QUESTION ONE

1) Using the information provided,

a) Evaluation of audit risks including utilisation of the analytical procedures

Evaluation of the audit risks

Evaluation of audit risk New audit client The Group is a new client of our firm which may create detection risk as we have no previous experience with the client. However, thorough planning procedures which focus on obtaining a detailed knowledge and understanding of the Group and its activities will minimise this risk. We need to obtain a thorough understanding of each of the subsidiaries as they are all significant components of the Group, with Kafue Silk Co, Blantyre Recycling Co and Lusaka Furnitures Co's assets representing respectively 20%, 22·3% and 26% of Group assets. There is also a significant risk that comparative information and opening balances are not correct.

Analytical review

Relevant trends and ratio calculations:
– Revenue increased by 11·5%
– Gross profit increased by 12·7%
– Operating profit increased by 59·5%
– Cash fell by 54·5%
– Inventories increased by 100%
– Receivables increased by 59·1%

	2019	2018
Gross Margin	36·1%	35·8%
Operating margin	1·7%	1·2%
Interest cover	12·2	7·7
Current ratio	1·8	2·2
Gearing	22·5%	25·1%

Commented [MKM1]: Put the ratios in line under 2019 and under 2018

The analytical review indicates that the Group's revenue generation and profitability has improved during the year. There could be valid business reasons to explain the trends, however, the audit team should be alert for possible overstatement of revenue and understatement of expenses.

The risk is increased due to the bonus scheme which gives rise to a risk of material misstatement at the financial statement level. Management will be biased towards accounting treatments which lead to overstatement of revenue, for example, the early recognition of revenue.

There is also a risk of management manipulation of the financial statements due to the renegotiation of the Group's lending facilities, for example, it would be favourable to present a good interest cover to the bank as an analysis of interest cover is likely to feature in their lending decision.

The current ratio has fallen, largely due to the significant reduction in cash of 54·5%. Other changes within current assets could indicate audit risk, as both inventories and trade receivables have increased significantly, by 100% and 59·1% respectively. Given that revenue has increased by only 11·5% in the year, these increases appear very large and could indicate potential overstatement.

The analytical review also reveals that the amount recognised in respect of property, plant and equipment has not changed over the year. This seems unlikely to be reasonable, as the Group would presumably have incurred some capital expenditure in the year, disposed of some assets and charged depreciation. There are implications for operating profit, which, for example, is overstated if any necessary depreciation has not been charged.

Brand name

The brand is material at 7·4% of Group assets. It is recognised in the statement of financial position as an intangible asset which is appropriate given that the brand is a purchased intangible asset. However, the asset is recognised at its original cost and there is risk attached to the policy of non-amortisation of the brand. IAS® 38 Intangible Assets states that an intangible asset with a finite useful life is amortised, and an intangible asset with an indefinite useful life is not. The risk is that the assumption that the brand has an indefinite life is not correct, and that the asset is overstated and operating expenses understated through the lack of an annual amortisation charge against the asset.

There is also a risk that the brand could be impaired given the bad publicity and allegations made by the journalist against the Group. IAS 36 Impairment of Assets requires an impairment review to be carried out when indicators of potential impairment exist. The allegations may have damaged the Group's reputation, with consequential impact on revenue and cash flows, though the increase of 11·5% in the Group's revenue could indicate that this is not the case, as claimed by the Group finance director. However, sales of certain products could be in decline, and the fact that inventories have doubled in value could indicate problems in selling some of the Group's products. The risk is that if any necessary impairment has not been recognised, the asset is overstated and operating expenses understated by the amount of the impairment loss.

Associate

A new associate has been acquired during the year, which gives rise to several risks. It is material at 11·2% of Group assets.

Because this is the first addition to the Group for many years, there is an inherent risk that the Group lacks accounting knowledge on the appropriate accounting treatment. Associates are accounted for under IAS 28 Investments in Associates and Joint Ventures, which states that an entity with joint control of, or significant influence over, an investee shall account for its investment in an associate or a joint venture using the equity method.

There is a risk that the equity method has not been properly applied. The investment in the associate recognised in the statement of financial position has increased in value since acquisition by K0·5 million, presumably due to the inclusion of the Group's share of profit arising since investment. There is a risk that this has not been calculated correctly, for example, it is not based on the correct share of profit, and the investment may therefore be over- or understated. Risk also arises in relation to any possible impairment of the investment, which may cause it to be overstated in both the individual financial statements of Salapo Co, and the Group financial statements.

There is also a disclosure issue, as the Group's share of post-investment profit of Zambia Clothing Co should be recognised in profit or loss, and IAS 1 Presentation of Financial Statements requires that the profit or loss section of the statement of profit or loss shall include as a line item the share of the profit or loss of associates accounted for using the equity method. The draft statement of profit or loss and other comprehensive income does not show income from the associate as a separate line item; it may have been omitted or netted against operating expenses, and the risk is inappropriate presentation of the income from investment.

There is also a risk that the investment should not have been classified as an associate. According to IAS 28, if an entity holds, directly or indirectly, 20% or more of the voting power of the investee, it is presumed that the entity has significant influence, unless it can be clearly demonstrated that this is not the case. If the 25% holding does not give rise to significant influence, for example, if the shares do not convey voting rights, it should be classified as an investment rather than an associate. There is a risk of inappropriate classification, recognition and measurement of the investment in Zambia Clothing Co.

Kafue Silk Co's inventory in multiple locations

A risk arises in relation to inventory, which is held in each of the department stores. There is a risk that controls are not sufficiently strong in respect of the movement of inventory and counting procedures at the year end, as it will be hard for Kafue Silk Co to ensure that all locations are subject to robust inventory counting procedures. This control risk leads to potential over or understatement of inventory and cost of sales.

Systems and controls

The audit committee states that the Group's systems are out of date; this may give rise to control risk across the Group as a whole. In addition, Blantyre Recycling Co has implemented a new inventory control system. A new system introduced during the year can create control risk. With any new system, there are risks that controls may take time to develop or be properly understood, and the risk of error in relation to inventories is relatively high.

Lusaka Furnitures Co's investment properties

The investment properties are material to both Lusaka Furnitures Co's individual financial statements, representing 35·7% of its total assets, and also to the Group's financial statements, representing 9·3% of Group assets.

According to IAS 40 Investment Property, an entity can use either the fair value model or the cost model to measure investment property. When the fair value model is used the gain is recognised in profit or loss. The draft consolidated statement of profit or loss and other comprehensive income includes the investment property revaluation gain as other comprehensive income rather than as profit or loss, and therefore the gain is not presented in accordance with IAS 40.

An accounting error may have been made in the adjustment made to increase the value of the investment property. The statement of financial position shows an increase in value of investment properties of K2·5 million, however, the gain in the statement of profit or loss and other comprehensive income is stated at K1 million. There is a risk that the gain is understated and part of the gain may have been classified elsewhere in profit or loss. The gain as stated in the statement of profit or loss and other comprehensive income is material at 9·3% of total comprehensive income.

It would be important to obtain information on the type of properties which have been invested in, and whether there have been any additions to the portfolio during the year, as part of the movement in the investment property balance during the year could be explained by acquisitions and disposals. Information should also be obtained on any disposals of investment properties during the year, and whether a profit or loss was made on such disposals. The possible error discussed above in relation to the presentation of the investment property gain is also relevant to the comparative information, which may also be materially misstated. This increases the risk that other balances and transactions in prior years have been incorrectly accounted for. The use of professional scepticism should be stressed during the audit, and further procedures planned on opening balances and comparative information.

Further information should be sought from the previous auditor of the Group in relation to the accounting treatment for the investment properties, and whether it had been identified as an error, in which case the audit reports of both Lusaka Furnitures Co and the Group should have been modified. A review of prior year audit reports is necessary, as well as a review of the previous audit firm's working papers, assuming permission is given for this to take place.

Bonus scheme

It is noticeable from the draft statement of financial position that there is no accrual recognised in respect of the bonus scheme, unless it has been included inappropriately in trade or tax payables. This indicates a potential understatement of liabilities and overstatement of profit if any necessary accrual has not been made for any bonus which is payable.

Management charges

The management charges imposed by the parent company on the subsidiaries represent inter-company transactions. In the individual financial statements of each subsidiary, there should be an accrual of K800,000 for the management charge payable in August 2018, and Salapo Co's individual financial statements should include K2·4 million as a receivable. There is a risk that these payables and the corresponding receivable have not been accrued in the individual financial statements.

At Group level, the inter-company balances should be eliminated on consolidation. If this has not happened, the liabilities and receivables in the Group financial statements will be overstated, though there would be no net effect on Group profit if the balances were not eliminated.

Tutorial note: Credit will also be awarded for comments on relevant issues to do with transfer pricing and relevant tax implications which have not been considered and recognised appropriately in the financial statements.

Inventory

The draft consolidated statement of financial position shows that inventory has doubled in the year. Given that the Group is involved in retail, there could be issues to do with obsolescence of inventory, leading to potentially overstated inventory and overstatement of profit if any necessary write down is not recognised. This may be especially the case for the mass market fashion clothing made by Blantyre Recycling Co. Inventory is material to the Group, representing 11·2% of Group assets.

Inter-company transfers

Kafue Silk Co transfers goods to Blantyre Recycling Co for recycling when its goods are considered obsolete. There is a risk that at Group level the inter-company trading is not eliminated on consolidation, which would lead to overstated receivables and payables. In addition, if the inventory is transferred at a profit or loss, which is then not realised by the Group at the year end, the Group inventory figure and operating profit could be over- or understated if any necessary provision for unrealised profit or loss is not recognised.

Goodwill

The draft consolidated statement of financial position does not recognise goodwill, which is unusual for a Group with three subsidiaries. It may be that no goodwill arose on the acquisitions, or that the goodwill has been fully written off by impairment. However, there is a risk of understatement of intangible assets at the Group level.

Component auditor Blantyre Recycling Co is audited by a different firm of auditors. This may introduce audit risk in that Puta & Co will be relying to some extent on their work. Careful planning will be needed to reduce this risk to a minimum, and this is discussed in the next section of the briefing notes.

Tutorial note: Credit will be awarded for relevant calculations which form part of relevant analytical review performed, such as calculations relating to profit margins, liquidity and gearing, *and for discussion which is relevant to the evaluation of audit risk. Credit will also be awarded for discussion of other relevant audit risks, for example, risks associated with the lack of a deferred tax figure in the statement of financial position, and the change in effective tax rate.*

b) In respect of planning to use the work of Kamuzu & Co.

i) Matters to be considered

The requirements in respect of using the work of component auditors are given in ISA 600 Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors). ISA 600 requires that if the Group engagement team plans to request a component auditor to perform work on the financial information of a component, the Group engagement team shall obtain an understanding of four matters.

- The Group engagement team should ascertain whether the component auditor understands and will comply with the ethical requirements which are relevant to the group audit and, in particular, is independent. When performing work on the financial information of a component for a group audit, the component auditor is subject to ethical requirements which are relevant to the group audit. Given that Kamuzu & Co is based in Malawi, the ethical requirements in that location may be different, possibly less stringent, to those followed by the Group.
- The component auditor's professional competence should also be assessed, including whether the component auditor has the relevant industry specific skills and technical knowledge to adequately obtain evidence on the component. As Blantyre Recycling Co reports under IFRS® Standards, there is less likelihood of Kamuzu & Co having a knowledge gap in terms of the Group's applicable financial reporting framework than if the company used local accounting rules. The fact that Kamuzu & Co is a member of an international network means it is likely to have access to regular training programmes and technical updates which adds to the credibility of their audit work.
- The Group audit team should also gain an understanding of Kamuzu & Co's resource base to ensure it can cope with the work required by the Group. There should also be evaluation of whether the Group engagement team will be able to be involved in the work of the component auditor to the extent it is necessary to obtain sufficient appropriate audit evidence.
- Whether the component auditor operates in a regulatory environment which actively oversees auditors should be understood. The Group audit team should ascertain whether independent oversight bodies have been established in the jurisdiction in which Kamuzu & Co operates, to oversee the auditing profession and monitor the quality of audit. This allows greater reliance to be placed on their work.

In addition to the matters required to be considered in accordance with ISA 600 discussed above, the risk of material misstatement in the subsidiary being audited by the component auditor must be fully assessed, as areas of high risk may require input from the Group audit team, and not be subject to audit solely by the component auditors. For areas of high risk, such as Blantyre Recycling Co's inventories, the Group audit team may consider providing instructions to the component auditor on the audit procedures to be performed.

ii) Procedures to be performed

- Review the local ethical code (if any) followed by Kamuzu & Co, and compare with the IESBA Code of Ethics for Professional Accountants for any significant difference in requirements and principles.

- Obtain confirmation from Kamuzu & Co of adherence to any local ethical code and the IESBA Code. Establish through discussion or questionnaire whether Kamuzu & Co is a member of an auditing regulatory body, and the professional qualifications issued by that body. – Obtain confirmations of membership from the professional body to which Kamuzu & Co belongs, or the authorities by which it is licensed.
- Discuss the audit methodology used by Kamuzu & Co in the audit of Blantyre Recycling Co, and compare it to those used under ISAs (e.g. how the risk of material misstatement is assessed, how materiality is calculated, the type of sampling procedures used).
- A questionnaire or checklist could be used to provide a summary of audit procedures used.
- Ascertain the quality control policies and procedures used by Kamuzu & Co, both firm-wide and those applied to individual audit engagements.
- Request any results of monitoring or inspection visits conducted by the regulatory authority under which Kamuzu & Co operates.

c) Audit procedures

i) On the K12 million recognised as investment in associate

- Obtain the legal documents relating to the share acquisition, and review to confirm the terms and conditions including the number of shares purchased and the voting rights attached to each share.
- Agree the cost of investment of K11·5 million to the legal documentation and to Salapo Co's bank statement and cash book.
- Review the minutes of Group management meetings to understand the business rationale for the investment, and to confirm that the Group intends to exercise significant influence over Zambia Clothing Co, for example, through appointment of board members.
- Obtain management's calculation to determine the K12 million recognised in the Group financial statements, review the method of the calculation for compliance with IAS 28.
- Obtain the financial statements of Zambia Clothing Co to confirm the amount of profit made in the year and confirm that the Group's share of that profit is included in the Group financial statements.
- Enquire with management as to whether any impairment review of the investment in Zambia Clothing Co has taken place, and if so, obtain management's workings and review the assumptions used and the method of calculation.

ii) On the K8 million recognised as a brand name.

- Obtain the Group's marketing budget and plans, and review to confirm that there is adequate support of the brand name through advertising.
- Obtain the results of any market research which has been recently carried out by the Group and review its conclusions, for example, on the market share of the Group's product lines.
- Given the materiality of the brand name, consider using an expert in brand valuation to provide a fair value for the brand, which can then be compared to the amount recognised in the financial statements.
- Discuss with management whether in their opinion there are any indicators that the brand name is impaired, in particular discussing the impact of the bad publicity on sales.
- Obtain written representation from management that in their opinion the brand is not impaired at the year end.

2) Professional scepticism

i) Professional scepticism – definition and relevance to the Salapo Group

An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.

In the context of Salapo group, the concept is relevant because of group related risk indicators such as:

- As a group entity – The audit of a group is much involving requiring the application of various international reporting standards such as IFRS 3, Business Combination
- The group is a listed entity. As a public interest entity, higher levels of due care and independence are expected
- The existence of a foreign entity – this requires careful determination of the application consolidation method to be applied

ii) Demonstrating professional scepticism

Some of the ways in which this can be achieved include:

- The use of experts in risk areas
- Allocation of more experienced staff on the audit
- Closer supervision of staff
- Use of consultations as recommended by quality control procedures
- Focused on more reliable evidence – external and that generated by the auditor

3) Using the information provided in Exhibit 3, -Ethical threats and recommended action

Non Assurance IT related service

The first threat relates to the audit committee's request for our firm to provide advice on the new accounting and management information systems to be implemented next year. If the advice were given, it would constitute the provision of a non-assurance service to an audit client. The ZiCA's Code of Ethics for Professional Accountants has detailed guidance in this area and specific requirements in the case of a public interest entity such as the Group which is a listed entity.

The Code states that services related to IT systems including the design or implementation of hardware or software systems may create a self-review threat. This is because when auditing the financial statements the auditor would assess the systems which they had recommended, and an objective assessment would be difficult to achieve as the auditor would be reluctant to find errors or shortcomings in the recommendations and work performed by their firm. There is also a risk of assuming the responsibility of management, especially as the Group apparently has little experience in this area, so would rely on the auditor's suggestions and be less inclined to make their own decision.

In the case of an audit client which is a public interest entity, the Code states that an audit firm shall not provide services involving the design or implementation of IT systems which form a significant part of the internal control over financial reporting or which generate information which is significant to the client's accounting records or financial statements on which the firm will express an opinion.

Recommended action

Therefore the audit firm should not provide a service to give advice on the accounting systems. With further clarification on the nature of the management information systems and the update required to them, it may be possible for the audit firm to provide a service to the Group, as long as those systems are outside the financial reporting system. However, it may be prudent for the audit firm to decline offering any advice on systems to the client especially as Salapo Group is a listed entity.

Request to attend meeting
Second, the audit committee has asked the audit engagement partner to attend a meeting with the bank, the objective of the meeting being the renegotiation of the Group's lending facilities. This is an advocacy threat to objectivity, as the audit partner will be supporting the client in its renegotiation and may be perceived as supporting or confirming the Group's financial position.

If the partner were to attend the meeting and confirm the strength of the Group's financial position, or confirm any work performed on the cash flow forecast, there could be legal implications. These actions would potentially expose Puta & Co to liability, it could be perceived that the audit firm is in some way guaranteeing the loan or guaranteeing that the Group is in a position to service the debt.

Recommended action
The partner should not attend the meeting or be seen to be supporting the Group in its attempt to raise further finance.

These ethical issues should be discussed with those charged with governance of the Group, with an explanation provided as to why the audit firm cannot attend the meeting with the bank.

4) Using the information in in exhibit 4, - quality control and other issues and implications for the completion of the audit

	Quality control, ethical and other issues	**Implications for the completion of the audit**
1	The first comment made by the audit assistant shows that the audit of the provision in relation to the legal claim has not been properly carried out,	It would seem that there is not sufficient, appropriate audit evidence to conclude that provisions are fairly stated.
2	The finance director telling the audit assistant not to approach the company's legal advisers would appear to be placing a limitation on the evidence which can be obtained. Also, the finance director could have used his seniority to intimidate the audit assistant. The situation indicates that the finance director may be trying to hide something, and professional scepticism should be exercised. Possibly the finance director knows that the amount which should be provided is much larger than the K214,300 and he is reluctant to recognise a larger liability in the financial statements or that the legal advisers are aware of other provisions which should be included with the financial statements which are currently not being recognised.	As the key risk for provisions is understatement, the audit team should not so readily accept the finance director's assessment that the amount included is complete. The audit team should challenge his statement regarding the adequacy of the provision and ask for written evidence, for example, confirmation from the legal advisers.
3	It is also concerning that the audit manager told the audit assistant to conclude on the audit work when the planned procedures had not been	There could be a material misstatement if the provision is significantly understated, and there is not sufficient evidence on the audit file to currently support the conclusions drawn.

	performed. This does not provide good direction to the audit team and increases audit risk.	
4	It is unlikely that the audit senior's 'quick look' at Bradley Co's financial statements is adequate to meet the requirements of ISA 520 and audit documentation would seem to be inadequate. The fact that the audit manager suggested that a detailed review was not necessary shows a lack of knowledge and understanding of ISA requirements. An audit client being assessed as low risk does not negate the need for analytical review to be performed, which the audit manager should know. Alternatively, the audit manager may have known that analytical review should have been performed, but regardless of this still instructed the audit assistant not to perform the review, maybe due to time pressure. The audit manager should be asked about the reason for his instruction and given further training if necessary.	Regarding the second comment made by the audit assistant, it is a requirement of ISA 520 Analytical Procedures that analytical procedures are performed at the overall review stage of the audit. An objective of ISA 520 is that the auditor should design and perform analytical procedures near the end of the audit which assist the auditor when forming their opinion as to whether the financial statements are consistent with the auditor's understanding of the entity. The lack of final analytical review increases audit risk. Because Bradley Co is a new audit client, it is particularly important that the analytical review is performed as detection risk is higher than for longer-standing audit engagements where the auditor has developed a cumulative knowledge of the audit client. Therefore if the audit manager, or another auditor, does not perform a detailed analytical review on Bradley Co's financial statements as part of the completion of the audit, there is a breach of ISA 520. Failing to perform the final analytical review could mean that further errors are not found, and the auditor will not be able to check that the presentation of the financial statements conforms to the requirements of the applicable financial reporting framework. It is also doubtful whether a full check on the presentation and disclosure in the financial statements has been made. The firm should evidence this through the use of a disclosure checklist.
5	The manager is not providing proper direction and supervision of the audit assistant, which goes against the principles of ISA 220 Quality Control for an Audit of Financial Statements, and ISQC1 Quality Control for Firms that Perform Audits and Reviews of Financial Statements and other Assurance and Related Services Engagements.	This implies that it is unlikely that without proper direction and supervision, there will be good quality of audit engagement performance
6	The final issue relates to the chairman's statement. ISA 720 The Auditor's Responsibilities Relating to Other Information requires that the auditor shall read the other information to identify material inconsistencies, if any, with the audited financial statements. The audit manager has discussed the chairman's statement but this does not necessarily mean that the manager has read it for the purpose of identifying potential misstatements, and it might not have been read at all. Even if the manager has read the chairman's statement, there may not be	As the work performed does not comply with the ISA 720 requirements, then the necessary procedures must be performed before the audit report is issued. This is especially important as the necessary paragraphs will need to be included within the auditor's report setting out that the other information has been obtained, the responsibility that the auditor has for the other information explained and whether anything needs to be reported in relation to any inconsistencies. Again, the situation could indicate the audit manager's lack of knowledge of ISA requirements, or that a short-

	any audit documentation to show that this has been done or the conclusion of the work. The manager needs to be asked exactly what work has been done, and what documentation exists.	cut is being taken, probably as a result of time pressure. In either case, the quality of the audit is in jeopardy.

5) Using the information in exhibit 5, - evaluation of uncorrected misstatements and impact on auditor's report

i) Evaluation of uncorrected misstatements

During the completion stage of the audit, the effect of uncorrected misstatements must be evaluated by the auditor, as required by ISA 450 Evaluation of Misstatements Identified during the Audit. In the event that management refuses to correct some or all of the misstatements communicated by the auditor, ISA 450 requires that the auditor shall obtain an understanding of management's reasons for not making the corrections and shall take that understanding into account when evaluating whether the financial statements as a whole are free from material misstatement. Therefore a discussion with management is essential in helping the auditor to form an audit opinion.

ISA 450 also requires that the auditor shall communicate with those charged with governance about uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report.

Each of the matters included in the schedule of uncorrected misstatements will be discussed below and the impact on the auditor's report considered individually and in aggregate.

Share-based payment scheme

The adjustment in relation to the share-based payment scheme is material individually to profit, representing 12% of revenue. It represents less than 1% of total assets and is not material to the statement of financial position.

IFRS® 2 Share-based Payment requires an expense and a corresponding entry to equity to be recognised over the vesting period of a share-based payment scheme, with the amount recognised based on the fair value of equity instruments granted. Management's argument that no expense should be recognised because the options are unlikely to be exercised is not correct. IFRS 2 would classify the fall in Bradley Co's share price as a market condition, and these are not relevant to determining whether an expense is recognised or the amount of it.

Therefore management should be requested to make the necessary adjustment to recognise the expense and entry to equity of K6,428,570. If this is not recognised, the financial statements will contain a material misstatement, with consequences for the auditor's opinion.

Restructuring provision

The adjustment in relation to the provision is material to profit, representing 2% of revenue. It represents less than 1% of total assets so is not material to the statement of financial position.

The provision appears to have been recognised too early. IAS 37 Provisions, Contingent Liabilities and Contingent Assets requires that for a restructuring provision to be recognised, there must be a present obligation as a result of a past event, and that is only when a detailed formal plan is in place and the entity has started to implement the plan, or announced its main features to those affected. A board decision is insufficient to create a present obligation as a result of a past event. The provision should be recognised in the following year when the announcement to employees was made.

Management should be asked to explain why they have included the provision in the financial statements, for example, there may have been an earlier announcement before 31 May 2019 of which the auditor is unaware.

In the absence of any such further information, management should be informed that the accounting treatment of the provision is a material misstatement, which if it remains unadjusted will have implications for the auditor's opinion.

Inventory provision

The additional slow-moving inventory allowance which the auditor considers necessary is not material on an individual basis to either profit or to the statement of profit or loss or the statement of financial position, as it represents only 0·4% of revenue and less than 1% of total assets.

Despite the amount being immaterial, it should not be disregarded, as the auditor should consider the aggregate effect of misstatements on the financial statements. ISA 450 does state that the auditor need not accumulate balances which are 'clearly trivial', by which it means that the accumulation of such amounts clearly would not have a material effect on the financial statements. However, at 0·4% of revenue the additional provision is not trivial, so should be discussed with management.

This misstatement is a judgemental misstatement as it arises from the judgements of management concerning an accounting estimate over which the auditor has reached a different conclusion. This is not a breach of financial reporting standards, but a difference in how management and the auditor have estimated an uncertain amount. Management should be asked to confirm the basis on which their estimate was made, and whether they have any reason why the provision should not be increased by the amount recommended by the auditor.

If this amount remains unadjusted by management, it will not on an individual basis impact the auditor's report.

ii) Impact on auditor's report

When considering their opinion, the auditor must conclude whether the financial statements as a whole are free from material misstatement. In order to do this, they must consider whether any remaining uncorrected misstatements are material, either on an individual basis or in aggregate.

Aggregate materiality position

In aggregate, the misstatements have a net effect of K260,000 (K310,000 – K1.071,400), meaning that if left unadjusted, profit will be overstated by K260,000 and the statement of financial position overstated by the same amount. This is material to profit, at 10·4% of revenue, but is not material to the statement of financial position at less than 1% of total assets. Impact on auditor's report The misstatements in relation to the share-based payment scheme and restructuring provision are individually material to the statement of profit or loss and therefore management should be requested to make this adjustment as the statement of profit or loss is materially misstated if the adjustments are not made by management. According to ISA 705 Modifications to the Opinion in the Independent Auditor's Report, the auditor shall modify the opinion in the auditor's report when the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement.

The type of modification depends on the significance of the material misstatement. In this case, these misstatements in aggregate are material to the financial statements, but are unlikely to be considered pervasive even though they relate to a number of balances in the financial statements as they do not represent a substantial proportion of the financial statements. This is supported by the fact that the adjustment is not material to the statement of financial position and it is therefore unlikely that the auditor will conclude that the financial statements as a whole are misleading.

Therefore a qualified opinion should be expressed, with the auditor stating in the opinion that except for the effects of the matters described in the basis for qualified opinion paragraph, the financial statements show a true and fair view. The basis for qualified opinion paragraph should be placed immediately after the opinion paragraph, and should contain a description of the matters giving rise to the qualification This should include a description and quantification of the financial effects of the misstatement.

The remaining uncorrected misstatement in relation to the inventory allowance is, individually, immaterial to the financial statements and although management should be encouraged to amend all misstatements, failure to amend the inventory allowance will have no impact on the auditor's report. It should be emphasised to management that failure to correct the allowance will have an impact on future periods. If management intends to leave uncorrected misstatements, written confirmation of their immaterial nature should be obtained via a written representation.

QUESTION TWO

1) **BUSAKA Co**

a) **Money laundering - Policies and procedures for anti-money laundering programme**

Thole & Associates should have established an anti-money laundering programme within the firm. As part of this programme, the firm should have appointed a money laundering reporting officer (MLRO) with an appropriate level of experience and seniority. The audit firm should also have established internal reporting lines which should be followed to report any suspicions. Thole & Associates will probably have a standard form which should be used to report suspicions of money laundering to the MLRO. Staff should receive appropriate training on compliance with the anti-money laundering requirements and how to report issues to the MLRO.

The typical content of an internal report on suspected money laundering may include the name of the suspect, the amounts potentially involved, and the reasons for the suspicions with supporting evidence if possible, and the whereabouts of the laundered cash. The firm's internal policies should have been set up to ensure that all pertinent information is captured in this standardised report.

Any individual in the audit firm who has suspicions of money laundering activities is then required to disclose these suspicions to the MLRO. The report must be done as soon as possible as any non-disclosure or failure to report such suspicions will constitute an offence under the money laundering regulations.

On receipt of the internal report, the MLRO must consider all of the circumstances surrounding the suspicions of money laundering activities, document this process and decide whether to report the suspicions to the appropriate external authorities. The audit firm has a legal duty to report even though this may conflict with the auditor's duty of confidentiality.

Tutorial note: Credit will be awarded for other relevant answer points in relation to a firm's anti-money laundering programme such as client due diligence, further staff training and maintaining adequate records.

b) **Evaluation of possible indicators of money laundering activities**

Money laundering is the process by which criminals attempt to conceal the true origin and ownership of the proceeds of criminal activity, allowing them to maintain control over the proceeds, and ultimately providing a legitimate cover for their sources of income.

In the case of Busaka Co the circumstances which may be indicative of money laundering activities include the following:

Cash-intensive business

Busaka Co has a high level of cash-based sales (75%) and a high volume of individual sales reports. The nature of its business therefore creates a significant risk that illicit cash funds are being passed off as legitimate sales. More specifically Mr Banda' sale to a business associate for K33,000 may be an example of the placement of illegal funds in order to legitimise them as genuine sales.

The size of the transaction in a business selling cleaning products and the round sum amount may be additional grounds for suspicion in relation to this transaction.

International property transactions

The performance of Mr Banda' personal taxation computation has identified a significant number of transactions involving the purchase and sale of properties in international locations. These transactions may be examples of real estate laundering by Mr Banda in his personal affairs. It is possible that he may be purchasing these properties with illegal funds ('placement') and then selling them in order to make funds appear legitimate ('integration').

A high volume of such transactions may also be indicative of the 'layering' of transactions in an attempt to make the original source of the funds more difficult to trace.

c) Ethical and professional issues

Taxation services

i) Issues arising

The performance of the company tax computation creates a self-review threat. A self-review threat arises when an auditor reviews work which they themselves have previously performed – for example, if the external auditor is involved in the process of preparing the financial statements and then audits them. As a result, there is a risk that the auditor will not be sufficiently objective in performing the audit and may fail to identify any shortcomings in their own work. In this case therefore, a self-review threat to auditor independence arises because the tax calculation forms the basis of the tax payable and the tax charge in the financial statements and as such the audit team may be more likely to accept the tax calculations without adequate testing.

There is also a potential advocacy threat. An advocacy threat arises when the auditor is asked to promote or represent their client in some way. In this situation, there is a risk of the auditor being seen to promote the interests of Busaka Co with a third party such as the tax authorities and therefore that the auditor will be biased in favour of the client and cannot be fully objective.

ii) Recommended action

According to the ZICA Code of Ethics for Professional Accountants (the Code), however, completing tax returns does not generally create a threat to independence provided management takes responsibility for the returns including any judgements which have been made. Where tax calculations have been prepared by the auditor for the purpose of preparing accounting entries, the Code states that this may be acceptable for an unlisted audit client and that the firm should consider implementing safeguards in order to reduce the self-review threat to an acceptable level. In this case, these safeguards might have included, for example, using professionals who are not members of the audit team to prepare the tax computations together with independent senior or partner review of the work.

Therefore, given that Busaka Co is an unlisted client, Thole & Associates should ascertain which members of staff performed the taxation services and should review whether the threat to independence has been adequately assessed before the taxation services were performed and whether adequate safeguards have been applied.

Mr Banda' personal tax computation

i) Issues arising

From an ethical perspective, there is no prohibition in the Code on the preparation of personal tax returns for the directors of an audit client such as Busaka Co.

ii) Recommended action

However, in this case the auditor should consider whether the preparation of Mr Banda' personal tax return may result in the auditor being associated with criminal activities if the suspicions of money laundering activities noted above prove to be well founded.

The auditor should also consider the appropriateness of personal taxation services being billed to the company. Indeed, the preparation of Mr Banda' personal tax return may be a taxable benefit which should be included in his tax return and the fee for this service may need to be reflected in his director's loan account with the company.

Website and online sales system

i) Issues arising

According to the Code, providing services to an audit client involving the design or implementation of IT systems which form a significant part of the internal control over financial reporting or generate information which is significant to the accounting records or financial statements on which the firm will express an opinion constitutes a self-review threat. A self-review threat arises when an auditor reviews work which they themselves have previously performed – for example, if the external auditor is involved in the process of preparing the financial statements and then audits them. As a result, there is a risk that the auditor will not be sufficiently objective in performing the audit and may fail to identify any shortcomings in their own work. In this case, the self-review threat arises as the new systems will produce data which will be used directly in the preparation of the financial statements.

The audit process will therefore include reviewing and testing of financial data and systems which Thole & Associates has helped to design and implement. As a result, there is a clear risk that the audit team may too readily place reliance on these systems.

ii) Recommended action

With reference to Busaka Co therefore, it is clear that providing assistance with the design and implementation of the website and online sales system will constitute a self-review threat as the auditor will audit sales figures which are generated by the system and there is also a risk that the firm may assume a management responsibility if they become involved in making management decisions. In the case of revenue, this self-review threat may be heightened further by the auditor's reliance on controls testing and on analytical review of the data summaries generated by the new system.

It also seems clear that the new online sales system will be significant to the client's financial statements and records. The Code states that such a self-review threat may be too significant even for an unlisted client such as Busaka Co unless appropriate safeguards are put in place. Examples of possible safeguards which might assist in managing the self-review threat include the following:

- The client should acknowledge its responsibility for establishing and monitoring the system of internal controls and for the operating system and data it generates;
- The respective responsibilities of the audit firm and the client should be clearly defined in a separate engagement letter in order to ensure that the client makes all management decisions in relation to the design and implementation process;
- Thole & Associates should use a separate team made up of non-audit staff to perform the systems design and implementation assignment and the work performed by this team should be subject to independent professional review.

If the self-review threat cannot be reduced to an acceptable level, or the engagement will result in the firm assuming a management responsibility, the service should not be provided.

Office party

i) Issues arising

The Code states that client hospitality (in this case the attendance at the office party by the audit team) may create a familiarity threat. A familiarity threat occurs when the auditor is too sympathetic or trusting of the client because of a close relationship with them. There is a risk therefore that as a result of attending the client office party, the audit staff may be getting too close to the client staff especially given that according to the audit senior, this practice has occurred every year. This close relationship may result in the audit team becoming less objective and less able to challenge explanations provided by the client.

ii) Recommended action

The Code also states that gifts from a client to a member of the audit team may create a self-interest threat. A self-interest threat arises when the auditor derives a potential personal benefit from an audit client which may motivate them to behave in a manner which aims to protect that benefit. With reference to the office party therefore, the audit staff are receiving a direct financial benefit from the client (in this case in the form of vouchers). Unless the value of such gifts is trivial and inconsequential, the self-interest threat would be too significant to mitigate with safeguards and the gifts should not be accepted.

The audit firm should consider introducing internal authorisation procedures in order to ensure transparency and to establish whether the value is trivial and inconsequential. In this case, the value of K30 per head does appear to be trivial but the auditor might still consider declining the gifts in order to maintain a visible professional distance from a client which may be involved in criminal activities.

2) TARCLAYS BANK

a) On becoming aware of the situation in the clothing industry

According to IFRS9, an entity must create a credit loss allowance provision equal to twelve months expected losses when it first becomes aware of any indication of impairment. This is calculated by multiplying the probability of a default occurring in the next twelve months by the total lifetime expected credit losses that would result from that default.

Subsequently, if the credit risk increases significantly since initial recognition, this amount will be replaced by lifetime expected credit losses. If the credit quality subsequently improves and the lifetime credit losses criterion is no longer met, the twelve months expected credit losses basis is reinstated. This is the situation with Tarcalys Bank

Tarclays Bank should segment the mortgage portfolio to identify borrowers who are employed by suppliers and service provides to the clothing manufacturers. This segment of the portfolio may be regarded as being in “Stage 2”, that is having a significant increase in credit risk. Lifetime losses must be recognised

In estimating lifetime credit losses for the mortgage portfolio, Tarclays Bank will take into account amounts that will be recovered from the sale of property used as collateral.

b) Particular loans defaulted

According to IFRS 9, Financial instruments for which there is objective evidence of an impairment at the reporting date. Impairment is recognised at the present value of expected credit shortfalls over the remaining life (Life time expected credit losses). **Interest** is calculated on the net basis (after deducting expected credit losses from the carrying amount). This is the situation with Tarcalys Bank

- The actual impairment should be written off to the profit or loss
- Lifetime credit losses should continue to be recognised, and interest revenue should switch to a net interest basis, that is on the carrying amount net of allowance for credit losses

c) **Recommend principal audit procedures**

i) **The accounting treatment of the provisions brought down under IAS 39**

ZiCA has issued an advisory note relating to the treatment of brought forward impairment losses. The purpose of this Advisory Note is to give clarity on the application of International Financial Reporting Standard (IFRS) 9: Financial Instruments.

IFRS 9 introduces a new impairment model for financial instruments based on the forward looking Expected Credit Loss (ECL) model. The new ECL model represents a fundamental shift from the incurred loss model and will have significant implications in terms of implementation as well as systems perspective. The new impairment model will have the most significant impact on financial institutions. However, non-financial Institutions are also bound to be affected. IFRS 9 brings about greater provisions and upfront recognition of credit losses. Its implementation will also require alterations to systems and processes, greater segmentation of portfolios and more integration of the credit risk management systems with the accounting systems.

In preparing for the implementation of IFRS 9, several industry players have been consulting over the implementation of the standard, including formation of the IFRS 9 Working Group to assess the impact of the standard. The Bank of Zambia recently issued a circular providing guidance on how provisions under IFRS 9 will be treated for regulatory purposes. The Bank of Zambia Guidance Note 1 requires that the difference in the provision figure computed under IAS 39 as of 31 December 2017 and the opening balance computed under IFRS 9 be expensed by the financial service provider.

Guidance by ZICA

Notwithstanding the Bank of Zambia guidance issued for prudential purposes, preparers and auditors of financial statements are advised to follow the provisions of IFRS 9 in its entirety for accounting purposes. Any departure from these provisions will render the affected financial statements to be non-compliant with IFRS.

ii) **The treatment of particular loans that defaulted**

- Inspect a sample of loan agreements / covenant and review terms
- Review economic information relating to the South Zone
- Review a sample of loan applications to verify the post code and collateral according to loan covenants
- Discuss with management to review process of tracking the probability of customer failure in accordance with Bank of Zambia guidelines
- Discuss basis for computing impairment losses
- Recompute 12 month credit allowances and lifetime credit losses as appropriate
- Review business / economic reports for evidence of companies closing in the industry

iii) **The disclosures** **(4 marks)**

Review financial statements of Tarcalys Bank and discuss with management to verify that the following disclosures have been made:

- Credit risk: - loss by other party failing to discharge an obligation
- Currency risk: - risk from fluctuations in exchange rates
- Interest rate risk: - Risk from fluctuations in market interest rates
- Liquidity risk: - Risk arising from financial difficulties

- Market risk: - Risk from changes in market prices comprising currency risk, interest rate risk and other price risk
- Other price risk: Risk from changes in market prices other than from currency risk or interest rate risk
- Past due: - Risk arising from failing to make payments when due

Tarcalys Bank should also disclose: -

- The exposure to risk and how they arise
- Its objectives, policies and processes for managing the risk and the methods used to measure the risk
- Any changes in exposure and objectives from previous period

3) LIN CONSTRUCTION

a) Matters to consider and the evidence to find

i) Valuation of the Livingstone property

Matters to consider:

- **Transaction – Balance**

Included within the non-current assets of Lin Construction is a property in Livingstone which has been leased to Sun Hotels under a 40-year lease. Lin Construction has classified the building as an investment property and has adopted the fair value model.

- **Accounting standard – Risk of misstatement**

According to IFRS 16, Leases, the Livingstone property should not have been classified as an investment property because it is a finance lease as the lease term is equal to the useful life and its residual value is deemed to be minimal. Sun Hotels should record a right to use asset and Lin Construction should derecognise the property.

Lin Construction should instead record a lease receivable equal to the net investment in the lease.

- **Financial Statement extracts**

The property needs to be removed from investment properties and the fair value gains of K8 million reversed. In any case, the fair value gains were incorrectly calculated since adjustments should have been made for the differences between the Livingstone building and the one sold due to the different location and quality of the materials between the two buildings. It would appear that K22 million would have been a more accurate reflection of fair value.

The incorrect treatment has enabled Lin Construction to remain within its debt covenant limits. Gearing per the financial extracts is currently around 49·8% (50/(10 + 20·151 + 70·253)). Fair value gains on investment properties are reported within profit or loss. Retained earnings would consequently be restated to K62·253 million (K70·253m – K8m). Gearing would subsequently become 54·1% (50/10 + 20·151 + 62·253).

Furthermore, retained earnings would be further reduced by correcting for rental receipts. These presumably have been included in profit or loss rather than deducted from the net investment in the lease. This would in part be offset by interest income which should be recorded in profit or loss at the effective rate of interest.

- **Materiality**

After correcting for these errors, Lin Construction would be in breach of their debt covenants. They have a negative cash balance and would appear unlikely to be able to repay the loan. Serious consideration should therefore be given as to whether Lin Construction is a going concern. It is likely that non-current assets and non-current liabilities should be reclassified to current and recorded at their realisable values.

As an absolute minimum, should Lin Construction be able to renegotiate with the bank, the uncertainties surrounding their ability to continue to trade would need to be disclosed.

The matter is both material and pervasive

Evidence to find
- Lease agreement with Sun Hotels
- Carrying value of property at 1 October 2017
- Determination of carrying value at 31st March 2018
- Sale of similar property for the proceeds of K28 million
- Valuation report for the valuation at 31st December 2018
- Transfer of valuation gains / losses to the profit and loss account
- Discussion of confirmation of no depreciation on property since classified as investment property at fair value
- Discussion of incorrect treatment according to IFRS 16

ii) Revenue of recognition

Matters to consider

- **Transaction – Balance**
  Lin Construction has included refundable deposit as part of its revenue

- **Accounting standard – Risk**
  According to IFRS 15, Revenue with Contracts with Customers, where obligation is performed over time, revenue should be recognised based on proportion of costs incurred to date or value delivered, depending on the accounting policy adopted by the entity

  As the deposit is refundable, it should not be accounted for until the contract obligations are satisfied

- **Financial Statement extract**
  The revenue is overstated by the amount of deposit include and payable are similarly underestimated as the deposits should be held as refundable until contract is completed

- **Materiality**

  The materiality will depend on the amount deposits included

Evidence to find
- Contract of sale
- Terms of the contract relating to deposit and refund
- Accounting policy regarding revenue recognition
- Discussion with managing director re revenue recognition

- Any correspondence between Lin Construction and the customers

b) Ethical issues

It is concerning that the property has been incorrectly classified as an investment property. Accountants have an ethical duty to be professionally competent and act with due care and attention. It is fundamental that the financial statements comply with the accounting standards and principles which underpin them.

This may be a genuine mistake but even so would not be one expected from a professionally qualified accountant. The financial statements must comply with the fair presentation principles embedded within IAS 1 Presentation of Financial Statements.

Self-interest

The managing director appears to be happy to manipulate the financial statements. A self-interest threat arises from the issue over the debt covenants. It is likely that the managing director is concerned about his job security should the bank recall the debt and deem Lin Construction to no longer be a going concern.

It appears highly likely that the revaluation was implemented in the interim financial statements to try to maintain a satisfactory gearing ratio. Even more concerning is that the managing director has deliberately overstated the valuation for the year-end financial statements, even though he is aware that it breaches accounting standards.

Integrity, professional behaviour and objectivity

Such deliberate manipulation is contrary to the ethical principles of integrity, professional behaviour and objectivity. It appears that the managing director is trying to defraud the bank by misrepresenting the liquidity of the business to avoid repayment of the loan. This would be in breach of anti-money laundering regulations.

Corporate governance

The sales contract is further evidence that the managing director may be attempting to manipulate the financial statements. The proposed treatment will overstate both revenue and assets which would improve the gearing ratio. A governance issue arises from the behaviour of the managing director. It is important that no one individual is too powerful and domineering in running an entity's affairs.

Intimidation threat

An intimidation threat arises from the managing director pressurising the accountant to overstate revenue from the contract. It was also the managing director who implemented the excessive revaluations on the property.

It would appear that the managing director is exercising too much power over the financial statements. The accountant must not be influenced by the behaviour of the managing director and should produce financial statements which are transparent and free from bias. Instead, the managing director should be reminded of their ethical responsibilities. The accountant may need to consider professional advice should the managing director refuse to correct the financial statements.

4) ZAMBISA COMPANY plc

a) Appraisal of the extract from the auditor's report

There are a number of issues to consider in critically appraising the auditor's report extract which has been drafted by the audit senior. These include the following:

Key audit matters (KAM)

The section should include an introductory paragraph explaining the concept of KAM in order for users of the auditor's report to understand its importance and significance. The introduction should also clearly state that the auditor is not forming a separate opinion on the items identified as KAM.

Valuation of financial instruments

This is an area of significant audit judgement with a high risk of material misstatement, hence inclusion as KAM is appropriate although the disclosure should explain the factors which led the auditor to determine the matter was a KAM. It would also aid user understanding further if the auditor's report quantified the size and significance of the issue and explained its impact on the nature and extent of the audit effort.

The auditor should describe how the KAM was addressed in the audit, and although this is a matter for auditor judgement, the auditor may describe aspects of the auditor's response or approach, provide a brief overview of the procedures performed and an indication of the outcome of the procedures. Based on the current wording, the users of the auditor's report would have no clear indication of how the auditor has gathered evidence over this key area.

Criticism – professional language

There are also several issues in relation to the detailed drafting of the paragraph. The report should not refer to the Group's finance director by name and should not imply criticism of him as result of his inexperience. The use of the word 'guesswork' is inappropriate and undermines the credibility of the audit and financial reporting process.

Customer liquidation

The amount owed by the customer of K287,253 is material to the loss before tax at 13·1% and to assets at 2%. The 'except for' qualification on the grounds of material misstatement is therefore appropriate. However, the details of the material misstatement should not be included in the KAM section at all but should be given in the basis for qualified opinion paragraph. This should also be clearly cross referenced within the opinion paragraph itself. Furthermore, the wording of the report currently references reducing the profit before tax when it should refer to increasing the loss before tax.

Opinion paragraph

This is incorrectly positioned and incorrectly titled. It should be at the start of the auditor's report and should simply be titled 'Qualified Opinion'. The opinion paragraph should be clearly cross referenced to the 'Basis for Qualified Opinion' paragraph which should be placed immediately below the opinion paragraph and should clearly describe the issue which has given rise to a qualified opinion. As above, the 'except for' qualification on the grounds of materiality is appropriate.

Going concern – Emphasis of matter

Following ISA 570 Going Concern, the use of an emphasis of matter paragraph to refer to uncertainties in relation to going concern disclosures in the financial statements is no longer appropriate. The auditor's report should now include a specific section headed 'Material

Uncertainty Related to Going Concern' immediately after the basis for opinion paragraph and before the KAM section.

The material uncertainty related to going concern should be cross referenced clearly to the disclosure note where the directors have given details of the uncertainty. If the matter has not been adequately disclosed by the directors in the financial statements, the auditor should give full details of the uncertainties in relation to going concern and the audit opinion should be qualified 'except for' the material misstatement in relation to this lack of disclosure.

ISA 701 Communicating Key Audit Matters in the Independent Auditor's Report states 'The purpose of communicating key audit matters is to enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed.'

b) Key Audit Matters – Benefits and difficulties

Key audit matters ('KAM') are the matters which, in the auditor's judgement, were of most significance in the audit of the financial statements. They were introduced by ISA 701 Communicating Key Audit Matters in the Independent Auditor's Report, to enhance the auditor's report issued in respect of listed entities by providing more relevant information to the users of those reports.

Benefits

The principal reason for the disclosure of KAM in the auditor's report was to provide increased transparency in response to requests from users of the financial statements for more information in relation to significant judgements made by both management and the auditor. This should lead to increased focus on the uncertainties created by judgement in the reporting process and help to improve users' understanding of the financial statements. This in turn will serve to increase confidence in the audit process and the perception of audit quality.

The audit expectation gap is the difference between the actual role of the external auditor and the role which the public believes the auditor performs. In this context, the inclusion of KAM within the auditor's report represents an important step in the process of informing and educating the public about the auditor's role in evaluating areas of high risk, judgements and significant events or transactions which occurred during the period.

Furthermore, auditors are expected to discuss how they addressed KAM during the course of the audit and the provision of detail in relation to the procedures performed will also go some way to provide greater transparency on how the audit is performed.

Difficulties

The determination of which audit matters to report as 'key' is subjective and requires auditor judgement. As a result, this may reduce the consistency and comparability of auditor reporting. In order to assist with this, ISA 701 provides a decision making framework to help auditors determine which matters are KAM. This should help reduce ambiguity and promote consistency across audits.

The inclusion of KAM in the auditor's report may lead to a significant increase in the volume of detail contained in the report thereby obscuring which of the matters are of the greatest significance. This increase in volume may deter users from reading the auditor's report in full and therefore undermine its role in closing the audit expectation gap.

There are also concerns that the lack of specific guidance may lead to standardised ‘boilerplate’ disclosures which add little value to the auditor’s report.