

Key Audit Matters (KAM)—Issues and Drafting Team Recommendations

Summary of the IAASB's Discussions at Its June 2014 Meeting

Applicability of Proposed ISA 701¹

In relation to the Drafting Team's recommendations set out in Agenda Item 4-A, the Board:

- Agreed to limit the requirement to communicate KAM to audits of complete sets of general purpose financial statements of listed entities, but allow for voluntary application for audits of complete sets of general purpose financial statements of other entities and in circumstances addressed by ISA 800² and ISA 805.³ In this regard, the Board agreed to include additional application material in proposed ISA 700 (Revised)⁴ explaining the possibility of communicating KAM for entities such as public interest entities, and to revise application material in ISA 210⁵ addressing voluntary application of proposed ISA 701.
- Agreed to continue to prohibit communication of KAM when the auditor disclaims an opinion on the financial statements, but decided to retain the position in the exposure draft (ED) to require communication of KAM when the auditor expresses an adverse opinion. The Board was generally of the view that, because the auditor is able to complete the audit in such circumstances, there may be additional matters that may be relevant to the intended users' understanding of the audit; however, such matters may not be "of most significance" as compared to the matter(s) related to the adverse opinion. The Board asked the Drafting Teams to further consider the appropriate placement of the material relating to disclaimers of opinion, in order to simplify and avoid duplication where possible.
- Agreed to retain the flexibility permitted by proposed ISA 700 (Revised) in relation to KAM when law or regulation prescribes the form and content of the auditor's report.
- Agreed to require wording to describe the auditor's responsibilities in relation to KAM when proposed ISA 701 applies. Such requirement is included in proposed ISA 700 (Revised).

Circumstances in Which a Matter Determined to Be a KAM Is Not Communicated in the Auditor's Report

The Board continued to support the concept of a new requirement in proposed ISA 701 to address the possibility that the auditor might decide not to communicate in the auditor's report a matter that had been determined to be a KAM. Ms. de Beer noted that, in the Consultative Advisory Group's (CAG) view, the circumstances in which the auditor might decide not to communicate a KAM should be very restrictive. The Board considered the Drafting Team's suggestions included in Agenda Items 4-A and paragraph 11 and related application material in Agenda Item 4-A, and agreed it is necessary to put proper parameters

¹ Proposed ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

² ISA 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*

³ ISA 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statements*

⁴ Proposed ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

⁵ Proposed ISA 701, *Agreeing the Terms of Audit Engagements*

around a decision not to communicate a matter and to promote disclosure in most cases. In this regard, the IAASB agreed that such circumstances should be:

- Linked first to the possibility that law or regulation preclude public disclosure about the matter; and
- Extremely rare, taking into account the severity of adverse consequences of such communication. The Board asked the Drafting Team to further consider how this concept could be best articulated in the standard, including whether the requirement or application material should further elaborate on the concept of harm to the entity.

In relation to the application material supporting this requirement, the Board:

- Asked the Drafting Team to further clarify the auditor's consideration of relevant ethical requirements in potentially concluding not to communicate a matter determined to be a KAM.
- Agreed to delete examples of potential circumstances in which this requirement might apply, as concern was expressed that including examples could lead to a greater proliferation of non-communication about these matters.
- Agreed to relocate guidance addressing the auditor's required communication with those charged with governance (TCWG) in such circumstances, in particular to highlight that management or TCWG may choose to enhance disclosures about a KAM rather than the auditor providing original information in the auditor's report.
- Suggested it may be appropriate to make reference to the possibility that the auditor may communicate about the matter with regulatory or enforcement authorities rather than include it in the auditor's report, a point which had previously been supported by the CAG.

Other Revisions to Proposed ISA 701

In discussing the revised draft of proposed ISA 701 included as Agenda Item 4-B, the IAASB agreed to:

- Refine the factors to be taken into account in determining those matters that required significant auditor attention to clarify that such considerations are in the context of the audit that was performed.
- Include a new requirement aimed at prohibiting the auditor from using the communication of KAM as a substitute for the auditor expressing a qualified or an adverse opinion in accordance with proposed ISA 705 (Revised),⁶ similar to the approach taken to Emphasis of Matter (EOM) paragraphs in proposed ISA 706 (Revised).⁷
- Shorten and simplify the introductory language when KAM are communicated and when the auditor has determined that there are no KAM to communicate, in an effort to minimize standardized language in the auditor's report.
- Clarify the documentation requirement and align it with the proposed requirement in the ED.

The IAASB also agreed a number of editorial and less substantive matters, and reordering of application material. These changes were reflected in the IAASB's discussion of Updated Agenda Item 4-B. The IAASB will consider a revised draft of proposed ISA 701 for approval at its September 2014 meeting.

⁶ Proposed ISA 705, *Modifications to the Opinion in the Independent Auditor's Report*

⁷ Proposed ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*

Illustrative Examples

Similar to the Drafting Team's position set out in Agenda Item 4-A, the Board expressed mixed views about whether the IAASB should continue to provide illustrative examples of KAM and, if so, whether these should be included in the final standard or another vehicle such as a Staff publication. On balance, the IAASB agreed that a limited number of examples could be provided and included in non-authoritative Staff guidance to be issued concurrently with the final standards. Doing so would allow flexibility for the IAASB to refine the examples over time, if necessary, and also highlight other national developments and real-time examples, such as the UK. Ms. de Beer noted that there is an expectation that illustrative examples will be provided by the IAASB to assist auditors with the implementation of the new standard.

Amendments to Other ISAs

The Board agreed revisions to ISA 260 (Revised)⁸ as set out in Agenda Item 4-D, subject to any further changes needed to align with proposed ISA 701 and strengthen the link between the two standards.

The Board agreed with the Drafting Team's recommendation in Agenda Item 4-A to retain the possibility of auditors using EOM paragraphs even when KAM are communicated in the auditor's report. However, the Board asked the Drafting Team to further clarify the proposed guidance addressing the potential circumstance in which a matter that is determined to be a KAM may also be considered fundamental to users' understanding of the financial statements, with the following noted:

- As drafted, this guidance was potentially confusing in light of the view that when KAM are communicated, the use of EOM paragraphs to draw attention to other matters is likely to be rare.
- If a matter that was fundamental to users' understanding of the financial statements was determined to be a KAM, users would be provided with greater detail by its inclusion in the KAM section (rather than what would have been required for an EOM paragraph in extant ISA 706) and differentiation would be less important. However, two Board members were of the view that the auditor should always be required to explain that the matter was fundamental to users' understanding.
- It may not be necessary to require the auditor to explicitly note in the auditor's report that an EOM paragraph was included because, in the auditor's judgment, it is fundamental to users' understanding of the financial statements, in particular when KAM are not required to be communicated in the auditor's report (i.e., for other than listed entities).

Ms. de Beer noted that the retention of EOM paragraphs was supported at the March 2014 CAG meeting, with similar advice given as to the need to take appropriate steps, including clarifications within proposed ISA 701, to ensure that users will understand the relationship between EOM paragraphs and KAM. The CAG has also previously acknowledged that while the primary purpose of communicating KAM is to provide transparency about the audit that was performed, it would be useful if the auditor would take cognizance of information of interest to the user, in order for such communication to also assist intended users of the financial statements in understanding the entity and areas of significant management judgment in the audited financial statements.

The Board will consider revised drafts of ISAs 260 (Revised) and 706 (Revised) for approval at its September 2014 meeting.

Objectives of the Discussion

The following are the objectives of the IAASB discussion at its September 2014 meeting:

- Discuss and finalize the requirement and related application material addressing circumstances in which a matter determined to be a KAM is not communicated in the auditor's report.
- Approve the revised draft of ISA 701 as a final standard.
- Consider additional proposed revisions to ISA 706 in response to the IAASB's June 2014 discussions and approve as a final standard.
- Approve proposed revisions to ISA 700 (Revised), ISA 705 (Revised) and ISA 260 (Revised) relating to KAM.

I. Communicating KAM – Circumstances in Which a Matter Determined to Be a KAM Is Not Communicated in the Auditor's Report

A. Drafting Team Recommendations

1. In light of the IAASB's feedback at its June 2014 meeting, DT-701 has continued to refine the new requirement and related application material in proposed ISA 701 addressing circumstances in which a matter determined to be a KAM is not communicated in the auditor's report. DT-701's proposed changes are included in paragraphs 14 and A52–A61 of **Agenda Item 2-B**.
2. In this regard, the IAASB agreed that such circumstances should be:
 - Linked first to the possibility that law or regulation preclude public disclosure about the matter; and
 - Extremely rare, taking into account the severity of adverse consequences of such communication.

The Board asked DT-701 to further consider how this concept could be best articulated in the standard, including whether the requirement or application material should further elaborate on the concept of harm to the entity. At its March 2014 meeting, the CAG was supportive of including the requirement in the standard to address when a KAM might not be communicated, but expressed a view that the circumstances in which the auditor might decide not to communicate a KAM should be very restrictive.

3. DT-701 believes that establishing appropriate parameters within the final standard is necessary to ensure that this provision is not used when it would be inappropriate to do so, in light of the purpose of communicating KAM in the auditor's report (i.e., to provide greater transparency about the audit that was performed). DT-701 is therefore of the view that proposed ISA 701 should be very clear in highlighting that, unless law or regulation preclude disclosure, circumstances in which the auditor would judge it necessary to not communicate a KAM in the auditor's report are expected to be extremely rare, with the decision to not communicate being based on the facts and circumstances of the entity and the audit, and involving discussion with TCWG.

⁸ Proposed ISA 260 (Revised), *Communication with Those Charged with Governance*

Proposed Requirement

4. DT-701 has also further considered the level of prescription needed in the requirement, including whether the requirement should further elaborate on the concept of harm to the entity, against the practical challenges that may arise from too much specificity due to differing legal and regulatory frameworks in various jurisdictions. While the concept of adverse consequences as the rationale for not communicating a KAM has been retained in the proposed requirement, DT-701 is of the view that it is necessary to focus the auditor on the principles to be taken into account in potentially making a determination not to communicate a KAM in the auditor's report. Of note:
- The requirement itself is first premised on the fact that if law or regulation preclude public disclosure about the matter, then the auditor would not be required to communicate the KAM. This overarching premise was viewed as a useful threshold by the IAASB, CAG and others, as it acknowledges the interaction with applicable laws and regulations. (See paragraph A52.)
 - Importantly, DT-701 is of the view that, if there is public disclosure about a matter, whether in the financial statements, another section of the annual report, or elsewhere, communication about the matter in the auditor's report generally would not be expected to lead to adverse consequences and the auditor may take into account relevant publicly available information in describing a key audit matter (see paragraph A54).
 - Absent law or regulation precluding public disclosure about the matter, the intent of the proposed requirement in paragraph 14(b) is therefore to focus the auditor's judgment about whether a KAM should not be communicated in the auditor's report on only a matter(s) "that has not otherwise been publicly disclosed."
 - When a matter has not been publicly disclosed, a key aspect of the auditor's judgment about whether the KAM should not be communicated relates to management's assertion as to why public disclosure about the matter is not appropriate, as well as the views of TCWG in relation to this assertion.
 - Communication with TCWG is therefore required by paragraph 17(a) of proposed ISA 701 to inform the auditor's determination that communicating the KAM would reasonably be expected to result in adverse consequences. Application material has been included to explain how such communications may be of benefit to the auditor in making the determination to not communicate a KAM in the auditor's report, in particular the possibility that management and TCWG may voluntarily provide disclosure about the matter (see further discussion in the second bullet of paragraph 8 below).
 - DT-701 considered that using more specific terms than "adverse consequences" could make the requirement even more difficult to implement in practice, in particular if it were viewed as the auditor making a legal determination. DT-701 also notes that this construct is similar to that used in proposed ISA 700 (Revised) in relation to the rare circumstances when the name of the engagement partner would not be included in the auditor's report.

5. In addition, other requirements in proposed ISA 701 and ISA 220⁹ further support the application of this requirement and the related auditor judgments. For example:
- Paragraph 17(a) of proposed ISA 701 requires the auditor to communicate all matters determined to be KAM to TCWG, including those that the auditor has determined should not be communicated in accordance with paragraph 14.
 - Paragraph 18(c) of proposed ISA 701 requires the auditor to document the rationale for the auditor's determination not to communicate in the auditor's report a matter determined to be a key audit matter.
 - ISA 220¹⁰ requires discussion with the engagement quality control reviewer (EQCR) when the auditor decides not to communicate a KAM.

Interaction with Relevant Ethical Requirements

6. DT-701 was also asked to further clarify the auditor's consideration of relevant ethical requirements in potentially concluding not to communicate a matter determined to be a KAM. DT-701 notes that relevant ethical requirements may be embedded in law or regulation, in which case paragraph 14(a) would apply if such ethical requirements preclude public disclosure. However, regardless of whether relevant ethical requirements are embedded in law or regulation, it may not be clear whether the auditor might breach a requirement within those requirements by communicating a KAM, so thoughtful analysis, involving the exercise of professional judgment will likely be needed by the auditor in making the determination as to whether communication of a matter in the auditor's report would be precluded by relevant ethical requirements. In addition, the auditor may consider it appropriate to seek legal advice.
7. Input from the International Ethics Standards Board for Accountants (IESBA) Planning Committee was that communication of KAM would not be prohibited by the *Code of Ethics for Professional Accountants* (IESBA Code), because the duty of confidentiality under the IESBA Code would not override a professional duty to disclose client information to comply with technical standards (e.g., the ISAs). However, notwithstanding this input, discussion with national auditing standards setters (NSS) and the Board has highlighted the need to allow for flexibility for the auditor to consider the interactions and relationships between the requirements in proposed ISA 701 and relevant ethical requirements other than the IESBA Code, as other codes might not be interpreted or applied in the same manner. Paragraph A53 of proposed ISA 701 therefore acknowledges that it may be necessary for the auditor to consider the implications of communicating about a matter determined to be a key audit matter in light of the relevant ethical requirements and the facts and circumstances of the engagement. DT-701 is of the view that providing additional guidance in an international standard would be difficult in light of the potential approaches taken by ethical codes other than the IESBA Code, and is of the view that further guidance would best be addressed by NSS in the context of their respective jurisdictions and applicable ethical requirements.

⁹ ISA 220, *Quality Control for an Audit of Financial Statements*

¹⁰ ISA 220, paragraphs 20 and A27

Application Material in Support of the Proposed Requirement

8. Robust application material has also been developed to support the requirement addressing circumstances in which a KAM may not be communicated and to elaborate on the auditor's decision-making process. In particular:
- The application material highlights the notion of the auditor considering whether it is possible to communicate a matter in the auditor's report in such a way that would mitigate concerns about adverse consequences. Previous DT-701, IAASB and CAG discussions have suggested that the presumption in the ISA should be that the auditor cannot decide not to communicate a matter determined to be a KAM unless the auditor has first considered, in light of the facts and circumstances related to the matter, whether it would be possible to describe the matter in an appropriate manner (including in a more general way), and has nevertheless concluded that it is not possible to do so. The likelihood of the auditor being able to communicate a sensitive KAM in an appropriate manner increases if management or TCWG have decided to include additional information in the financial statements or elsewhere in the annual report about the matter.
 - Application material also explains that the auditor's judgment regarding the decision not to communicate a KAM in the auditor's report is informed by required communication with TCWG in accordance with paragraph 17(a). These required discussions are firstly aimed at assisting the auditor in finding a way of communicating about a matter in the auditor's report rather than deciding not to communicate the matter at all (i.e., exhausting other possible options). (See paragraphs A56–A59.)
 - The first possibility is that communication with management and TCWG helps the auditor to understand why management has not disclosed a matter. Previously, the CAG and DT-701 have generally agreed that, if the applicable financial reporting framework or law or regulation allows for delayed disclosure about a matter, the auditor should not override management's decision in that regard by communicating the matter as a KAM before management has made any disclosures about the matter.
 - The second possibility is that management or TCWG decides to include information about the matter either in the financial statements or elsewhere, such as in another section of the annual report. Reference within proposed ISA 701 to disclosing such information elsewhere acknowledges the possibility that, while disclosure in the financial statements about the matter may not be required by the applicable financial reporting framework, management has a responsibility to provide information that is relevant to users.
 - A third possibility is that, in communicating with management and TCWG, the auditor may become aware of ongoing communications related to the matter between the entity and regulatory, enforcement or supervisory authorities ("authorities"). Discussion with management and TCWG, or direct communications between the auditor and the applicable authorities, may provide the auditor with additional perspective on whether communication in the auditor's report about the matter could result in adverse consequences, for example by negatively affecting the entity's ability to resolve the matter. Proposed ISA 701 also highlights that the auditor may be required or may otherwise consider it appropriate to communicate with applicable authorities in relation

to the matter, regardless of whether the matter is communicated in the auditor's report. On balance, DT-701 was of the view that describing the potential need for the auditor to discuss the possibility of not communicating a KAM in the auditor's report with others was an appropriate way to highlight the importance of those discussions without implying that they could be used as a substitute for communication in the auditor's report.

9. Further guidance is also included to describe the concepts of "extremely rare circumstances" and "the significance of adverse consequences that can reasonably be expected to arise as a result of such communication" (see paragraphs A57–A59). DT-701 considered feedback received from various Board members at the June 2014 IAASB meeting, as well as the CAG, in developing this material. Such guidance highlights that the auditor may determine that communicating information in the auditor's report about a matter that is not otherwise publicly disclosed, while potentially informative to intended users, nevertheless is inappropriate in view of the significance of the adverse consequences that can reasonably be expected to arise as a result of such communication.
10. DT-701 considered how best to highlight the balance that the auditor would be expected to consider between the benefit of communicating a KAM in the auditor's report with the potential adverse consequences of such a communication, recognizing there may be significant public interest implications involved in both communicating and deciding not to communicate. Paragraph A57 of proposed ISA 701 explains that the likely adverse consequences on the entity, the public or an individual could be so significant such that communication by the auditor of the matter is unjustified, notwithstanding the potential public interest benefits of making the communication. Therefore, in making a judgment to not communicate a KAM in the auditor's report, the auditor takes into account:
 - The facts and circumstances in relation to the matter.
 - Management's assertion as to why public disclosure about the matter is not appropriate, as well as the views of TCWG in relation to this assertion.

In addition, the auditor may consider it appropriate to obtain legal advice to inform the auditor's judgment that a matter should not be communicated in the auditor's report.

11. As agreed during the June 2014 IAASB discussion of Updated Agenda Item 4-B, DT-701 has deleted the illustrative examples of potential circumstances to which this requirement might apply, as concern was expressed that including examples could lead to a greater proliferation of non-communication about these matters. However, the example explaining how the auditor may describe KAM relating to going concern when the auditor concludes that no material uncertainty exists relating to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern has been retained (see paragraph A55). Previous discussions with the IAASB and the CAG have highlighted the need to deal more explicitly with "close calls" in relation to going concern and, as drafted, DT-701 believes this guidance illustrates how matters relevant to this judgment and that may be viewed as "sensitive matters" can be appropriately communicated in the auditor's report.

Summary

12. On balance, DT-701 believes the proposed requirement and related application material appropriately respond to the concerns expressed both by the IAASB and the CAG that any requirement addressing the possibility that the auditor would decide not to communicate a KAM in the auditor's report should occur only when law or regulation preclude communication about a matter or, when there is no such preclusion, only in extremely rare circumstances and with a sufficient

process around this determination. The removal of examples of “sensitive matters”, and new guidance explaining what would not constitute adverse consequences (such as legal liability or legal, regulatory or professional sanctions that may validly arise for the entity, the auditor or the firm, or negative market reactions to information provided about the matter), serves to reiterate the Board’s intent to restrict the application of this requirement. Safeguards such as documentation requirements to address the rationale for the determination and required consideration by the engagement quality control reviewer of the applicable judgments are also likely to be help in practice by limiting the application of this requirement to those circumstances in which it is appropriate to apply it.

13. DT-701 supports moving forward with the proposed requirement and related application material in response to comments received on ED, as well as input from IAASB and CAG discussions. However, DT-701 notes that this will be an area that is likely to attract significant attention during the post-implementation review, in particular if regulators and audit oversight bodies find that auditors’ decisions not to communicate KAM in the auditor’s report are occurring beyond “extremely rare circumstances.”

Matter for IAASB Consideration

1. The IAASB is asked for its views on the revised requirement and application material in proposed ISA 701 developed to acknowledge the extremely rare circumstances in which, having considered all relevant facts and circumstances, the auditor may decide not to communicate a matter determined to be a KAM in the auditor’s report.

II. Other Changes Proposed to ISA 701

A. Drafting Team Recommendations

14. Recognizing the IAASB’s broad support for the revisions proposed in Updated Agenda Item 4-B discussed during the June 2014 IAASB meeting, DT-701’s efforts in relation to the other requirements and related application material in proposed ISA 701 were focused on matters of clarity, responding to comments made during the Board discussion, and review of editorial comments provided off-line. DT-701 also agreed to reorder the requirements to reflect a more logical flow and to add additional subheadings within the Requirements section to describe key elements of the auditor’s thought process when communicating KAM.
15. The following highlights the rationale for the remaining changes proposed to the requirements in proposed ISA 701 (**Agenda Item 2-B**).
 - The requirement in paragraph 9 has been amended slightly to link to the existing concepts in the ISAs, including the concept of accounting estimates that have been identified as having high estimation uncertainty discussed in ISA 540,¹¹ which further aligns with how such concepts were addressed in application material.
 - Changes were made to the requirement in paragraph 12 to align the wording more closely with a similar requirement in proposed ISA 706 (Revised) in relation to the need for the auditor to obtain sufficient appropriate audit evidence that a matter determined to be KAM is not materially misstated in the financial statements.

¹¹ ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

- A requirement (which was included in the ED) has been reinstated addressing circumstances when the auditor expresses a qualified or adverse opinion or 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. This requirement (paragraph 15) now indicates that these matters are by their nature KAM, a point that was previously included in application material. The requirement also indicates that these matters are not presented in the KAM section of the auditor's report, but rather in the "Basis for Qualified (or Adverse) Opinion" or the "Material Uncertainty Related to Going Concern" section(s), with a reference to these sections in the KAM section. On balance, DT-701 believes that this requirement addresses the interaction of KAM with these other matters in the auditor's report.
- Paragraph 16 was revised to respond to concerns expressed at the June 2014 IAASB meeting that it was unclear whether the requirement would apply in circumstances where the auditor determines that there is only one KAM and, in accordance with paragraph 14, has determined that this KAM should not be communicated in the auditor's report. Application material in paragraphs A62–A65 provides further guidance.

Matter for IAASB Consideration

2. The IAASB is asked for its views on the revisions to the other requirements and related guidance in proposed ISA 701.

III. Changes to Proposed ISA 700 (Revised) and Proposed ISA 705 (Revised) Relating to the Application of Proposed ISA 701

A. Drafting Team Recommendations

Changes to Proposed ISA 700 (Revised)

Requirement to Communicate KAM

16. At its June 2014 meeting, the IAASB agreed to limit the requirement to communicate KAM to audits of complete sets of general purpose financial statements of listed entities, but allow for voluntary application by other entities. A revised requirement and related application material was considered during the meeting, and generally supported. However, minor editorial changes were suggested, which DT-701 supports. See paragraphs 30–31 of proposed ISA 700 (Revised) and related application material (**Agenda Item 4-B**).
17. The IAASB also agreed to revise application material in ISA 210¹² addressing voluntary application of proposed ISA 701. Changes from the June 2014 Agenda Material are shown in marked text in Section I.A. of **Agenda Item 2-F**.

Auditor's Report Prescribed by Law or Regulation

18. At its June 2014 meeting, the IAASB agreed to retain the flexibility permitted by proposed ISA 700 (Revised) in relation to key audit matters when law or regulation prescribes the form and content of the auditor's report, and supported the changes that were presented during the meeting. No further

¹² ISA 210, *Agreeing the Terms of Audit Engagements*

changes are considered necessary. See paragraph 50(h) and related application material of proposed ISA 700 (Revised).

Requirement to Describe the Auditor's Responsibilities When KAM Are Communicated

19. At its June 2014 meeting, the IAASB agreed to require a statement in the auditor's report to describe the auditor's responsibilities in relation to KAM in all circumstances when proposed ISA 701 applies, in order to provide transparency in circumstances when a matter determined to be a KAM is not communicated. Minor changes are needed to the turnaround version of proposed ISA 700 (Revised) discussed at the IAASB meeting to align with the changes in proposed ISA 701. DT-701 is recommending further changes to align with the requirements in paragraphs 9 and 14 of proposed ISA 701. See paragraph 40(c) and related application material of proposed ISA 700 (Revised).

Changes to Proposed ISA 705 (Revised)

20. The IAASB also agreed to continue to prohibit communication of KAM when the auditor disclaims an opinion on the financial statements, but decided to retain the position in the ED to require communication of KAM when the auditor expresses an adverse opinion. The Board was generally of the view that, because the auditor is able to complete the audit in such circumstances, there may be additional matters that may be relevant to the intended users' understanding of the audit. The Board asked the Drafting Teams to further consider the appropriate placement of the material relating to disclaimers of opinion, in order to simplify and avoid duplication where possible.
21. Both DT-701 and DT-700 agree it would be appropriate to retain within proposed ISA 705 (Revised) the requirement relating to the prohibition on communicating KAM. This is included as paragraph 29 of proposed ISA 705 (Revised) (**Agenda Item 4-C**), with further guidance in paragraph A26.
22. Within proposed ISA 701, application material refers to the underlying requirement in proposed ISA 705 (Revised) (see paragraph A7 of proposed ISA 701) and also highlights the importance that language used in the description of a key audit matter does not contain or imply discrete opinions on separate elements of the financial statements, which may be particularly relevant in circumstances where the auditor has expressed an adverse opinion on the financial statements as a whole, but has determined one or more matters other than the matter giving rise to the adverse opinion to be key audit matters (see paragraph A47 of proposed ISA 701).

Matter for IAASB Consideration

3. The IAASB is asked for its views on the revised requirements and application material relating to proposed ISA 700 (Revised), ISA 210, and proposed ISA 705 (Revised) addressing KAM in response to the IAASB's comments at its June 2014 meeting and the changes made to proposed ISA 701.

IV. Changes to Proposed ISA 706 (Revised)

A. Drafting Team Recommendations

13. At its June 2014 meeting, the Board agreed with DT-701's recommendation to retain the possibility of auditors using EOM paragraphs even when KAM are communicated in the auditor's report. However, the Board asked DT-701 to look for ways to further differentiate the concepts of KAM and EOM, including clarifying the proposed guidance addressing the potential circumstance in which a

matter that is determined to be a KAM may also be considered fundamental to users' understanding of the financial statements.

14. In considering how best to respond to the IAASB's feedback and further refine proposed ISA 706 (Revised), DT-701 took into account the Board's thinking in developing the approach to determining and communicating KAM in accordance with proposed ISA 701 and notes the following:
 - In many instances, matters determined to be KAM will relate to matters presented or disclosed in the financial statements. In such cases, DT-701 continues to believe that communicating the matter under the new reporting model of KAM serves as the most useful and meaningful mechanism for highlighting the importance of the matter. This is because communication as a KAM is intended to provide additional information to intended users of the financial statements beyond what would be included in an EOM paragraph (i.e., more than a simple reference to the disclosure of the matter). This rationale is the basis for the requirement in paragraph 8(b) of proposed ISA 706 (Revised) (**Agenda Item 2-D**), which essentially prohibits using EOM paragraphs as a substitute for KAM.¹³ Accordingly, when KAM are communicated, EOM paragraphs are used to draw attention to *matters not meeting the definition of KAM* that are, in the auditor's judgment, fundamental to users' understanding of the financial statements.
 - Under proposed ISA 706 (Revised), the auditor is not required to make an assessment of whether each KAM would also have met the definition of an EOM paragraph. However, some respondents to the ED, and one DT-701 member, are of the view that proposed ISA 706 (Revised) should provide for the possibility that a matter determined to be a KAM is, in the auditor's judgment, fundamental to the users' understanding of the financial statements. DT-701 acknowledged that, in presenting the matter in the KAM section, the auditor may wish to highlight or draw further attention to the relative importance of the matter by, for example, presenting it more prominently than other matters in the KAM section (e.g., as the first matter) or by including additional information in the description of the key audit matter (see paragraph A2 of proposed ISA 706 (Revised)). However, DT-701 did not believe it was necessary to require that the description of the KAM include the specific wording that the matter is "fundamental to users' understanding of the financial statements," as such a requirement could be seen as blurring, rather than differentiating, KAM and EOM.
15. In light of this view, DT-701 has also reconsidered its previous recommendation to require a statement in all EOM paragraphs that, in the auditor's judgment, the matter being emphasized is fundamental to users' understanding of the financial statements," recognizing this was adding standardized language to EOM paragraphs in all cases, including for audits of other than listed entities for which ISA 701 does not apply and communication of KAM would not be required). DT-701 is now proposing that the term "Emphasis of Matter" be included in the heading of an EOM paragraph unless law or regulation prescribes a specific heading (see paragraph 9(a) of proposed ISA 706 (Revised)). DT-701 is of the view that requiring the reference to EOM in the heading is consistent with the concept in proposed ISA 700 (Revised) that greater specificity of headings is a means of increasing consistency in auditor's reports and aiding intended users in recognizing key elements of the auditor's report.

¹³ A similar prohibition is established by paragraph 10(b) of proposed ISA 706 (Revised) in relation to Other Matter (OM) paragraphs.

16. On balance, DT-701 is of the view that these proposals respond to calls to seek to further differentiate KAM and EOM paragraphs, in light of the Board's agreement of the definitions of each. There may also be further opportunities to educate users and others on how the two concepts are intended to be applied and their relationship when both elements are included in an auditor's report (e.g., through the Basis for Conclusions and other communication or educational materials).

Matters for IAASB Consideration

4. The IAASB is asked for its views on the revisions to proposed ISA 706 (Revised).

V. Other Matters

Changes to Proposed ISA 260 (Revised)

17. At its June 2014 meeting, the Board agreed revisions to ISA 260 (Revised), subject to any further changes needed to align with proposed ISA 701. DT-701 has made minor revisions as included in **Agenda Item 2-E**.

Conforming Amendment to ISA 220

18. At its June 2014 meeting, the Board supported making a conforming amendment to ISA 220 to address how the auditor's judgments relating to KAM are considered by the engagement quality control reviewer. DT-701 proposes minor changes to further clarify the new application material. See Section I.B of **Agenda Item 2-F**.

Conforming Amendments to Other ISAs

19. DT-701 notes that other minor conforming amendments related to proposed ISA 701 and proposed ISA 706 (Revised) were included in the ED. DT-701 is of the view that these conforming amendments continue to be necessary and has considered whether changes are needed to align with the final positions in proposed ISA 701 and proposed ISA 706 (Revised). See Sections I.C-I.E of **Agenda Item 2-F**.

Significant Matters Identified by DT-701

20. In DT-701's view, the significant matters it has identified as a result of its deliberations since the beginning of this project, and its considerations therein, have all been reflected in the issues papers presented to the IAASB at its meetings. In DT-701's view, there are no significant matters it has discussed in this project that have not been brought to the IAASB's attention.