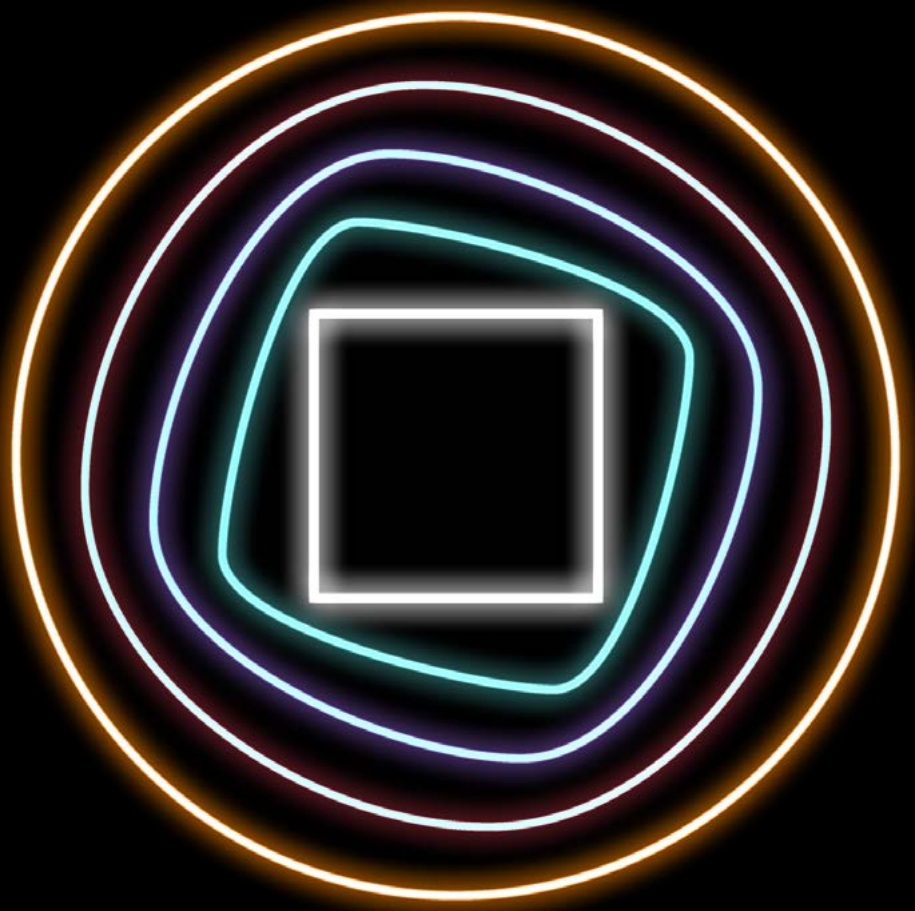
Deloitte.



Benchmarking the new auditor's report

Key audit matters and other additional information

Audit & Assurance

Contents

Introduction

Released **six** months after the end of the 2016 calendar year, this publication is the first comprehensive analysis of the new auditor's report with a main focus on the new key audit matters. Our first impression is: **a first step has been made, but the journey has not yet ended.**

What has changed?

The annual reports of companies listed on a stock exchange in Switzerland include the auditor's opinion on the consolidated financial statements and the standalone financial statements of the holding company. The audit report on consolidated financial statements prepared in accordance with IFRS, Swiss GAAP FER or US GAAP has now changed for listed companies. After a five-year project led by the International Auditing and Assurance Standards Board (IAASB), followed by a transition period, auditors of listed entities needed to apply the revised International Standard on Auditing (ISA) 700 and the new ISA 701 for the first time in their audits of financial statements for periods ended **December 2016**.

This change comes from a demand by investors and users of financial statements for more insights and transparency into the audit. The revision of ISA 700 has also led to a new structure of the audit opinion. With the new structure, the auditor's report begins directly with the "opinion" and the identification of the document that has been audited. Investors and users of financial statements benefit from an increased understandability of the auditor's report.

For listed companies, the new auditor's report discloses the matters that were of most significance in the audit. The new ISA 701 defines them as "key audit matters". With this information the auditor's report has been transformed from a standard pass/fail report into a more meaningful and customised report and represents a move towards more clarity and transparency.

The benefits of the new structure and disclosing key audit matters were discussed in detail in our earlier publication **Clear, transparent reporting.**

What have we analysed?

This publication analyses the recently published new auditor's reports for companies in Switzerland listed at the SMI ("Swiss Market Index") or SPI ("Swiss Performance Index").

We selected a representative sample of 50 companies: 19 SMI companies and 31 SPI companies. These 50 companies cover a broad range of industries and sizes. As for their consolidated financial statements, 70% prepare them in accordance with IFRS, 20% with Swiss GAAP FER and 10% with US GAAP.

Swiss GAAP FER is mainly applied by SPI companies and IFRS by SMI companies. The holding company information is subject to Swiss law and therefore prepared in accordance with the requirements of the Swiss Code of Obligation (SCO).

For the 50 companies, we have analysed both the auditor's report on the consolidated financial statements as well as on the standalone financial statements of the holding company. The analysed companies are all audited by one of the Big 4 audit firms (Deloitte, EY, KPMG and PwC).

Our main focus was to see how the requirements of the revised ISA 700 and the new ISA 701 have been implemented in practice. In particular, we were interested to see which audit areas have been identified as key audit matters and how they have been addressed. We were also interested in additional information such as the materiality and group scoping.

What are the key messages?

Our most important finding in the analysis of the new audit report is that **audit firms in Switzerland apply the new auditing standards in different ways**. We noted two divergent trends: two Big 4 audit firms did not disclose voluntary additional information such as reporting materiality and group scoping and limited themselves to the minimum requirements.

In contrast, the other two audit firms disclosed more information than was required by the standards to increase transparency. Deloitte was one of these two firms and, as a firm, we have concluded that information relating to materiality and group scoping is also important information for the readers of the financial statements.

We understand from the results of our analysis that audit firms support innovation and are willing to provide investors and other stakeholders with greater transparency into the audit as well as insights. We at Deloitte, are of the opinion that the more transparent we are in our daily business, the better the quality of our work will be. We, as a firm, are keen to go the extra mile to respond to regulatory and investor expectations and introduce enhanced information in our new audit report.

What will be the challenges?

As stated at the beginning, a first step towards greater transparency and understandability has been made. However, the journey has just started. **Both auditors as well as board members, management, investors and other stakeholders need to balance the right level of information.**

However, there is a risk that the new auditor's report becomes a boilerplate report disclosing "standard" key audit matters without tailoring to the companies' circumstances or without revising them in subsequent years. In light of this, we as audit firms need to be proactive in reflecting these changes in the auditor's report.

The company and industry specific circumstances should be considered prior to disclosing certain key audit matters or materiality and group scoping information. We do not consider that there is only one approach that fits all situations. Consequently, we are encouraging our audit teams to discuss such matters with audit committee members and management at an early stage of the audit in order to agree on an approach which meets the expectations of the investors and users of the financial statements whilst not disclosing sensitive financial information.

Thierry Aubertin, Managing Partner, Audit & Assurance

Benchmarking results: key audit matters

Our analysis shows that 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.

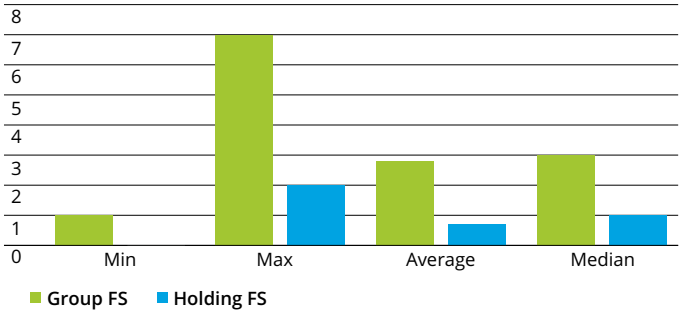
On average, the auditors disclosed 2.8 KAMs per group audit. In comparison, the auditor's reports on the financial statements of the holding company describe 0.7 KAMs on average.

This number is interesting as there are already two presumed significant risks as per Swiss/International Standards on Auditing (SAS/ISA): management override of controls and revenue recognition. Depending on their nature, these risks may not require significant auditor attention, and therefore would not be considered in the auditor's determination of KAMs. Nevertheless, given this background, a low number of KAMs might be seen as slightly surprising.

The range of KAMs reported in the auditor's report on the financial statements of the holding company is far lower. It ranges from no KAM up to two KAMs. In 30% of the analysed auditor's reports on the holding company the auditor stated that there were no KAMs. In contrast, 35 out of 50 auditor's reports (70%) disclose one or two KAMs. All of these reports disclosed valuation of investments and/or loans as one of the KAMs. In two cases the auditor disclosed the topics of going concern and impairment of intangible assets as the second KAM.

So let's look a bit deeper into the KAMs relating to the consolidated financial statements. All auditor's reports analysed contain at least one KAM. In fact, **a quarter of analysed reports (26%) disclosed only one KAM.** 10 out of 50 companies (20%) disclosed two KAMs and 11 out of 50 companies (22%) disclosed either three or four KAMs in the attached audit opinion. In contrast, three companies disclosed five KAMs, whereas two companies disclosed more than five KAMs (maximum seven KAMs).

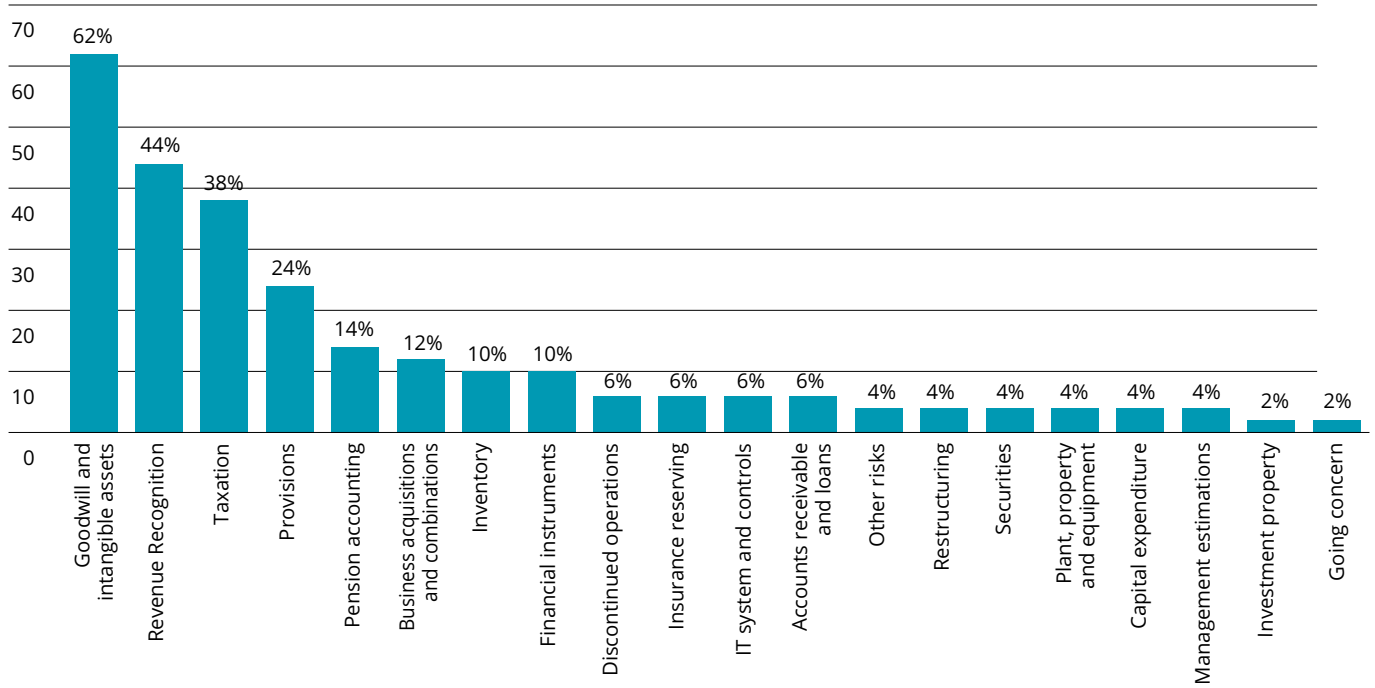
Number of KAMs



When analysing the number of KAMs per audit firm, 3 out of 4 audit firms disclosed more KAMs than the average (2.8), Deloitte (3.5), EY (3.1) and KPMG (3.9) all show more than 3 KAM per auditor's report on average. In comparison, PwC only disclosed 2 KAMs on average.

31 audit reports (62%) have reported goodwill and intangible assets being either one or two KAMs. Trailing a fair distance behind in second place is revenue recognition related audit matters (22 companies have reported in total 23 KAMs, being 44% of all companies) and third place goes to taxation related audit matters (19 companies have reported 26 KAMs, being 38% of the analysed companies). The fourth most reported KAM is related to provisions (12 out of 50 auditor's reports (24%) discloses 13 provision related KAM. 7 auditor's reports (14%) disclosed pension accounting and IAS 19 related topics as KAMs, being the fifth most disclosed KAM.

Disclosure of KAMs



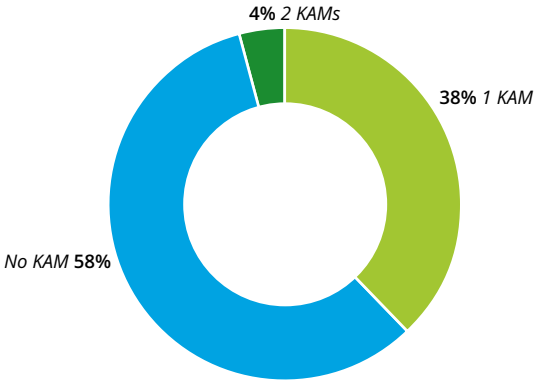
Our analysis of 50 auditor's reports on the consolidated financial statements identified 138 KAMs in total. The top five disclosed KAMs represents two-thirds (69%) of all the analysed KAMs (138). This gives a clearer picture of five main focus areas in Switzerland.

Goodwill and intangible assets

In a majority of the audit reports analysed (31 companies, 62%) the auditor reported that the valuation and recoverability of goodwill or other intangibles as a KAM. But why is this?

There could be a variety of answers but one clear reason is the increased number of business transactions over the last 10 to 20 years, whereby goodwill arises from the excess of what the acquiring companies pay for the target companies over their fair values. Therefore, goodwill has become more important for companies and more significant for their balance sheets.

KAM: goodwill and intangible assets



Under IFRS and US GAAP goodwill is not amortized and instead companies have to test their goodwill (and other intangible assets with indefinite life) annually for potential impairment. This assessment involves significant management judgement around accounting estimates. For example, management has to project future cash flows, tax rates, interest rates, costs of capital, and future investments for at least the next five years. This therefore brings uncertainties and hence a greater audit risk.

Figures 1 and 2 illustrate how KAMs related to goodwill and intangible assets have been addressed.

Goodwill and indefinite-lived intangible assets

Area of focus	Goodwill and indefinite-lived intangible assets represent 34% of the Group's total assets and 93% of the Group's total shareholders' equity as of December 2016. As stated in Note 1 to the consolidated financial statements, the carrying value of goodwill and indefinite-lived intangible assets is tested annually for impairment. The Company performed its annual impairment test of goodwill and indefinite-lived intangible assets in the fourth quarter of 2016 and determined that there was no impairment. Key assumptions concerning the impairment test are disclosed in Note 5 to the consolidated financial statements. In determining the fair value of reporting units and indefinite-lived intangible assets, the Company must apply judgment in estimating – amongst other factors – future revenues and margins, long-term growth and discount rates. Due to the significance of the carrying values for goodwill and indefinite-lived intangible assets and the judgment involved in performing the impairment test, this matter was considered significant to our audit.
Our audit response	We assessed the Company's internal controls over its annual impairment test and key assumptions applied. We evaluated Management's interpretation of reporting units. We involved EY valuation specialists to assist in examining the Company's valuation model and analyzing the underlying key assumptions, including long-term growth and discount rates. We assessed future revenues and margins and the historical accuracy of the Company's estimates and considered its ability to produce accurate long-term forecasts. We evaluated the sensitivity in the valuation resulting from changes to the key assumptions applied and compared these assumptions to corroborating information, including industry reports, economic outlooks, analyst reports and data from competitors.

Illustrative example 1: Adecco

Impairment assessment: Goodwill and intangible assets with infinite useful lives

Key audit matter

The impairment assessment for goodwill and intangible assets with infinite useful lives is considered as a key audit matter due the size of balance (goodwill: CHF 495 million; brands: CHF 212 million) and the significant assumptions involved by management. The main assumptions relate to the future cash flows of the underlying businesses as well as the discount rates applied to derive the associated net present values. Refer to pages 102 to 104 (note 13).
Goodwill and other intangible assets with indefinite useful life are allocated to the operating segments that are expected to benefit from the associated business combination and at which level the performance is monitored by the Chief Operation Decision Maker (CODM). These operating segments correspond to the cash-generating units (CGUs).

In 2016, and following a reorganization of the Surface Solutions Segment (OSS), the associated goodwill was reallocated to OSS' business units Balzers Industrial Solutions, Metco Aero & Energy, Automotive Solutions and Additive Manufacturing.

Goodwill and intangible assets with indefinite useful life are tested annually for possible impairment.

How our audit addressed the key audit matter

We have obtained all impairment tests provided by management and performed following tests:

- We ensured that the recoverable amount calculations are based on the latest business plans. Management follows a clearly documented process for estimating future cash flow. The forecast period used for future cash flows covers the years 2017 to 2021. The 5 year business plan used to determine the recoverable amount is approved by the Board of Directors.
- We have assessed the reasonableness of the business plan by comparing the implicit growth rates to the market and analyst forecasts and assessed that overall the growth rates appear to be reasonable.
- We have further compared the current year actual results with the forecast figures included in the prior year impairment tests and assessed that the prior year assumptions have been proven to be reasonable.
- We assessed the extent to which management has reflected the result from the comparison of budgeted versus actual numbers in its current assessment and adjusted to actual revenue growth rates and operating margins in this year's model and we are satisfied with the incorporation into the current growth rates.
- We performed procedures to ensure that model inputs such as the weighted average cost of capital, the long term growth rate and other assumptions are consistent with observable market data and did not note material deviations.
- We reperformed thorough sensitivity analyses on the key assumptions to ascertain the extent of change in those assumptions that would be required for the goodwill to be impaired. We discussed the headroom of the sensitivity analyses with management and are of the view that no impairment is necessary.

Overall, based on our review of the impairment testing model, the supporting evidence consulted as well as our own sensitivity analyses we conclude that the results of the impairment tests are reasonable.

We have further reviewed and assessed the reallocation of Goodwill in the OSS segment to the newly defined operating segments. In our view the reallocation was performed in line with the respective accounting standards.

Illustrative example 2: OC Oerlikon

Our analysis shows that audit firms take these (potential) uncertainties very seriously by focusing audit effort on these matters and as discussed above, this is reflected in the higher number of KAMs.

Revenue recognition

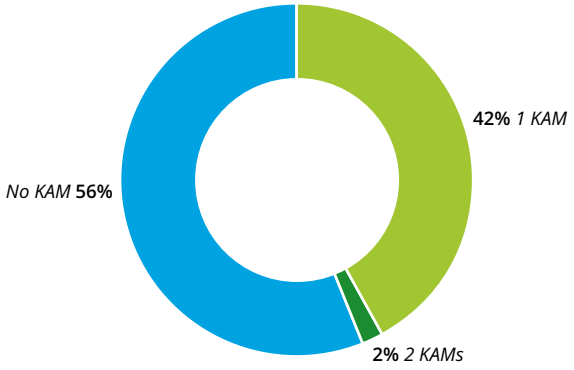
Revenue recognition is the second most disclosed KAM.

22 auditor's reports representing 44% of the analysed population have reported revenue related KAMs.

21 reports reported one KAM and one report even discloses two different KAMs related to revenue recognition, resulting in a total of 23 KAMs.

Revenues represent the companies' gross inflow of economic benefits in terms of cash, receivables or other assets arising from the operating activities. This is for example from the sale of goods or the rendering of services. The latter is often recognised by reference to the stage of completion of transactions at the balance sheet date (the percentage-of-completion method). Accounting for the percentage-of-completion method requires management estimates and judgement in determining the correct amount and timing of revenues. This is reflected in our results: 10 out of 23 disclosed revenue KAMs (44%) are linked to the high degree of management estimates and the underlying complex method to recognise revenues.

KAM: revenue recognition



Revenue recognition	
Risk	Total net sales for the business year 2016 amount to CHF 10,505 million. Based on its business model DKSH has many different types of revenues arising from different types of transactions and events with its customers. This requires detailed analysis of each contract regarding timing of revenue recognition and regarding gross/net accounting. Corresponding accounting policy are discussed in Note 2 (r) to the consolidated financial statements. Assessing whether a sale transaction contains the features of acting as principal or as agent requires significant judgment. These judgments result in a risk that revenue from the sale of goods is presented gross instead of net.
Our audit response	We performed the following procedures, among others, analytical reviews on revenues recognized to identify any material new revenue streams, we assessed the nature of revenues and we analyzed the timing of the recognition and unusual contractual terms. Our testing included agreeing amounts to customer contracts and verifying the extent, timing and customer acceptance of delivery, where relevant. We evaluated management's assessment with regard to the principal versus agent presentation of revenue based on the substance of underlying customer agreements.

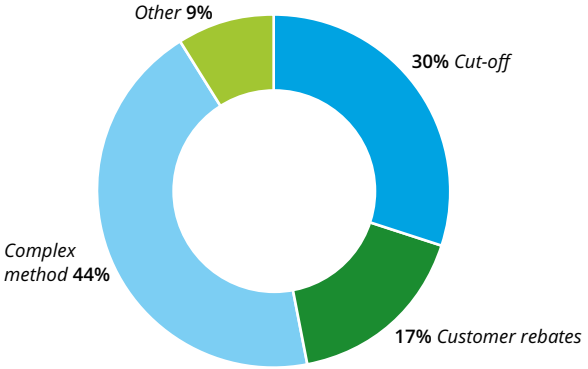
Illustrative example 3: DKSH

In addition, the ISA and SAS require the auditor to identify and assess the risks of material misstatement due to fraud at the financial statements level, and at the assertion level for classes of transactions, account balances and disclosures. This includes a presumption that there are risks of fraud in revenue recognition. The auditor shall therefore evaluate which types of revenue or revenue transactions give rise to risks of fraud in revenue recognition and if there is any, treat those assessed risks of material misstatement due to fraud as significant risks. This presumption leads to the fact that 7 out of 23 revenue related KAMs (30%) are pinpointed to the correct cut-off at year end.

The third most frequent KAM is linked to customer rebates (17%). The remaining 2 KAMs (9%) state that revenue recognition is a KAM due to its size or due to a high volume of IT based transactions.

The ISA and SAS require the auditor to identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures.

Types of revenue recognition



Revenue recognition according to the PoC method / work in progress

Key audit matter	How our audit addressed the key audit matter

Revenue from the main areas of activity (construction projects, general contracting projects and real-estate projects) is recognised when the work is performed based on the stage of completion of the total contract (percentage-of-completion (PoC) method). For this purpose the stage of completion as at the balance sheet date and the expected future costs to completion are assessed. This requires the use of estimates made by the project leadership and Management. The use of the PoC method involves significant scope for judgement by Management, which can have a material impact on the consolidated financial statements (net assets from work in progress of CHF 314.4 million and net liabilities from work in progress of CHF 753.7 million).
 	
The Group Executive Board (GEBO) discusses and monitors any non-standard projects (e.g. of unusual size or unusual exposure to risk). These projects are discussed at meetings of the Board of Directors at the request of the GEBO.
 	
Please refer to note 2.6, 4.1.1 and 13 in the notes to the consolidated financial statements for further information.
	Our audit focussed on revenue recognition and, as part of this, due to the complexity of the projects, on the use of the PoC method. We checked the logic and the systematic application of this approach to project valuations and revenue recognition and performed a critical assessment of the process. Our opinion is based on the following audit procedures:
	– We reviewed the internal reporting to Management and the Board of Directors
	– We tabled questions at Project Review Meetings
	– We discussed selected projects with Management and the Audit Committee.
	– We tested the related key controls. The tests of controls is the basis for the examination of project revenue. Examples of key controls in this area are:
	  – Ensuring that amounts booked to projects were checked by the project leader and the project controller for completeness and accuracy.
	  – Checking the existence of period-end accruals controls for construction and production projects.
	
	– During the 2016 interim and year-end audits, we examined in depth numerous projects. We made a risk-based selection of projects for our samples by applying criteria that we defined, including:
	  – The amount of the contribution margin in the financial year.
	  – The amount of revenue in the financial year.
	  – Change in the contribution margin compared with the prior year.
	  – Material project-related accruals.
	  – The size of the projects.
	  – Projects attracting particular attention from Implenia Management.

Illustrative example 4: Implenia

Taxation

The third most disclosed KAM is related to taxation. 19 (38%) of analysed auditor's reports disclosed 26 taxation related matters as KAMs.

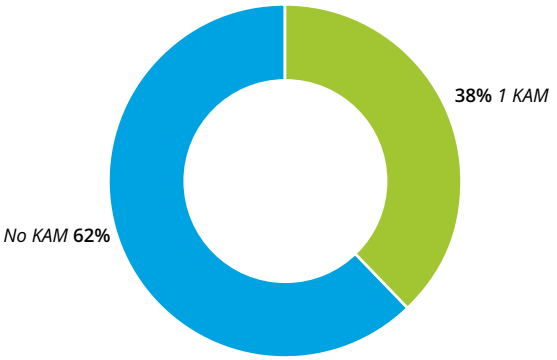
We have identified three tax areas which were subject to the auditor's special attention: income tax, deferred tax and transfer pricing.

50% of the reported tax related KAMs are related to income taxes. This results from the fact that the audited companies represent large groups with operations in various countries around the world and hence in different jurisdictions. Such groups are subject to multiple tax regimes with differing rules and regulations.

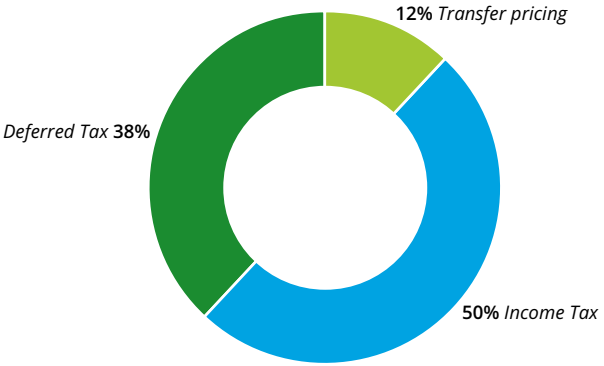
38% of them reported deferred tax as a KAM. Deferred tax assets or liabilities arise from temporary differences between the carrying value of an asset or liability in the balance sheet and its tax base. Such temporary differences are either "taxable" or "deductible" temporary differences resulting in either deferred tax assets being recognised for deductible temporary differences and for unused tax losses carried forward. Deferred tax liabilities are also recognised for taxable temporary differences and for income taxes payable in future years.

This requires group management to apply judgement in determining the calculation of both current and deferred income taxes, as well as in assessing provisions for uncertain tax positions including estimates of interest and penalties, if any.

KAM: taxation



Types of taxation



Key Audit Matters	How the scope of our audit responded to the Key Audit Matters
Taxation The Group operates in a large number of different jurisdictions and is therefore subject to many tax regimes with differing rules and regulations. As described in the Summary of Significant Accounting Policies in Note 2 and in Note 3 on Critical Accounting Estimates and Judgments, significant judgment is required in determining provision for income taxes, both current and deferred, as well as the assessment of provisions for uncertain tax positions including estimates of interest and penalties where appropriate. The effective tax rate of the Group increased from 10% in 2015 to 18% in 2016. The rate in 2015 was considerably lower following changes in Swiss Accounting Law and as a result of internal restructuring. The Consolidated Statement of Financial Position includes current tax assets of CHF 26 million, current tax liabilities of CHF 46 million, together with deferred tax assets of CHF 259 million and deferred tax liabilities of CHF 93 million. The tax expense recognised in the Consolidated Income Statement of CHF 140 million represents 18% of Group income before taxes. Details of all current and deferred tax balances are disclosed in Note 16 to the consolidated financial statements. Due to their significance to the financial statements as a whole, combined with the judgment and estimation required to determine their values, the evaluation of current and deferred tax balances is considered to be a key audit matter.	We evaluated the design and implementation of controls in respect of provisions for current tax and the recognition and recoverability of deferred tax assets. We discussed with management the adequate implementation of Group policies and controls regarding current and deferred tax, as well as the reporting of uncertain tax positions. We examined the procedures in place for the current and deferred tax calculations for completeness and valuation and audited the related tax computations and estimates in the light of our knowledge of the tax circumstances. Our work was conducted with our tax specialists. We performed an assessment of the material components impacting the Group's tax expense, balances and exposures. We reviewed and challenged the information reported by components with the support of our own local tax specialists, where appropriate. Utilising our own central tax specialists, we verified the consolidation and analysis of tax balances at Group level. We considered management's assessment of the validity and adequacy of provisions for uncertain tax positions, evaluating the basis of assessment and reviewing relevant correspondence and legal advice where available including any information regarding similar cases with the relevant tax authorities. In respect of deferred tax assets and liabilities, we assessed the appropriateness of management's assumptions and estimates, including the likelihood of generating sufficient future taxable income to support deferred tax assets for tax losses carried forward as disclosed in Note 16 of CHF 32 million. We validated the appropriateness and completeness of the related disclosures in Note 16 of the consolidated financial statements. Based on the procedures performed above, we obtained sufficient audit evidence to corroborate management's estimates regarding current and deferred tax balances and provisions for uncertain tax positions.

Illustrative example 5: Givaudan

The third most disclosed KAM is related to taxation. 19 (38%) analysed auditor's reports disclosed 26 taxation related matters as KAMs.

12% of the analysed KAMs around taxation are concentrated on business transactions and financing activities between multiple group entities as well as other arrangements where centralised functions perform services for other group entities and charge them for this, known as transfer pricing. It assumes that there is a potential risk that tax authorities do not accept the prices used for these transactions, because they are not at arm's length and consequently adjust the related tax charge.

Provisions

Provisions represent liabilities of **uncertain** timing or amounts. If the management of a company concludes that it must recognise a provision, it should be the best estimate of the expenditure required to settle the obligation at the balance sheet date. This estimation, as well as the inherent litigation risks of many companies, led to provisions being the fourth most disclosed KAM: 12 audit reports (24%) have disclosed 13 KAMs related to provisions in total.

The majority of provision-related KAMs are associated with litigation risks and a high degree of uncertainty in estimating the likelihood of occurrence of events and future cash outflows.

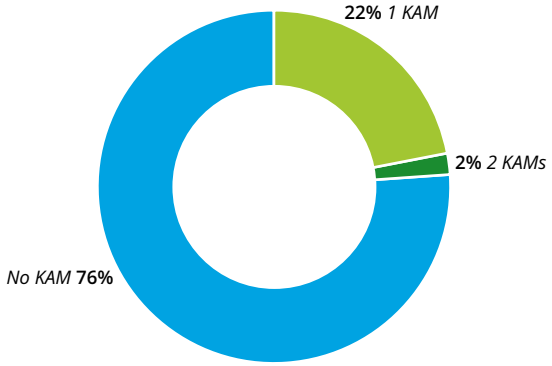
The embedded example of Roche illustrates how companies may face litigations and proceedings and that such issues are usually complex and require the auditor's special attention. Consequently, they are often considered as key audit matters.

Provisions and contingent liabilities in respect of litigations

Key Audit Matter	Our response
The pharmaceuticals industry is heavily regulated which increases the inherent litigation risk. In the normal course of business, provisions and contingent liabilities may arise from product-specific and general legal proceedings, or from anti-trust and other government investigations. At 31 December 2016, the Group held provisions of CHF 705 million in respect of legal actions. Given the highly complex nature of regulatory and legal cases, management applies significant judgement when considering whether, and how much, to provide for the potential exposure of each matter. These estimates could change substantially over time as new facts emerge and each legal case progresses. We focused on this area given the number, complexity and magnitude of potential exposures across the Group, and the judgement necessary to determine whether and what amounts to provide for and/or to disclose.	We discussed the status of significant known actual and potential litigation with in-house legal counsel, other management and directors who have knowledge of these matters. We challenged the decisions and rationale for provisions held or for decisions not to record provisions or make disclosures. For the most significant of the matters, we assessed relevant historical and recent judgments passed by the court authorities and considered legal opinion obtained by management from external lawyers to challenge the basis used for the provisions recorded and the disclosures made by the Group. We used our own forensic and compliance specialists to assist with our assessment of the Group's internal audit reports and compliance logs and reports prepared by management to identify actual and potential non-compliance with laws and regulations, both those specific to the Group's business and those relating to the conduct of business generally. For those matters where management concluded that no provisions should be recorded, we also considered the adequacy and completeness of the Group's disclosures made in relation to contingent liabilities.

Illustrative example 7: Roche

KAM: provisions



Pension accounting

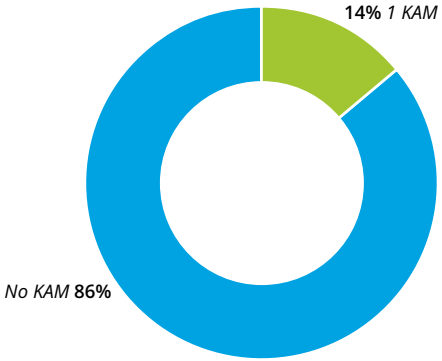
Pension accounting, known as "IAS 19R - Employee Benefits", deals with the accounting for employee benefits, including short-term benefits such as wages and salaries, post-employment benefits such as retirement benefits, other long-term benefits (for example long service leave) and termination benefits. The accounting for such transactions is often complex and the measurement is based on actuarial assumptions. These factors lead to a high level of management estimates and judgement in pension accounting.

Our analysis shows that only 7 auditor's reports (14%) disclosed pension accounting as a KAM. Considering the significance of management assumptions in the pension calculation and the importance of this topic in Switzerland and internationally we were expecting to find more KAMs in the audit reports analysed.

In our view, the fact that pension accounting KAMs are less frequent than anticipated may be explained by two factors:

- firstly, there are companies in our sample that are reporting under Swiss GAAP FER and thus are significantly less impacted;
- secondly, due to the relative stability of some of the key assumptions (e.g. inflation rate; longevity), pension accounting may have been considered as less sensitive.

KAM: pension accounting



RETIREMENT BENEFIT OBLIGATIONS

The Group maintains a number of defined benefit pension plans. The material defined benefit plans are in Switzerland, USA and UK.

At 31 December 2016, the Group recorded a net retirement benefit liability of CHF 94 million, being the net of pension fund assets of CHF 60 million, included in Other Non-Current Assets and CHF 154 million pension fund liabilities, included in Non-Current Liabilities.

The retirement benefit obligations recognised in the balance sheet represent the present value of defined benefit obligations calculated annually by independent actuaries. These actuarial valuations are sensitive to key assumptions such as discount rates, inflation rates and mortality rates. Changes in any of these assumptions can lead to a material movement in the net retirement benefit liability.

Given the judgement required by Management in setting these assumptions, the volatility in retirement benefit balances that can result from changes in assumptions, and the significance of the balances to the consolidated financial statements as a whole, the estimation of retirement benefit obligations is an area of focus for the Audit Committee (see page 122) and a key audit matter.

Refer to the accounting policy in note 2 and additionally notes 24 and 13.

We evaluated the Group's assessment of the assumptions used in the valuation of defined benefit liabilities and the information contained within the actuarial valuation reports for each plan. We also assessed the design and implementation of controls in respect of the valuation process for the retirement benefit plans.

We tested the membership and salary data used in the valuation of the retirement benefit plans by reconciliation to payroll records on a sample basis. We also verified retirement benefit assets to third-party confirmations.

Working with our pension specialists both at central and local level, we considered the process applied by the Group's actuaries and the scope of the valuations performed and we evaluated their expertise and independence. This included assessed the benchmarking of the key assumptions applied, including discount rates, inflation and mortality rates, against external data, where available, and forming our own independent expectations based on our knowledge of local market practices.

We also assessed the adequacy and completeness of the related retirement benefit disclosures in the consolidated financial statements.

Based on the procedures performed, we consider Management's estimates and disclosures regarding retirement benefit obligation balances to be appropriate.

Illustrative example 9: SGS

Audit procedures to address KAMs

It is interesting to note that audit firms interpret the disclosure of audit procedures slightly differently.

In 52% of the analysed reports, the auditor provides a conclusion on the KAMs and the results of the audit procedures performed. However, none of the analysed auditor's reports shows any observations, findings, numeric misstatements or control deficiencies. The fact that 52% of the reports disclosed conclusions is very interesting, because the International Standards on Auditing (ISAs) and the Statements on Auditing Standards (SAS) do not require disclosure of any conclusion on the KAMs. This is therefore additional information going beyond the standard setter's requirements.

Conclusion on KAMs

We support this development, because it provides more comprehensive information to the investors. Without concluding on the individual KAM the investors or other stakeholder might not be in a position to assess the outcome for each of the KAM. Indeed, the audit report provides a conclusion on the audit of the overall financial statements.

We further analysed the types of conclusion provided by the auditors. Since there is no requirement to provide such conclusions, the Swiss/International Standards on Auditing as well as related literature do not provide guidance on this. Auditors deciding to provide a conclusion, are perhaps influenced by other jurisdictions like within the European Union, whereby auditors reporting on financial statements for listed companies have increasingly chosen to disclose their key observations arising with respect to KAMs, and this will become mandatory for periods commencing on or after 17 June 2016 (i.e. 2017 year-end).

Our analysis shows that there is a mixture of conclusion styles on KAMs provided by audit firms. We have identified five different types of conclusions such as "The auditor agrees with management's assumptions" (63%) and "The auditor has not identified any material findings or issues" (21%).

With effect for periods commencing on or after 17 June 2016, the EU audit regulation will also require the auditor to specifically state in their report that the auditor's report is consistent with the audit committee report. Therefore, key observations need to be consistent with what will be written in the audit committee report. This may mean more disclosure than "the auditor agrees with management's assumptions" for example.

Additional information in the auditor's report

In other jurisdictions (for example the UK) the auditor's report may comprise additional information going beyond the requirements of the International Standards on Auditing including the **determination of materiality** and **group scoping**. This also goes beyond the requirements of the International/Swiss Standards on Auditing. In Switzerland, it is permitted to disclose such additional information and therefore audit firms can decide whether or not to present this information. This information is certainly interesting and valuable for the readers of the financial statements but can also be sensitive. Our analysis shows that the audit firms deal with this in a variety of ways.

Determination of materiality

As part of establishing the overall audit strategy, the auditor is required to determine a materiality for the financial statements. Materiality is considered as the smallest aggregate level of misstatements that could be considered significant to the users of the financial statements and thus would influence their decision-making process. Its determination is not a mechanical exercise. It involves the auditor to exercise professional judgement by considering the facts and circumstances surrounding the audit engagement. In practice the auditor usually applies a percentage to a chosen benchmark as a starting point in determining materiality.

The level of materiality has an important impact on the audit because it determines the audit scope, nature, the extent of audit evidence to be obtained to respond to the potential risk that the financial statements are not free of material misstatements.

It is considered to be one of the most important decisions of the audit and thus one of the most valuable information for users of the financial statements. **Disclosing this information obviously requires early engagement and agreement of the audit committee or the Board of Directors due to its sensitivity.**

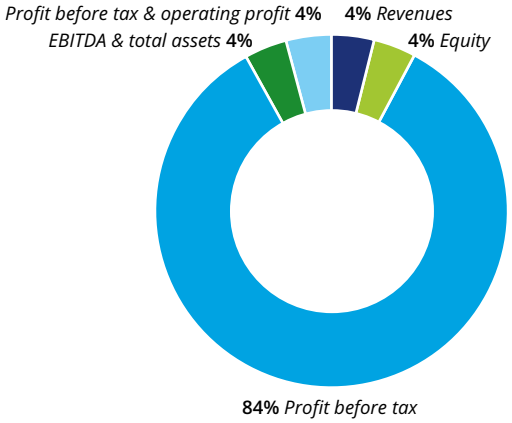
Our analysis draws a split picture: 24 out of 50 (48%) of the analysed auditor's reports disclosed this information. Whilst one audit firm showed this information in almost all audit opinions, Deloitte disclosed this in 50% of its reports. In contrast the remaining two audit firms did not provide this information in any of their auditor's reports.

Disclosure of materiality

Benchmarks to determine materiality

We have further analysed the information on disclosed materiality. In 20 out of 24 reports (84%) materiality was determined based on the consolidated profit before tax as a benchmark and with an average percentage of 4.9% (the median was 5%). Profit before tax is considered as one of the most relevant financial indicator for listed companies.

Benchmarks



Group scoping

The second element of additional information provided is the disclosure of audit scoping. Group scoping includes the auditor's description of the audit coverage of certain financial information achieved by audit procedures. Similar to the additional information about materiality, the auditor in Switzerland is not required to disclose information about the group scoping. Group scoping information, however, provides additional important information to the reader of the financial statements by indicating the key locations/regions of the group and the level of work performed by the auditor, we support the disclosure of this information, subject to the company being willing to disclose it due to potential sensitivity of this information. Based on an understanding of the group and its environment, and the assessment of risks of material misstatements at the group level, the auditor identifies at which subsidiaries audit work will need to be performed.

This can involve full audits of the subsidiaries, review engagements or depending on the subsidiaries' size or risk characteristics, specific audit procedures on certain balances. For example, if a significant risk is pinpointed to a non-significant component it might be more appropriate to focus on this balance/risk only.

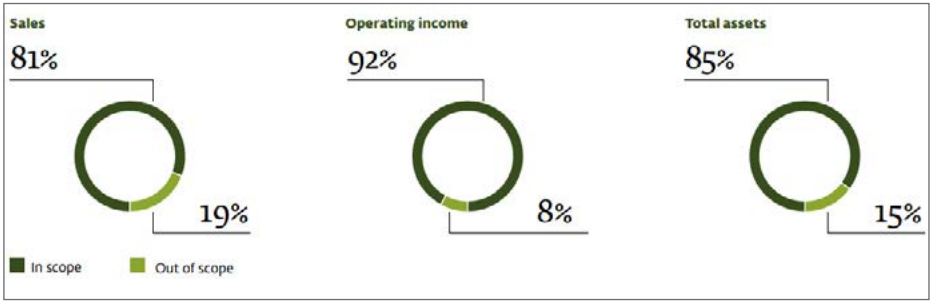
Disclosure of group scoping

Group scoping information provides additional important information to the reader of the financial statements by indicating the key locations/regions of the group and the level of work performed by the auditor.

These types of components are "in scope" of the group audit. In contrast, those components for which neither a full scope nor a review engagement nor specific audit procedures are performed are "out of audit scope".

As part of the audit planning the group auditor determines the total amount of financial information to be covered by full audits, limited reviews, or specific audit procedures. This determination is based on the auditor's professional judgement without specific requirements in the International Standards on Auditing or Swiss Standards on Auditing to cover a certain minimum amount of revenues, total assets, equity, profit, etc.

This information is important for the readers of the financial statements, because it indicates the extent to which the auditor has audited across the group which may consist of hundreds of legal entities. 46% of the auditor's reports analysed disclosed information on coverage. This trend goes in the same direction as the disclosure of materiality. Of our sample, PwC (91%) and Deloitte (50%) disclosed the audit coverage, whereas EY and KPMG did not.



Illustrative example 11: Givaudan

With the new structure and the additional information (KAMs, materiality, group scoping) the auditor's report on the consolidated financial statements was 5 pages long in average with a range from 2 pages to 9 pages.

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Notes

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