

## 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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**[CLEAN]**

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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 auditor's report.
2. Communicating key audit matters provides additional information to users of the financial statements to enhance their understanding of those matters that, in the auditor's professional judgment, were of most significance in the audit. Key audit matters are selected from matters communicated with those charged with governance. Communicating key audit matters may also assist users of the financial statements in understanding the entity and areas of significant management judgment in the audited financial statements, as such matters are often areas of focus in performing the audit. (Ref: Para. A1–A2)
3. The communication of key audit matters in the auditor's report may provide users of the financial statements 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 audits of complete sets of general purpose financial statements of listed entities. It is intended to address both the auditor's judgment as to what to include and the form and content of such communication. The auditor of financial statements of a listed entity whose financial statements have been prepared in accordance with a special purpose framework is not required to comply with this ISA. However, this ISA is to be applied in those circumstances when the auditor chooses to communicate key audit matters. (Ref: Para. A3)
5. This ISA also applies when auditors of financial statements of entities other than listed entities communicate key audit matters in the auditor's report. Law or regulation may require the auditor to do so, or the auditor may choose to do so. (Ref: Para. A4–A5)
6. Law or regulation may also require the auditor to include additional communication in the auditor's report about specific matters of significance in the audit of the financial statements. If those requirements are intended to provide information that is similar to key audit matters, the requirements in this ISA relating to the form and content of such communication may be applied (see paragraph 15).

## Effective Date

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

## Objectives

8. The objectives of the auditor of the financial statements of a listed entity are to:
  - (a) Determine, from the matters communicated with those charged with governance, those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements; and
  - (b) Having formed an opinion on the financial statements, communicate those matters by describing them in the auditor's report.

9. These objectives and the requirements in this ISA also apply in circumstances when the auditor of financial statements of an entity other than a listed entity communicates key audit matters in the auditor's report (see paragraph 5).

## Definitions

10. For purposes of the ISAs, the following terms have the meaning attributed below:
- (a) *Key audit matters*—Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements.
  - (b) *Matters communicated with those charged with governance*—All matters required to be communicated by proposed ISA 260 (Revised),<sup>1</sup> 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.

## Requirements

### Determining Key Audit Matters

11. The auditor shall determine which of the matters communicated with those charged with governance are key audit matters, unless the auditor disclaims an opinion on the financial statements in accordance with proposed ISA 705 (Revised).<sup>2</sup> The determination of key audit matters relates to the audit of the financial statements of the current period and shall take into account areas of significant auditor attention or effort in performing the audit, in particular: (Ref: Para. A6–A20)
- (a) Areas identified as significant risks in accordance with ISA 315 (Revised)<sup>3</sup> or other areas assessed as having a higher risk of material misstatement or involving significant auditor judgment; (Ref: Para. A21–A24)
  - (b) Those areas in which the auditor encountered significant difficulty in performing the audit, including with respect to obtaining sufficient appropriate audit evidence; or (Ref: Para. A25–A26)
  - (c) Circumstances that required significant modification of the auditor's planned approach to the audit, including as a result of the identification of a significant deficiency in internal control. (Ref: Para. A27–A29)

### Communicating Key Audit Matters

12. The auditor shall communicate key audit matters determined in accordance with paragraph 11 in a separate section of the auditor's report under the heading "Key Audit Matters." The auditor's report shall state that:
- (a) Key audit matters are those matters communicated with [those charged with governance] that the auditor has determined, in the auditor's professional judgment, were of most significance

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<sup>1</sup> Proposed ISA 260 (Revised), *Communication with Those Charged with Governance*

<sup>2</sup> Proposed ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*, paragraphs 9–10

<sup>3</sup> ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

in the audit of the financial statements [of the current period], but are not intended to represent all matters that were discussed with them;

- (b) The auditor has determined the matters described to be key audit matters;
  - (c) The auditor's procedures relating to these matters were designed in the context of the audit of the financial statements as a whole; and
  - (d) The auditor's opinion on the financial statements is not modified with respect to any of the key audit matters, and the auditor does not express an opinion on these individual matters. (Ref: Para. A30–A32)
13. Except in the circumstances described in paragraph 14, the auditor shall describe the key audit matters in the Key Audit Matters section using an appropriate subheading for each matter. The description of each key audit matter shall include: (Ref: Para. A33–A34)
- (a) An explanation of why the auditor considered the matter to be of most significance in the audit and, to the extent necessary, its effect on the audit; and (Ref: Para. A35–A42)
  - (b) Where applicable, a reference to management's disclosure about the matter in the financial statements. (Ref: Para. A43–A45)

*Interaction between Descriptions of Key Audit Matters and Other Sections Required to Be Included in the Auditor's Report*

14. When the auditor expresses a qualified or adverse opinion in accordance with proposed ISA 705 (Revised),<sup>4</sup> or a material uncertainty relating to going concern has been identified in accordance with proposed ISA 570 (Revised),<sup>5</sup> the auditor shall:
- (a) Report on the matter(s) in accordance with the applicable ISA(s);
  - (b) Not describe these matter(s) in the Key Audit Matters section of the auditor's report; and
  - (c) Include a reference to the Basis for Qualified (or Adverse) Opinion or the Going Concern section(s) in the introductory language of the Key Audit Matters section. (Ref: Para. A46–A47)

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

15. Law or regulation may require the auditor to provide information similar to key audit matters or may require those charged with governance to issue a report that includes similar information. In such circumstances, 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 12 to explain why the information is being provided, for example by making reference to the relevant law or regulation;
  - (c) Where applicable, consider the implications of the circumstances addressed by paragraph 14 and include appropriate cross-references to other sections of the auditor's report;

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<sup>4</sup> Proposed ISA 705 (Revised), paragraphs 7–8

<sup>5</sup> Proposed ISA 570 (Revised), *Going Concern*, paragraphs 21–23

- (d) Provide a description of the matter as required by paragraph 13 of this ISA, or to the extent appropriate, a cross-reference to the description of the matter in the report issued by those charged with governance, unless law or regulation prescribes the nature and extent of the description of the matter. (Ref: Para. A48–A50)

#### *Communication with Those Charged with Governance*

- 16. The auditor shall communicate with those charged with governance those matters the auditor has determined are key audit matters to be included in the auditor's report, and how such matters will be described. (Ref: Para. A51)

#### **Circumstances in which the Auditor Has Determined There Are No Key Audit Matters**

- 17. When the auditor determines that there are no key audit matters to communicate in the auditor's report, the auditor shall:
  - (a) Discuss this conclusion with the engagement quality control reviewer, for those engagements where one has been appointed;
  - (b) Communicate this conclusion with those charged with governance; and
  - (c) State in the auditor's report that this section of the auditor's report is intended to describe matters communicated with those charged with governance that the auditor has determined, in the auditor's professional judgment, were of most significance in the audit of the financial statements and the auditor has determined that there are no matters to report. (Ref: Para. A52–A53)

#### **Documentation**

- 18. The determination of key audit matters is a significant professional judgment that shall be documented in accordance with ISA 230.<sup>6</sup> When applicable, this documentation shall include the rationale for the auditor's conclusion that there are no key audit matters to communicate in the auditor's report.

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#### **Application and Other Explanatory Material**

##### **Scope of this ISA (Ref: Para. 2–4)**

- A1. Significance can be described 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. 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. Users of the financial statements have expressed 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. Therefore, a focus on “matters of most

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<sup>6</sup> ISA 230, *Audit Documentation*, paragraph 8

significance in the audit” and the application of the requirement in paragraph 11 of this ISA is intended to result in the auditor reporting on matters that are likely to be of interest to users.

- A2. ISA 320<sup>7</sup> 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.

- A3. Reference to a listed entity is intended to mean 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.

*Communicating Key Audit Matters for Entities Other than Listed Entities (Ref: Para. 5)*

- A4. Auditors of entities other than listed entities are not precluded from including a section describing key audit matters in the auditor’s report, unless prohibited by law or regulation. 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 arrangements of the entity and relevant law or regulation.<sup>8</sup> Acknowledging the possibility of communicating key audit matters in the auditor’s report at the commencement of the audit makes management and those charged with governance aware of the fact that the auditor may choose to do so.

Considerations Specific to Public Sector Entities

- A5. Public sector entities may be significant due to size, complexity or public interest aspects, and may have a wide range of stakeholders. In such cases, an auditor of such an entity may choose, or may be required by law, regulation or the mandate of a supreme audit institution, to communicate key audit matters in the auditor’s report.

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<sup>7</sup> ISA 320, *Materiality in Planning and Performing the Audit*

<sup>8</sup> ISA 210, *Agreeing the Terms of Audit Engagements*, paragraphs 9 and A21

## Determining Key Audit Matters

### *Relationship between Key Audit Matters and the Auditor's Opinion (Ref: Para. 11)*

- A6. As noted in paragraph 8, the objectives to determine and communicate key audit matters in the auditor's report are 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 matters; 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 proposed ISA 705 (Revised)).
- A7. Matters giving rise to a modification of the auditor's opinion are, by their nature, key audit matters, notwithstanding that such matters are not presented in the Key Audit Matters section of the auditor's report (see paragraphs 14 and A46).
- A8. When the auditor disclaims an opinion on the financial statements, the auditor is required to describe in the Basis for Opinion section of the auditor's report the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion, and the effects thereof.<sup>9</sup> Any discussion of key audit matters other than the matter(s) giving rise to the disclaimer of opinion may suggest the financial statements are more credible in relation to those matters than would be appropriate in the circumstances and would be inconsistent with the disclaimer of an opinion on the financial statements as a whole.
- A9. However, when the auditor is expressing a qualified or adverse opinion, a discussion of any other key audit matters would still be relevant to enhancing users' understanding of the audit and therefore the requirement in paragraph 11 applies.

### *The Auditor's Decision-Making Process to Determine Key Audit Matters (Ref: Para. 11)*

- A10. The auditor's decision-making process in determining key audit matters is designed to narrow the matters communicated 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. This enables the communication of key audit matters in the auditor's report to highlight for users areas of significant auditor attention or effort in the audit, and provide transparency about significant judgments made by the auditor in planning and performing the audit, in obtaining sufficient appropriate audit evidence, and in forming the opinion on the financial statements as a whole. Areas of significant auditor attention or effort in planning and performing the audit are often related to the areas of significant management judgment in preparing the financial statements.
- A11. Determining the 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, including the nature and extent of communication with those charged with governance. For example, the auditor may find it necessary to have more in-depth and frequent communications with those charged with governance on more difficult and complex matters.

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<sup>9</sup> See paragraph 27 of proposed ISA 705 (Revised).

## Considerations Relevant to Determining the Significance of Individual Matters

- A12. Paragraph 11 includes factors that are required to be taken into account in determining key audit matters. One or more of these factors may be applicable in the context of a matter, as the factors may be interrelated. This in turn influences the likelihood of the auditor identifying it as a key audit matter.
- A13. In addition to the factors included in paragraph 11, considerations that may be relevant to determining the significance of a matter communicated with those charged with governance and whether such matter is a key audit matter include:
- The industry in which the entity operates. There may be areas of complexity in financial reporting that are specific to a particular industry, or accounting policies unique to that industry.
  - Recent significant economic, accounting, regulatory or other developments. For example, significant changes to the economic environment that affected management's assumptions or judgments, or the auditor's approach, may cause the auditor to determine that a matter is a key audit matter.
  - Whether the matter involved a number of separate, but related, auditing considerations. For example, the audit of long-term contracts may involve significant auditor attention or effort with respect to revenue recognition, litigation or other contingencies, and the effect on other accounting estimates.
  - Whether the auditor determined it was necessary to obtain written representation from management to support other audit evidence relevant to the matter or one or more specific assertions in the financial statements relating to the matter.<sup>10</sup> For example, such written representations may include representations about plans or intentions that may affect the carrying value or classification of assets and liabilities.
- A14. 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 audit. The auditor's decision-making process also is not intended to be a discrete consideration at a point in time, but is linked to the auditor's understanding of the entity and its environment, the auditor's risk assessment and response, and the auditor's communications with those charged with governance throughout the audit. The auditor may develop a preliminary view at the planning stage about matters that are likely to be the key audit matters in the audit and may communicate this with those charged with governance when discussing the planned scope and timing of the audit in accordance with proposed ISA 260 (Revised).
- A15. The auditor's determination and communication of key audit matters is limited to those matters of most significance in the most recent period presented in the financial statements, even when comparative financial statements are presented (i.e., the auditor's opinion refers to each period for which financial statements are presented).<sup>11</sup> Users are interested in the most recent information possible to make informed decisions, and therefore are more likely to value information from the auditor about matters of significance in the audit of the current period rather than prior periods. In

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<sup>10</sup> See ISA 580, *Written Representations*.

<sup>11</sup> See ISA 710, *Comparative Information—Corresponding Figures and Comparative Financial Statements*.

addition, because the factors affecting the auditor's judgment in determining key audit matters may differ from year to year, communicating about key audit matters is most valuable to users when it relates to the audit of the most recent period. When comparative financial information is presented, paragraph 12(a) requires the introductory language of the Key Audit Matters section to draw attention to the fact that the key audit matters described relate to only the audit of the financial statements of the current period, which may include reference to the specific date (e.g., "for the year ended December 31, 20X1").

- A16. Notwithstanding that the auditor's decision-making is in the context of the audit of the financial statements of the current period, it may nevertheless be useful for the auditor to consider whether a matter was a key audit matter in the prior year's audit in determining key audit matters in accordance with paragraph 11. For example, the auditor may consider whether any economic conditions or entity-specific circumstances that led to a matter being determined as a key audit matter in the prior year continue to exist. It may also be appropriate for the auditor to consider whether key audit matters in the prior year have been resolved, for example if the effects of a significant unusual transaction in the prior year are not material in the current year. Finally, it may be the case that, while a matter communicated as a key audit matter in the prior year continues to affect the financial statements of the current period, other matters arising during the current year audit may be considered to be more significant and the prior year key audit matter may not, in the auditor's judgment, meet the threshold of "most significance" in the current year's audit on a relative basis.
- A17. The number of matters to be included in the auditor's report is affected by the size and complexity of the entity, the nature of its business and environment, and the facts and circumstances of the audit engagement. In general, the greater the number of key audit matters, the less relevant the auditor's communication of key audit matters may be. When the auditor has determined a long list of key audit matters, the auditor may need to reconsider whether each of these matters meets the definition of a key audit matter and therefore would be relevant to users' understanding of matters of most significance in the audit.
- A18. Proposed ISA 706 (Revised)<sup>12</sup> establishes mechanisms for auditors of all entities to include additional communication in the auditor's report through the use of Emphasis of Matter and Other Matter paragraphs when the auditor considers it necessary to do so. In the case of a listed entity, the use of such paragraphs is incremental to the auditor's communication of key audit matters and therefore is not intended to be a substitute for a description of individual matters as key audit matters determined in accordance with paragraph 11 of this ISA.

#### Areas of Significant Auditor Attention or Effort (Ref: Para. 11)

- A19. The concept of significant auditor attention or effort relates to the allocation of resources or extent of audit effort in relation to a particular matter, including the extent of involvement of senior personnel on the audit engagement. The auditor may also have considered it necessary to involve persons with expertise in a specialized area of accounting or auditing, whether engaged or employed by the firm, on the engagement. Matters for which significant hours were incurred by the engagement partner, or an auditor's expert, may be key audit matters.

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<sup>12</sup> Proposed ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*

A20. ISA 220 establishes requirements for the engagement partner in relation to undertaking appropriate consultation on difficult or contentious matters and discussion of, among other things, significant matters arising during the audit engagement with the engagement quality control reviewer.<sup>13</sup> Matters discussed with, or evaluated by,<sup>14</sup> the engagement quality control reviewer, in particular those involving consultation, may be considered key audit matters. The auditor also may have consulted with others within the firm on significant technical and other matters. The need for consultation outside of the engagement team on a particular matter may be an indicator that it is a key audit matter.

Significant risks (Ref: Para. 11(a))

A21. Paragraph 15 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 and significant unusual transactions may often be identified as significant risks. The auditor also may discuss how the auditor addressed other identified risks of material misstatement beyond those identified as significant risks, in particular those assessed as having a higher risk of material misstatement. However, the identification of a matter as a significant risk, including a matter identified as a significant risk due to fraud, does not necessarily mean that such a matter will be determined as a key audit matter.

A22. In determining whether matters identified as significant risks are key audit matters, it may be relevant for the auditor to consider whether the matter is presumed in the ISAs to be a significant risk or whether the auditor has specifically identified the matter as a significant risk in the context of the entity and the audit. For example, ISA 240 presumes that there are risks of fraud in revenue recognition and requires the auditor to treat those assessed risks of material misstatement due to fraud as significant risks.<sup>15</sup> In addition, ISA 240 indicates that, due to the unpredictable way in which management override of controls could occur, it is a risk of material misstatement due to fraud and thus a significant risk.<sup>16</sup> The auditor may determine that a fraud risk specifically identified in the context of the entity and the audit is a key audit matter, especially if other factors in paragraph 11 also apply. However, explicit disclosure of fraud risks in the auditor's report is likely to be a sensitive matter, in particular if no material misstatement due to fraud was detected. In such cases, the auditor may consider whether an explicit reference to fraud risk in the description of key audit matters is necessary to explain why the matter was of most significance of the audit. For example, the description of the matter in accordance with paragraph 13 may refer to the underlying financial statement item and the auditor's work thereon, and not explicitly indicate that the matter was identified as a risk of material misstatement due to fraud.

A23. 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.<sup>17</sup> In many cases, this relates to critical accounting estimates and related disclosures,

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<sup>13</sup> ISA 220, *Quality Control for an Audit of Financial Statements*, paragraphs 18–19.

<sup>14</sup> ISA 220, paragraph 20

<sup>15</sup> ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraphs 26–27

<sup>16</sup> ISA 240, paragraph 31

<sup>17</sup> Proposed ISA 260 (Revised), paragraph 16(a)

which are likely to be areas of significant auditor attention or effort, and may be identified as significant risks. 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, may require the involvement of both a management's expert and an auditor's expert, and may be identified as significant risks.<sup>18</sup> As a result, these areas of the audit may be considered key audit matters.

- A24. Significant unusual transactions, including significant transactions with related parties, and the auditor's response to them, also may be key audit matters about which communication in the auditor's report would be useful. When such a transaction exists, management or those charged with governance may have communicated 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 recognition, measurement, presentation or disclosure of the transaction.

Significant difficulty in performing the audit, including difficulty encountered in obtaining sufficient appropriate audit evidence (Ref: Para. 11(b))

- A25. Proposed ISA 260 (Revised) requires the auditor to communicate significant difficulties encountered during the audit to those charged with governance.<sup>19</sup> The ISAs acknowledge potential difficulties in relation to, for example:

- Related party transactions,<sup>20</sup> 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 a similar 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.<sup>21</sup>
- Extensive effort required to obtain sufficient appropriate audit evidence.<sup>22</sup>

The auditor may also communicate with those charged with governance about significant difficulties encountered when obtaining sufficient appropriate audit evidence relating to critical accounting estimates made by management or a management's expert.

- A26. In some circumstances, difficulties encountered during the audit may constitute a scope limitation that requires a modification of the auditor's opinion.<sup>23</sup> As noted in paragraph A7, a matter giving rise to a modification of the auditor's opinion is, by its nature, a key audit matter. However, because of the importance of communicating to users the reasons for the modifications of the option, the description of the key audit matter leading to the modified opinion is presented in the Basis for

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<sup>18</sup> See paragraph 11 of ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*.

<sup>19</sup> Proposed ISA 260 (Revised), paragraph 16(b)

<sup>20</sup> ISA 550, *Related Parties*, paragraph A42

<sup>21</sup> ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, paragraph 49(d)

<sup>22</sup> Proposed ISA 260 (Revised), paragraph A22

<sup>23</sup> See paragraph A8 of ISA 705 (Revised).

Qualified (or Adverse) Opinion section of the auditor's report instead of the Key Audit Matters section (see paragraph 14).

Circumstances that required significant modification of the auditor's planned approach to the audit (Ref: Para. 11(c))

- A27. Revision to the auditor's risk assessment and reevaluation of the planned audit procedures with respect to a particular area of the financial statements (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 that the matter is a key audit matter. ISA 315 (Revised) 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.<sup>24</sup> Difficulties in obtaining audit evidence, as contemplated by paragraph 11(b), may cause the auditor to reevaluate the planned audit approach. 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 beyond those originally contemplated.
- A28. 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.<sup>25</sup> The auditor is not required by the ISAs to report externally on significant deficiencies in internal control identified during the audit.
- A29. However, the auditor may determine that the identification of a significant deficiency in relation to a matter may constitute a key audit matter, especially if other factors in paragraph 11 are relevant or there are risks of material misstatement for which the auditor is not able to obtain sufficient appropriate audit evidence through substantive audit procedures alone. For example, when deviations from controls upon which the auditor intends to rely are detected, ISA 330<sup>26</sup> requires the auditor to understand these matters and their potential consequences and determine whether the auditor can rely on those controls or whether additional audit procedures are necessary. Rather than explicitly stating that a significant deficiency was identified, the auditor's communication about the matter in accordance with paragraph 13 may focus on the implications of significant deficiencies on the audit scope and strategy, for example by explaining that certain additional audit procedures were performed in the circumstances.

## Communicating Key Audit Matters

*Placement in the Auditor's Report* (Ref: Para. 12)

- A30. Because the additional information about key audit matters 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 audit, and enables the engagement-specific information in the auditor's report to be easily recognized by users.

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<sup>24</sup> ISA 315 (Revised), paragraph 31

<sup>25</sup> ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*, paragraph 9

<sup>26</sup> ISA 330, paragraph 17

A31. Except as required by paragraph 15, 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 in paragraph 12 to include subheadings is intended to further differentiate the matters.

*Introductory Language in the Key Audit Matters Section* (Ref: Para. 12)

A32. Illustration 1 of the Appendix to proposed ISA 700 (Revised)<sup>27</sup> includes an illustration of key audit matters in the auditor's report when the auditor of financial statements of a listed entity expresses an unmodified opinion on the financial statements.

*Nature and Extent of the Descriptions of Key Audit Matters in the Auditor's Report* (Ref: Para. 13)

A33. The sufficiency and appropriateness of the descriptions of key audit matters is a matter of professional judgment, but is intended to provide a succinct explanation to enable users of the financial statements to understand why the matter was of significance in the audit that was performed and, to the extent necessary, its effect on the audit. Limiting the use of highly technical auditing terms helps to enable users who do not have a reasonable knowledge of auditing are nevertheless to understand the basis for the auditor's focus on particular matters during the audit.

A34. As noted in paragraph A1, users of the financial statements are interested in knowing more about the matters for which there was the most robust dialogue between the auditor and those charged with governance. However, users 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 nature and extent of the descriptions of key audit matters may therefore be less extensive than what is communicated with those charged with governance, such that the descriptions in the auditor's report remain clear and concise. 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.

*Explaining Why the Auditor Considered the Matter to Be of Most Significance in the Audit and the Effect on the Audit* (Ref: Para. 13(a))

A35. The description of a key audit matter in the auditor's report is intended to provide insight as to why the matter was determined to be a key audit matter and, to the extent necessary, its effect on the audit and may make reference to the following:

- Why the matter was assessed as a significant risk or as having a higher assessed risk of material misstatement, for example due to high estimation uncertainty.
- Key communications with those charged with governance.
- Economic conditions that affected the auditor's ability to obtain audit evidence, for example illiquid markets for certain financial instruments.
- New or emerging accounting policies, for example entity-specific or industry-specific matters on which the engagement team consulted within the firm.

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<sup>27</sup> Proposed ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

- Changes in the entity’s strategy or business model that had a material effect on its current operations.
  - Whether the auditor used an expert to obtain audit evidence, for example the use of actuaries or other experts to evaluate management’s assumptions.
  - Whether the auditor agreed with management’s approach to a particular matter.
- A36. Written communications, or the auditor’s documentation of oral communications, with those charged with governance and other audit documentation provides a useful basis for the auditor’s communication in the auditor’s report. This is because audit documentation in accordance with ISA 230 is intended to address the significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions, and serves as a record for the nature, timing and extent of the audit procedures performed, the results of those procedures, and the audit evidence obtained. Such documentation may assist the auditor in developing a description of key audit matters that explains the significance of the matter and describes the key elements of the effect of the matter on the audit.
- A37. The factors in paragraph 11 and the guidance in paragraphs A13 and A19–A29 related to determining key audit matters may also be helpful for the auditor in considering how such matters are to be communicated in the auditor’s report. For example, explaining the reasons why a particular matter was the subject of significant auditor attention or effort is likely to be of interest to users.
- A38. 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, or a remedy for material misstatement of the financial statements relating to non-disclosure of information required to be disclosed. In such cases, the auditor is required to express a modified opinion in accordance with proposed ISA 705 (Revised). In addition, law, regulation or ethical standards may restrict the auditor’s ability to communicate key audit matters because of investigations, auditor confidentiality or data protection requirements. The ISAs do not override law or regulation that governs an audit of financial statements or relevant ethical requirements, but potential conflicts between the auditor’s obligations of confidentiality and obligations to communicate in accordance with this ISA may be complex. In such cases, the auditor may consider discussing the situation with those charged with governance and may consider obtaining legal advice.
- A39. 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, may assist 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.
- A40. For example, the audit approach in a particular year may have been influenced by entity-specific circumstances, economic conditions, or industry-developments (see paragraph A13). Noting these types of circumstances in the auditor’s report and their effect on the audit assists users in understanding why matters were key audit matters in the audit.
- A41. The auditor may consider it necessary to describe, at a high level, the effect of the matter on the audit. In most cases, this will not involve describing in detail the specific 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. However, there may be challenges in summarizing the auditor's procedures, particularly in complex areas, in a succinct way that adequately communicates the nature and extent of the auditor's response to the matter and the significant auditor judgments involved.

- A42. In order to avoid creating uncertainty as to whether the matter was satisfactorily resolved, the auditor may also consider it necessary to address the specific outcome of the auditor's response in the description of the key audit matter in the auditor's report. However, 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 matters. While the auditor may find it useful to explain how the matter was resolved in the context of the audit as a whole, care may be needed to avoid implying 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.

*Reference to Where the Matter Is Disclosed in the Financial Statements (Ref: Para. 13(b))*

- A43. Because the objective of this ISA is focused on matters of most significance in the audit, the description of key audit matters cannot merely reiterate what is disclosed in the financial statements. However, a reference to where management's disclosures are presented enables users to understand both management's and the auditor's perspectives on these matters.
- A44. In describing how the audit was affected by a key audit matter, the auditor may draw attention to key aspects of management's disclosures. More robust disclosure by management about specific aspects or factors in relation to how a particular matter is affecting the financial statements of the current period may help the auditor in pinpointing particular aspects of how the matter was addressed in the audit such that users can understand why the matter is a key audit matter. This also may help to avoid the auditor inappropriately providing original information about the entity. 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.
- A45. It is appropriate for the auditor to seek to avoid the description of key audit matters inappropriately providing original information about the entity that is the responsibility of the entity's management and those charged with governance unless, in the auditor's judgment, the additional information that the auditor may provide is critical to the auditor's description of the key audit matter. In such circumstances, the auditor may encourage management or those charged with governance to make relevant disclosures in the financial statements that include such other information, and so that reference can be made to those disclosures within the description of the key audit matters in the auditor's report, rather than the auditor providing original information.

*Interaction between Descriptions of Key Audit Matters and Other Elements Required to Be Included in the Auditor's Report (Ref: Para. 14)*

- A46. Presenting the description of matters for which the auditor has concluded it is necessary to modify the opinion separately in the Basis for Qualified (or Adverse) Opinion section helps to promote users' understanding and to identify such circumstances when they occur. Separating the

discussion of these matters from other key audit matters therefore gives them the appropriate prominence in the auditor's report. The Appendix in proposed ISA 705 (Revised) includes illustrative examples of how the introductory language in the Key Audit Matters section is affected in such circumstances.

- A47. The existence of a material uncertainty relating to going concern is, by its nature, a key audit matter. However, the auditor's statements relating to going concern are required to be presented in a separate section of the auditor's report under the heading "Going Concern."<sup>28</sup> When a material uncertainty has been identified and adequate disclosure is made in the financial statements, proposed ISA 570 (Revised) requires the auditor to include a statement in the auditor's report to draw attention to the note in the financial statements that discloses a material uncertainty and highlight the existence of a material uncertainty relating to the event or condition that may cast significant doubt on the entity's ability to continue as a going concern.<sup>29</sup> When a material uncertainty has been identified and adequate disclosure is not made in the financial statements, proposed ISA 570 (Revised) requires the auditor to modify the auditor's opinion and describe this in the Basis for Qualified (or Adverse) Opinion paragraph as well as the Going Concern section of the auditor's report.<sup>30</sup> The Appendix in proposed ISA 570 (Revised) includes illustrative examples of how the introductory language in the Key Audit Matters section is affected in such circumstances.

*Form and Content of the Auditor's Report Prescribed by Law or Regulation (Ref: Para. 15)*

- A48. 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.<sup>31</sup> 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.
- A49. 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 communicated with the auditor during the performance of the audit. Where such circumstances exist, the auditor may communicate key audit matters by including a cross reference in the auditor's report to the description of the matter in the report of those charged with governance. The auditor may also 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 and remedy the deficiency by communicating the matter in the auditor's report. Including such information under the heading "Key Audit Matters" alerts users of the financial statements that the approach taken by law or regulation is similar to the objective of key audit matters determined in accordance with this ISA.

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<sup>28</sup> Proposed ISA 570 (Revised), paragraph 19

<sup>29</sup> Proposed ISA 570 (Revised), paragraph 22

<sup>30</sup> Proposed ISA 570 (Revised), paragraph 23

<sup>31</sup> Paragraph 49 of ISA 600 includes specific matters to be communicated by group auditors with those charged with governance.

## Considerations Specific to Public Sector Entities

A50. 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).

### *Communication with Those Charged with Governance* (Ref: Para. 16)

A51. The communication required by paragraph 16 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. As explained in paragraph A46, 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 in which the Auditor Has Determined There Are No Key Audit Matters** (Ref: Para. 17)

A52. It is unlikely that there will be no key audit matters for an audit of a listed entity. However, this may be the case, for example, in an audit of a smaller listed entity with a relatively simple business, or entities that have no financial activity (e.g., dormant listed entities or shell corporations). 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 are aware of the results of the auditor's decision-making process about whether additional information in the auditor's report is necessary to enhance users' understanding of the audit and the implications for the auditor's report.

A53. 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**

This section of our auditor's report is intended to describe matters selected from those communicated with *[those charged with governance]* that we have determined, in our professional judgment, were of most significance in our audit of the financial statements. [Except for the matter described in the Basis for Qualified (or Adverse) Opinion section and the material uncertainty described in the Going Concern section,] We have determined that there are no such matters to report.