Proposed International Standard on Auditing (ISA) 701
Communicating Key Audit Matters in the Independent Auditor’s Report

Effective for audits of financial statements for periods [beginning/ending on or after date]

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Appendix: Illustration of Key Audit Matters in the Auditor’s Report When the Auditor of a Listed Entity Expresses an Unmodified Opinion on the Financial Statements

Proposed International Standard on Auditing (ISA) 701, Communicating Key Audit Matters in the Independent Auditor’s Report, should be read in conjunction with ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing.
Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor’s responsibility to communicate key audit matters in the independent auditor’s report. The matters to be communicated are based on the auditor’s professional judgment and are influenced by the nature and extent of matters communicated with those charged with governance in accordance with proposed ISA 260 (Revised).¹

2. Communicating key audit matters provides additional transparency about the auditor’s work in performing the audit and in forming an opinion on the financial statements as a whole. This communication in the auditor’s report is intended to provide users of the financial statements with additional information to enhance their understanding of the audit. Because of the nature of the risk-based approach in an audit in accordance with ISAs, communicating matters that were of most significance in performing the audit and, where appropriate, providing reference to relevant disclosures in the financial statements can assist users of the financial statements in understanding the entity and areas of significant management judgment in the audited financial statements. (Ref: Para. A1)

3. Users of the financial statements may also use the communication in the auditor’s report as a basis to further engage with management and those charged with governance about certain matters relating to the entity and the audited financial statements, for example at the shareholders’ general meeting or assembly.

4. This ISA applies to auditors of listed entities, and is intended to address both the auditor’s judgment as to what to include and the form and content of such communication. (Ref: Para. A2)

5. This ISA may be applied, adapted as necessary in the circumstances, for audits of entities other than listed entities (see paragraphs 18–19). Law, regulation or national auditing standards may also require communication of key audit matters for entities other than listed entities, for example public interest entities (see paragraph 21).

6. Law or regulation may also require the auditor to include additional communication in the auditor’s report about specific matters. If those requirements are intended to provide information that is consistent with the objective and requirements of this ISA, the requirements in this ISA relating to the form and content of such communication can be applied (see paragraph 20).

Effective Date

7. This ISA is effective for audits of financial statements for periods [beginning/ending on or after date].

Objective

8. The objective of the auditor, having formed an opinion on the financial statements, is to communicate in the auditor’s report those matters that, in the auditor’s professional judgment, were of most significance in the audit of the financial statements.

¹ Proposed ISA 260 (Revised), Communication with Those Charged with Governance
Definition

9. For purposes of the ISAs, the following term has the meaning attributed below:

Key audit matters—Those matters that, in the auditor’s professional judgment, were of most significance in the audit of the financial statements. Key audit matters are, in all cases, a selection of matters communicated with those charged with governance.

Requirements

Determining Key Audit Matters

10. The auditor shall communicate key audit matters in the auditor’s report for audits of listed entities, including when the auditor expresses a qualified or adverse opinion in accordance with ISA 705. The auditor shall not communicate key audit matters in the auditor’s report when the auditor expresses a disclaimer of opinion in accordance with ISA 705. (Ref: Para. A3–A5)

11. In determining whether a matter is communicated as a key audit matter, the auditor shall use professional judgment, taking into account the nature and extent of communications with those charged with governance, including, at a minimum: (Ref: Para. A6–A10)

- Whether the matter was identified as, or is related to, a significant risk in accordance with ISA 315. (Ref: Para. A11–A12)
- The degree of difficulty encountered in obtaining sufficient appropriate audit evidence about the matter. (Ref: Para. A13)
- The difficulty of the judgment involved relating to the matter. (Ref: Para. A14–A15)
- Whether the auditor identified a significant deficiency in internal control relating to the matter. (Ref: Para. A16)

12. In the rare circumstances where the auditor of a listed entity determines, in the auditor’s professional judgment, that there are no key audit matters to communicate in the auditor’s report, the auditor shall, in addition to the reporting required by paragraph 15 of this ISA:

(a) Discuss this conclusion with the engagement quality control reviewer;
(b) Communicate this conclusion with those charged with governance; and
(c) Document the rationale for this conclusion in the audit file. (Ref: Para. A17)

Communicating Key Audit Matters

Presentation in the Auditor’s Report for a Listed Entity

13. The auditor shall communicate those matters determined in accordance with paragraph 11 in a separate section of the auditor’s report under the heading “Key Audit Matters”, and include appropriate subheadings for each of the key audit matters communicated. (Ref: Para. A18–A19, A22)

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2 ISA 705, Modifications to the Opinion in the Independent Auditor’s Report, paragraphs 7–8
3 ISA 705, paragraphs 9–10
4 ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment
14. When key audit matters are communicated for audits of listed entities, the auditor’s report shall state that:
   (a) The Key Audit Matters section of the auditor’s report describes matters that, in the auditor’s professional judgment, were of most significance in the audit of the financial statements;
   (b) This information is intended to enhance users’ understanding of the audit of the financial statements;
   (c) The auditor’s opinion is not modified with respect to any of these matters, and the auditor’s audit procedures relating to these matters were designed in the context of the audit of the financial statements as a whole, and not to express an opinion on individual accounts or disclosures;
   (d) Although these matters were discussed with [those charged with governance], this communication is not intended to be a comprehensive list of all matters that were discussed;
   (e) Reading the auditor’s report is not intended to be a substitute for reading the financial statements, including the notes, in their entirety; and
   (f) The Auditor’s Responsibilities for the Audit of the Financial Statements section of the auditor’s report provides additional information about the objectives of the audit and may assist users in understanding these matters in the overall context of the audit. (Ref: Para. A20–A22)

15. When the auditor of a listed entity determines that there are no key audit matters to report, in addition to complying with the requirements in paragraphs 12–13, the auditor shall state in the auditor’s report that the auditor has determined that there are no matters on which to report auditor has determined that there are no matters on which to report. (Ref: Para. A23)

**Nature and Extent of the Descriptions of Key Audit Matters in the Auditor’s Report**

16. In determining the nature and extent of the descriptions of key audit matters to communicate in the auditor’s report, the auditor shall consider the sufficiency and appropriateness of the descriptions to enhance users’ understanding of the matter in the context of the audit that was performed. (Ref: Para. A24–A36)

**Interaction between Descriptions of Key Audit Matters and the Basis for Qualified and Adverse Opinions**

17. When a key audit matter is also a matter that gives rise to a qualified or adverse opinion, the auditor shall:
   (a) Provide a description of the matter in the Basis for Modification paragraph in accordance with ISA 705,5 and
   (b) Not discuss the matter in the Key Audit Matters section of the auditor’s report. (Ref: Para. A37)

**Communicating Key Audit Matters for Entities Other than Listed Entities**

18. Paragraph 5 of this ISA acknowledges that auditors of entities other than listed entities may include a discussion of key audit matters in the auditor’s report. In such circumstances, the auditor shall

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5 ISA 705, Modifications to the Opinion in the Independent Auditor’s Report, paragraphs 16–21
discuss doing so as part of agreeing the terms of the audit engagement in accordance with ISA 210.  
(Ref: Para. A38–A41)

19. When key audit matters are communicated for audits of entities other than listed entities, the auditor shall:
   (a) Determine key audit matters in accordance with paragraph 11; and
   (b) Present the key audit matters in the auditor’s report in accordance with paragraphs 13, 14 and 16.

Form and Content of the Auditor’s Report Prescribed by Law or Regulation

20. Law or regulation may require the auditor to provide information that is consistent with the objective of this ISA or the requirement in paragraph 11. In such circumstance, the auditor shall:
   (a) Include a separate section of the auditor’s report with a heading “Key Audit Matters,” unless a specific heading is prescribed by law or regulation;
   (b) Tailor the statements required by paragraph 14 to explain why the information is being provided, for example by making reference to the relevant law or regulation;
   (c) Include appropriate subheadings for each of the key audit matters communicated; and
   (d) Provide a description of the matter as required by paragraph 16 of this ISA, unless law or regulation prescribes the nature and extent of the description of the matter.  (Ref: Para. A42–A43)

21. When law or regulation requires the auditor of an entity other than a listed entity to communicate key audit matters in the auditor’s report, the auditor shall comply with the requirements in paragraph 20 of this ISA.  (Ref: Para. A44)

Documentation

22. In addition to the documentation required in the circumstances described in paragraph 12, the auditor shall include in the audit documentation:
   (a) Reference to the documentation relating to matters communicated with those charged with governance considered in determining the key audit matters;
   (b) The rationale for key judgments in the auditor’s decision-making process, including the conclusions in relation to the factors in paragraph 11, where these are not otherwise clear.  (Ref: Para. A42)

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Application and Other Explanatory Material

Scope of this ISA (Ref: Para. 2, 4)

A1. The Glossary of Terms relating to International Standards issued by the International Auditing and Assurance Standards Board in the Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements (Glossary) defines significance as the
relative importance of a matter, taken in context. The significance of a matter is judged by the 
auditor in the context in which it is being considered. This might include, for example, the 
reasonable prospect of its changing or influencing the decisions of intended users of the auditor’s 
report; or, as another example, where the context is a judgment about whether to report a matter to 
those charged with governance, whether the matter would be regarded as important by them in 
relation to their duties. Significance can be considered in the context of quantitative and qualitative 
factors, such as relative magnitude, the nature and effect on the subject matter and the expressed 
interests of intended users or recipients.

A2. The Glossary defines a listed entity as an entity whose shares, stock or debt are quoted or listed on 
a recognized stock exchange, or are marketed under the regulations of a recognized stock 
exchange or other equivalent body.

Determining Key Audit Matters

Relationship between Key Audit Matters and the Auditor’s Opinion (Ref: Para. 10)

A3. As noted in paragraph 8, the objective to communicate 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 intended to:

(a) Express an opinion on individual accounts or disclosures; or
(b) Be a substitute for the auditor expressing a qualified opinion or an adverse opinion when 
required by the circumstances of a specific audit engagement (see ISA 705).

A4. Adverse opinions relating to audits of listed entities may be rare, or may be prohibited by law or 
regulation. Notwithstanding this, a qualified or adverse opinion relating to a specific matter does not 
relieve the auditor of a listed entity of the requirement in paragraph 10 to include in the auditor’s 
report a description of key audit matters other than that which gave rise to the qualified or adverse 
opinion. In such cases, the discussion of key audit matters would still be relevant to enhancing 
users’ understanding of the audit. Paragraph 17 explains how key audit matters are presented 
when the auditor expresses a qualified or adverse opinion.

A5. However, to include a discussion of key audit matters would contradict the auditor’s disclaimer of 
opinion on the financial statements as a whole.

The Auditor’s Process to Determine Key Audit Matters (Ref: Para. 11)

A6. Users of the financial statements have indicated they have an interest in those matters about which 
the auditor and those charged with governance had the most robust dialogue as part of the two-
way communication required by proposed ISA 260 (Revised) and have called for additional 
transparency about those communications. The auditor’s decision-making process is therefore 
designed to narrow the matters discussed with those charged with governance to a smaller number 
of matters based on the auditor’s judgment about which matters were of most significance in the 
audit. The determination of key audit matters for the purpose of external reporting is not intended 
to be a separate assessment or identification process for purposes of planning and performing the

7 Throughout this ISA, the phrase “matters communicated with those charged with governance” is intended to mean all matters 
required to be communicated by proposed ISA 260 (Revised) and other ISAs as described in Appendix 1 of proposed ISA 260 
(Revised), and any other matters arising during the audit that were communicated with those charged with governance.
Proposed ISA 701  
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Determined what key audit matters to communicate in the auditor’s report is a matter of the auditor’s professional judgment. Judging the significance of a matter requires an objective analysis of the facts and circumstances. Paragraph 11 includes factors that are required to be taken into account in determining key audit matters. These factors are intended to promote consistency in auditor judgments in relation to key audit matters, in particular when auditors’ reports of similar entities are compared by users of the financial statements.

Revision to the auditor’s risk assessment and reevaluation of the planned audit procedures (i.e., a change in the audit approach, for example, when a significant deficiency in internal control has been identified) may lead the auditor to determine a matter is a key audit matter. ISA 315 notes that the auditor's assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit evidence is obtained. Further, if during the audit the auditor’s risk assessment is significantly revised, the auditor may consider the facts and circumstances giving rise to the changed assessment to be a key audit matter. In particular, if the auditor encounters circumstances that cause the auditor significant difficulty in applying necessary audit procedures, the auditor may need to obtain audit evidence by performing additional audit procedures than originally contemplated.

Often, more than one factor may be applicable in the context of a matter. This in turn influences the likelihood of the auditor identifying it as a key audit matter. For example, in relation to a significant transaction outside the entity's normal course of business, management or those charged with governance may have discussed the matter with the auditor prior to undertaking the transaction and at various stages throughout the audit. The auditor may have assessed the transaction as a significant risk and there may have been difficult judgments both by management and the auditor in relation to the presentation and disclosure of the transaction.

While the auditor is not precluded from including a discussion of any number of matters determined to be key audit matters, given the factors in paragraph 11, a range of two to seven matters may generally be appropriate. However, the number of matters to be included in the auditor's report is affected by the size and complexity of the entity, the nature and conditions of its business, and the facts and circumstances of the audit engagement. Paragraph 12 addresses the rare circumstance in which the auditor of a listed entity determines there are no key audit matters to report.

**Significant Risks**

A11. Paragraph 11 requires the auditor to consider whether a matter was identified as, or related to, a significant risk in accordance with ISA 315. Paragraph 16(a) of proposed ISA 260 (Revised) requires the auditor to communicate the auditor's identification of, and responses to, significant risks to those charged with governance. Areas of significant management judgment, significant or unusual transactions, and significant auditor judgments will often be identified as significant risks.

A12. ISA 540 requires the auditor to determine whether, in the auditor's judgment, any of those accounting estimates that have been identified as having high estimation uncertainty give rise to

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8 ISA 330, *The Auditor's Responses to Assessed Risks*
9 ISA 315 (Revised), paragraph 31
significant risks.\textsuperscript{10} Accounting estimates with high estimation uncertainty are of interest to users of the financial statements because, among other things, they are highly dependent on judgment and may require the involvement of both a management’s expert and an auditor’s expert.

\textit{Degree of Difficulty Encountered in Obtaining Sufficient Appropriate Audit Evidence}

A13. Proposed ISA 260 (Revised) requires the auditor to communicate significant difficulties encountered during the audit to those charged with governance.\textsuperscript{11} The ISAs acknowledge potential difficulties in relation to, for example:

- Related party transactions,\textsuperscript{12} in particular limitations on the auditor’s ability to obtain audit evidence that all other aspects of a related party transaction (other than price) are equivalent to those of the arm’s length transaction.

- Limitations on the group audit, for example, where the group engagement’s team’s access to information may have been restricted.\textsuperscript{13}

- Extensive effort required to obtain sufficient appropriate audit evidence.\textsuperscript{14}

The auditor may also communicate with those charged with governance about significant difficulties encountered when obtaining sufficient appropriate audit evidence relating to valuations performed by management or a management’s expert.

\textit{Difficulty of the Judgments Involved}

A14. ISA 220 requires the engagement partner to take responsibility for the engagement team undertaking appropriate consultation on difficult or contentious matters and be satisfied that such consultation has taken place.\textsuperscript{15} ISA 220 also requires the engagement partner to discuss, among other things, significant matters arising during the audit engagement with the engagement quality control reviewer.\textsuperscript{16} In addition, the engagement quality control reviewer is required to perform an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached in formulating the auditor’s report.\textsuperscript{17} This may include matters to be communicated to those charged with governance. The extent to which a matter involved consultation with others, both within or outside the firm, and the nature and extent of discussions with the engagement quality control reviewer, may be relevant considerations for the auditor in determining whether a matter is a key audit matter.

A15. For example, the allocation of resources or audit effort in relation to a particular matter, including the involvement of senior personnel on the audit engagement, may be a relevant consideration in determining whether a matter represents a key audit matter. This includes both persons with expertise in a specialized area of accounting or auditing, whether engaged or employed by the firm,

\begin{itemize}
\item \textsuperscript{10} ISA 540, \textit{Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures}, paragraph 11
\item \textsuperscript{11} Proposed ISA 260 (Revised), paragraph 16(d)
\item \textsuperscript{12} ISA 550, \textit{Related Parties}, paragraph A42
\item \textsuperscript{13} ISA 600, paragraph 49(d)
\item \textsuperscript{14} Proposed ISA 260 (Revised), paragraph A24
\item \textsuperscript{15} ISA 220, \textit{Quality Control for an Audit of Financial Statements}, paragraph 18
\item \textsuperscript{16} ISA 220, paragraph 19
\item \textsuperscript{17} ISA 220, paragraph 20
\end{itemize}
as well as those within the firm who are consulted on significant technical, ethical and other matters.

Identification of Significant Deficiencies in Internal Control

A16. The significance and disposition of corrected and uncorrected misstatements identified during the audit is an example of a matter that may be considered in an engagement quality control review relevant to evaluating the significant judgments made by the engagement team.\textsuperscript{18} A material misstatement detected by the auditor’s procedures is a strong indicator of the existence of a significant deficiency in internal control.\textsuperscript{19} ISA 265 requires the auditor to communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis.\textsuperscript{20} The auditor is not required by the ISAs to report externally on significant deficiencies in internal control identified during the audit. However, the auditor may determine that the identification of a significant deficiency in relation to a matter may constitute a key audit matter, in particular if other factors in paragraph 11 are relevant.

Determination that There Are No Key Audit Matters to Report (Ref: Para. 12)

A17. It is expected to be rare that an auditor of a listed entity would not determine any of those matters communicated with those charged with governance to be key audit matters to be included in the auditor’s report. However, this may be the case, for example, in an audit of a smaller listed entity with a relatively simple business. In such circumstances, discussion with those charged with governance or the engagement quality control reviewer ensures that those most familiar with the significant matters arising during the audit have input to the auditor’s decision-making process about whether additional information in the auditor’s report is necessary to enhance users’ understanding of the audit.

Communicating Key Audit Matters

Presentation in the Auditor’s Report for a Listed Entity (Ref: Para. 13–14)

A18. Because this additional information is intended to enhance users’ understanding of the audit of the financial statements, placement of this section in close proximity to the auditor’s opinion on the financial statements as a whole acknowledges that this communication provides additional transparency about the auditor’s work in performing the audit, and enables the engagement-specific information in the auditor’s report to be easily recognized by users.

A19. Except as required by paragraph 20, the presentation of individual matters within this section is a matter of professional judgment, though such information may be best organized in order of relative importance, and the requirement to include subheadings is intended to further differentiate the matters.

A20. Explaining the objective of communicating key audit matters is intended to make clear to the user why this additional information is being provided and how it relates to the audit and the auditor’s opinion on the financial statements as a whole.

\textsuperscript{18} ISA 220, paragraph A28
\textsuperscript{19} ISA 330, The Auditor’s Responses to Assessed Risks, paragraph A40
\textsuperscript{20} ISA 265, Communicating Deficiencies in Internal Control to Those Charged with Governance and Management, paragraph 9
A21. Explaining that the key audit matters discussed in the auditor’s report are not all the significant matters arising during the audit that have been communicated to those charged with governance assists users in understanding the application of the auditor’s professional judgment and the possibility that auditors of similar entities may discuss different matters in their auditors’ reports or in differing levels of detail.

A22. The Appendix to this ISA includes an illustration of key audit matters in the auditor’s report when the auditor of a listed entity expresses an unmodified opinion on the financial statements.

Illustrative Example when No Key Audit Matters Are Described (Ref: Para. 15)

A23. The following illustrates the presentation in the auditor’s report when the auditor has determined there are no key audit matters to report:

**Key Audit Matters**

We have determined that there are no matters on which to report.

*Nature and Extent of the Descriptions of Key Audit Matters in the Auditor’s Report* (Ref: Para. 16)

Users of the Auditor’s Report

A24. ISA 320\(^{21}\) notes that it is reasonable for the auditor to assume that users of the financial statements:

(a) Have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;
(b) Understand that the financial statements are prepared, presented and audited to levels of materiality;
(c) Recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment and the consideration of future events; and
(d) Make reasonable economic decisions on the basis of the information in the financial statements.

Because the auditor’s report accompanies the audited financial statements, the users of the auditor’s report are considered to be the same as the users of the financial statements. Because not all users of the financial statements may have a reasonable knowledge of auditing, it is necessary for the auditor to communicate clearly in such a way that enables users to understand key audit matters and, more broadly, the auditor’s responsibilities in an audit.

Purpose of the Discussion of Key Audit Matters

A25. The discussion of key audit matters is intended to explain why the matter involved significant auditor judgment, and the standardized language in the *Auditor’s Responsibilities for an Audit of Financial Statements* section of the auditor’s report may provide context to the engagement-specific discussion of key audit matters. Limiting the use of highly technical auditing terms helps ensure that users who do not have a reasonable knowledge of auditing are nevertheless able to understand the basis for the auditor’s focus on particular matters during the audit.

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\(^{21}\) ISA 320, *Materiality in Planning and Performing an Audit*, paragraph 4
A26. In most cases, this will not involve describing all audit procedures performed to address significant matters arising during the audit, but on the other hand, it is important for the description not to be so summarized as to be ambiguous, nor written in a way that is overstated or embellished. Users may also want to understand how the matter was addressed by the auditor, and it is important that there is not a perception that particular matters were not resolved to the auditor’s satisfaction. However, there are likely challenges in summarizing the auditor’s procedures, particularly in complex areas, in a succinct way that reflects the extent of the underlying work effort and the significant auditor judgments involved.

A27. The value to users of information about key audit matters may depend on the level of detail provided in the auditor’s report, and the nature of matters will differ from entity to entity. The sufficiency and appropriateness of the descriptions such that users of the financial statements can understand why the matter was of significance in the audit that was performed is a matter of professional judgment.

Challenges of Communicating Key Audit Matters without the Benefit of Two-Way Communication

A28. The nature and extent of the descriptions of key audit matters is less extensive than what is communicated with those charged with governance, such that the descriptions in the auditor’s report remain clear and concise. As noted in paragraph A6, users of the financial statements may be interested in knowing more about these communications. However, they do not have the benefit of the effective two-way communication that occurs when the auditor discusses those matters with those charged with governance. Accordingly, the auditor’s judgment as to what to include in the auditor’s report about these matters, or how to describe the matters, takes this into account, including the risk of inadvertently providing information about the entity that would be more appropriately disclosed by management or those charged with governance. For example, two-way communication may be necessary in order to fully understand:

- The auditor’s subjective views about significant qualitative aspects of the entity’s accounting practices.\(^{22}\)
- Significant risks of material misstatement due to fraud,\(^ {23}\) in particular when the auditor’s work relating to such risks did not detect any material misstatements, or due to the nature and sensitivity of fraud involving senior management, or fraud that results in a material misstatement in the financial statements. Notwithstanding this, the auditor may be able to highlight the significance of the matter in other ways, for example by drawing attention to the fact that a matter, which was related to a fraud risk, represents an unusual transaction outside the course of the entity’s business.

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\(^{22}\) Paragraph 16(c) of proposed ISA 260 (Revised) requires the auditor to communicate with those charged with governance the auditor’s views about significant qualitative aspects of the entity’s accounting practices, including accounting policies, accounting estimates, and financial statement disclosures.

\(^{23}\) Paragraph 16(a) of proposed ISA 260 (Revised) requires the auditor to communicate with those charged with governance the significant risks of material misstatement due to fraud. Paragraph 41 of ISA 240, The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements, requires the auditor to communicate with those charged with governance when the auditor has identified or suspects fraud in certain circumstances, and paragraph 42 requires the auditor to communicate with those charged with governance any other matters related to fraud that are, in the auditor’s judgment, relevant to their responsibilities.
• Significant deficiencies in internal control identified by the auditor, notwithstanding that the auditor may be able to describe the implications of significant deficiencies on the audit scope and strategy without explicitly indicating that a significant deficiency was identified.

Other Factors to Consider in Determining the Nature and Extent of the Descriptions of Key Audit Matters

A29. Other factors to consider in determining the nature and extent of the descriptions of key audit matters include:

• The manner in which the matter(s) are disclosed in the financial statements, including the notes.
• Circumstances specific to the entity that affect the assessed risks of material misstatements.
• Specific engagement circumstances that affect the availability of audit evidence, or difficulties encountered during the audit, and the auditor’s response thereto.
• The intended users’ expectation about the level of detail to be provided in the auditor’s report.

Manner in which the matters are disclosed in the financial statements

A30. The discussion of key audit matters is not a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make. It is also necessary that the auditor’s discussion of key audit matters is not seen as providing original information about the entity, as this is the responsibility of the entity’s management and those charged with governance. Rather, the auditor may make reference to the most relevant disclosures in the financial statements as a means of explaining the matters of most significance in the audit.

A31. A reference to where management’s disclosures are presented enables users to understand both management’s and the auditor’s perspectives on these matters. For example, when an entity includes robust disclosure about accounting estimates, the auditor may draw attention to the disclosure of key assumptions and other sources of estimation uncertainty, the disclosure of the range of possible outcomes, and other qualitative and quantitative disclosures relating to key sources of estimation uncertainty or critical accounting estimates, as part of explaining why the matter was important to the audit.

A32. Paragraph 16(g) of proposed ISA 260 (Revised) requires the auditor to communicate with those charged with governance the matters that the auditor will include as key audit matters in the auditor’s report. Proposed ISA 260 (Revised) explains that such communication enables those charged with governance to be made aware of the manner in which the auditor intends to describe the key audit matters in the auditor’s report, and provides them with an opportunity to obtain further clarification where necessary. In some cases, management or those charged with governance may decide to include new or enhanced disclosures in the financial statements relating to the key audit matter, for example to provide more robust disclosures about sensitivity of key assumptions used in accounting estimates or the entity’s rationale for a particular accounting practice or policy when acceptable alternatives exist under the applicable financial reporting framework.

Circumstances affecting the auditor’s risk assessment or the Availability of Audit Evidence

A33. Describing the audit approach in relation to a matter, in particular when the audit approach required significant tailoring to the facts and circumstances of the entity, assists users in understanding
unusual circumstances and significant auditor judgment required to address the risk of material misstatement. This may be appropriate, for example, when the auditor employed or engaged an auditor’s expert or the auditor consulted on complex matters within or outside the firm.

A34. There is also a need for the auditor to ensure that the discussion about key audit matters in the auditor’s report is not seen as the auditor expressing an opinion on individual accounts or disclosures. While the auditor may find it useful to explain how the auditor addressed the matter in the audit, including a conclusion on the matter may imply a greater level of specificity on individual amounts in the financial statements than is appropriate in light of the auditor’s opinion on the financial statements as a whole.

Potential Effect of Law, Regulation and Relevant Ethical Requirements on the Nature and Extent of Descriptions of Key Audit Matters

A35. Law or regulation may restrict the auditor’s communication of certain matters in the auditor’s report. For example, law or regulation may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act. In some circumstances, potential conflicts between the auditor’s obligations of confidentiality and obligations to communicate may be complex. In such cases, the auditor may consider obtaining legal advice.

A36. The auditor may also consider obtaining legal advice in circumstances where the auditor believes discussion of certain matters determined to be key audit matters may be highly sensitive from a business perspective. In addition, relevant ethical requirements may prohibit the disclosure of confidential information or information that could cause harm to the entity or its shareholders.

Interaction between Descriptions of Key Audit Matters and the Basis for Qualified and Adverse Opinion Paragraphs (Ref: Para. 17)

A37. Presenting the description of matters for which the auditor has concluded it is necessary to modify the opinion separately in the Basis for Modification paragraph helps to promote users’ understanding and to identify unusual circumstances when they occur. Accordingly, while matters for which the opinion is modified are, by their nature, key audit matters, separating the discussion of these matters from other key audit matters gives them the appropriate prominence in the auditor’s report.

Communicating Key Audit Matters for Entities Other than Listed Entities (Ref: Para. 18–19)

A38. Auditors of entities other than listed entities are not precluded from including a section addressing key audit matters in the auditor’s report, unless prohibited by law or regulation. However, when the auditor decides to do so based on the facts and circumstances of the engagement or is requested to do so by management or those charged with governance of the entity, the requirement in paragraph 18 applies.

A39. ISA 210 requires the auditor to agree the terms of the audit engagement with management and those charged with governance, as appropriate, and notes that the roles of management and those charged with governance in agreeing the terms of the audit engagement for the entity depend on the governance structure of the entity and relevant law or regulation.24 ISA 210 also requires the

24 ISA 210, paragraphs 9 and A21
audit engagement letter to include reference to the expected form and content of any reports to be issued by the auditor. Communication about the possibility of including a discussion of key audit matters in the auditor’s report at the commencement of the audit ensures that management and those charged with governance are aware of the auditor’s ability to do so.

A40. However, because those charged with governance may not always have agreed the terms or engagement, and the auditor may not decide to include a discussion of key audit matters in the auditor’s report until such time as communicating the significant findings of the audit to those charged with governance, proposed ISA 260 requires the auditor to communicate which matters the auditor will include as key audit matters to those charged with governance.

Considerations Specific to Public Sector Entities

A41. Listed entities are not common in the public sector. However, there may be other public sector entities that are significant due to size, complexity or public interest aspects, and which consequently have a wide range of stakeholders. Examples of public sector entities include state owned corporations and public utilities. Ongoing transformations within the public sector may also give rise to new types of significant entities, and an auditor of such an entity may decide to communicate key audit matters in the auditor’s report.

Form and Content of the Auditor’s Report Prescribed by Law or Regulation (Ref: Para. 20)

A42. Law or regulation may require the auditor to communicate in the auditor’s report about certain matters, for example, in relation to materiality and the scope of the audit, including the use of other auditors. Law or regulation may also require the auditor to include additional communication in the auditor’s report about particular findings, for example a description of significant risks, the auditor’s responses to those risks (including, in some cases, a description of the auditor’s procedures) and a conclusion on the matter.

A43. Law or regulation may also require those charged with governance (for example, an entity’s Board of Directors or Audit Committee) to report on key audit matters discussed with the auditor during the performance of the audit. Where such circumstances exist, the auditor’s report may make reference to the report of those charged with governance and, instead of providing the same information, the auditor may be required to report by exception when the report of those charged with governance does not appropriately address matters communicated by the auditor to those charged with governance.

Considerations Specific to Public Sector Entities

A44. Auditors of public sector entities may be required by law, regulation or their audit mandate to report publicly on certain matters, either in the auditor’s report or in a supplementary report. This may include, for example, reporting on fraud, questionable business practices, significant transactions and other matters that would be expected to be communicated to those charged with governance in accordance with proposed ISA 260 (Revised). In such cases, the requirement in paragraph 21 applies.

25 ISA 210, paragraph 10(e)
26 Proposed ISA 260 (Revised), paragraph 16(g)
27 Paragraph 49 of ISA 600 includes specific matters to be communicated by group auditors with those charged with governance.
Documentation (Ref: Para. 22)

A45. Documentation of the auditor's decision-making process in relation to communicating key audit matters is to be sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the rationale for the auditor's determination of what to include in the auditor's report. The auditor may consider it necessary, for example, to document why certain matters that would otherwise appear to meet the criteria in paragraph 11 were not discussed in the auditor's report, in particular when the auditor has obtained legal advice in relation to the matters (see paragraphs A35–A36).
Appendix
(Ref: Para. A22)

Illustration of Key Audit Matters in the Auditor’s Report When the Auditor of a Listed Entity Expresses an Unmodified Opinion on the Financial Statements

See Illustration 1 of Section A in Agenda Item 2-A.