former tend to have more complex clients which are also more heavily regulated [14]. At a more granular level, the gender of the audit partner may have an impact on the number and style of KAMs. A UK-based study found that female partners disclose more KAMs than do male counterparts [17]. In contrast, a South African-based study found that a change in audit partner is not associated with changes in reported KAMs but changing audit firms has a significant impact on the KAMs added/removed from an audit report [6]. The experience, expertise and decision-making style of audit partners will impact how professional judgement is applied to determine what constitutes a KAM [16]. Differences in the audit methodologies of firms and how they determine materiality may also explain variations in the number and type of KAMs reported among audit firms [16].

Much of the prior research on KAM determination deals with the USA and the UK. Developed economies such as Australia [12] and developing economies including China [19] and Jordan [20] have received some attention. South African based research has been growing [3, 6, 7], however, there is comparatively little on how developing economies are applying ISA 701 and how KAM reporting is varying over time and in different contexts. This is the basis for the remainder of the report which focuses on South African experiences with KAMs.

Figure 1: KAM determinants

Client features	Auditor features
• Complexity of buwsiness and operations which gears the auditors risk assessment at the overall financial statement level and the assertion level for specific transactions/balances/events	• Higher audit service fees may result in an increased audit firm resource allocation to significant areas resulting in more KAM disclosures, particularly for entity-level KAMs (the exact audit fee/KAM relationship has still not been empirically determined)
• Client complexity can be impacted by, inter alia, firm profitability, industry category, accounting standards, range of estimates used, geographical locations and the number of components in the group structure	• Audit partner and firm considerations: - Research shows that female partners disclose more KAMs than male counterparts - Decision-making styles of audit partners - Size of the audit firm which will impact the level of resources, skills and experience that are assigned to the audit - Change in audit firms (with a new engagement carrying increased risk resulting in higher scrutiny and professional sceptism)
• Increased financial and audit risk results in an increase in KAMs disclosed	
• Higher revenue, inventory, goodwill, intangible asset, receivables and provision balances are associated with a greater number of KAMs	• Audit materiality levels may impact the issues determined to be key
• Higher share price volatility may result in an increase in KAM disclosures as stakeholder scrutiny is higher	• Audit firm methodologies may differ and produce varying results
• Nature of industry	• Time spent on critical matters impacts the KAM identification

Source: developed from 6, 12, 14, 15, 16-18

Methodology applied to the study

The sample collection process commenced by collecting the audit reports of all JSE-listed companies for financial years ending on or after 1 January 2017 and ended four years later with the audit reports for the financial years up to and including 31 December 2020. The 2016 financial year of South African listed companies has been excluded from the analysis because not all companies early adopted the KAM requirements. Preliminary analysis of the data revealed that 54 Companies reported 141 KAMs in their 2016 audit reports. The remainder did not. This is not considered to be material in the context of the total KAMs analysed form 2017 - 2020.

The goal is to examine the KAMs reported by these companies and how they change over the sample period. As a result, the analysis excluded[2] all companies which were delisted or newly listed during the period, leaving a final sample of 356 JSE-listed companies with 1,424 audit reports containing 2,903 KAMs issued between the beginning of 2017 and the end of 2020.

Qualitative content analysis was used to collect and analyse the data. Each entity's audit report was read several times, focusing on the part of the report detailing the KAMs. Each KAM was treated as the unit of analysis. The KAMs were reviewed to determine the issue being flagged by the auditor, how the auditor framed the underlying risks and the accounting for the balances and transactions under review.

The result was 2 903 KAMs coded into 50 subcategories. The subcategories are consistent with those highlighted by earlier studies [see 3, 12, 14] and the recognition, measurement and presentation/disclosure requirements articulated in the applicable International Financial Reporting Standard (IFRS). Details were recorded per firm and year.

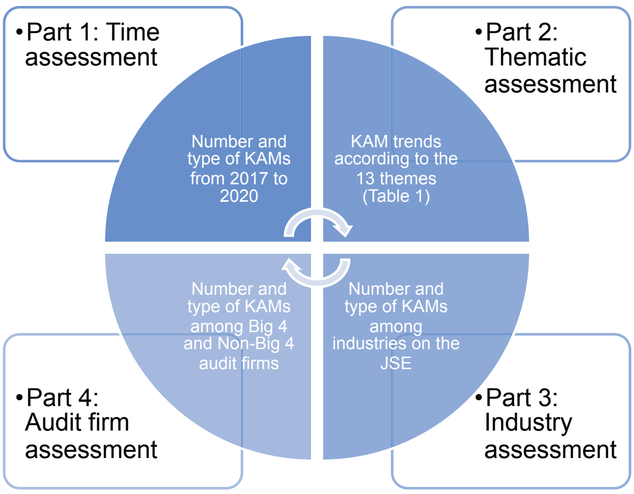
The KAMs were then grouped using one of the 13 themes developed interpretively by the researchers and listed in **Table 1**. The examples are not intended to be exhaustive. The researchers also differentiated between entity- and account-level KAMs. The former impact the organisation on a broad entity-wide level whilst account-level KAMs focus on specific issues for individual financial statement line items [14]. As a validity safeguard, the KAM classifications were examined, on a sample-basis, by an experienced audit manager and audit academic[3].

Descriptive statistics, supported by data visualisations, are used to analyse the KAM disclosures. The number and type of KAMs are evaluated from 2017 to 2020 distinguishing between KAMs reported by the Big 4 (PwC, Deloitte, KPMG and EY) and other audit firms operating in South Africa[4]. To compare KAMs among industries, the JSE industry groupings have been used.

Results

The sections below present the insights gathered from the assessment of the 2 903 KAM disclosures [refer to 7 for further detail]. The insights are presented in four parts which are summarised in **Figure 2**.

Figure 2: Analysis of KAM results



2 This is an inherent limitation as certain KAM observations were lost by excluding entities; however, this ensures consistency and comparability in the information under review

3 The KAM classification was piloted with a sample of 20 companies. This was used to refine the data collection instrument and determine coding buckets provisionally. As additional reports were analysed, the number of categories (code buckets) being used was increased. Previously coded KAMs were re-evaluated. This continued until a sense of thematic saturation was achieved which was after the 51st company had been coded (for a single year).

4 These include (in order of highest to lowest KAM disclosures): BDO, Grant Thornton/SNG, Mazars, Nexia, Saffery Champness, Crowe, Moore Stephens, PKF, RSM, Baker Tilly, Thawt, Horwath Leveton Boner, Nolands, CMA, HLB CMA, SVG and Mahdi Meyer Steyn Chartered Accountants Incorporated.

Table 1: Core KAM themes and examples of KAM detail classification buckets

Core KAM themes	E.g.s of classification buckets	Entity/account level grouping
1. Accounting changes & errors	• Changes in accounting policy • Correction of prior period misstatements • Accounting for changes in estimates	Entity-level
2. Business combinations & goodwill	• Valuation and impairment of subsidiaries, associates and joint ventures • Determination, measurement and impairment of goodwill • Bundling, un-bundling, restructuring and common control transactions • Disposals/purchases/control considerations • Equity accounting • Related party transactions • Translation into presentation currency	Entity-level
3. Complex estimates	• Insurance contracts • Government grants • Assets held for sale • Repurchase agreements	Account-level
4. Employee benefits	• Accounting for employee benefits	Account-level
5. Financial instruments	• Risk assessment, recognition, measurement, impairment and presentation & disclosure of financial instruments (IFRS 9) • Convertible instruments • Hedge accounting	Account-level
6. Inventories	• Measurement and impairment of inventories	Account-level
7. Non-financial assets	(De)recognition, measurement and impairment of property, plant and equipment, investment property, intangible assets, mining assets and biological assets	Account-level
8. Other issues	• Compliance with debt covenants/guarantees • Adoption of new standards • Functional currency • Events after the reporting period • Audit risk • Hyperinflation	Entity-level
9. Provisions	• Determination and measurement of provisions • Contingent assets and liabilities • Environmental rehabilitation	Account-level
10. Revenue	• Revenue recognition, measurement and presentation & disclosure (IFRS 15) • Supplier/customer rebates/discounts/incentives • Adjustments to cost of sales/revenue • Accounting for management fees	Account-level
11. Systems, controls & governance	• Control/systems-related issues • Governance issues • Reviews/investigations by regulators • General fraud risk	Entity-level
12. Taxes	• Uncertain tax exposures/positions • Recoverability of tax assets • Determination of current and deferred taxes • Changes in tax rates or laws	Account-level
13. Going concern issues and impact of COVID-19	• Going concern assessments • COVID-19-related impacts on estimates/ future profitability	Entity-level

Number of KAMs over time

The average/(median) number of 2.04/(2) KAMs per company is relatively consistent with results reported in other settings. For example, Australia, the UAE, Kenya, Brazil, and Nigeria report an average of 1.8 to 2.8 KAMs per company from 2017 to 2020 [see 6, 10, 12]. In contrast, the United Kingdom[5] reports an average 4.1 KAMs per company [10].

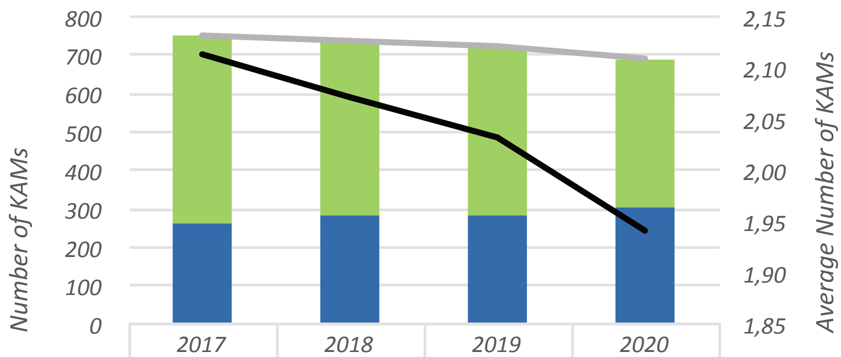
If KAMs can enhance the transparency of the audit process and reduce information asymmetry [3], auditors may be inclined to increase the absolute number of KAMs being reported. In keeping with a risk-based approach to assurance, auditors will also focus on the most complex and judgemental areas of a client's financial reporting [10, 14, 18] with implications for the type of problems which are being flagged as KAMs. That auditors become more experienced with KAM determination over time [10] and that the South African assurance market is not as litigious as the American one [see 13 dealing with auditor liability] may further incentivise auditors to include additional KAMs in their audit reports over time. Yet, **Figure 3** shows the total number of KAMs reported for the sample of 356 JSE-listed companies steadily declines across the four-year period.

The 2017 financial year reported the most KAMs, possibly because firms were dealing with new auditor reporting requirements and taking a more conservative approach when it came to classifying issues as KAMs. From 2017 to 2020, the average number of KAMs reported per company has decreased from 2.11 in 2017 to 1.94 in 2020.

As audit firms become more familiar with the application of ISA 701, they may be refining the number of material issues identified during an engagement. Equally possible is that audit firms are standardising their disclosures and reducing the level of detail reported as a means of reducing risk of regulatory inspections and legal exposure [13].

Categorising KAMs according to entity- or account-level shows the overall decline in the number of KAMs is mainly due to fewer account-level KAMs being reported each year. While the number of entity-level KAMs increased by 14% over the sample period, the number of account-level KAMs dropped by 20% from 488 to 390 over the same period. The difference between the number of entity- and account-level KAMs suggests that, as auditors' understanding of their clients and the requirements of ISA 701 improves, the core issues being flagged as "key" are moving away from granular or account considerations to broader considerations affecting an auditee.

Figure 3: Total reported KAMs per year in South Africa



	2017	2018	2019	2020
Account level	488	453	442	390
Entity-level	264	284	281	301
Total KAMs	752	737	723	691
Total audit reports with 1 or more KAMs	299	310	315	303
Average	2,11	2,07	2,03	1.94

Year-on-year changes	2017-2018	2018-2019	2019-2020	2017-2020
Percentage change - total	-2%	-2%	-4%	-8%
Percentage change – account-level	-7%	-2%	-12%	-20%
Percentage change – entity-level	8%	-1%	7%	14%

5 The United Kingdom was the first country to adopt KAMs per the Financial Reporting Council's election to early adopt the standard in 2013.

KAM disclosure themes

The 13 core themes and related number of KAMs per theme over the four-year period are presented in **Figure 4**.

Business combinations and goodwill (including goodwill impairment) have the highest frequency of KAM disclosures with 801 reported KAMs (28%). This is followed by 680 KAMs (23%) dealing with the accounting for non-financial assets, the main focus of which is the impairment of these assets. Next are KAMs concerned with the application (including impairment considerations) of IFRS 9 to financial instruments (410 KAMs; 14%). Employee benefits (4 KAMs, 0.1%), changes in accounting policies and errors (28 KAMs, 1%) and the accounting for inventory (73 KAMs, 2.5%) resulted in the fewest number of KAMs.

There are only 111 reported KAMs (4%) dealing specifically with going concern issues over the four-year period, including the resulting impact of COVID-19. This proportion appears low but auditors discussed the effects of the global pandemic and related liquidity issues as part of their assessment of the impairment of goodwill, non-financial assets and financial assets which were the three most common KAM themes.

When comparing the results to those of other jurisdictions, Australian listed companies' audit reports included KAMs most frequently related to acquisitions, impairment considerations, valuation of goodwill and the valuation of non-current assets (including property, plant and equipment and inventory) [see 12]. This aligns with the results in the current study with more than half (51%) of all KAMs in South Africa dealing with business combinations and goodwill (including goodwill impairment) and the accounting for non-financial assets. The Australian KAMs address revenue recognition as a common KAM theme [12]. In a South African context, revenue is the fourth most disclosed KAM theme (182 KAMs, 6%), indicating that it is being raised with less prominence by South African auditors in contrast to other jurisdictions where it is a more common theme. Similarly, data from the UK, Brazil, United Arab Emirates, Kenya, Nigeria, Cyprus, Oman, Romania and Zimbabwe flag impairments as the most reported KAM theme [10], which aligns with the South African themes.

Figure 4: Number of KAMs per core disclosure theme

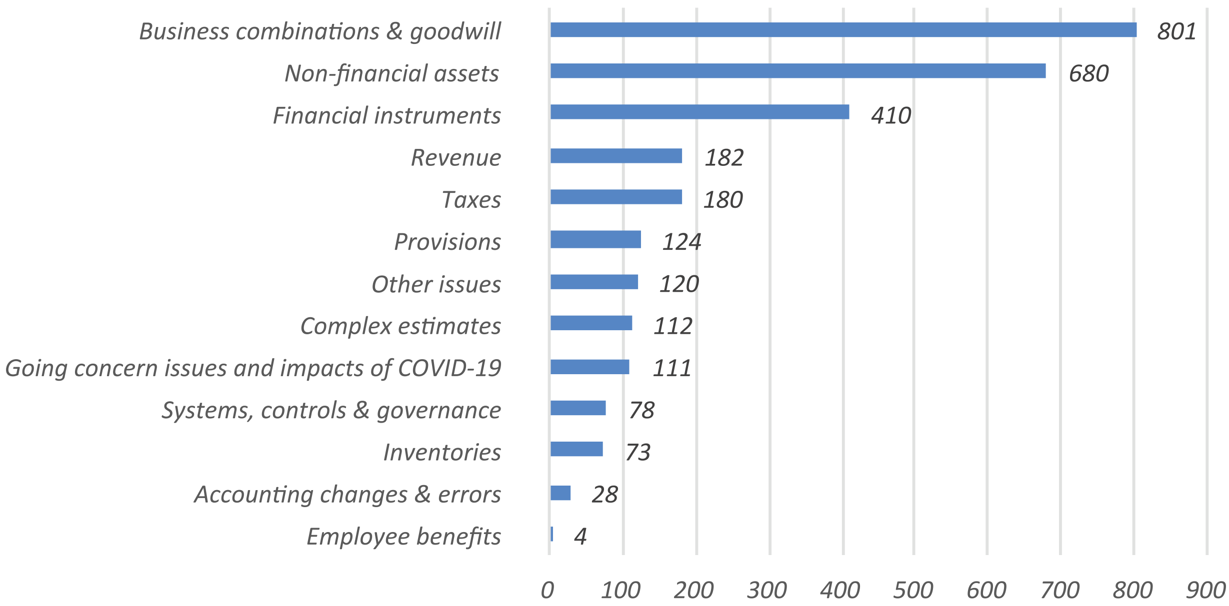
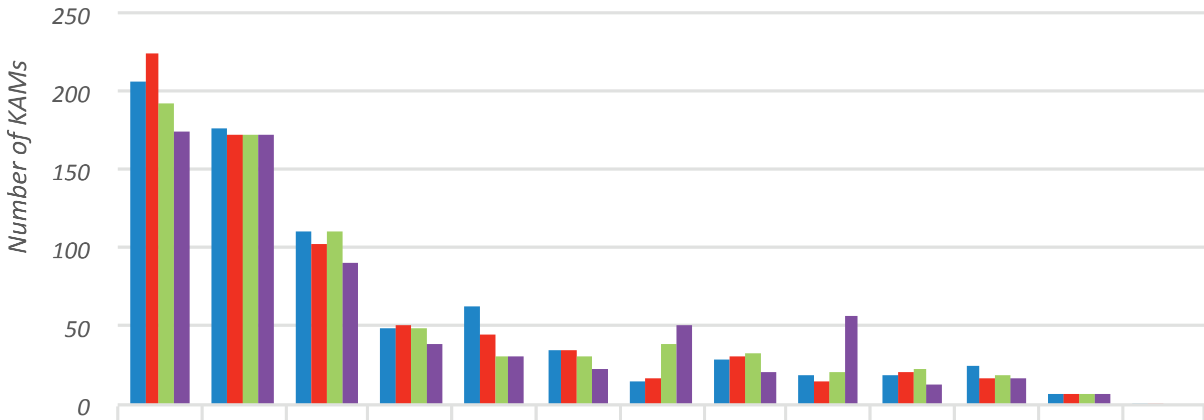


Figure 5 highlights the number of KAMs disclosed in each audit report from 2017 to 2020 showing the 13 KAM themes separately.

Figure 5 confirms the increased number of KAMs dealing with "going concern and impact of COVID-19" in 2020. The only other KAM theme which has an increase in the frequency of disclosure is "other issues". These KAMs deal mainly with the adoption of new accounting standards which become effective over the period under review, such as the IFRS dealing with leases and revenue[6]. Consistent with the results in **Figure 3**, the frequency of other reported KAMs is either stable or falling.

Figure 5: KAMs reported per year split by core theme



	Business combinations & goodwill	Non-financial assets	Financial instruments	Revenue	Taxes	Provisions	Other issues	Complex estimates	Going concern issues and impact of COVID-19	Systems, controls & governance	Inventories	Accounting changes & errors	Employee benefits
2017	207	177	110	49	62	35	14	29	18	19	24	6	2
2018	224	172	103	50	44	35	17	31	15	21	17	7	1
2019	192	172	111	48	31	30	38	32	21	23	18	7	0
2020	175	172	91	38	30	22	50	21	56	13	16	7	0

Differences in KAMs among industries

Figure 6 examines how KAMs differ among industries after controlling for differences in the number of companies per industry.

Figure 6 shows that companies in the construction (average 2.34) and public administration (average 2.32) industries reported the highest number of KAMs. On the other extreme, companies in the agriculture, forestry and fishing (average 1.53) and manufacturing (average 1.54) industries reported fewest KAMs.

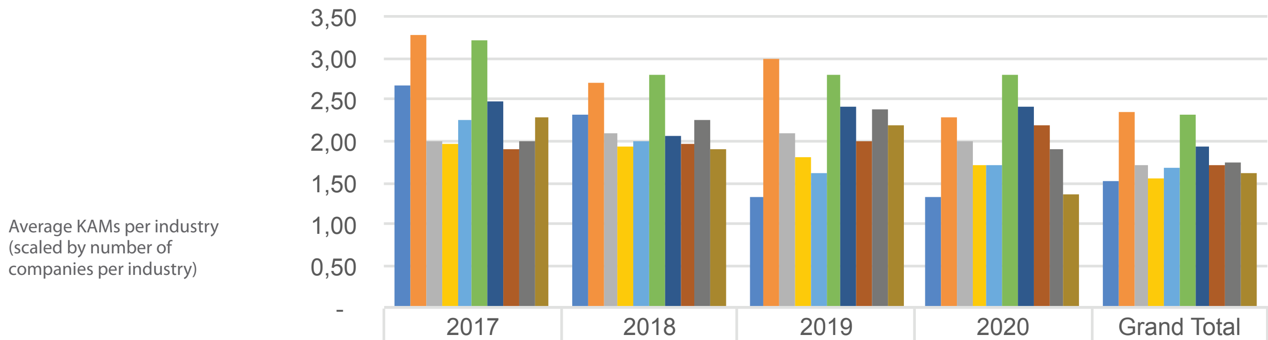
Readers may have expected firms in the finance, insurance, and real estate industry to have most complex accounting and, in turn, the greatest number of KAMs per organisation. ISA 701, however, requires auditors to select from material issues those which were most significant for conducting an audit. That banks, insurance providers or property funds have complex business models and accounting requirements is not unusual, and audit firms have well developed methodologies for dealing with these types of entities. As a result, the underlying complexity of an auditee's business environment, information systems and financial statements does not automatically give rise to additional KAMs. Whether or not a material issue is also a KAM is a matter of professional judgement and the context at each client. It cannot be assumed that specific types of companies or business sectors will, therefore, have more/less KAMs in their audit reports than other entities have.

Over the sample period, 14% of audit reports included no KAMs[7], 53% reported 1 or 2 KAMs, 31% reported 3 to 5 KAMs, and 2% reported 6 or more KAMs. Of particular interest are those reports which resulted in a high frequency of KAMs. Refer to **Table 2**.

6 International Financial Reporting Standards (IFRS) adopted during the study period include IFRS 15: Revenue from Contracts with Customers and IFRS 16: Leases.

7 Of the 14%, a total of 12% of audit reports had missing KAMs either due to the audit reports being unavailable at the time of data collection or the report referring to entities in the broader group structure for KAM details.

Figure 6: Average KAMs per industry



	2017	2018	2019	2020	Grand Total
Agriculture, Forestry, Fishing	2,67	2,33	1,33	1,33	1,53
Construction	3,29	2,71	3,00	2,29	2,34
Finance, Insurance, Real Estate	2,01	2,10	2,08	2,00	1,72
Manufacturing	1,97	1,94	1,79	1,71	1,54
Mining	2,24	2,00	1,63	1,72	1,68
Public Administration	3,20	2,80	2,80	2,80	2,32
Retail Trade	2,48	2,07	2,41	2,41	1,92
Services	1,91	1,97	2,00	2,18	1,70
Transportation & Public Utilities	2,00	2,26	2,39	1,91	1,75
Wholesale Trade	2,27	1,91	2,18	1,36	1,60

Table 2: Top 10 highest reported KAMs

Company	Specific industry	Audit Firm/(s) over the 4-year period	Total KAMs over 4 years	Avg. KAMs per year
Standard Bank Group Ltd	Finance	KPMG and PwC (joint auditor)	29	7
Glencore Plc	Mining	Deloitte	27	7
African Equity Emp Inv L	Investment holding company	BDO / Crowe & Thawt	25	6
Trustco Group Hldgs Ltd	Finance, Insurance,	BDO / Nexia	21	5
Tongaat Hulett Ltd	Agri-processing/ manufacture	Deloitte	20	5
Adcorp Holdings Limited	Services	Deloitte	19	5
Brimstone Inv Corp Ltd	Investment holding company	Deloitte	19	5
Remgro Ltd	Investment holding company	PwC	19	5
Argent Industrial Ltd	Manufacturing	Grant Thornton / BDO	18	5
E Media Holdings Ltd	Media	Grant Thornton / BDO	18	5

Differences in KAMs among industries

Specific KAM classifications dealt with in the above entities include:

- financial instruments – recognition, measurement and impairments;
- insurance contracts – measurements;
- impairment of non-financial assets and goodwill (including CGUs[8]);
- non-financial assets – measurement of investment property;
- bundling, unbundling and restructure transactions;
- business combinations and goodwill – valuation and impairments of investments in subsidiaries, associates or joint ventures (including goodwill);
- going concern assessments;
- revenue recognition and measurement;
- uncertain tax exposures and recoverability of tax assets;
- compliance with debt covenants and
- hyperinflation.

Differences in KAMs among audit firms

The average number of KAMs per year for the Big 4 and Non-Big 4 audit firms are presented in **Table 3**.

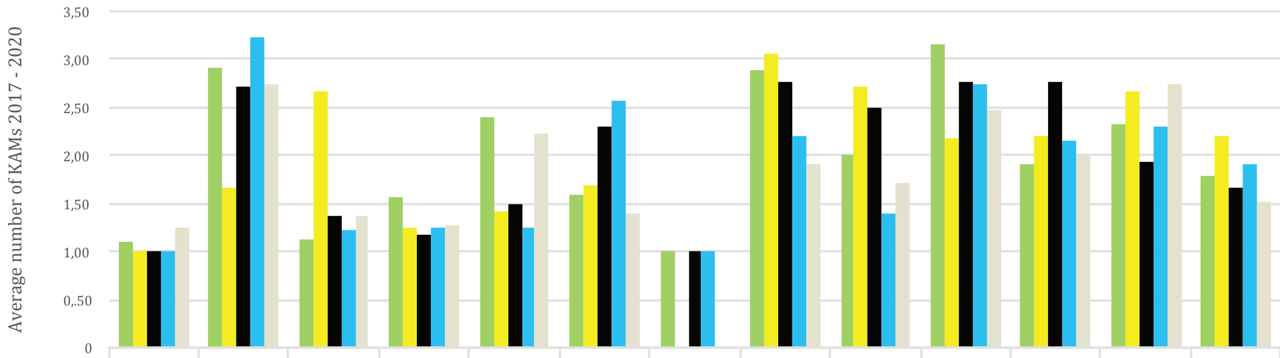
Table 3 shows that the Big 4 audit firms account for 71% of all KAM disclosures which is reasonable because they audit 64% of the companies in the sample, which are also the largest and most complex clients [see 14]. PwC has the highest share of reported KAMs (26%), followed by Deloitte (20%), KPMG (14%) and then EY (11%) – in line with the audit market shares of the respective firms. Compared to their non-Big 4 counterparts, the Big 4 audit firms also report slightly more KAMs per client (2.25 compared to 2.11). On average, KPMG reports 2.39 KAMs per client, followed by Deloitte (2.35), EY (2.29), and PwC reports the lowest number of KAMs per client (2.11), despite having most KAMs in total. The average number of KAMs reported by the Big 4 audit firms in South Africa is also consistent with how their international offices[12] are applying ISA 701 and may reflect the effort expended by the Big 4 to standardise audit methodologies among their offices.

Figure 7 illustrates the average KAMs per audit report by type and audit firm from 2017 – 2020, controlled for differences in the number of each audit firm's clients. This shows how often a KAM theme is mentioned when a particular issue is identified.

Table 3: Average number of KAMs identified per South African auditors (2017–2020)

	Avg. 2017	Avg. 2018	Avg. 2019	Avg. 2020	Average KAM per audit client over 4-year period	Audit firm percentage of total KAMS in South Africa
KAM distribution of South African Big 4 auditors[9]						
PwC	2.11	2.05	2.13	2.15	2.11	26%
Deloitte	2.55	2.28	2.25	2.33	2.35	20%
KPMG	2.52	2.52	2.24	2.08	2.39	14%
EY	2.43	2.31	2.29	2.15	2.29	11%
Big 4	2.40	2.29	2.23	2.18	2.25	71%
KAM distribution of South African Non-Big 4 (small- to mid-tier) auditors						
BDO/Grant Thornton						
/SNG[10]	2.26	2.39	2.33	1.60	2.17	7%
Mazars	2.13	1.85	2.18	2.25	2.12	5%
Nexia	1.50	1.50	1.56	2.00	1.68	2%
Other[11]	1.89	2.11	2.15	1.60	2.11	5%
Non-Big 4	1.93	2.09	2.13	1.65	2.11	29%

Figure 7: Average KAMs by type and audit firm[13]



	Accounting changes & errors	Business combinations & goodwill	Going concern issues & impact of COVID-19	Other issues	System controls & governamce	Complex estimates	Employee benefits	Financial instruments	Inventories	Non-financial assets	Provisions	Revenue	Taxes
Deloitte	1,11	2,92	1,13	1,56	2,40	1,60	1,00	2,88	2,00	3,15	1,92	2,33	1,79
EY	1,00	1,67	2,67	1,25	1,43	1,70	-	3,05	2,73	2,19	2,20	2,67	2,21
KPMG	1,00	2,73	1,38	1,17	1,50	2,30	1,00	2,76	2,50	2,77	2,77	1,93	1,67
PWC	1,00	3,23	1,21	1,25	1,25	2,57	1,00	2,20	1,40	2,75	2,15	2,29	1,91
Non-Big 4	1,25	2,73	1,37	1,26	2,23	1,40	-	1,90	1,71	2,47	2,00	2,74	1,52

Figure 7 shows that KAM themes are indicative of risks impacting various aspects of that theme in an organisation at both the entity- and account-level. Audit reports can reinforce significant risk areas by addressing the same KAM theme multiple times in the report, as shown by themes that have more than one KAM reported for the same theme. For example, PwC reports 3.23 business combinations and goodwill KAMs per client where that issue has been identified. This indicates that the core issues are being reinforced and have impacted the client from more than one perspective.

Overall, the proportion of KAMs per theme is not consistent across the audit firms. Despite efforts to standardise how ISA 701 is interpreted and applied in other jurisdictions [consider 16], South African audit firms and individual engagement teams probably have considerable discretion when it comes to identifying KAMs at individual clients [6].

Other than employee benefits, all of the audit firms include at least one account- and entity-level KAM. Account-level KAMs are, on average, reported more frequently by audit firms (2.03) compared to entity-level KAMs (1.67). Account-level KAMs may also include significant risk areas across different aspects of the accounting standard applicable to that theme which may result in multiple KAMs being recorded for that theme for one client.

There is no indication of audit firms having a preference for certain types of KAMs. KAMs are a function of the nature and circumstances at each client rather than a product of generic firm guidance which pre-determines certain KAMs.

8 Cash-generating units: refer to IAS 36: Impairment of Assets.

9 Note - 114 KAMs among the Big 4, represent KAMs issued by dual auditors of financial institutions across 29 reports (8 entities). These have been allocated to only one of the audit firms to avoid double counting the KAM disclosure – this is deemed to be immaterial as it represents less than 4% of total KAM disclosures.

10 To remove the effect of mergers and splits between BDO, Grant Thornton and SNG, these three entities have been amalgamated into a single line item.

11 This consists of 13 audit firms: Saffery Champness, Crowe, Moore Stephens, PKF, RSM, Baker Tilly, Thawt, Horwath Leveton Boner, Nolands, CMA, HLB CMA, SVG and Mahdi Meyer Steyn Chartered Accountants Incorporated.

12 For example, Kend and Nguyen (2020) report that the average KAMs per audit client in Australia between 2017 and 2018 are as follows: Deloitte = 1.92; EY = 2.42, KPMG = 2.05, PwC = 2.66 and Non-Big 4 = 1.82.

13 Themes denoted with an asterisk (*) are entity-level KAMs and themes denoted with an upper arrowhead (^) are account-level KAMs.

Conclusion

This report provides an overview of KAM disclosures in a South African context from 2017 to 2020 based on prior academic research [7]. Most common KAM disclosures are related to business combinations and impairments of goodwill, followed by measurement and impairment considerations for non-financial assets. These areas deal with technical and highly complex features of financial accounting where auditors can be expected to devote more time and attention. In particular, the use of estimates, the impact of uncertainty and the need to apply professional judgement mean that these are more likely to be higher risk areas in an audit where a greater number of issues are discussed with governing bodies and flagged as key audit matters.

Less often resulting in KAMs are the auditees' systems and internal controls, inventories and employee benefits. KAMs dealing with prior period errors, changes in accounting policies and going concern issues are also infrequent, except in 2020 when COVID-19 hit and posed additional risks to business continuity.

Figure 8 proposes four KAM-reporting strategies based on the relative number of KAMs identified and the mix of account and entity-level KAMs.

The KAM typology presented in **Figure 8** provides a preliminary framework for evaluating KAMs and understanding how they contribute to users' understanding of the audit process. The findings and principles discussed in this report should be relevant to a broad audience, but additional research will be required to understand in more detail how KAMs vary among countries and the factors which contribute to the homogenisation of, or divergence in, the application of ISA 701 by audit firms.

Figure 8: KAM disclosure techniques for listed entities

Entity-level KAMs / Account-level KAMs	Low	High
High	**Granular focus** • This is common for first-time identification of KAMs at a client • High focus on complexities in the accounting standards, particularly, impairment decisions • Less emphasis on entity-level considerations • 39% of KAM disclosures noted in this range over 4 years • Big 4 (80%) and Non-Big 4 (20%) split • Dominant industries: Mining; retail trade; transportation and public utilities	**Broad identification** • Many KAMs disclosed (both entity and account-level) • Number and complexity of KAMs may highlighted audits with the greatest number of issues which required significant attention by the auditor • 16% of KAM disclosures noted in this range over 4 years • Big 4 (67%) and Non-Big 4 (33%) split • Dominant industries: Finance, insurance, real estate and manufacturing
Low	**Narrow identification** • Client may have limited complexities leading to a low number of KAMs of both types • Audit process disclosure is limited • May be indicative of less rigorous risk assessment and response • 27% of KAM disclosures noted in this range over 5 years • Big 4 (70%) and Non-Big 4 (30%) split • Dominant industries: Wholesale retail; public administration; construction; agriculture, forestry and fishing	**Holistic identification** • Focus on material issues impacting the entity as a whole rather than a more granular analysis of accounting-level factors • May capture entities which do not have complex financial reporting environments which lead to material audit risks at for specific balances and transactions. • The most significant audit issues concern system-wide or governance factors • 18% of KAM disclosures noted in this range over 5 years • Big 4 (58%) and Non-Big 4 (42%) split • Dominant industries: Services

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