

Agenda Item 2-G

Comparison of Requirements in Proposed ISA 701 from the Exposure Draft (ED) to September 2014 Agenda Material

Note: The purpose of this Staff-prepared agenda item is to compare the requirements set out in the ED with those included in the September 2014 IAASB agenda material (**Agenda Items 2-B and 2-C**) and includes, at a high level, the rationale for those changes. Further details on the Drafting Team Recommendations and the IAASB's deliberations in respect of these changes are included in the issues papers and meeting minutes for the March, June and September 2014 meetings.

| Exposure Draft | September 2014 Agenda Item 2-C | Rationale for Changes from Exposure |
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| Objectives | | |
| 6. The objectives of the auditor are to determine key audit matters and, having formed an opinion on the financial statements, communicate those matters by describing them in the auditor's report. | 7. The objectives of the auditor are to determine key audit matters and, having formed an opinion on the financial statements, communicate those matters by describing them in the auditor's report. | No change – respondents were broadly supportive of how the objective had been articulated. |
| Definition | | |
| 7. For purposes of the ISAs, the following term has the meaning attributed below: <i>Key audit matters</i> —Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance. | 8. For purposes of the ISAs, the following term has the meaning attributed below: <i>Key audit matters</i> —Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance. | No change – respondents were broadly supportive of how the definition had been articulated. |
| Requirements | | |
| Determining Key Audit Matters | | |
| 8. The auditor shall determine which of the matters communicated with those | 9. The auditor shall determine, from the matters communicated with those | <ul style="list-style-type: none"> • Retained the premise in the ED that the determination of key audit matters (KAM) |

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| <p>charged with governance are the key audit matters. In making this determination, the auditor shall take into account areas of significant auditor attention in performing the audit, including: (Ref: Para. A1–A14, A24)</p> <p>(a) Areas identified as significant risks in accordance with ISA 315 (Revised)¹ or involving significant auditor judgment. (Ref: Para. A15–A19)</p> <p>(b) Areas in which the auditor encountered significant difficulty during the audit, including with respect to obtaining sufficient appropriate audit evidence. (Ref: Para. A20–A21)</p> <p>(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. A22–A23)</p> | <p>charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following: (Ref: Para. A9–A18)</p> <p>(a) Areas of higher assessed risks of material misstatement, or significant risks identified in accordance with ISA 315 (Revised).² (Ref: Para. A19–A22)</p> <p>(b) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty. (Ref: Para. A23–A24)</p> <p>(c) The effect on the audit of significant events or transactions that occurred during the year. (Ref: Para. A25–A26)</p> <p>10. The auditor shall determine which of the matters determined in accordance with paragraph 9 were of most significance in the audit of the financial statements</p> | <p>is based firstly on matters communicated with those charged with governance (TCWG), with the auditor applying professional judgment in making that determination, in light of support from the majority of respondents to the ED and discussion with the Consultative Advisory Group (CAG)</p> <ul style="list-style-type: none"> • However, further refinements have been made to the “decision framework” in an effort to make the requirements capable of more consistent application. • Firstly, the original requirement has been split into two requirements in response to concerns (including those arising from firm field testing) that the decision framework was not sufficiently clear. Respondents indicated that the first step in the auditor’s thought process of determining the matters of “most significance” would be to focus on those areas requiring the most attention in the audit from the range of matters that were communicated to TCWG. • Respondents to the ED were of the view that matters relating to the financial statements were mostly likely to be relevant to users, without ruling out the possibility that other matters requiring |
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¹ ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

² ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

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| | <p>of the current period and therefore are the key audit matters. (Ref: Para. A9–A11, A27–A30)</p> | <p>significant auditor attention may be determined to be KAM. As such, respondents were of the view that the considerations set out in paragraphs 8(b)–(c) in the ED may not always result in relevant information being provided to users.</p> <ul style="list-style-type: none">• In light of this agreement amongst respondents to first focus on “matters that required significant auditor attention”, paragraph 9 continues to set forth minimum considerations as to what such areas may be, revised to align more closely with matters related to the financial statements. Importantly, the ISA requires the auditor to always consider these areas, but application material explains that these matters may not always be determined to be KAM or that other matters not related to these required minimum considerations could also be determined to be KAM.• Application material has also been enhanced to provide further context to explain the intent of “significant auditor attention” and highlight matters relevant to the required considerations, including how they relate to other ISAs and the performance of a risk-based audit. While no longer required considerations, the concepts of areas of significant difficulty in the audit and changes in the auditor’s approach continue to be highlighted in the |
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| | | <p>application material as possibly relevant to the auditor's decision-making.</p> <ul style="list-style-type: none"> • Further application material has been provided in support of the new requirement in paragraph 10, in particular to explain how the significance of a matter may be determined relative to other matters. For example, it was frequently noted that the nature and extent of interaction with TCWG was likely to provide an indication that a matter was a KAM, as would the importance of the matter to intended users' understanding of the financial statements as a whole (including its materiality), and the nature and extent of audit effort needed to address the matter. • Concept of KAM being limited to the current period audit, as also included in the definition, has been incorporated into the requirement in paragraph 10. |
| Communicating Key Audit Matters | | |
| <p>9. The auditor shall communicate the key audit matters determined in accordance with paragraph 8 in a separate section of the auditor's report under the heading "Key Audit Matters." The auditor's report shall state that:</p> <p>(a) Key audit matters are those matters that, in the auditor's</p> | <p><i>Introductory Language When KAM Are Communicated</i></p> <p>11. When key audit matters are communicated, the auditor shall include the descriptions of the individual key audit matters, with an appropriate subheading for each, in a separate section of the auditor's report under the heading "Key Audit Matters," except for those matters communicated in</p> | <ul style="list-style-type: none"> • Retained the concept of a separate section in the auditor's report with the heading "Key Audit Matters" and the need for a separate subheading for each matter (relocated from paragraph 10 of the ED). • Required language in the introductory paragraph in the auditor's report has been streamlined in light of concerns over lengthy standardized language in the entity-specific KAM section. Some of this |

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| <p>professional judgment, were of most significance in the audit of the financial statements [of the current period];</p> <p>(b) Key audit matters are selected from matters communicated with [those charged with governance], but are not intended to represent all matters that were discussed with them;</p> <p>(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</p> <p>(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. A25–A29)</p> | <p>accordance with paragraph 15. The introductory language in this section of the auditor's report shall state that:</p> <p>(a) Key audit matters are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements [of the current period]; and</p> <p>(b) These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters. (Ref: Para. A31–A33)</p> | <p>material would now be required to be presented in the section of the auditor's report describing the auditor's responsibilities.</p> <ul style="list-style-type: none"> • Editorial changes made to both the requirement and the illustrative wording in the auditor's reports to more clearly articulate the intent of KAM and the relationship with the auditor's opinion. |
| | <p><i>Key Audit Matters Not a Substitute for Expressing a Qualified or Adverse Opinion</i></p> <p>12. The auditor shall communicate a matter determined to be a key audit matter in the Key Audit Matters section of the auditor's report only when the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements. (Ref: Para. A5)</p> | <ul style="list-style-type: none"> • New requirement to acknowledge explicitly that KAM is not to be used as a substitute for a qualified or adverse opinion, a concept that was previously articulated in the application material in the ED and is similarly expressed in a requirement in ISA 706. |

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| <p>10. The auditor shall describe each key audit matter in the Key Audit Matters section using an appropriate subheading, except in the circumstances explained in paragraph 11. The description of each key audit matter shall include: (Ref: Para. A30)</p> <p>(a) An explanation of why the auditor considered the matter to be one of most significance in the audit and, to the extent the auditor considers it necessary as part of this explanation, its effect on the audit; and (Ref: Para. A31–A41)</p> <p>(b) A reference to the related disclosure(s), if any, in the financial statements. (Ref: Para. A42–A43)</p> | <p><i>Descriptions of Individual Key Audit Matters</i></p> <p>13. The description of each key audit matter in the Key Audit Matters section of the auditor’s report shall include a reference to the related disclosure(s), if any, in the financial statements and shall address: (Ref: Para. A34–A41)</p> <p>(a) Why the matter was considered to be one of most significance in the audit and therefore determined to be a key audit matter; and (Ref: Para. A42–A45)</p> <p>(b) How the matter was addressed in the audit. (Ref: Para. A46–A51)</p> | <ul style="list-style-type: none"> • Requirement strengthened to require that the description, in all cases, includes how the matter was addressed in the audit (rather than describing the “effect on the audit” if considered necessary). This was done in response to feedback from exposure that such information was necessary in order for the description to achieve the objective of being relevant to users and that the concept of “effect on the audit” was unclear. • Application material enhanced to further explain what may be included in the auditor’s report to describe how the matter was addressed in the audit, retaining a level of flexibility for the auditor to judge how best to describe the KAM in a manner that will be meaningful to users. |
| | <p><i>Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor’s Report</i></p> <p>14. The auditor shall describe each key audit matter in the auditor’s report unless:</p> <p>(a) Law or regulation preclude public disclosure about the matter; or (Ref: Para. A52–A53)</p> <p>(b) In extremely rare circumstances, the auditor determines that a matter that has not otherwise</p> | <ul style="list-style-type: none"> • New requirement to address circumstances in which a matter determined to be a KAM is not communicated in the auditor’s report. Such requirement was determined to be necessary in light of feedback from field testing and calls from respondents across stakeholder groups (including preparers and some regulators) to explain how the auditor might approach “sensitive matters” that have been determined to be KAM, in particular in light of concerns that the auditor could be providing original |

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| | <p>been publicly disclosed should not be communicated in the auditor’s report, in view of the significance of the adverse consequences that can reasonably be expected to arise as a result of such communication. (Ref: Para. A54–A61)</p> | <p>information about the entity or that the auditor communicating the matter may be viewed as in conflict with confidentiality requirements. Specifically, questions arose about whether it was appropriate for auditors to be describing these matters, in particular when management was not required to disclose information about them.</p> <ul style="list-style-type: none"> • With the advice of the CAG, the Board very seriously considered how to put appropriate parameters in the standard to address this circumstance – acknowledging that, while disclosure of a “sensitive matter” may be viewed as being in the public interest, disclosure by the auditor in advance of when such matter would otherwise be required to be disclosed by the entity could have unintended adverse consequences. • New application material has been developed to support this requirement, aimed at helping to guide the auditor’s decision-making process whether to not communicate a matter and highlighting that the issues, in particular relating to consideration of relevant ethical requirements, are complex and require significant auditor judgment. • In combination, the new requirement and guidance is intended to promote disclosure of matters determined to be KAM in the |
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| | | <p>auditor’s report, rather than be overly permissive in allowing for auditors to not communicate matters determined to be KAM. For example, guidance explains that, in all cases, the expectation is that the auditor will look to find ways to communicate about a matter, either more generally (taking into account what has already been disclosed in the financial statements) or after management and TCWG agree to include additional disclosure about the matter to which the auditor can refer.</p> |
| <p><i>Interaction between Descriptions of Key Audit Matters and Other Elements Required to Be Included in the Auditor’s Report</i></p> | | |
| <p>11. A matter giving rise to a qualified or adverse opinion in accordance with proposed ISA 705 (Revised),³ or the existence of a material uncertainty related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern (hereinafter referred to as “material uncertainty”) in accordance with proposed ISA 570 (Revised),⁴ is by its nature a key audit matter. However, the auditor shall:</p> <p>(a) Report on these matter(s) in</p> | <p>15. A matter giving rise to a qualified or adverse opinion in accordance with proposed ISA 705 (Revised), or a material uncertainty related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern in accordance with proposed ISA 570 (Revised),⁵ are by their nature key audit matters. However, in such circumstances, these matters are not described in the Key Audit Matters section of the auditor’s report. Rather, the auditor shall:</p> | <ul style="list-style-type: none"> • Requirement retained, with minor editorial changes to clarify the intent |

³ Proposed ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor’s Report*, paragraphs 7–8

⁴ Proposed ISA 570 (Revised), *Going Concern*, paragraphs 21–23

⁵ Proposed ISA 570 (Revised), *Going Concern*, paragraphs 22–23

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| <p>accordance with the applicable ISA(s);</p> <p>(b) Not describe these matter(s) in the Key Audit Matters section of the auditor’s report; and</p> <p>(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. A44–A45)</p> | <p>(a) Report on these matter(s) in accordance with the applicable ISA(s); and</p> <p>(b) Include a reference to the Basis for Qualified (or Adverse) Opinion or the Material Uncertainty Related to Going Concern section(s) in the Key Audit Matters section. (Ref: Para. A6–A7)</p> | |
| <p>Circumstances in which the Auditor Has Determined There Are No Key Audit Matters</p> <p>13. If the auditor determines that there are no key audit matters to communicate in the auditor’s report, the auditor shall:</p> <p>(a) Discuss this conclusion with the engagement quality control reviewer, for those engagements where one has been appointed;</p> <p>(b) Communicate this conclusion with those charged with governance; and</p> <p>(c) Explain in the auditor’s report 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</p> | <p><i>Form and Content of the Key Audit Matters Section in Other Circumstances</i></p> <p>16. 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 or that the only key audit matters communicated are those in accordance with paragraph 15, the auditor shall include a statement to this effect in a separate section of the auditor’s report under the heading “Key Audit Matters.” (Ref: Para. A62–A65)</p> | <ul style="list-style-type: none"> • Retained the possibility that the auditor may determine that there are no KAM to communicate, in light of support of respondents for this possibility. • However, application material clarifies that it is expected to be unusual that the auditor of a complete set of general purpose financial statements of a listed entity would not determine at least one KAM from the matters communicated with TCWG to be communicated in the auditor’s report. • The concept of discussing this conclusion with the engagement quality control reviewer has been retained, but is now addressed via a conforming amendment to ISA 220 in response to comments that it was viewed as part of the engagement quality control reviewer’s required review of conclusions reached by the engagement partner in formulating the auditor’s report. |

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| <p>the financial statements and the auditor has determined that there are no matters to report. (Ref: Para. A47–A48)</p> | | <ul style="list-style-type: none"> • Requirement to communicate with TCWG when the auditor has determined there is nothing to report now incorporated in paragraph 17, as compared to paragraph 13(b) of the ED. • Requirement for statement to be included in the auditor’s report has been simplified; application material continues to provide an illustration of such wording. |
| <p>Communication with Those Charged with Governance</p> | | |
| <p>12. The auditor shall communicate with those charged with governance those matters the auditor has determined are the key audit matters to be included in the auditor’s report. (Ref: Para. A46)</p> | <p>17. The auditor shall communicate with those charged with governance:</p> <p>(a) Those matters the auditor has determined to be the key audit matters; or</p> <p>(b) If applicable, depending on the facts and circumstances of the entity and the audit, the auditor’s determination that there are no key audit matters to communicate in the auditor’s report. (Ref: Para. A66–A69)</p> | <ul style="list-style-type: none"> • Requirement to communicate with TCWG when the auditor has determined there are no KAM now incorporated in paragraph 17, as compared to paragraph 13(b) of the ED. • Changes to paragraph 17(a) are intended to also take into account required communication with TCWG in circumstances where the auditor has concluded that a matter determined to be a KAM will not be communicated in the auditor’s report. Such communications are explained in application material to paragraph 14. |
| <p>Documentation</p> | | |
| <p>14. The auditor shall document the matters that will be communicated as key audit</p> | <p>18. The auditor shall include in the audit documentation:⁷ (Ref: Para. A70)</p> | <ul style="list-style-type: none"> • Retained the premise of what is required to be documented, in light of support received |

⁷ ISA 230, *Audit Documentation*, paragraphs 8–11 and A6

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| <p>matters, and the significant professional judgments made in reaching this determination, in accordance with ISA 230.⁶ This includes, where applicable, the rationale for the auditor's determination that there are no key audit matters to communicate in the auditor's report. (Ref: Para. A49)</p> | <p>(a) The matters that will be communicated as key audit matters in the auditor's report, and the significant professional judgments made in reaching this determination;</p> <p>(b) Where applicable, the rationale for the auditor's determination that there are no key audit matters to communicate in the auditor's report; and</p> <p>(c) Where applicable, the rationale for the auditor's determination not to communicate in the auditor's report a matter determined to be a key audit matter. (Ref: Para. A60)</p> | <p>on exposure and recognition that it would be impracticable to require auditors to document why other matters were not determined to be KAM.</p> <ul style="list-style-type: none"> • Requirement restructured to align more closely with documentation requirements in other ISAs. • Paragraph 19(c) added to require documentation of the auditor's rationale in circumstances contemplated by the new requirement in paragraph 14. • This requirement continues to be supplemented by a conforming amendment to ISA 230 as an additional example of a significant professional judgment required to be documented. |
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⁶ ISA 230, *Audit Documentation*, paragraphs 8(c) and A10