

Key Audit Matters (KAM)—Issues and Drafting Team Recommendations**Summary of the IAASB's Discussions at Its March 2014 Meeting**

The Board tentatively agreed with the Drafting Team's recommendations set out in Agenda Item 4-B¹ as follows:

- Developing new and revised requirements for determining KAM. The Board acknowledged the importance of robust application material to further support the decision-making framework and, among other matters, encouraged the Drafting Team to explore how best to clarify the concept of significant auditor attention and explain how the factors to be considered may relate to one another, particularly in light of the definition of significant risks, and to form a view as to what documentation would be necessary to support the auditor's judgments.
- Retaining the requirement for the auditor to determine whether, in describing a key audit matter, it is necessary to communicate how such matter was addressed in the audit, rather than requiring this in all cases. The Board was of the view that such flexibility would enable auditors to reflect on how to make the description most meaningful to users and respond to concerns that excessive prescription in the standard may restrict innovation and relevance to users. However, the Board also agreed it would be appropriate to further consider how to encourage such disclosures, for example by developing application material in proposed ISA 701² to be more definitive in explaining circumstances in which it may be appropriate for the auditor to comment on how a matter was addressed in the audit and to explain how the auditor might go about describing audit procedures at a high level and the outcome of the auditor's work, and why this information may be relevant to users.

The Board also considered the topic of sensitive matters and tentatively agreed that it is necessary within proposed ISA 701 to establish a requirement addressing the auditor's actions when such matters are determined to be KAM, to acknowledge that, in certain cases, a matter might not be communicated in the auditor's report. IAASB members generally supported the view of some IAASB Consultative Advisory Group (CAG) Representatives that the standard should not be overly permissive in this regard or prohibit the communication of certain types of sensitive matters in the auditor's report. Rather, the Board encouraged the Drafting Team to explore an appropriate balance between auditors providing useful information about the most significant matters in the audit that was performed, while at the same time respecting the important concept of client confidentiality, often addressed in law, regulation and relevant ethical requirements. The Board also noted the initial views of the International Ethics Standards Board for Accountants (IESBA) Planning Committee 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).

¹ Agenda item 4-B is available on the IAASB's website at http://www.ifac.org/sites/default/files/meetings/files/20140317-IAASB-Agenda_Item_4B-Auditor_Reporting-KAM-final.pdf.

² Proposed ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

Objectives of the Discussion

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

- Obtain input on DT-701's recommendations related to the applicability of proposed ISA 701, including that:
 - Proposed ISA 701 continue to be required only for complete sets of general purpose financial statements of listed entities, with guidance provided in ISA 210³ to make reference to voluntary application and how this may be addressed in the audit engagement letter.
 - Additional application material be included in proposed ISA 700 (Revised)⁴ to explain when the auditor may consider it useful to apply ISA 701 voluntarily, for example in the case of public interest entities (PIEs).
 - KAM be prohibited when the auditor expresses a disclaimer of opinion, as well as when the auditor expresses an adverse opinion (unless required by law or regulation).
- Obtain input on DT-701's proposed new requirement and related application material addressing circumstances in which a matter determined to be a KAM is not communicated in the auditor's report.
- Obtain input on DT-701's proposed revised draft of ISA 701.
- Obtain input on DT-701's proposed revisions to ISA 706.⁵
- Obtain input on DT-701's proposed revisions to ISA 260.⁶
- Obtain input on DT-701's initial thinking related to illustrative examples of KAM.

I. Applicability of ISA 701

The following requirement relating to the application of ISA 701 was included in proposed ISA 700 (Revised) in the Exposure Draft (ED):

30. For audits of complete sets of general purpose financial statements of a listed entity, the auditor shall communicate key audit matters in the auditor's report in accordance with proposed ISA 701. When the auditor of a complete set of general purpose financial statements of an entity other than a listed entity is required by law or regulation to communicate key audit matters in the auditor's report or otherwise decides to do so, the auditor shall apply proposed ISA 701.

A. Applicability of Proposed ISA 701 beyond Listed Entities

1. The Explanatory Memorandum (EM) of the ED articulated the IAASB's decision to initially limit the application of ISA 701 to audits of complete sets of general purpose financial statements of listed entities, noting the absence of a globally accepted definition of PIEs in the ISAs.

³ ISA 210, *Agreeing the Terms of Audit Engagements*

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

⁵ Proposed ISA 706 (Revised), *Emphasis of Matter and Other Matters Paragraphs in the Independent Auditor's Report*

⁶ Proposed ISA 260 (Revised), *Communication with Those Charged with Governance*

2. The ED also explained that law, regulation or national auditing standards may require auditors of entities other than listed entities (e.g., PIEs, public sector entities, or all entities) in a particular jurisdiction to communicate KAM in the auditor's report. It was also acknowledged by respondents to the June 2012 Invitation to Comment (ITC) that auditors of financial statements of entities other than listed entities may wish to apply proposed ISA 701 on a voluntary basis. The IAASB therefore believed it is important, if KAM are communicated for audits of financial statements of entities other than listed entities (either voluntarily or when required by law or regulation), that such matters should be determined and communicated in the same manner as for listed entities (i.e., consistent with proposed ISA 701), as articulated in paragraph 30a of proposed ISA 700 (Revised).
3. In light of the possibility of auditors of other than listed entities applying ISA 701 voluntarily, or being requested by management or those charged with governance to do so, the IAASB proposed limited amendments to ISA 210. Specifically, if the auditor of the financial statements of an entity other than a listed entity is not required to communicate KAM but intends to do so, a new requirement for the auditor to include a statement in the audit engagement letter regarding such intent was proposed in the ED. In addition, application material was included to clarify that, in certain jurisdictions, it may be necessary for the auditor to include a reference to the possibility of determining and communicating key audit matters in the terms of the audit engagement in order to retain the ability to do so (e.g., due to legal or regulatory requirements, including those relating to confidentiality).

Feedback from Respondents to the ED

Views on Limiting KAM to Audits of Complete Sets of Financial Statements of Listed Entities

4. The ED did not pose a specific question about the IAASB's approach to limiting the applicability of proposed ISA 701 to audits of complete sets of financial statements of listed entities. Nevertheless, acknowledging the matter will be considered further in the context of the post-implementation review, respondents expressed views as follows:
 - Two Monitoring (MG) respondents,⁷ supported by others,⁸ were of the view that proposed ISA 701 should be required for audits of PIEs; and
 - Other respondents⁹ were of the view that ISA 701 should apply to all entities in light of views of the importance of comparability of auditor's reports of entities of different sizes.

Views on Circumstances Where Proposed ISA 701 Is Applied Voluntarily

5. A strong majority (77/94 or 82%)¹⁰ of the respondents who answered Question 5¹¹ of the ED, including one Monitoring Group (MG) member, generally supported the proposed requirement that

⁷ *Regulators and Oversight Authorities:* BCBS, IAIS

⁸ *Regulators and Oversight Authorities:* EAIG, EBA; *NSS:* FAP, NBA; *Accounting Firms:* CHI; *Member Bodies and Other Professional Organizations:* IBR-IRE

⁹ *Investors and Analysts:* S&P, CFA; *NSS:* AUASB, CNCC-CSOEC, IDW; *Accounting Firms:* MAZARS; *Public Sector Organizations:* AGA; *Member Bodies and Other Professional Organizations:* ICAC, ICGN; *Academics:* HC, HGortemaker; *Individuals and Others:* ANA, CMunarriz

¹⁰ *Investors and Analysts:* ABI, BR, CFA, IMA; *Regulators and Oversight Authorities:* DFSA, ESMA, IRBA, MAOB, WB; *National Auditing Standard Setters (NSS):* AUASB, CAASB, CNCC-CSOEC, FAP, HKICPA, IDW, JICPA, NBA, NZAuASB, UKFRC; *Accounting Firms:* BDO, BT, CHI, DTT, EYG, KI, KPMG, MS, PKF, PP, PWC, RSM; *Public Sector Organizations:* ACAG, AGC,

KAM may be communicated on a voluntary basis but, if so, proposed ISA 701 should be followed. Respondents noted that the use of proposed ISA 701 in all circumstances when KAM is communicated will:

- Promote consistency and comparability in auditor reporting; and
 - Help to avoid confusion among users of the financial statements.
6. Respondents that did not support the requirement as articulated in ISA 700 were mainly concerned about the comparability and consistency of auditor's reports, in part when comparing reports of listed entities with entities other than listed entities that had not decided to communicate KAM. A few respondents¹² expressed the view that two entities with very similar risks and controls may have significantly different auditor's reports and different levels of information would be provided to users, which in turn would make the auditor's report less understandable by those users outside the accounting profession. Two respondents¹³ noted that it may not be clear to users whether the auditor's report of an entity other than a listed entity did not include KAM because no such matters were identified (as a "nothing to communicate" section is only required if the auditor had decided to determine and communicate KAM at the time of agreeing the written terms of engagement) or because the auditor has decided not to communicate KAM on a voluntary basis in accordance with proposed ISA 701.

Views on the Auditor Signaling Intent to Apply Proposed ISA 701 Voluntarily in the Audit Engagement Letter

7. A majority of the respondents (71/94)¹⁴ who answered question 5 of the ED, including one MG member, generally supported the proposed requirement that the auditor must signal the intent to apply proposed ISA 701 voluntarily in the audit engagement letter.
8. Respondents¹⁵ that were not supportive of signaling the intent to apply proposed ISA 701 voluntarily in the audit engagement letter suggested that the auditor should always have the option

AGM, AGSA, CIPFA, NAOS, NAUK, PA; *Preparers of Financial Statements*: AA, SH, SPL; *Member Bodies and Other Professional Organizations*: ACCA, AIA, CAI, CalCPA, CICPA, DNR, EFAA, FAR, FEE, IBRACON, ICAA, ICAEW, ICAG, ICAJ, ICAN, ICAP, ICAS, ICPAI, ICPAK, IMCP, IPAR, ISCA, KACR, KHT, KICPA, NZICA, PICPA, SMPC, WPK, ZICA; *Academics*: ABurrowes; *Individuals and Others*: CBarnard, CMunarriz, DJuvenal, Flrungu

¹¹ Question 5 of the ED was as follows: "Do respondents agree with the approach the IAASB has taken in relation to key audit matters for entities for which the auditor is not required to provide such communication – that is, key audit matters may be communicated on a voluntary basis but, if so, proposed ISA 701 must be followed and the auditor must signal this intent in the audit engagement letter? If not, why? Are there other practical considerations that may affect the auditor's ability to decide to communicate key audit matters when not otherwise required to do so that should be acknowledged by the IAASB in the proposed standards?"

¹² *Public Sector Organizations*: AGO; *NSS*: MAASB; *Member Bodies and Other Professional Organizations*: ASSIREVI, IAA, IBR-IRE; *Academics*: HC

¹³ *NSS*: MAASB; *Member Bodies and Other Professional Organizations*: AIA

¹⁴ *Investors and Analysts*: ABI, BR, CFA, IMA; *Regulators and Oversight Authorities*: DFSA, ESMA, IRBA, MAOB, WB; *NSS*: AUASB, CAASB, CNCC-CSOEC, FAP, FAR, FEE, HKICPA, IDW, JICPA, NBA, NZAuASB, UKFRC; *Accounting Firms*: BDO, CHI, DTT, EYG, KI, KPMG, MS, PKF, PP, PWC, RSM; *Public Sector Organizations*: ACAG, AGC; AGM, AGNZ, AGSA, CIPFA, NAOS, NAUK; *Preparers of Financial Statements*: AA, SH, SPL; *Member Bodies and Other Professional Organizations*: ACCA, CAI, CalCPA, CICPA, DNR, EFAA, IBRACON, ICAA, ICAEW, ICAG, ICAJ, ICAN, ICAP, ICAS, ICPAI, ISCA, KACR, KHT, KICPA, NZICA, PICPA, WPK, ZICA; *Academics*: ABurrowes; *Individuals and Others*: CBarnard, CMunarriz, DJuvenal, Flrungu.

to apply proposed ISA 701 voluntarily, whether this decision was made at the commencement or conclusion of an audit. A requirement to signal the intent in the audit engagement letter may inappropriately preclude an auditor of an entity other than a listed entity from applying proposed ISA 701 voluntarily if the auditor does not come to an agreement with management or those charged with governance (TCWG). Two respondents¹⁶ that were supportive of signaling the intent to apply proposed ISA 701 voluntarily in the audit engagement letter suggested that it should be clear that management or TCWG are not required to agree with the auditor's decision to include KAM in the auditor's report. Other respondents that were not supportive suggested that the intent to apply proposed ISA 701 voluntarily should be discussed with management in the earliest possible stage of the audit.

9. Despite the broad support for signaling the intent to apply proposed ISA 701 voluntarily in the audit engagement letter, respondents offered suggestions as to how the proposed requirement could be improved in light of the practical challenges identified. For example:

- A few respondents¹⁷ suggested that more guidance is needed for the auditor in the event that the audit engagement letter does not include the intent to apply proposed ISA 701 voluntarily and during the audit the auditor decides to determine and communicate KAM, or TCWG or management requests it be done. A few respondents¹⁸ highlighted the practical difficulties of issuing a new audit engagement letter and were of the view that the auditor should not be in a position of having no other option other than to reissue the audit engagement letter in order to determine and communicate KAM. Two respondents¹⁹ suggested subsequent written communication to management or TCWG by the auditor could address this matter, rather than requiring or implying the need for an updated engagement letter;
- A few respondents²⁰ raised concerns about the auditor being pressured not to apply proposed ISA 701 voluntarily by management or TCWG, subsequent to signing the audit engagement letter, for example, due to controversial issues or KAM descriptions. Additional guidance was suggested to determine whether the auditor should still include KAM in the auditor's report despite objections from management, consistent with a view more broadly that the possibility of disagreements could be usefully addressed in application material. One respondent was of the view that the guidance should make it clear that, if intent to apply proposed ISA 701 is added to the audit engagement letter at the outset of the audit, it is not possible to opt out, while two other respondents were of the view that a later request by management or TCWG not to apply proposed ISA 701 should be considered a change in scope of the engagement; and

¹⁵ *Accounting Firms: GTI; Public Sector Organizations: PA; Member Bodies and Other Professional Organizations: IMCP, SMPC; Individuals and Others: ANA*

¹⁶ *NSS: IDW; Public Sector Organizations: AGC*

¹⁷ *Regulators and Oversight Authorities: IRBA; Accounting Firms: DTT, GTI, PKF; Public Sector Organizations: GAO; Member Bodies and Other Professional Organizations: ACCA, AIA, EFAA, SMPC*

¹⁸ *Regulators and Oversight Authorities: IRBA; Accounting Firms: DTT, GTI; Member Bodies and Other Professional Organizations: ACCA, AIA, SMPC*

¹⁹ *Accounting Firms: DTT, GTI*

²⁰ *Accounting Firms: KI, PP; Member Bodies and Other Professional Organizations: ACCA, FEE, ISCA, KACR*

- Related, a few respondents²¹ suggested to build into proposed ISA 701 safeguards against entities or auditors deciding to apply proposed ISA 701 voluntarily in “good” years, i.e., when an entity has strong results and few audit issues, and then electing in subsequent “bad” years to not to have such communications. These respondents were of the view that unrestricted flexibility to opt in and out of proposed ISA 701 is not desirable and could result in misleading reports over time. Similarly, other respondents²² suggested additional guidance to ensure a consistent application.

Drafting Team Recommendations

Limiting KAM to Audits of Complete Sets of General Purpose Financial Statements of Listed Entities

10. In light of feedback from the ED and previous IAASB and DT-701 discussions, DT-701 proposes retaining the position that proposed ISA 701 initially apply only to audits of complete sets of general purpose financial statements of listed entities, with plans to revisit the applicability during the post-implementation review. This position may be revisited depending on the findings of the post-implementation review and could potentially be reconsidered in connection with other IAASB discussions, for example, in connection with the IAASB’s plans to address special audit considerations relevant to financial institutions in its Work Program for 2015–2016.
11. However, DT-701 believes it is necessary to further explain circumstances in which auditors may consider it necessary or may be required to apply ISA 701, to respond to feedback from some respondents about the likely interest and perceived importance of KAM from the perspective of users of financial statements of PIEs. Additional application material is therefore being proposed to the requirement in proposed ISA 700, building upon how PIEs are addressed in ISA 260 as well as the IESBA Code, with application material relating to public sector entities also retained (see paragraphs 30a and A42–A43 of **Agenda Item 2-C**).
12. The matter of whether KAM would be required, permitted or prohibited when special purpose reports are issued is further addressed in **Agenda Item 2-F**. However, DT-701 notes the construct in paragraph 30a of proposed ISA 700 (Revised) would not limit voluntary application of proposed ISA 701 to audits of complete sets of financial statements of an entity other than a listed entity and therefore allows for flexibility for auditors of special purpose financial statements to include KAM in the auditor’s report in the same manner as would be required by proposed ISA 701 if the auditor judges it useful to do so.

Applying Proposed ISA 701 Voluntarily, Including Whether to Signaling the Intent to Do So in the Audit Engagement Letter

13. Given the widespread support, DT-701 recommends retaining the requirement as proposed in the ED that KAM may be communicated on a voluntary basis but, if so, ISA 701 should be followed.
14. Reflecting on concerns about the practicalities of always requiring the auditor to signal the intent to apply proposed ISA 701 voluntarily in the audit engagement letter, DT-701 has further considered whether this needs to be explicitly addressed in the requirement in paragraph 10 of ISA 210, in light of the overall requirement to make reference to the expected form and content of the auditor’s

²¹ *Regulators and Oversight Authorities: IRBA; NSS: CNCC-CSOEC, IDW; Accounting Firms: PWC; Member Bodies and Other Professional Organizations: FEE*

²² *Accounting Firms: EYG; Member Bodies and Other Professional Organizations: KHT*

report. For example, reflecting on previous IAASB debates, it may be appropriate to indicate that the auditor may want to refer in the engagement letter to the auditor’s “ability” to apply ISA 701 on a voluntary basis, rather than require the auditor to make a decision before the audit is commenced and explicitly signal this intent in the engagement letter. This would alleviate the possibility that the auditor of an entity other than a listed entity could potentially be scoped in to the “nothing to communicate” requirement as a result of signaling the intent to apply ISA 701 in the engagement letter when there are ultimately no matters determined to be KAM.

15. In addition, DT-701 is of the view that it may not be possible to address all the practical considerations that may arise and that a balance needs to be struck between providing useful guidance and simply allowing practice to emerge in this area. For example, DT-701 sees merit in allowing the auditor, management, and TCWG the flexibility to address the intention to voluntarily apply proposed ISA 701 through either the audit engagement letter (or other written terms of engagement) or through subsequent written communication to management and TCWG by the auditor (i.e., if the decision to do so is made after the written terms of engagement have been finalized). Adding this guidance may increase the number of entities communicating KAM by eliminating barriers that may be created by requiring in all cases that the intention to apply proposed ISA 701 be addressed in the written terms of engagement.
16. On the other hand, notwithstanding the benefits of consistency between periods, DT-701 is of the view that it would be difficult to require that, once the auditor voluntarily chooses to apply proposed ISA 701, the auditor would always be required to do so in future periods. Doing so may have unintended consequences, such as triggering “nothing to communicate” sections more often, or auditors of entities other than listed entities simply choosing to never communicate KAM because of concerns of never being able to “opt out” once the initial decision is made.
17. On balance, DT-701 believes that it would be useful to continue to retain proposed revised application material in ISA 210 addressing voluntary application of proposed ISA 701 and how this may be addressed in the audit engagement letter, but not require the intent to apply proposed ISA 701 to be explicitly addressed in the audit engagement letter. DT-701’s view is that it may be preferable to allow for NSS to address circumstances beyond listed entities in the context of their national environments, rather than trying to anticipate all possible scenarios within the ISAs. DT-701 acknowledges there may also be other means of addressing practical considerations if considered necessary, for example through planned implementation support. DT-701’s recommended changes to what was originally proposed in the ED relating to ISA 210 are included in Section I of **Agenda Item 4-E**.

B. Application of ISA 701 When an Adverse Opinion or Disclaimer of Opinion Is Expressed

18. Paragraph 29 of proposed ISA 705 (Revised)²³ prohibited the auditor from reporting on KAM when the auditor disclaimed an opinion on the financial statements as a whole, explaining that any discussion of KAM unrelated 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 overshadow the disclaimer of an opinion on the financial statements as a whole.
19. A question has also arisen as to how KAM should be treated when the auditor expresses an adverse opinion, notwithstanding the fact that adverse opinions for audits of financial statements of

²³ Proposed ISA 705, *Modifications to the Opinion in the Independent Auditor’s Report*

listed entities are not permitted by many securities regulators. The US Public Company Accounting Oversight Board's (PCAOB) auditor reporting proposals do not require "critical audit matters" or "CAM" to be identified and communicated when the auditor expresses an adverse opinion. The accompanying release to the proposed rules notes that requiring the auditor to identify and communicate additional CAM when the auditor expresses an adverse opinion was not considered necessary because the most important matter to investors and other financial statement users would be the reason for the adverse opinion. Similar to the IAASB's position in relation to a disclaimer of opinion, the PCAOB would not require identification and communication of CAM because the auditor is unable to form or has not formed an opinion as to the fairness of presentation of the financial statements. Because the auditor has not, and is not able to complete the audit and form an opinion on the financial statements, the auditor would not be able to determine the matters that involved the most difficult, subjective, or complex auditor judgments, posed the most difficulty in obtaining sufficient appropriate audit evidence, or posed the most difficulty in forming the opinion on the financial statements (i.e., those matters that met the PCAOB's definition of CAM).

Drafting Team Recommendation

20. DT-701 notes that adverse opinions are relatively rare for listed entities, and believes that, similar to what was explained in relation to when the auditor disclaims an opinion on the financial statements, communicating KAM when the auditor expresses an adverse opinion may imply the financial statements are more credible than is warranted, and may also overshadow the adverse opinion. Accordingly, DT-701 is recommending that KAM be prohibited when the auditor expresses an adverse opinion, unless required by law or regulation. Proposed ISA 700 (Revised) has been revised to incorporate the prohibition for both adverse opinions and disclaimers of opinions (see paragraphs 30–30a of **Agenda Item 2-C**).

C. Form and Content of KAM When Law or Regulation Prescribes the Form and Content of the Auditor's Report

21. ISA 700 allows for flexibility when law or regulation prescribes the form and content of the auditor's report. Limited feedback was received on the flexibility allowed in relation to KAM. DT-701 has therefore recommended making limited changes to the proposed requirement and application material in proposed ISA 700 (Revised) (see paragraphs 48(g) and A70–A73 of **Agenda Item 2-C**).

Matter for IAASB Consideration

1. The IAASB is asked for its views as to DT-701's recommendations in relation to the applicability of proposed ISA 701 and how such matters have been addressed in proposed ISA 700 (Revised), the changes proposed to ISA 210, and proposed ISA 701 (see paragraph 5 of **Agenda Item 4-B**).

II. Communicating KAM – Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor’s Report

A. Drafting Team Recommendations

22. To respond to concerns generally about the auditor providing original information in KAM descriptions and specifically about whether it would be appropriate for the auditor to communicate about certain sensitive matters, at its March 2014 meeting the IAASB agreed with DT-701’s recommendation that a new requirement is needed in proposed ISA 701 to address the situation when matters not disclosed in the financial statements are determined to be KAM, and where the auditor might not communicate such matters in the auditor’s report. At the same time, the IAASB agreed that such a requirement should not be overly permissive in this regard or explicitly prohibit the communication of certain types of sensitive matters in the auditor’s report. Rather, the IAASB encouraged DT-701 to explore an appropriate balance between auditors providing useful information about the most significant matters in the audit that was performed, while at the same time respecting the important concept of client confidentiality, often addressed in law, regulation and relevant ethical requirements.
23. DT-701 has therefore developed a new requirement and related application material in proposed ISA 701 addressing such circumstances, which is included in paragraphs 11 and A31–A37 of **Agenda Item 4-B**.
24. This new requirement is firstly premised on the fact that law or regulation may prohibit public disclosure of a matter, either by management or the auditor. In such cases, the auditor would not be required by ISA 701 to communicate a matter determined to be a KAM.
25. Paragraph 11(b) is then intended to address the possibility that, in exceptional circumstances, the auditor may, after careful consideration of the facts and circumstances of the entity, decide that it is not possible to describe a matter determined to be a KAM in an appropriate matter in the auditor’s report, and accordingly the KAM will not be communicated therein. DT-701 is of the view 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 whether it would be possible to describe the matter in an appropriate manner, and has concluded that it is not possible to do so.
26. Application material supporting this requirement builds upon an existing concept in law or regulation and some financial reporting frameworks about disclosure being likely to be “seriously prejudicial” to the entity, and highlights the importance of both communication with TCWG and, when necessary, obtaining legal advice to inform the auditor’s judgment about such matters.
27. DT-701 also considered whether to provide examples of circumstances in which paragraph 11 of proposed ISA 701 might apply, and has sought to illustrate a limited number of circumstances highlighted during field testing within the application material, with the caveat in paragraph A34 of proposed ISA 701 that these examples are not intended to circumvent the auditor’s judgment as to whether it is possible to describe a matter in an appropriate manner in the auditor’s report in accordance with paragraph 11(b) of proposed ISA 701.
28. Finally, as part of the overall documentation requirement included in proposed ISA 701, DT-701 is proposing to require documentation of the rationale for the auditor’s determination not to communicate in the auditor’s report a matter determined to be a key audit matter (see paragraph 16(a) of **Agenda Item 4-B**).

29. DT-701 believes that this requirement and the additional guidance strikes an appropriate balance between enhanced transparency for users about matters that have been determined to be KAM that may not be disclosed in the financial statements, while at the same time responding to the concerns expressed about the auditor doing so by providing for limited circumstances when the auditor might conclude that it is not possible to appropriately describe such matters and therefore not communicate them as KAM in the auditor's report. Section III.D of this paper further explains how the possibility of such circumstances will be acknowledged in the auditor's report through new illustrative wording to be included in the Auditor's Responsibilities section.

Matter for IAASB Consideration

2. The IAASB is asked for its views on the new requirement and application material in proposed ISA 701 developed to acknowledge the exceptional 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.

III. Revisions to Proposed ISA 701

30. In addition to revisions arising from the matters described in Sections I and II of this paper, DT-701 considered the need for further revisions to proposed ISA 701 in light of feedback from respondents to the ED and previous IAASB and CAG discussions at their respective March 2014 meetings. Accordingly, proposed ISA 701 as included in the ED was substantively redrafted, and is presented as **Agenda Item 4-B** for the IAASB's consideration. The DT Chair will walk through the proposed ISA to solicit feedback during the June 2014 IAASB meeting. Agenda Item 4-B from the March 2014 meeting highlighted DT-701's plans to revise application material to align with its recommended changes to the requirements to determine and communicate KAM. The following describes some of the more significant changes in the revised ISA 701 and, where applicable, the feedback from the ED in relation to questions included in the ED but not previously tabled for discussion at the March 2014 IAASB meeting.

A. Descriptions of Individual KAM

31. DT-701 initially proposed to retain the flexibility in the requirement in paragraph 10 of the ED to allow the auditor to determine whether it was necessary to describe how a matter was addressed in the audit (rather than "the effect on the audit"). The IAASB was also of the view that such flexibility would enable auditors to reflect on how to make the description most meaningful to users and respond to concerns that excessive prescription in the standard may restrict innovation and relevance to users. However, the Board also agreed it would be appropriate to further consider how to encourage such disclosures, for example by developing application material in proposed ISA 701 to be more definitive in explaining circumstances in which it may be appropriate for the auditor to comment on how a matter was addressed in the audit and to explain how the auditor might go about describing audit procedures at a high level and the outcome of the auditor's work, and why this information may be relevant to users.
32. CAG Representatives variously encouraged the IAASB to consider what would be responsive to investor needs and also to consider the UK auditor's reports in determining how best to address the description of an individual KAM, while at the same time recognizing that the challenges of

describing procedures in a meaningful way and the risk that describing an outcome or a conclusion could be misinterpreted.

Drafting Team Recommendation

33. Taking these considerations into account, DT-701 is proposing to require the auditor to describe how the matter was addressed in the audit, in addition to explaining why the matter was considered to be one of most significance in the audit and therefore determined to be a KAM. DT-701 is of the view that such information is likely to be useful to investors and others. However, the flexibility as originally intended would be retained by referring more broadly to describing “how the matter was addressed in the audit” vs. specifically requiring a description of the auditor’s response, findings, or procedures, thereby providing the auditor the ability to exercise judgment in deciding which aspects to address. In addition, flexibility in describing how the matter was addressed in the audit would be provided through application material stating that the amount of detail necessary is a matter of professional judgment and indicating, at a high level, the nature of what might be included in the description.
34. The revised requirement, and related application material, are included in paragraphs 12 and A38–A55 of **Agenda Item 4-B**. This application material more broadly addresses the concept of “original information” by explicitly noting that providing original information is the responsibility of the entity’s management and TCWG, and explains how “other information” (i.e., information included in an entity’s annual report) may be considered by the auditor in describing a KAM, and in considering the extent to which the auditor might be providing original information through the communication of a KAM.
35. The proposed application material also explains DT-701’s view that the amount of detail necessary to describe how a key audit matter was addressed in the audit is a matter of professional judgment, taking into account the facts and circumstances of the entity and the audit. In order to explain how the matter was addressed in the audit in accordance with paragraph 12(a) of proposed ISA 701, application material explains that the description may include one or more of the following:
 - Aspects of the auditor’s response or approach that were most relevant to the matter or specific to the assessed risk of material misstatement.
 - A brief overview of procedures performed.
 - An indication of the outcome of the auditor’s procedures.
 - Any other observations with respect to the matter.Law or regulation or national auditing standards may prescribe a specific form or content for the description of a key audit matter beyond what is required by this ISA.
36. The proposed ISA provides further guidance to inform the auditor’s consideration of what to include in the description of a KAM, taking into account whether such information is likely to be useful to intended users’ decision making in the context of the audit that was performed and whether the description would enable a better understanding of the audit and the auditor’s judgment.

B. Auditor Determination that There Are No KAM

37. A strong majority of the respondents (98/102 or 96%)²⁴ who answered Question 6²⁵ of the ED, including two MG members, supported the proposed requirement to allow for the possibility that the auditor may determine that there are no KAM to communicate. Respondents in favor of the requirement were of the view that requiring KAM (e.g., at least one KAM) to be identified in all circumstances would pressure auditors to look for matters to communicate, which could result in boilerplate disclosures that do not add value to users. A few respondents²⁶ also noted that ISA 701 may be required by legislation for entities other than listed entities in some jurisdictions. In that event, it would be more likely that the auditor has not determined any matters to be KAM and therefore would potentially be in a position of having nothing to communicate. It was also noted that allowing for the possibility that there were no KAM to communicate may help to alleviate concerns about requiring KAM for all listed entities, regardless of size. DT-701 also notes that the PCAOB's auditor reporting proposals also permitted this possibility.
38. Notwithstanding the strong support for the proposed requirement, five respondents²⁷ were of the view that at least one KAM should always be communicated. Two of these respondents highlighted that the current requirement would provide entities with leverage in their discussion with auditors about KAM and would therefore be inappropriate if its application resulted in the auditor "opting out" of communicating matters that should be communicated. Two respondents were of the view that there will always be matters of increased audit focus, regardless of the circumstances of the audit, and therefore there should always be at least one KAM. This is consistent with feedback from other respondents²⁸ who, while supporting the possibility of the auditor having no KAM to communicate, highlighted the contradiction between the words "most significance" in the definition of a KAM and this possibility. Some were of the view that, because KAM is a relative concept, there will always be a matter of most significance in an audit, but the issue is rather whether disclosure of such a matter would be meaningful to the user.

²⁴ *Investors and Analysts:* ABI, BR, EUMEDION, ICGN, IMA; *Regulators and Oversight Authorities:* CPAB, CSA CAC, ESMA, IOSCO, IRBA, JSE, MAOB, WB; *NSS:* CAASB, CNCC-CSOEC, FAP, HKICPA, IDW, JICPA, MAASB, NBA, NZAuASB, UKFRC; *Accounting Firms:* BDO, BT, CHI, DTT, EYG, GTI, KI, KPMG, MAZARS, MS, PKF, PP, PWC, RSM; *Public Sector Organizations:* ACAG, AGA, AGC, AGM, AGNZ, AGSA, CIPFA, ECA, GAO, NAOS, NAOUK, PA; *Preparers of Financial Statements:* AA, CFOF, Gof100-A, SH, SPL; *Member Bodies and Other Professional Organizations:* ACCA, AIA, ASSIREVI, CAI, CalCPA, CICPA, DNR, EFAA, FACPCE, FAR, FEE, FSR, IBRACON, IBR-IRE, ICAA, ICAEW, ICAG, ICAJ, ICAN, ICAP, ICAS, ICAZ, ICPAI, ICPAK, IMCP, IPAR, ISCA, KACR, KICPA, NYSSCPA, NZICA, MIA, SAICA, SMPC, ZICA; *Academics:* HC, HGortemaker, MU; *Individuals and Others:* ABurrowes, ANA, CBarnard, CMunarriz, DJuvenal, Flrungu

²⁵ Question 6 of the ED was as follows: "Do respondents believe it is appropriate for proposed ISA 701 to allow for the possibility that the auditor may determine that there are no key audit matters to communicate?"

(a) If so, do respondents agree with the proposed requirements addressing such circumstances?

(b) If not, do respondents believe that auditors would be required to always communicate at least one key audit matter, or are there other actions that could be taken to ensure users of the financial statements are aware of the auditor's responsibilities under proposed ISA 701 and the determination, in the auditor's professional judgment, that there are no key audit matters to communicate?"

²⁶ *Accounting Firms:* GTI; *Public Sector Organizations:* NAOUK

²⁷ *Investors and Analysts:* CFA; *Regulators and Oversight Authorities:* DFSA; *NSS:* AUASB; *Member Bodies and Other Professional Organizations:* WPK; *Academics:* JCarcello

²⁸ *Regulators and Oversight Authorities:* CSA CAC; *NSS:* AUASB, CAASB, IDW; *Accounting Firms:* DTT, GTI, MAZARS, PKF; *Public Sector Organizations:* AGSA; *Member Bodies and Other Professional Organizations:* FAR, FEE, FSR

39. A strong majority of the respondents (88/98 or 90%),²⁹ including two MG members, who supported the proposed requirement to allow for the possibility that the auditor may determine that there are no KAM to communicate, also expressed support for the requirement in paragraph 13 of proposed ISA 701 included in the ED. Discussing the auditor's decision that there were no KAM to communicate with TCWG and the engagement quality control reviewer was generally viewed as helpful to inform the auditor's decision. The remaining respondents did not believe that the requirements in paragraph 13 were appropriate and of those respondents:
- Two³⁰ deemed the requirement in paragraph 13(a) as duplicative of paragraph 20(b) of ISA 220,³¹ which requires the engagement quality review partner to review the financial statements and the auditor's report; and
 - A few respondents³² were of the view that the requirement in paragraph 13(c) to include a section in the auditor's report explaining the auditor has nothing to communicate does not add any value to users, and therefore suggested to leave the KAM section out in these circumstances. A counterpoint was raised by a few respondents that including a "nothing to communicate" section at least serves to highlight the auditor's responsibilities and draws attention to the auditor's judgment that KAM does not exist, and could generate dialogue between investors and auditors at an annual general meeting.
40. A few respondents³³ were of the view that, when an auditor determines there are no KAM, the auditor's rationale should be explained in the auditor's report or should be documented in the auditor's working papers. One respondent³⁴ disagreed.
41. Proposed ISA 701 also provided guidance for those limited circumstances in which no KAMs could be identified ("e.g., a listed entity that has very limited operations or assets"). A few respondents,³⁵ including one MG member, also suggested including more guidance and examples of when no KAM are likely to be identified, as the notion of "rare" has not been articulated in the proposal.³⁶

²⁹ *Investors and Analysts:* ABI, BR, EUMEDION, ICGN, IMA; *Regulators and Oversight Authorities:* CPAB, ESMA, IOSCO, IRBA, JSE, MAOB, WB; *NSS:* CNCC-CSOEC, FAP, HKICPA, IDW, JICPA, MAASB, NBA, NZAuASB, UKFRC; *Accounting Firms:* BDO, BT, CHI, DTT, EYG, GTI, KI, KPMG, MAZARS, MS, PKF, PP, PWC, RSM; *Public Sector Organizations:* AGA, AGM, CIPFA, ECA, NAOS, NAOUK, PA; *Preparers of Financial Statements:* AA, CFOF, Gof100-A, SH, SPL; *Member Bodies and Other Professional Organizations:* ACCA, AIA, ASSIREVI, CAI, CalCPA, CICPA, DNR, EFAA, FACPCE, FAR, FEE, FSR, IBRACON, IBR-IRE, ICAA, ICAEW, ICAG, ICAJ, ICAN, ICAP, ICAS, ICAZ, ICPAI, ICPAK, IMCP, IPAR, ISCA, KACR, NZICA, MIA, SAICA, SMPC, ZICA; *Academics:* HC, HGortemaker, MU; *Individuals and Others:* ABurrowes, CBarnard, CMunarriz, DJuvenal, Flrungu

³⁰ *NSS:* CAASB; *Public Sector Organizations:* AGC

³¹ ISA 220, *Quality Control for an Audit of Financial Statements*

³² *Regulators and Oversight Authorities:* CSA CAC; *Public Sector Organizations:* ACAG, AGNZ, AGSA, GAO; *Member Bodies and Other Professional Organizations:* KICPA, NYSSCPA

³³ *Investors and Analysts:* ICGN; *Regulators and Oversight Authorities:* ESMA; *Member Bodies and Other Professional Organizations:* CICPA

³⁴ *NSS:* IDW

³⁵ *Regulators and Oversight Authorities:* ESMA, IOSCO; *NSS:* AUASB; *Member Bodies and Other Professional Organizations:* FACPCE, ICAA, ICPAK, NYSSCPA, NZICA; *Academics:* MU; *Individuals and Others:* CMunarriz

³⁶ Respondents variously referred to listed companies where activities are minimal/small listed company with very limited operations or assets/simple business environments, recently created entities with no operations/development stage entities/shell companies/holding companies, (near) dormant entities, and investment companies/investment funds

More guidance and better examples should also deter the auditor from inappropriate usage of the exemption. One MG member³⁷ specifically questioned whether the Board's intent in proposing this requirement is to scope out of ISA 701 a listed entity that has very limited operations and assets and set an expectation that, for other than these entities, it should be rare to have no KAM, and suggested the Board consider including wording in the requirement to indicate that an auditor of a non-complex entity with limited operations or limited assets may not identify any KAM depending on the facts and circumstances of the entity. Another MG member³⁸ suggested that the lack of KAM in the auditor's report would need to be sufficiently explained in the auditor's communication with TCWG.

Drafting Team Recommendations

42. Given the widespread support for the proposed requirement to allow for the possibility that the auditor may determine that there are no KAM to communicate, DT-701 recommends retaining a requirement and illustrative wording for the auditor's report when the auditor has "nothing to communicate", revised as follows to take into account feedback from respondents (see paragraphs 14 and A59–A60 of **Agenda Item 4-B**).

Introductory Language When the Auditor Has Determined There are No Key Audit Matters

13. If the auditor determines, depending on the facts and circumstances of the entity and the audit, 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; [Now addressed in paragraph A27a of ISA 220]~~
 - (b) ~~Communicate this conclusion with those charged with governance; and [Now addressed in paragraph 14(b) of proposed ISA 701]~~
 - (c) ~~E~~explain in a separate section of the auditor's report that this section of the auditor's report under the heading "Key Audit Matters" that this section of the auditor's report is intended to describe the 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 communicate in the auditor's report.

43. DT-701 is of the view that it would be appropriate for this requirement in proposed ISA 701 to refer only to the reporting responsibilities, and other material relevant to the decision-making could be relocated elsewhere in the requirements and application material, in light of the other changes to proposed ISA 701. Accordingly, DT-701 is proposing that:
- Reference to the discussion with the engagement quality control reviewer about no KAM being determined can be made via a conforming amendment to application material in ISA 220 (see **Section II of Agenda 4-E**). DT-701 is of the view that it is useful to highlight the significant judgments made in relation to KAM, consistent with how these matters are addressed in communications with TCWG and the proposed documentation requirement.

³⁷ *Regulators and Oversight Authorities: IOSCO*

³⁸ *Regulators and Oversight Authorities: WB*

- The requirement to communicate the conclusion with TCWG that there are no KAM to communicate would be better addressed as part of the overall requirement to communicate with TCWG (see paragraphs 15(b) and A65 of **Agenda Item 4-B**).
44. DT-701 did not consider it necessary to develop more guidance in the application material to explain the notion of “rare” or “certain limited circumstances”, as such concepts will likely vary by jurisdiction and may be best addressed by national auditing standards. DT-701 also does not recommend requiring the auditor to explain in the auditor’s report the rationale for the auditor’s determination that there are no KAM to communicate in the auditor’s report, though the auditor would be required to document this rationale in the audit file (see paragraph 16(b) of **Agenda Item 4-B**).

C. Limiting KAM to Matters in the Audit of the Current Period

45. A strong majority of the respondents (91/100 or 91%)³⁹ who answered Question 7⁴⁰ of the ED, including two MG members, agreed that, when comparative financial information is presented, the auditor’s communication of KAM should be limited to the audit of the most recent financial period. Proponents of the proposal agreed with the practical challenges as highlighted in paragraph 65 of the EM to the ED and were also of the view that:
- Including the previous period’s KAM could confuse users of the financial statements;
 - KAM related to audit of the most recent financial statements are likely the most relevant to the users. Should users wish to consider KAM related to the prior period they can, in most instances, access prior period’s auditor’s report; and
 - Including the previous period’s KAM is repetitive and would make the auditor’s report unnecessarily long. Related, requiring auditors to “update” KAM communicated in the prior period could detract from the matters of most significance in the current period.
46. However, a few respondents⁴¹ were of the view that financial statement users are interested in comparability and, as such, KAM should not be limited to the audit of the most recent financial period. A few others⁴² were of the view that, if a matter was identified to be a KAM in the previous period and the matter still exists in the current period, it should be communicated as a KAM even if it was not determined to be a matter of most significance in the audit of the current period.

³⁹ *Investors and Analysts:* ABI, BR, ICGN, IMA; *Regulators and Oversight Authorities:* CPAB, DFSA, EAIG, ESMA, IOSCO, IRBA, MAOB, WB; *NSS:* AUASB, CAASB, CNCC-CSOEC, FAP, HKICPA, IDW, JICPA, MAASB, NBA, NZAuASB; *Accounting Firms:* BDO, BT, CHI, DTT, EYG, GTI, KI, KPMG, MAZARS, MS, PKF, PP, PWC, RSM; *Public Sector Organizations:* ACAG, AGC, AGM, AGNZ, AGO, CIPFA, GAO, NAOS, NAOUK; *Preparers of Financial Statements:* AA, NN, SH, SPL; *Member Bodies and Other Professional Organizations:* ACCA, AIA, ASSIREVI, CAI, CalCPA, CICPA, DNR, EFAA, FACPCE, FAR, FEE, FSR, IBRACON, IBR-IRE, ICAA, ICAEW, ICAG, ICAJ, ICAN, ICAP, ICAS, ICAZ, ICPAI, ICPAK, IMCP, IPAR, ISCA, KACR, KICPA, NZICA, SIACA, SMPC, WPK, ZICA; *Academics:* ABurrowes, HGortemaker, MU; *Individuals and Others:* ANA, CBarnard, CMunarriz, DJuvenal, Flrunqu

⁴⁰ Question 7 of the ED was as follows: “Do respondents agree that, when comparative financial information is presented, the auditor’s communication of key audit matters should be limited to the audit of the most recent financial period in light of the practical challenges explained in paragraph 65? If not, how do respondents suggest these issues could be effectively addressed?”

⁴¹ *Investors and Analysts:* CFA; *Preparers of Financial Statements:* Gof100-A; *Member Bodies and Other Professional Organizations:* NYSSCPA; *Individuals and Others:* PYoung

⁴² *Public Sector Organizations:* AGSA; *Academics:* HC, HGortemaker

47. Notwithstanding the broad support for limiting the communication of KAM to matters in the current period audit, respondents offered suggestions as how the concept could be further explained in ISA 701. Specifically:
- A few respondents,⁴³ including one MG member, were of the view that there might be situations where it is appropriate to communicate KAM related to prior periods and suggested the IAASB include similar guidance as paragraph 10 of the PCAOB's Auditor Reporting proposal. Paragraph 10 states that: *“when the current period financial statements are presented on a comparative basis with those of one or more prior periods, the auditor should consider communicating critical audit matters relating to the prior periods when (1) the prior period’s financial statements are made public for the first time, such as in an initial public offering, or (2) issuing an auditor’s report on the prior period’s financial statements because the previously issued auditor’s report could no longer be relied upon.”*;
 - A few respondents⁴⁴ suggested that certain matters identified in the current period but relating to prior periods could be KAM, for example restatement of materially misstated prior period financial statements or the effects of retroactive application of a change in accounting policy, and ISA 701 should therefore address such circumstances;
 - Three respondents⁴⁵ noted that the proposed introductory wording to the KAM section of the auditor’s report is not explicit about the commentary being limited to the audit of the most recent financial period and suggested the IAASB change the illustrative wording in the introductory paragraph and related requirement; and
 - Two respondents⁴⁶ recommended that proposed ISA 701 also contain an explicit statement indicating that the auditor is not expected to evaluate (or document) whether prior KAM remain KAM in the current period. Similarly, proposed ISA 701 should explicitly state that the auditor is not expected to evaluate (or document) whether a current KAM should have been a KAM in a prior period, if it was not previously communicated as a KAM. Others⁴⁷ suggested additional guidance re-emphasizing that a KAM, albeit originating in a previously audited period, may still be a KAM for the current period.

Drafting Team Recommendations

48. Given the widespread support for limiting KAM to the audit of the most recent financial period, DT-701 recommends retaining the concept in ISA 701 (see the definition of KAM in paragraph 8 and the requirement to determine KAM in paragraph 10, and application material in paragraphs A11–A12 of **Agenda Item 4-B**).

⁴³ *Investors and Analysts:* BR; *Regulators and Oversight Authorities:* ESMA, IOSCO; *NSS:* UKFRC; *Accounting Firms:* BDO, PWC; *Member Bodies and Other Professional Organizations:* CICPA, EFAA, FEE

⁴⁴ *Regulators and Oversight Authorities:* IOSCO; *NSS:* CAASB, FAP; *Accounting Firms:* MS; *Member Bodies and Other Professional Organizations:* CICPA, EFAA

⁴⁵ *NSS:* AUASB; *Accounting Firms:* KPMG; *Academics:* MU

⁴⁶ *Accounting Firms:* DTT; *Member Bodies and Other Professional Organizations:* FAR

⁴⁷ *Regulators and Oversight Authorities:* EAIG, ESMA; *NSS:* FAP

49. Revisions are also suggested to the requirement addressing the introductory language and the illustrative wording to be more explicit about the limitation to the current period (see paragraphs 13(a) and A58 of **Agenda Item 4-B**).

D. Revisions to Introductory Language in the KAM Section and Additional Language Proposed to Be Included in the Auditor’s Responsibilities Section

50. DT-701 also considered feedback from respondents to the ED in relation to the required introductory language in the KAM section of the auditor’s report. In addition, DT-701 was of the view that the language originally proposed did not contemplate circumstances whether a matter determined to be a KAM was not communicated in the auditor’s report (as described in Section II of this paper), and that such possibility should be acknowledged in the auditor’s report in some way.
51. DT-701 initially considered changing the introductory language in the KAM section to make reference to this possibility, but decided that doing so would lead to more standardized language in the KAM section, which as a whole was expected to be entity-specific.
52. Accordingly, DT-701 developed new illustrative wording and a related proposed requirement in ISA 700 (Revised) to require disclosure of the auditor’s responsibilities in relation to KAM when the auditor is required or otherwise elects to include KAM (see paragraphs 38(c) and A53 of **Agenda Item 2-C**, as well as the illustrative report included as **Agenda Item 2-D**). Previous DT-701 discussions indicated it would be helpful to use such wording to explain the fact that, in exceptional circumstances, certain KAM may not be communicated in the auditor’s report. This proposed wording would complement the introductory language required by paragraph 13 of **Agenda Item 4-B**.

Matter for IAASB Consideration

3. The IAASB is asked to provide feedback on the matters described in this section and the revised draft of proposed ISA 701 presented as **Agenda Item 4-B**.

IV. Revisions to Proposed ISA 706 to Address the Relationship between KAM and Emphasis of Matter (EOM) Paragraphs and Other Matter (OM) Paragraphs

A. Feedback from Respondents to the ED

53. A strong majority of the respondents (95/112 or 85%)⁴⁸ who answered Question 8⁴⁹ of the ED, including five MG members, generally supported the IAASB’s decision to retain the concepts of EOM paragraphs and OM paragraphs, even when the auditor is required to communicate KAM.

⁴⁸ *Investors and Analysts:* ABI, CFA, ICGN, IMA; *Regulators and Oversight Authorities:* BCBS, CSA-CAC, CPAB, DFSA, EAIG, EBA, ESMA, IAIS, ICAC, IFIAR, IOSCO, IRBA, MAOB, WB; *NSS:* ASB, AUASB, CAASB, CNCC-CSOEC, HKICPA, IDW, JICPA, NBA, NZAuASB, UKFRC; *Accounting Firms:* BDO, BT, CHI, DTT, EYG, GTI, KI, KPMG, MAZARS, MS, PKF, RSM, SRA; *Public Sector Organizations:* ACAG, AGA, AGC, AGM, AGNZ, AGSA, CIPFA, GAO, NAOS, NAOUK, PA; *Preparers of Financial Statements:* AA, SH, SPL; *Member Bodies and Other Professional Organizations:* ACCA, AIA, ASSIREVI, CAI, CalCPA, CICPA, DNR, EFAA, FACPCE, FAR, FEE, IAA, IBRACON, IBR-IRE, ICAA, ICAEW, ICAG, ICAJ, ICAN, ICAP, ICAS, ICAZ, ICPAI, ICPAK, IMCP, ISCA, KACR, KICPA, NZICA, PICPA, SMPC, WPK; *Academics:* ABurrowes, HGortemaker, MU; *Individuals and Others:* ANA, CBarnard, CMunarriz, DJuvenal, Flrungu

54. Respondents⁵⁰ in favor of the IAASB's proposal highlighted that retaining the concepts of the EOM paragraphs and OM paragraphs allows the auditor the ability to include additional matters that may not meet the definition of a KAM but may still be, in the auditor's judgment, fundamental to users' understanding of the financial statements (i.e., what is contemplated by an EOM paragraph) or relevant to users' understanding of the audit (i.e., what is contemplated by an OM paragraph). Examples provided by respondents include: subsequent events reporting, potential lawsuit, early adoption of a new accounting standard, change in accounting policy, significant related party transaction and change in auditor – many of which were provided as examples in proposed ISA 706 (Revised).
55. A minority of respondents⁵¹ did not support retaining the three separate concepts, and were almost unanimously of the view that an auditor's report that includes KAM, EOM paragraphs and OM paragraphs could potentially be confusing to users who may have difficulty understanding why some matters are communicated as KAM and others are communicated in an EOM paragraph or an OM paragraph, consistent with the view expressed by some respondents who nevertheless supported retaining the separate concepts.⁵² However, investors⁵³ were of the view that it would be possible for auditors to differentiate between the concepts if more than one concept is included in the auditor's report to mitigate potential confusion.
56. Both supporters and opponents⁵⁴ of the decision to retain the concepts of EOM paragraphs and OM paragraphs were of the view that the concepts should be retained for entities that are not required to communicate KAM.
57. Notwithstanding the strong support to retain the concepts of EOM paragraphs and OM paragraphs, even when the auditor is required to communicate KAM, respondents offered suggestions as to how the proposed concepts could be improved. For example:
- Many respondents,⁵⁵ including four MG members, were of the view that the interactions between proposed ISA 701 and proposed ISA 706 are not clear and that there is a need for more specific criteria and guidance in the standards in order to differentiate these paragraphs

⁴⁹ Question 8 of the ED was as follows: "Do respondents agree with the IAASB's decision to retain the concepts of Emphasis of Matter paragraphs and Other Matter paragraphs, even when the auditor is required to communicate key audit matters, and how such concepts have been differentiated in the Proposed ISAs? If not, why?"

⁵⁰ *Investors and Analysts:* IMA; *Regulators and Oversight Authorities:* DFSA, IRBA; *NSS:* ASB, AUASB, CNCC-CSOEC, IDW; *Accounting Firms:* CHI, DTT, KPMG; *Public Sector Organizations:* GAO; *Member Bodies and Other Professional Organizations:* AIA, FACPCE, ICAA, ICAJ, ICAN, KICPA; *Individuals and Others:* CBarnard, Flrungu

⁵¹ *Regulators and Oversight Authorities:* AGO, JSE; *NSS:* FAP, MAASB; *Accounting Firms:* PP, PWC; *Public Sector Organizations:* ECA; *Preparers of Financial Statements:* Gof100-A, NN; *Member Bodies and Other Professional Organizations:* CPAA, FSR, IPAR, NYSSCPA, SAICA, ZICA; *Academics:* HC

⁵² *NSS:* NBA, NZAuASB; *Accounting Firms:* GTI; *Public Sector Organizations:* NAOUK; *Member Bodies and Other Professional Organizations:* FAR, IBRACON

⁵³ *Investors and Analysts:* ABI, CFA, ICGN, IMA

⁵⁴ *Investors and Analysts:* IMA; *NSS:* CNCC-CSOEC, HKICPA, MAASB; *Accounting Firms:* PWC; *Public Sector Organizations:* AGM; *Member Bodies and Other Professional Organizations:* ACCA, CPAA, EFAA, FSR, IBRACON, ICAJ, ICPAI, SAICA, ZICA

⁵⁵ *Investors and Analysts:* ABI, CFA, IMA; *Regulators and Oversight Authorities:* BCBS, EAIG, ESMA, IAIS, IFIAR, IOSCO; *NSS:* HKICPA, ICAC; *Accounting Firms:* BT, CHI, DTT, MAZARS, RSM, SRA; *Public Sector Organizations:* AGC, AGO; *Member Bodies and Other Professional Organizations:* CICPA, DNR, FEE, FSR, IBR-IRE, ICAA, ISCA

and therefore to clarify the specificities and interactions among them, as users of the financial statements might find the concepts confusing;

- A few respondents⁵⁶ were of the view that EOM paragraphs should be positioned above the KAM section to show their relative importance (fundamental to users' understanding) vis a vis a KAM (matters of most significance in the audit of the financial statements). One respondent⁵⁷ specifically supported the flexibility in the ED;
 - A few respondents⁵⁸ suggested that including an illustrative example in the final standards of an auditor's report with a KAM, EOM paragraph, and OM paragraph would be helpful in further distinguishing between the concepts;
 - Five respondents⁵⁹ recommended clearly distinguishing the EOM paragraphs and OM paragraphs from the KAM section to minimize the confusion to users who may have difficulty understanding why some matters are communicated as KAM and others are communicated in an EOM or OM paragraph. Related, four respondents⁶⁰ were of the view that, when a KAM section is presented in the auditor's report the heading for any EOM paragraphs should be required to include further context to clearly differentiate it from KAM; and
 - One respondent⁶¹ suggested that, for listed entities when KAM is required, if any EOM paragraphs and OM paragraphs are included, they should be reported in a single new other matters section of the auditor's report.
58. A few respondents did not support the inclusion of materiality and the scope of the audit as an example of an OM paragraph in proposed ISA 706. Some⁶² did not agree with this type of disclosure in the auditor's report, while others⁶³ were of the view that such matters should either be addressed in KAM or be required to be communicated separately in the auditor's report (compared to the IAASB position explained in the EM that this disclosure may be required by particular jurisdictions). One responded⁶⁴ specifically supported acknowledging the inclusion of materiality and the scope of the audit in an OM paragraph due to the required disclosures in the UK.
59. One MG member, supported by a few other respondents,⁶⁵ was of the view that, when a financial statement matter that is of fundamental importance to the users' understanding of the financial statements is communicated as KAM in an auditor's report, it may still need to be included as an EOM paragraph. For example, a provision for litigation could be the subject of an EOM paragraph.

⁵⁶ NSS: AUASB; *Member Bodies and Other Professional Organizations*: ACCA, FEE, IBR-IRE, KACR

⁵⁷ *Accounting Firms*: GTI

⁵⁸ *Accounting Firms*: DTT, MAZARS, RSM; *Member Bodies and Other Professional Organizations*: FEE, IBR-IRE, ISCA

⁵⁹ *Investors and Analysts*: ABI; NSS: IDW, NZAuASB; *Accounting Firms*: SRA; *Member Bodies and Other Professional Organizations*: FEE

⁶⁰ *Regulators and Oversight Authorities*: CSA CAC; NSS: CAASB, UKFRC; *Member Bodies and Other Professional Organizations*: ISCA

⁶¹ *Accounting Firms*: PWC

⁶² NSS: IDW; *Member Bodies and Other Professional Organizations*: FEE, SMPC

⁶³ *Investors and Analysts*: EUMEDION, ICGN; NSS: UKFRC

⁶⁴ *Accounting Firms*: BT

⁶⁵ *Regulators and Oversight Authorities*: BCBS, EBA; *Preparers*: AA; *Member Bodies and Other Professional Organizations*: CAI

because of the outcome uncertainty, but it could also be covered in a KAM given that it involves significant auditor judgment.

B. Drafting Team Recommendations

60. Given the widespread support for IAASB's decision to retain the concepts of EOM paragraphs and OM paragraphs, even when the auditor is required to communicate KAM, DT-701 recommends retaining the concepts as proposed in the ED.

61. However, given the number of respondents who highlighted that users of the financial statements might have difficulty differentiating between the three concepts if included in the same auditor's report, DT-701 is of the view that further means of illustrating how these concepts differ from each other is necessary and is recommending further revisions to ISA 706, including:

- Requiring wording in all EOM paragraphs to explain that the auditor is drawing attention to the matter because, in the auditor's judgment, it is fundamental to users' understanding of the financial statements (see paragraph 9(d) of **Agenda Item 4-C**);
- Explicitly noting that, when proposed ISA 701 applies, the use of EOM paragraphs is not a substitute for a description of individual matters determined to be key audit matters and the requirements in paragraphs 12–13 of proposed ISA 701 relating to communicating KAM apply (see paragraph A2 of **Agenda Item 4-C**); and
- Providing illustrative examples that clearly distinguish the difference, recognizing that the circumstance in which KAM, an EOM paragraph and an OM paragraph occur on the same engagement would likely be rare (see Appendices 3 and 4 of **Agenda Item 4-C**).

DT-701 is also retaining language in relation to both EOM paragraphs and OM paragraphs that, when proposed ISA 701 applies, such paragraphs can only be included in the auditor's report if the matter has not been determined to be a KAM to be communicated in the auditor's report (see paragraphs 8(b) and 10(b) of **Agenda Item 4-C**. DT-701 also notes, if considered necessary, implementation support or communications to investors and others could provide useful opportunities to further explain the differentiation between the concepts, and findings from the planned post-implementation review could inform the IAASB as to whether these separate concepts should be retained over the longer term.

62. DT-701 also considered the feedback from a few respondents that, in cases when a matter is a KAM but also meets the criteria for an EOM paragraph (i.e., a matter that is of such importance that it is fundamental to users' understanding of the financial statements), the matter should be given additional prominence in the auditor's report. DT-701 has considered the following options:

- One option would be to allow it to be included as both an EOM and a KAM (with possible cross reference between the two), but this would involve changing the requirement in paragraph 8(b) of ISA 706 (Revised), which was intended to distinguish the two concepts and address concerns that EOM would be used as a substitute for KAM (as explained in the application material).
- A second option would be to allow for the auditor to judge whether it is necessary to include additional wording in the KAM description to indicate the matter is also of such importance that it is fundamental to users' understanding of the financial statements), and include application material to clarify on how the auditor may do so.

- A third option would be to include a requirement for the auditor to include similar information in the KAM as to what would be required in an EOM paragraph if the KAM is also a matter that is fundamental to users' understanding of the financial statements to give it further prominence.

DT-701 is of the view that the second option is the most appropriate and has proposed these changes in this draft, as paragraph A3 of **Agenda Item 4-C**.

63. DT-701 is also of the view that mandating EOM paragraphs to always be presented before KAM may be viewed as contrary to the Board's position affirmed at its March 2014 meeting that only the ordering of the Opinion and Basis for Opinion sections should be mandated. However, given the concerns expressed as to this information needing prominence, DT-701 has agreed that the illustrative report could present an EOM paragraph before the KAM section (see Appendix 3 of **Agenda Item 4-C**).

Matter for IAASB Consideration

4. The IAASB is asked to provide feedback on DT-701's recommendations to further differentiate the concepts of KAM, EOM paragraphs and OM paragraphs, including the proposed changes to ISA 706 included in **Agenda Item 4-C**.

V. Changes to ISA 260

64. In approving the ED, the IAASB determined that limited amendments to the required auditor communications with TCWG were necessary in light of proposed ISA 701. The most significant proposed change to ISA 260 relates to the existing requirement for the auditor to communicate with those charged with governance an overview of the planned scope and timing of the audit. The IAASB proposed to expand this requirement to include communicating about the significant risks identified by the auditor (see paragraph 15 of proposed ISA 260 (Revised)). Respondents who commented on the proposed changes to ISA 260 generally supported this change for the reasons outlined in the EM.
65. DT-701 has considered the need for any further changes to ISA 260 in light of feedback received on the ED and a review of the revisions made to ISA 701 since exposure, and is recommending a limited number of revisions to ISA 260 (see **Agenda Item 4-D**). The changes being proposed are primarily to align with the revised considerations included in paragraph 9(a)–(c) of proposed ISA 701, as certain material proposed to be added no longer applies.
66. In addition, DT-701 acknowledged that a number of ISAs require communication with TCWG about the form and content of the auditor's report, including:
- ISA 705 – When the auditor expects to modify the opinion in the auditor's report, the auditor shall communicate with TCWG the circumstances that led to the expected modification and the proposed wording of the modification.
 - ISA 706 – If the auditor expects to include an EOM paragraph or an OM paragraph in the auditor's report, the auditor shall communicate with TCWG regarding this expectation and the wording of this paragraph. This requirement would also have previously addressed the extant requirement to include an EOM paragraph when a material uncertainty in relation to going

concern exists or an OM paragraph in relation to a material inconsistency in other information.

In addition, paragraph 15 of proposed ISA 701 requires certain communications with TCWG relating to the auditor's determination of KAM, with application material in paragraph A62 explaining why such communication is important, and that the auditor may consider it useful to provide TCWG with a draft of the auditor's report to facilitate this discussion and illustrate how the key audit matters are described in the auditor's report. Further, DT-700 has proposed within ISA 700 a requirement to communicate with TCWG when the auditor intends not to name the engagement partner when required to do so (i.e., when invoking the harm's way exemption).

67. Given the various requirements, DT-701 believes it may be useful to acknowledge this in proposed ISA 260 (Redrafted) and has included a new conditional requirement in paragraph 16(d) of **Agenda Item 4-D**, with application material included in paragraphs A22–A24 of proposed ISA 260 (Revised).

Matter for IAASB Consideration

5. The IAASB is asked to provide feedback on DT-701's proposed changes to ISA 260 included in **Agenda Item 4-D**.

VI. Illustrative Examples of KAM

A. Feedback from Respondents to the ED

68. Question 4⁶⁶ of the ED asked for specific views on the usefulness of the illustrative examples of KAM. Many respondents⁶⁷ generally found the illustrative examples useful and informative in clarifying the intentions of the IAASB and in indicating how KAMs may be disclosed in practice. A few respondents⁶⁸ did not find them particularly useful and informative, while the remaining respondents did not express an overarching view.

⁶⁶ Question 4 of the ED was as follows: "Which of the illustrative examples of key audit matters, or features of them, did respondents find most useful or informative, and why? Which examples, or features of them, were seen as less useful or lacking in informational value, and why? Respondents are invited to provide any additional feedback on the usefulness of the individual examples of key audit matters, including areas for improvement."

⁶⁷ *Investors and Analysts:* ABI, ICGN; *Regulators and Oversight Authorities:* ESMA, MAOB; *National Auditing Standard Setters (NSS):* FAP, HKICPA, IDW, MAASB, NZAuASB; *Accounting Firms:* BT, DTT, EYG, GTI, MAZARS, MS, PKF, RSM; *Public Sector Organizations:* AGM, GAO, NAOUK, PA; *Member Bodies and Other Professional Organizations:* FSR, ICAEW, IMCP, KICPA, SMPC, ZICA; *Academics:* HC; *Individuals and Others:* CBarnard, CMunarriz, DJuvenal

⁶⁸ *Regulators and Oversight Authorities:* IRBA; *NSS:* CAASB, UKFRC; *Public Sector Organizations:* AGSA; *Member Bodies and Other Professional Organizations:* AIA, CalCPA, ICAA; *Academics:* ABurrowes; *Individuals and Others:* ANA

69. Respondents provided the following overarching comments on the illustrative examples as included in the ED:

Views on Including Illustrative Examples in the Proposed ISAs

- Many respondents⁶⁹ highlighted that including illustrative examples in the proposed ISAs may give rise to auditor's reports containing boilerplate reporting, as the auditor is under pressure to use consistent layout and wording that is understood by users. Some of these respondents⁷⁰ were therefore of the view that the final ISAs should not include illustrative examples.
- A few respondents⁷¹ specifically commented that illustrative examples should be included in the final standard to help auditors implement and present KAM in their reports.

Specific Feedback on the Examples in the ED

- A few respondents⁷² noted that the illustrative examples were not described in a consistent format and suggested the following structure to be used for every KAM:
 - Short description of the issue;
 - Explanation of why this issue is considered a KAM;
 - Audit procedures applied to the issue and outcome (if the auditor considers it necessary); and
 - Reference to related disclosure (if applicable).
- A few other respondents⁷³ suggested the IAASB should include additional background information and reference to the related disclosure in the illustrative financial statements in the illustrative examples in order to provide better context and improved understanding of how the auditor is to apply judgment in deciding how to identify and describe individual KAM.
- A few respondents found the reasoning for identification as a KAM and the references to the notes to be a positive feature of the illustrative examples included.
- Respondents had mixed views on whether or not to include a description of audit procedures in the illustrative examples. Three respondents,⁷⁴ including one MG member, specifically commented that they were in favor while others⁷⁵ had opposing views. A few respondents⁷⁶

⁶⁹ *Regulators and Oversight Authorities:* IRBA, MAOB; *NSS:* UKFRC; *Accounting Firms:* BT, KPMG, MS; *Preparers of Financial Statements:* Gof100-A; *Member Bodies and Other Professional Organizations:* AIA, ASSIREVI, FSR, ICAEW, NZICA, SAICA; *Academics:* ABurrowes, HGortemaker

⁷⁰ *NSS:* UKFRC; *Accounting Firms:* BT, MS; *Preparers of Financial Statements:* Gof100-A; *Member Bodies and Other Professional Organizations:* ICAEW

⁷¹ *NSS:* CNCC-CSOEC; *Member Bodies and Other Professional Organizations:* ASSIREVI, IBRACON, NZICA

⁷² *NSS:* NBA; *Accounting Firms:* KPMG; *Member Bodies and Other Professional Organizations:* FEE, IMCP, WPK; *Individuals and Others:* PYoung

⁷³ *NSS:* JICPA; *Accounting Firms:* DTT, KPMG, PKF

⁷⁴ *Regulators and Oversight Authorities:* IAIS, MAOB; *Member Bodies and Other Professional Organizations:* ICPAK

⁷⁵ *Regulators and Oversight Authorities:* IRBA; *NSS:* MAASB

⁷⁶ *Public Sector Organizations:* AGO; *Member Bodies and Other Professional Organizations:* CPAA, ICAA, WPK

were of the view that the description of the audit procedures included in the illustrative examples used too much profession-specific terminology and language that is unlikely to be useful for most users.

- A few respondents,⁷⁷ including one MG member, were of the view that the illustrative examples included in the ED were generic in nature and not sufficiently entity-specific. Others⁷⁸ noted that the illustrative examples contain narrative that may be considered obvious to users of the financial statements. The resulting view in each case was that illustrative examples as drafted were not very useful to users of the financial statements.

Request for Additional Illustrative Examples

- Many respondents⁷⁹ suggested the IAASB include additional illustrative examples for specific situations or sectors, in part to align with the factors to be considered in determining KAM as included in the ED. Amongst others, respondents suggested illustrative examples for areas in which the auditor encountered significant difficulty during the audit,⁸⁰ circumstances that required significant modification of the auditor's planned approach to the audit,⁸¹ sensitive matters⁸² and specific examples related to small- and medium-sized entities.⁸³

70. Many respondents also specifically highlighted which of the illustrative examples of KAM, or features of them, they found were most useful or informative and which were seen as less useful or lacking in informational value.

B. Drafting Team Initial Views

71. DT-701 has mixed views about whether the IAASB should continue to provide illustrative examples of KAM. While there may be merit in continuing to provide a limited number of illustrative examples of KAM, DT-701 has an overarching concern about such examples being used as de facto KAMs, leading to boilerplate, or limiting innovation. It was noted that the early adoption of the IAASB's proposals in the Netherlands highlighted that certain of the examples included in the ED were very closely replicated in auditor's reports. Including such examples in the final standard may signal that the IAASB has "approved" such examples, so it may be preferable to place them elsewhere, for example, in a separate document issued by Staff or others.

⁷⁷ *Regulators and Oversight Authorities:* CPAB, IAIS; *NSS:* CAASB; *Accounting Firms:* KPMG, PP; *Preparers of Financial Statements:* SPL; *Member Bodies and Other Professional Organizations:* FSR; *Academics:* ABurrowes

⁷⁸ *Regulators and Oversight Authorities:* IRBA; *NSS:* CAASB; *Accounting Firms:* BT; *Public Sector Organizations:* AGO; *Preparers of Financial Statements:* AA, NN, SPL; *Member Bodies and Other Professional Organizations:* AIA, FSR

⁷⁹ *Regulators and Oversight Authorities:* ESMA, IRBA; *NSS:* AUASB, MAASB, NBA, NZAuASB; *Public Sector Organizations:* ACAG, AGNZ, AGSA, NAOS, NAOUK; *Member Bodies and Other Professional Organizations:* EFAA, FACPCE, KICPA, SMPC; *Individuals and Others:* CMunarriz, Flrungu

⁸⁰ *Regulators and Oversight Authorities:* ESMA, IRBA; *NSS:* AUASB, MAASB, NZAuASB; *Public Sector Organizations:* ACAG, AGNZ, AGSA, NAOUK; *Member Bodies and Other Professional Organizations:* EFAA, KICPA

⁸¹ *Regulators and Oversight Authorities:* ESMA, IRBA; *NSS:* AUASB, MAASB, NZAuASB; *Public Sector Organizations:* ACAG, AGNZ, AGSA, NAOUK; *Member Bodies and Other Professional Organizations:* EFAA, KICPA

⁸² *NSS:* AUASB, NZAuASB

⁸³ *Member Bodies and Other Professional Organizations:* FACPCE, SMPC; *Individuals and Others:* CMunarriz

72. For comparison, DT-701 notes that the UK auditor reporting standard does not include illustrative examples, however in France examples have been provided to illustrate the application of the “justification of assessments” requirements. While the PCAOB’s auditor reporting proposals included illustrative examples, it remains to be seen whether examples will be included in its final rule. It is also important to acknowledge that real-life examples under the UK regime are also currently available in the marketplace. By the time proposed ISA 701 would be effective, there would be many more “real-life” examples available, including examples for periods following the initial year of implementation.
73. If illustrative examples are to be provided, DT-701 is of the initial view it would be preferable to develop only a very small number of examples and consider their appropriate placement. If the IAASB believes such examples should be included in the final standard, DT-701 would recommend placing these examples in an Appendix to proposed ISA 701, rather than within an illustrative report in proposed ISA 700 (Revised). It is likely DT-701 would seek to revise the goodwill and valuation of financial instruments examples included in the ED, as these examples received the most support from respondents, and possibly develop a third example. DT-701 also believes it will continue to be necessary to demonstrate in any examples that auditors can exercise judgment in determining the appropriate amount of detail to explain how a matter was addressed in the audit.

Matter for IAASB Consideration

6. The IAASB is asked to provide its initial views on whether illustrative examples of KAM should be provided and, if so, how many and in what manner.