

The new auditor's report

Study of first year of application
in Italy by listed companies

July 2018

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Introduction

What's new?

With the aim of promoting greater transparency of financial statements for third party users, the European legislator and the IAASB have respectively issued regulations and auditing standards that have changed the structure and content of the auditor's report. Prior to these changes, the auditor's report was the conclusion of a process that, based on the outcome

thereof, gave a concise opinion on the financial statements as a whole. To meet the increasingly growing needs of the market, the Legislator and the Standard Setter have deemed it appropriate to enhance the communicative value of the auditor's report, in the users' interest.

Directive 2014/56/EU Art. 28 (transposed by Leg. Dec. 135/16)

Amendments made to Directive 2006/43/EC (transposed into Italian law by Leg. Dec. 39/2010) relating to statutory audits of annual accounts and consolidated accounts

Revised ISAs

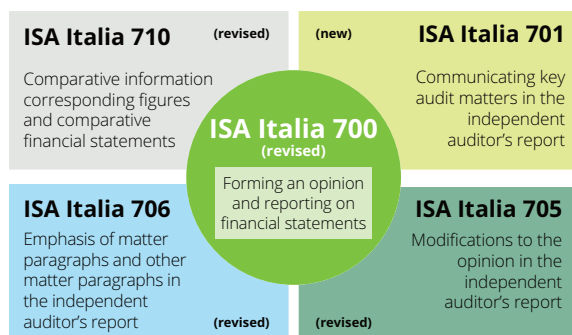
Regulation (EU) 537/2014 Art. 10

Regulation (EU) 537/2014 sets out specific requirements regarding statutory audits of the accounts of Public Interest Entities (PIEs)

New auditor's report

- ✓ Opinion
- ✓ Basis for opinion
- ✓ Key Audit Matters (PIEs)
- ✓ Responsibilities of the Directors and Board of Statutory Auditors for the Financial Statements
- ✓ Auditor's Responsibilities for the Audit of the Financial Statements
- ✓ Other information communicated pursuant to art. 10 of the EU Regulation 537/2014 (PIEs)
- ✓ Report on Other Legal and Regulatory Requirements

As a result of the enactment of Legislative Decree 135/16, which updated and amended Legislative Decree 39/10, and Regulation (UE) 537/14 concerning Public Interest Entities, the auditor's report has undergone substantial amendments, not only to its structure, but also to its content. Under these circumstances, the auditing standards below have been updated or prepared¹.



The new regulations for the preparation of the auditor's report are intended to increase transparency.

In fact, the inclusion of information on so-called "Key Audit Matters"² as required by the standard on auditing, ISA Italia 701, constitutes a significant change, the benefits of which had been expected by various corporate stakeholders, supervisory bodies, those charged with governance and the audit firms.

According to Regulation (UE) 537/14, Key Audit Matters should be communicated in the auditor's report for the financial statements of Public Interest Entities, which include:

- a) Italian companies with transferable securities listed on Italian and EU regulated markets
- b) banks
- c) insurance and reinsurance undertakings³.

What are Key Audit Matters?

Determining Key Audit Matters

The auditor shall determine from the **matters communicated with those charged with governance**, those matters that required **significant auditor attention** in performing the audit, including:

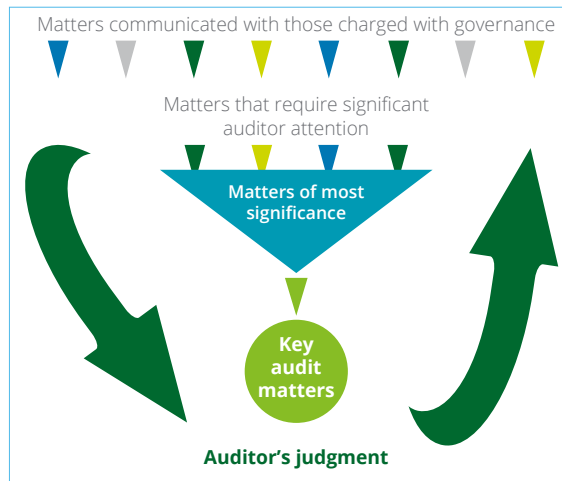
- **areas of higher assessed risk** of material misstatement, or for which **significant risks** have been identified
- **significant auditor judgements** relating to areas of **significant management judgement** in the financial statements, including **accounting estimates** subject to a **significant degree of uncertainty**
- the effect on the audit of **significant events or transactions** that occurred in the period.

1. The amendments to the auditing standards became effective for audits of financial statements for periods beginning on or after 6 August 2016 and, for Public Interest Entities, for periods beginning on or after 17 June 2016. The following have been revised: ISA Italia 570 (Revised) (Going concern); ISA Italia 260 (Revised) (Communication with those charged with governance); ISA 720B (Revised) (The auditor's statutory reporting responsibility in relation to directors' reports and certain specific information contained in the report on corporate governance and ownership structure) (effective for audits of financial statements for periods beginning on or after 1 July 2016). In order to implement the conforming amendments to the standards relating to the auditor's report as well as the amendments to Legislative Decree 39/10 introduced by Legislative Decree 135/16 and by Regulation (EU) 537/14 effective for audits of financial statements for periods beginning on or after 31 December 2017, amendments have also been made to other auditing standards. .

2. Key Audit Matters or KAM.

3. In accordance with ISA Italia 701, to facilitate the comparability and consistency of the content of the auditor's report on financial statements of companies other than PIEs, it is not permitted to communicate Key Audit Matters in the auditor's report on the financial statements of such companies.

Of those identified in accordance with the above criteria, the auditor should select those **matters that are of most significance in the audit** of the financial statements and that are, therefore, the **Key Audit Matters**.



Communicating Key Audit Matters

The description of each Key Audit Matter must include:

- a **concise and specific explanation of the matter**, which, having been determined to be of most significance in the audit of the financial statements, was deemed to be a Key Audit Matter
- a reference to the **related disclosure(s)**, if any, in the financial statements

- **why** the matter was considered to be a Key Audit Matter (**WHY**)
- the manner in which the matter was addressed during the course of the audit, being a summary of the **auditor's response** in terms of audit procedures performed (**HOW**)
- where pertinent, the main **observations** made in relation to the key matter described.

Paragraph 4 of ISA Italia 701 clarifies that:

"Communicating Key Audit Matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating Key Audit Matters in the auditor's report is not

- a **substitute for disclosures in the financial statements** that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;
- a **substitute for the auditor expressing a modified opinion** when required by the circumstances of a specific audit engagement in accordance with International Standard on Auditing (ISA Italia) 705;
- a **substitute for reporting in accordance with International Standard on Auditing (ISA Italia) 570 when a material uncertainty exists** related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, or
- a **separate opinion on individual matters**".

What have we analysed?

The analysis was conducted on auditor's reports issued since the implementation of Regulation (EU) 537/14 and of the new standard on auditing, ISA Italia 701, relating to the financial statements of **Italian companies with shares listed on the Electronic Equities Market (MTA)** organised and managed by Borsa Italiana, as resulting from the list available on Borsa Italiana's website "Listed companies capitalisation on 29 December 2017".

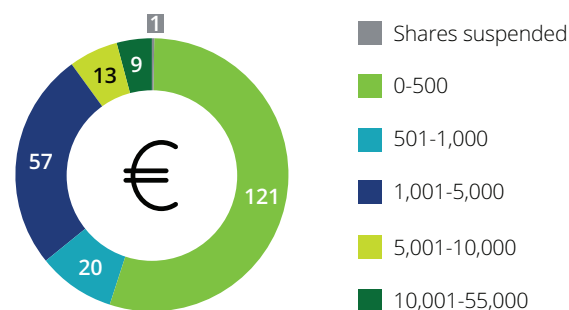
The analysis was performed on auditor's opinions on consolidated financial statements and, solely for companies that do not prepare the latter, on auditor's opinions on financial statements published on or before 15 June 2018.

The analysis thus covered **221 companies**, of which over 95% had a 31 December 2017 financial year end.

In dettaglio:

- 6 companies with a 30 June 2017 financial year end
- 1 company with a 31 October 2017 financial year end
- 212 companies with a 31 December 2017 financial year end
- 1 company with a 31 January 2018 financial year end
- 1 company with a 28 February 2018 financial year end.

The companies analysed had the following market capitalisation at the end of 2017 (in Euro million)⁴:



For each auditor's report subjected to analysis:

- we have categorised the Key Audit Matters based on the topic addressed
- we have considered, with reference to the audit procedures, if the foregoing had required the performance of tests of the operating effectiveness of the issuer's controls or recourse to specialists or experts
- we also collected and summarised further information, such as the type of opinion, the existence of sections addressing material uncertainties related to going concern and emphases of matter.

4. Source: Borsa Italiana's Listed Companies Capitalisation on 29 December 2017.

When categorising the KAMs, we adopted the following conventions and assumptions:

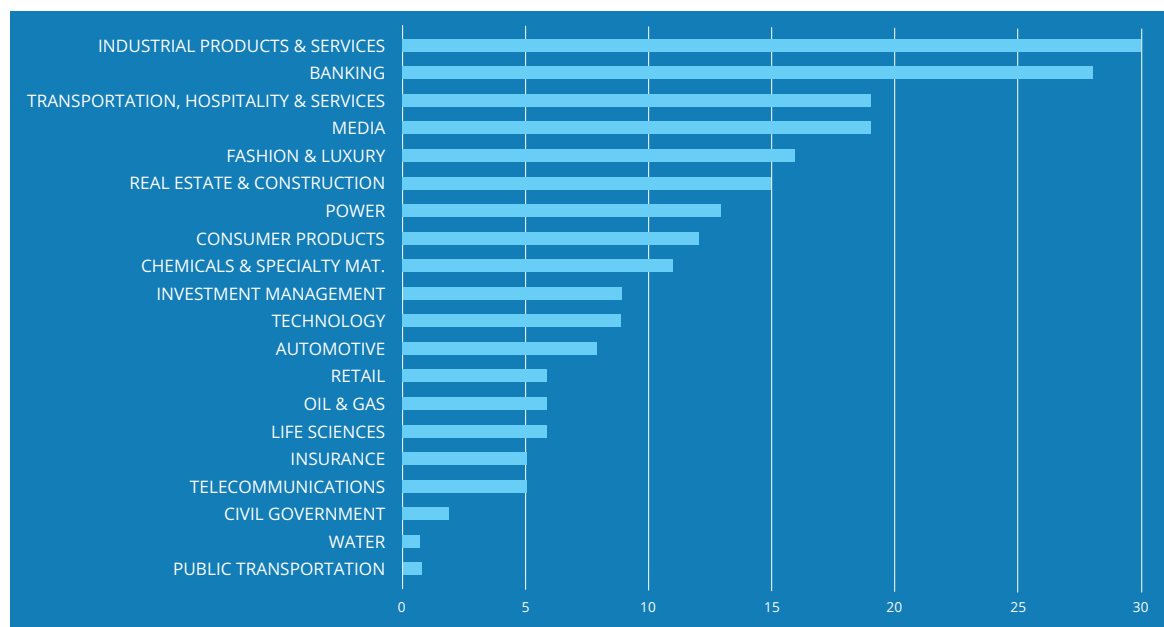
- Key Audit Matters concerning impairment testing involving goodwill and other asset components have been allocated to a category entitled "Goodwill and intangible assets"
- for Key Audit Matters concerning more than one item/category, we have allocated the KAM to the most significant category in quantitative terms
- the "going concern" category considers matters relating to the going concern basis other than those where a material uncertainty exists in relation to events or circumstances that may cast significant doubt over the entity's ability to continue as a going concern. Under the new ISA Italia 570, these last circumstances in constitute Key Audit Matters

but are dealt with by the auditor in a specific and separate section of the auditor's report. Situations characterized by material uncertainty are examined in the section "Other results arising from the analysis"

- a category entitled "Provisions and Contingencies" has been used for issues pertaining to allocations to provisions and KAMs concerning risk disclosures that did not give rise to the recognition of a provision.

Moreover, to enable further analysis of the results, we have classified the entities analysed into **sectors** in order to examine the correlation between KAM categories and different activity sectors.

The breakdown by sector is based on an internal classification by Deloitte. The companies analysed may be broken down by sector as follows:



Preliminary considerations

International studies show that in countries where the adoption of the new auditor's report took place prior to Italy (such as the United Kingdom, the Netherlands, South Africa and Australia) the reaction of various stakeholders was generally positive.

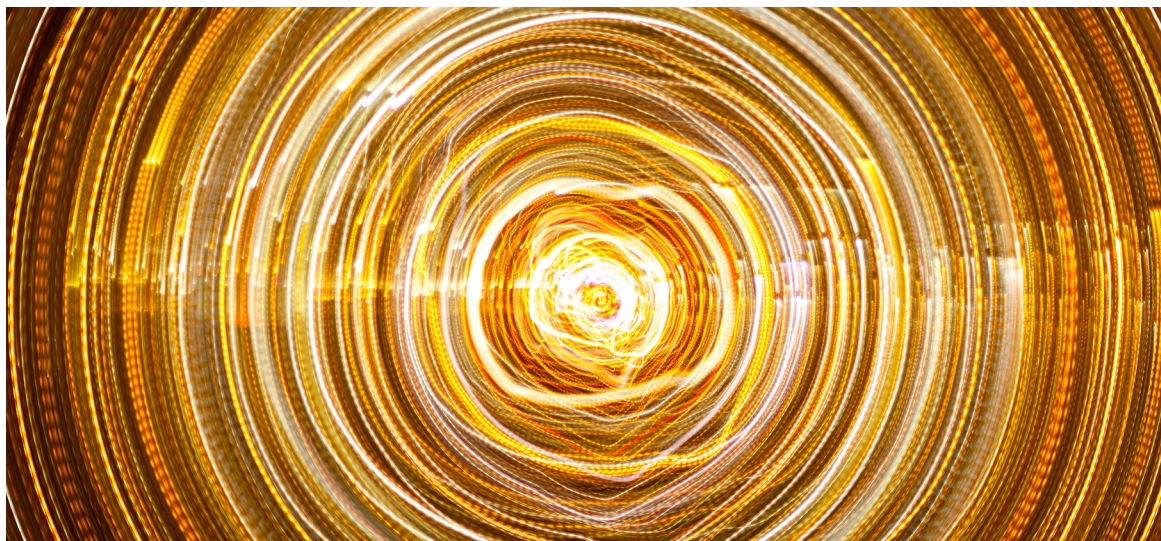
Also in Italy, at the end of the first year of adoption, an improvement was seen in the **two-way dialogue** between audit firms and governance bodies, especially with audit committees on risk areas and audit procedures identified to address them, thus encouraging the monitoring by such committees⁵ of the financial statement audit process.

We also believe that the adoption of the new auditor's report has driven issuers' management to give specific

attention to the disclosure of issues identified, such as KAMs, thus contributing in this manner to an improvement in the financial reporting process.

Interaction with governance bodies and company management, with a constant dialogue throughout the audit process, from planning to completion, has also increased the transparency of the work performed by the auditor, thus laying the foundations for continuous audit quality improvement.

It would thus appear that the changes introduced for 2017 audits onwards have marked the beginning of a new path that could provide value added to issuers, increase investors' confidence in the financial reporting process and meet supervisory expectations.



5. Depending on the governance system adopted by a public interest entity, the audit committee would be: a) the Board of Statutory Auditors for entities that have adopted the traditional system, b) the supervisory board or a subcommittee thereof for entities that have adopted the two-tier system; c) the internal control committee for entities that have adopted the one-tier system.

Results of the analysis

Number of Key Audit Matters

The number of Key Audit Matters was the starting point of the analysis. Some indication had been provided by authoritative sources, such as documents published in 2015 and 2016 by the **IAASB** that broached the subject as follows:

- “The number of KAM that will be communicated in the auditor’s report may be affected by the complexity of the entity, the nature of the entity’s business and environment, and the facts and circumstances of the audit engagement. It is envisaged that there will be at least one KAM for an audit of a listed entity.”⁶
- “The auditing standards therefore do not prescribe or limit the number of matters to be reported as KAM – practice to date has shown that the average number of KAM communicated falls somewhere between two and six.”⁷

In 2015, the **IDW**⁸ had developed a specific analysis of auditor’s reports issued in the United Kingdom and the Netherlands with the following findings:

“The range in number of KAMs varied quite considerably, possibly according to the complexity of particular industries and, of course, the individual entity’s circumstances. There was some evidence that delineation of individual KAM may not be straightforward, which will also impact the number of matters reported. KAM reporting in the first two years was generally not static, and matters reported changed, as did the level of detail, which in many cases increased in the second reporting year. We noted a marked difference between auditors’ reports issued in the UK in 2013 and early 2014 compared to the latter half of 2014 and subsequently. Noticeable differences over time were less significant in reports issued in the Netherlands”.

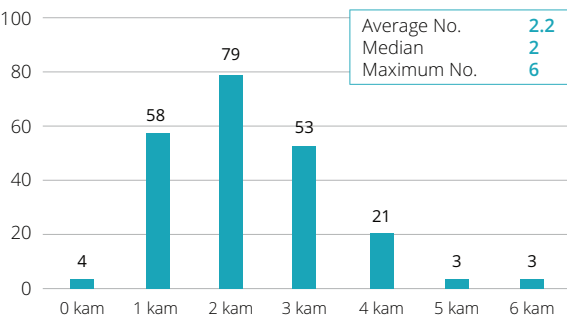
6. “Auditor Reporting – Illustrative Key Audit Matters”, IAASB April 2015

7. “More informative auditor’s reports – what audit committees and finance executives need to know - auditor reporting”, IAASB, March 2016

8. “Analysis of Auditor Reporting on Key Audit Matters (KAM) in the UK and the Netherlands”, Institut der Wirtschaftsprüfer in Deutschland e.V., June 2015

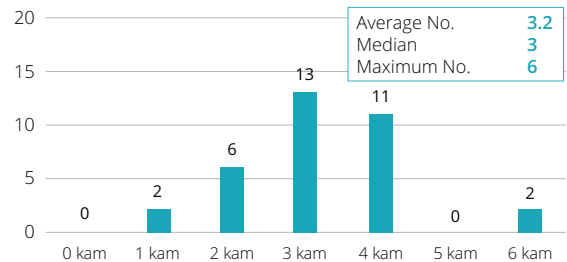
With reference to the sample of companies examined, we have analysed the number of Key Audit Matters included in each auditor's report and have noted the figure related to auditor's reports issued on the consolidated financial statements or, where this does not exist, the figure related to auditor's reports issued on the separate financial statements.

The table below shows that, of the 221 entities, more than 35% of the companies had at least 2 KAMs, 26% had 1 KAM and 24% had 3 KAMs. The numbers for the lower and upper limits were limited (0 KAM and 6 KAMs).



To examine the level of correlation between the number of KAMs and the size of the entities, we have performed the same analysis for a subset of highly capitalised issuers included in the **FTSE MIB** index.⁹

The analysis has revealed a higher number of KAMs for this subset, as shown in the following table:



In order to evaluate the results emerging, in a broader context, we have checked whether the results were in line with figures pertaining to other countries that had already adopted the new auditor's report in accordance with ISA 701.

Specifically, we have examined a study by Deloitte¹⁰ based on a sample of 50 listed companies in Switzerland with reference to reports on financial statements for the year ended 31 December 2016, the first year of adoption of the new auditor's report in that country, the results of which were the following: "All auditor's reports on the consolidated financial statements disclose at least one Key Audit Matter (KAM) in specific situations but not more than seven KAMs. On average, the auditors disclosed 2.8 KAMs per group audit".

9. This analysis was conducted with reference to 34 Italian companies included in the index, excluding 6 companies included in the index that have their head office in other countries.
10. "Benchmarking the new auditor's report: Key audit matters and other additional information".

Key Audit Matters categories

We then examined the number of Key Audit Matters by previously identified **category**. The chart provides details of the TOP 5, which represent approximately 65% of the key matters, clearly showing the significance of certain issues compared to others.

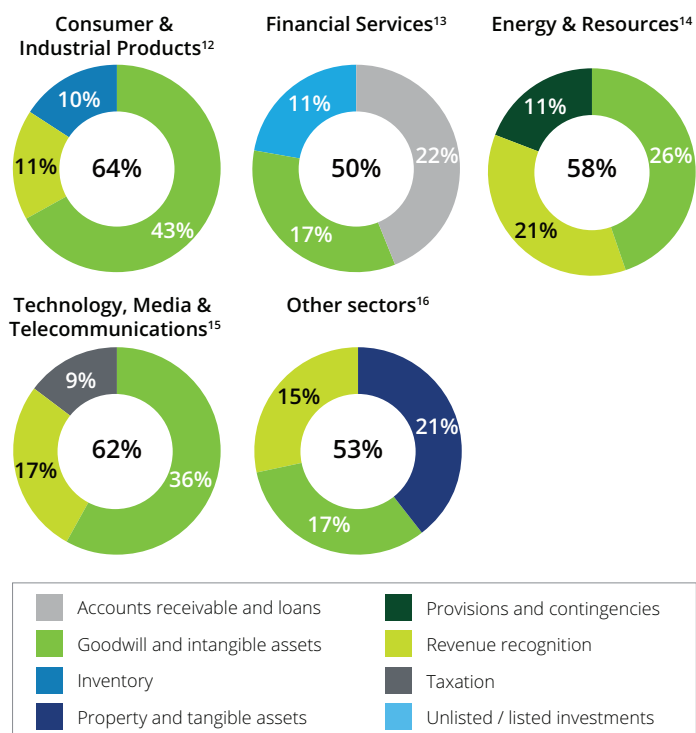
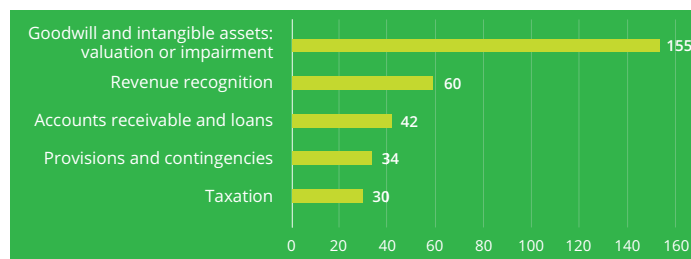
Further matters reported as KAMs pertain to the categories:

- “acquisitions / business combinations” (29 KAM)
- “property and tangible assets: valuation or impairment” (25 KAM)
- “unlisted/ listed investments” (24 KAM)
- “inventory” (23 KAM)
- “going concern” (in circumstances whereby no material uncertainties were identified related to going concern) (14 KAM)
- “insurance reserving” (9 KAM) with respect to insurance companies
- “derivatives and other financial instruments” (8 KAM)

that account for approximately 27% of total KAMs.

The remaining KAMs, which account for approximately 8% of the total, are very fragmented, with less than 5 KAMs for each further category.¹¹

An analysis of the results by industry sector shows a different weighting of the various KAM categories. In fact, the “**Goodwill and intangible assets**” category is the most frequent for the industrial sector, whereas the “**Accounts receivable and loans**” category is ranked first for the financial sector.



11. Issues addressed in the remaining categories relate to “Pensions”, “Related party transactions”, “Disposals / Held for sale assets”, “Presentation of exceptional / non-recurring items” and “IT change, security or controls”.

12. Includes the following sectors: Automotive, Chemicals & Speciality Mat., Consumer Products, Fashion & Luxury, Industrial Products & Services, Retail, Transportation, Hospitality and Services.

13. Includes the following sectors: Banking, Insurance and Investment Management.

14. Includes the following sectors: Oil & Gas, Power and Water.

15. Includes the following sectors: Media, Telecommunications and Technology.

16. Includes the following sectors: Life Sciences, Civil Government, Public Transportation, Real Estate & Construction.

Main matters

Goodwill and intangible assets

In approximately 64% of the auditor's reports there is at least one KAM pertaining to the “**Goodwill and intangible assets**” category. Why is this?

The reasons are surely diverse and range from the number of transactions completed in recent years, which, as a consequence thereof, have led to the recognition of often significant amounts of goodwill or other intangible assets, to difficulties in measuring such items. In accordance with the relevant accounting standards, the recoverability of goodwill is verified together with that of other tangible and intangible assets, with reference to the same cash generating unit to which the goodwill has been allocated and, thus, the KAMs included in this category also encompass other items subjected to impairment testing.

Key Audit Matters reported in connection with other intangible assets include KAMs relating to:

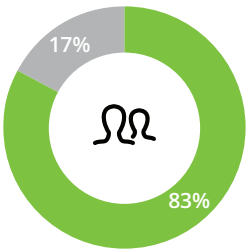
- recoverability of intangible assets primarily with **indefinite useful lives**
- measurement of **brands**
- recoverability of development costs
- measurement of **long-term rights**, concessions, etc..

Terms frequently used to describe the reason (WHY) for the matter having merited specific attention include the following:

Future expectations, subjectivity of estimates, high level of judgement involved in the main assumptions, models sensitive to changes in data inputs, materiality/ significance of the amount.

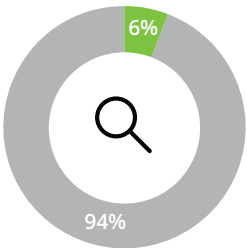
As regards the audit procedures performed to address the KAM (HOW), taking account of the complexity of the measurement issues associated therewith, there was widespread recourse to experts/specialists to support the performance of the audit procedures. In particular, experts were used by audit teams, who, under the management and the supervision of the latter, were engaged to perform specific audit procedures that required specific skills with respect to valuation models, benchmarking analysis, etc.

On the other hand, there were very limited cases of the adoption of an audit approach based on the testing of the operating effectiveness of a company's internal controls, as shown by the tables below.



Do the procedures envisage experts/specialists being involved?

- YES
- NO



Were tests performed of the operating effectiveness of controls?

- YES
- NO

Revenue recognition

There was also a significant, but expected, number of Key Audit Matters relating to the revenue recognition category, on account of the fact that revenue trend is frequently considerably important for the measurement of a listed company's performance and, accordingly, it constitutes a significant matter for users of financial statements and for the audit process. In fact, over 26% of the auditor's reports included at least a key matter relating to revenue recognition.

The most recurring issues for which a Key Audit Matter had been identified (**WHY**) were related to specific circumstances, such as:

- the complexity of revenue recognition in relation to a company's **industry sector** (estimates of electricity and gas revenue not yet billed; estimates of expected returns of unsold books; advertising revenue, etc.)
- **contractual or regulatory peculiarities** (revenue recognition net of adjustments for allowances, discounts and returns, the existence of multiple performance obligations, complexity of relevant legislation, etc.)
- **complexity of measurement** (recognition of revenue from and losses on long-term contracts; recognition of revenue and margins relating to contract work in progress, etc.).

In terms of procedures performed to address Key Audit Matters (**HOW**), for this category, the recourse to specialists was less frequent than that for the foregoing issue, whereas, what was widespread was **testing of the operating effectiveness of controls** as an audit procedure performed together with others.

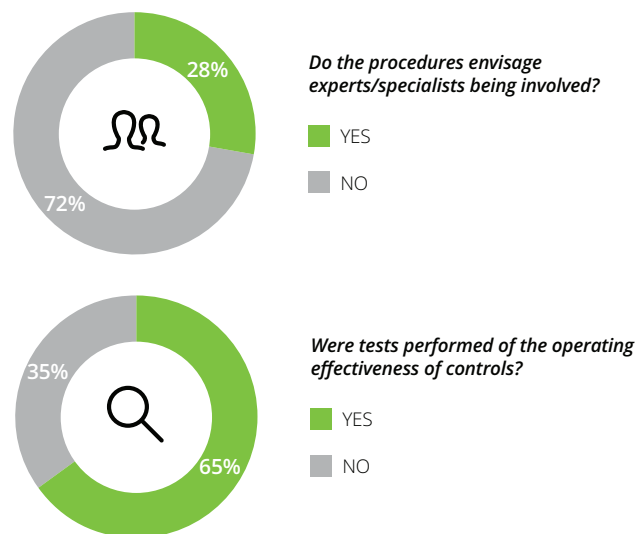
The widespread recourse to testing of the operating effectiveness of controls for revenue recognition issues identified as Key Audit Matters was reasonably attributable to circumstances having arisen, which, in accordance with the relevant auditing standards, required the performance of such tests:

"The auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls, if:

- a) the auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively (that is, the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures)
- b) substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level."¹⁷

As already stated, the use of specialists was less frequent than that for the category examined previously (Goodwill and intangible assets) and the field of specialisation differed, as it primarily concerned **Information Technology**.

The analysis performed also showed that the use of specialists was often combined with tests of the operating effectiveness of controls.



17. ISA Italia 330 – The auditor's responses to assessed risks, paragraph 8.

Accounts receivable and loans

Another significant issue was receivables and the recognition of impairment losses that was mentioned in approximately 16% of the auditor's reports examined.

Analysis by industry sector was important for this category, as it showed that the banking sector had an expected significant weighting (approximately 50%).¹⁸

Why was this? In fact, as regards the banking sector, the “Accounts receivable and loans” category was the most frequent, with particular reference to issues concerning the classification and measurement of receivables and loans due from customers, having in certain cases differentiated between, and treated separately, non-performing and performing loans due from customers (with a special focus on those deemed to be high risk or that had been performing poorly). In other cases, the KAM was focused on only one of the above or, the KAM made a general reference to receivables and loans due from customers.

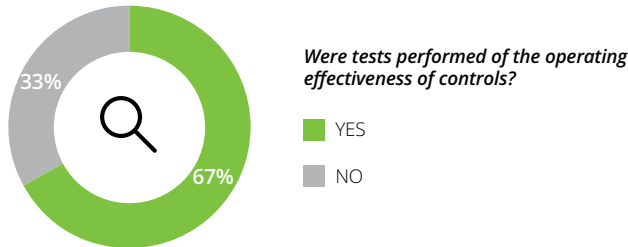
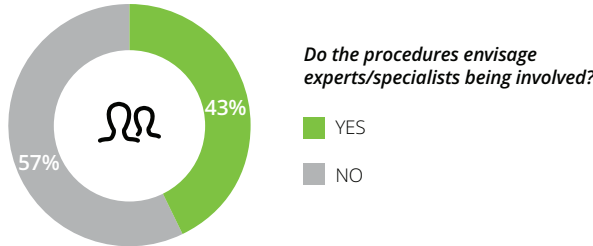
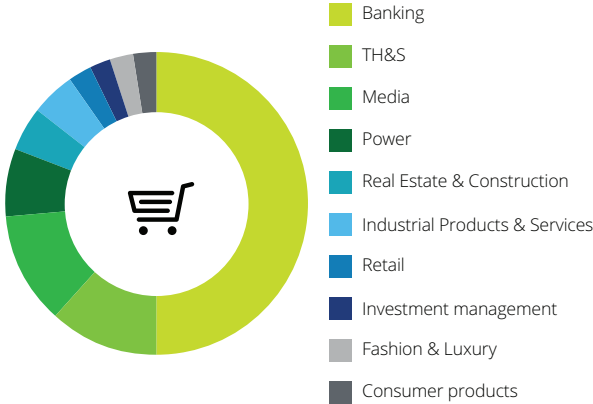
The reasons are evidently attributable to the nature of banking and the consequent significance and materiality of the amount of receivables and loans due from customers in banks' financial statements, plus, as is also the case for the Italian banking industry, the attention given to non-performing loans and the recognition of related impairment losses.

These aspects are confirmed by the reasons (WHY) underlying the identification of KAMs related to this category that include:

- the significance of the amount of receivables and loans recognised in the financial statements
- the complexity and subjectivity of the estimation processes adopted
- the use of valuation models characterised by many variables and parameters.

As regards the audit procedures (HOW) performed in response to the key matter identified, as it would appear evident from the charts below, what was significant was the performance of **testing**

of the operating effectiveness of controls (67% of the KAMs examined) that, particularly in the banking sector, was subsequent to having gained an understanding of the internal control system implemented by the banks in relation to the classification and monitoring of the quality of the receivables and loans due from customers. There was also significant **involvement of experts/ specialists** (approximately 43% of the KAMs). They are used in the banking sector given the pervasiveness and importance of information systems that are a feature of banking operations and the complexity of valuation models used.



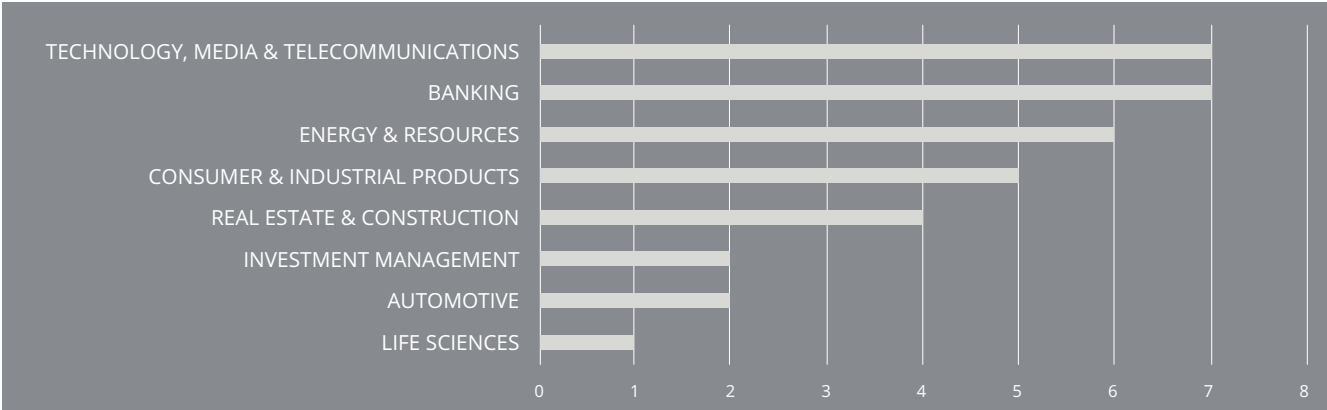
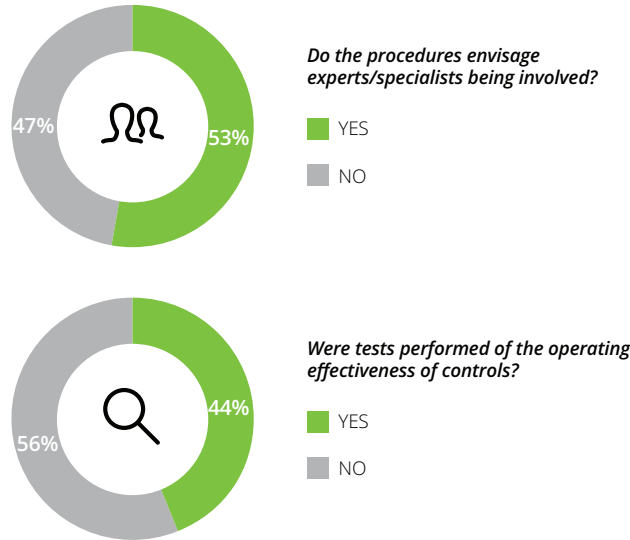
18. This sector, under categorization performed by Deloitte, includes, other than banks, other financial institutions.

Provisions and contingencies

The “Provisions and contingencies” category is broad in that it encompasses different cases, such as provisions for tax risks, work related risks or legal disputes, allocations to provisions and disclosures of risks.

As regards the reasons underlying the identification of KAMs related to the above issues (WHY), which are typically subject to accounting estimates, in approximately 13% of the auditor’s reports analysed, the reason given was recourse to estimation processes deemed to be complex, detailed, subject to significant uncertainties and changes in which may often have a material impact on the financial statements. As far as the audit responses are concerned (HOW), these included involvement to experts/ specialists (53% of the KAMs examined) and the performance of testing of the operating effectiveness of controls (44%) and, in certain cases, a combination of both.

An analysis of numbers by sector reveals a significant weighting in the **Banking** and **Investment Management** sectors, which are again in the financial sector. The reasons therefor may be explained by the specific industry sector, which is strongly regulated and which could thus lead to significant legal, compliance, reputational and operating risks for the companies concerned.



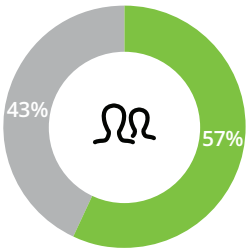
Taxation

Last in the TOP 5 list is the “**Taxation**” category, which is present in over 13% of the reports examined and which almost entirely encompasses issues related to the **recoverability of deferred tax assets**, while, in an extremely limited number of cases, this was combined with the measurement of deferred tax liabilities. Further tax related KAMs, which were reported in a small number of reports, related to the **US tax reform**, given the impact on the consolidated financial statements of the issuers in question.

The reasons (**WHY**) for the identification of KAMs related to deferred tax assets included considerations concerning the materiality of the item in question in the financial statements subject to audit, as well as the subjectivity of estimates concerning the generation of sufficient taxable income in future years.

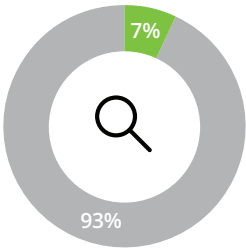
As regards the audit procedures adopted to address the issue (**HOW**), the use of experts/specialists was reasonably widespread, whereas cases where testing was performed of the operating effectiveness of controls were extremely limited.

Numbers by sector were not significant as they were quite uniformly distributed.



Do the procedures envisage experts/specialists being involved?

- YES
- NO



Were tests performed of the operating effectiveness of controls?

- YES
- NO

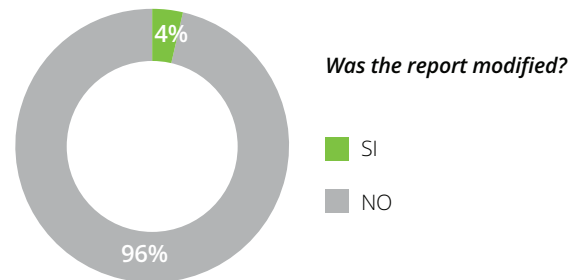
Other results arising from the analysis

Modifications to the opinion in the independent auditor's report

ISA Italia 705 deals "with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with International Standard on Auditing (ISA Italia) 700 the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary".¹⁹

The graph shows, for the sample analysed, the percentage of reports with modifications to the opinion, with reference to the various cases governed by the standard.

Nature of matter giving rise to the modification	Auditor's judgement about the pervasiveness of the effects or possible effects of the matter on the financial statements	
	Material but not pervasive	Material and pervasive
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

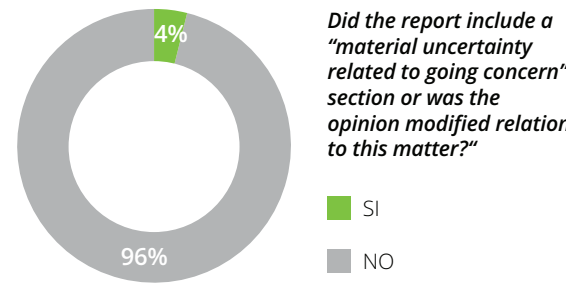


19. ISA Italia 705 - Modifications to the opinion in the independent auditor's report - Paragraph 1.

Going concern

In the event of a material uncertainty, the revised version of ISA Italia 570 requires a separate section to be included in the auditor's report under the heading "Material uncertainty related to going concern". In these circumstances, if adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion, but:

- shall draw attention to the disclosure provided in the financial statements
- shall state that these events or conditions indicate that a material uncertainty exists that may cast **significant doubt** on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.²⁰



If disclosure about the material uncertainty is inadequate, depending on the circumstances, the auditor shall express a qualified opinion or adverse opinion and, in the basis for qualified (adverse) opinion section of the auditor's report, state that a material uncertainty related to going concern exists and that the financial statements do not adequately disclose this matter.²¹

In situations involving multiple uncertainties that are significant to the financial statements as a whole, the auditor may consider it appropriate in extremely rare cases to express a disclaimer of opinion, stating that the going concern assumption is subject to the aforementioned multiple significant uncertainties with potential interactions and possible cumulative effects on the financial statements.²²

With respect to the reports analysed, there were 9 cases of material uncertainties related to going concern, whereby, for 6 of these, a material uncertainties related to going concern section was included in the auditor's report and, for the other 3 cases, the auditor expressed a disclaimer of opinion.

20. ISA Italia 570 – Going concern – paragraph 22.
21. ISA Italia 570 – Going concern – paragraph 23.
22. ISA Italia 570 – Going concern – paragraph A33.

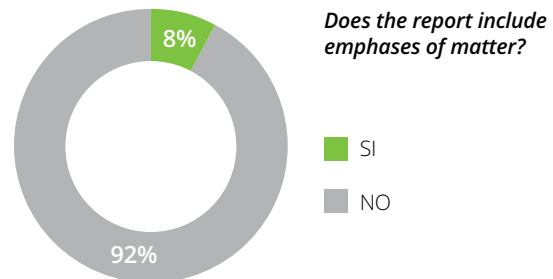
Emphases of matter

We have also analysed the number and weighting of the emphases of matter in the sample of auditor's reports reviewed by us.

By including an emphasis of matter in the auditor's report, the objective of the auditor is "to draw users' attention, **when in the auditor's judgement it is necessary to do so**, to a matter, although appropriately presented or disclosed in the financial statements, that is of **such importance that it is fundamental** to users' understanding of the financial statements".²³

With the introduction of KAM, the expectation was that there would have been a decrease in the number of emphases of matter, on account of the fact that the new version of the standard on auditing, ISA Italia 706, requires these to be included in the auditor's report provided that the matter being emphasised is not deemed to be a Key Audit Matter (nor that the auditor judges it necessary to express a modified opinion due to that matter in compliance with ISA Italia 705).

Despite the lack of perfectly comparable data, based on a comparison of the figure relating to the reports analysed in this study (weighting of 8%) against that resulting from a study conducted by SDA Bocconi on auditor's reports on listed companies in the two year period 2015-2016²⁴, for which the weighting of "Clean opinions with emphases of matter (financial statements for financial years 2015 and 2016)" was 13%, the expected decrease in emphases of matter appears to have been confirmed.



23. ISA Italia 706 – Emphasis of matter paragraphs and other matter paragraphs in the independent auditor's report.

24. "Opinions issued by audit firms on listed companies in the two year period 2015-16: Italian market and main European stock exchanges" SDA Bocconi - Audit Observatory, June 2017.



Forthcoming challenges

In relation to the implementation of the new accounting standards, IFRS 15 and IFRS 9, as well as the start of preparatory work in connection with the subsequent adoption of IFRS 16, it is expected that these accounting standards will require significant attention to be given in the performance of audits of 2018 financial statements and that, consequently, in the event that the related matters are deemed to be material, they may be included in the KAMs.

Another focal point will be the treatment accorded in the second year of adoption of Key Audit Matters:

- Will the same matters be repeated?
- Will the experience gained lead to a different determination of the matters addressed, especially with respect to the level of detail and the specific form used for the description of the matter and the audit procedures performed?



Extending the analysis to an international context, there is much interest in the application in the US of a new standard issued by PCAOB²⁵ that requires a section dedicated to "Critical Audit Matters" (CAM) and the consequent market reactions thereto.

The implementation of the new standard will be gradual. It will apply first to large accelerated filers and then to other companies falling within the scope of the adoption of the new standard.²⁶



PCAOB adopts changes to the auditor's report

On June 1, 2017, the PCAOB adopted a new auditing standard on the auditor's report (the "standard" or "release"). While retaining the current "pass/fail" opinion of the existing auditor's report, the standard includes several significant modifications. These changes are intended to increase the informational value, usefulness, and relevance of the auditor's report.

A CAM is defined in the standard as "any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that relates to accounts or disclosures that are material to the financial statements and involved especially challenging, subjective, or complex auditor judgment."

The release also states that CAMs could include matters that were (1) required to be communicated to the audit committee and (2) actually communicated, even if not required.



25. AS 3101, The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion

26. "Provisions related to critical audit matters will take effect for audits of fiscal years ending on or after June 30, 2019, for large accelerated filers; and for fiscal years ending on or after December 15, 2020, for all other companies to which the requirements apply".

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