A COMPARISON BETWEEN THE IAASB AND THE US PCAOB STANDARDS

This publication has been prepared by the Auditor Reporting Implementation Working Group. It does not constitute an authoritative pronouncement of the International Auditing and Assurance Standards Board (IAASB), nor does it amend or override the International Standards on Auditing (ISAs). Further, this publication is not meant to be exhaustive and reading this publication is not a substitute for reading the ISAs or the standards issued by the United States (US) Public Company Accounting Oversight Board (PCAOB).

This publication has been developed to illustrate the key similarities and differences between the IAASB's new and revised Auditor Reporting standards issued in January 2015 (IAASB Standards) and PCAOB Standard, AS 3101 (PCAOB Standard), *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, included in the PCAOB's Release No. 2017-001 *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards*.[1]

This publication focuses mainly on the IAASB's concept of Key Audit Matters (KAM), as set out in **ISA 701**, *Communicating Key Audit Matters in the Independent Auditor's Report*, and the PCAOB's concept of Critical Audit Matters (CAM). The IAASB and PCAOB have taken similar approaches to enhancing the auditor's report, by providing greater transparency to investors and others about audit-related matters and building on the two-way communications throughout the audit with those charged with governance (TCWG) (e.g., the audit committee). The approaches in other jurisdictions, such as the European Union (EU) and United Kingdom (UK), are highlighted later in this publication.

Comparing the IAASB and PCAOB Approaches

Under the IAASB Standards,[2] auditors of financial statements of listed entities[3] are required to communicate KAM in the auditor's report. Law, regulation or auditing standards in a particular jurisdiction may extend the requirement to communicate KAM to other entities, such as public interest entities (PIEs), public sector entities, entities in a particular industry, or all entities. The IAASB Standards also allow for auditors to communicate KAM on a voluntary basis for entities other than listed entities in the absence of a requirement to do so.

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1 The PCAOB Standard is subject to the approval of the US Securities and Exchange SEC Commission.

2 The IAASB standards came into effect for periods ending on or after December 15, 2016.

3 Paragraph 12(i) of ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements,* defines a listed entity as "An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body". This definition provides flexibility to reflect varying circumstances across jurisdictions related to what is considered "a recognized stock exchange." Accordingly, national jurisdictions are best placed to link the requirements to communicate KAM with existing securities or audit oversight regulations in their respective jurisdiction.

The PCAOB Standard[4] requires CAM to be communicated in the auditor's report for audits conducted under PCAOB standards, except for:

- Audits of brokers and dealers reporting under Rule 17a-5 of the Securities Exchange Act of 1934;
- Investment companies registered under the Investment Company Act of 1940 (other than business development companies);
- Employee stock purchase, savings, and similar plans; and
- Emerging growth companies as defined in Section 3(a)(80) of the Exchange Act.

The following table sets forth the respective IAASB and PCAOB definitions:

Definition	
IAASB Standards	**PCAOB Standard**
Key Audit Matters: 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. Key audit matters are selected from matters communicated with those charged with governance.	Critical Audit Matter: Any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that: • Relates to accounts or disclosures that are material to the financial statements, and • Involved especially challenging, subjective, or complex auditor judgment.

Determining Whether a Matter Is a KAM / CAM

KAM should be specific to the entity and the audit in order to provide relevant and meaningful information to users. Therefore, ISA 701 includes a two-step process using a **judgment-based decision-making framework** to help auditors determine which matters, from those communicated with TCWG, are KAM. This decision-making framework was developed to focus auditors on areas of the financial statements that involved the most significant or complex judgments by management and areas of auditor focus in accordance with the risk-based approach in the ISAs.

The **IAASB** and **PCAOB** approaches are intended to result in the communication of matters in the auditor's report that are likely to be of interest to users of the auditor's report.

The framework for determining CAM under the PCAOB Standard is similar to the IAASB Standards and starts with those matters communicated or required to be communicated to the audit committee. As defined, a CAM also relates to accounts or disclosures that are material to the financial statements.

[4] The requirement to communicate CAM under the PCAOB Standard comes into effect for fiscal years ending on or after June 30, 2019 for audits of large accelerated filers and fiscal years ending on or after December 15, 2020 for audits of all other companies to which the requirements apply. The other enhancements to the auditor's report under the PCAOB Standard come into effect for fiscal years ending on or after December 15, 2017 for all audits that are conducted under PCAOB standards.

Although not included in the definition of KAM, paragraph A29 of ISA 701 provides for the consideration of materiality by noting that the importance of the matter to the intended users' understanding of the financial statements as a whole and, in particular, its materiality to the financial statements, may be relevant to determining the relative significance of a matter communicated with TCWG and whether such a matter is a KAM. Some might believe that the inclusion of a materiality consideration in the definition of CAM may result in a narrower population of matters that may be a CAM under the PCAOB Standard than under the IAASB Standards or approaches in other jurisdictions. However, the PCAOB June 2017 release explicitly notes that "although the processes of identifying these matters vary across jurisdictions, there are commonalities in the underlying criteria regarding matters to be communicated and the communication requirements, such that expanded auditor reporting could result in the communication of many of the same matters under the various approaches."

Considerations in Determining Whether a Matter Is a KAM / CAM

The table below shows the requirements of the IAASB Standards and the PCAOB Standard. For the most part, the specific factors and other considerations underlying the auditor's determination of which matters are KAM / CAM are similar under both approaches. In addition to the factors in the table that the auditor is specifically required to take into account in determining KAM, ISA 701 provides a substantial amount of guidance to support the auditor's decision-making process.[5] In accordance with the IAASB Standards, application and other explanatory material is relevant to the proper application of the requirements of a standard.

Requirements in Determining KAM / CAM	
IAASB Standard	**PCAOB Standard**
The auditor shall determine, from the matters communicated with those 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: (a) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with ISA 315 (Revised).[6] (b) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including	In determining whether a matter involved especially challenging, subjective, or complex auditor judgment, the auditor should take into account, alone or in combination, the following factors, as well as other factors specific to the audit: (a) The auditor's assessment of the risks of material misstatement, including significant risks; (b) The degree of auditor judgment related to areas in the financial statements that involved the application of significant judgment or estimation by management,

[5] The application material in ISA 701 notes that the severity of any control deficiencies related to a matter is a factor that could be considered by the auditor in determining the relative significance of a matter communicated with those charged with governance, and whether the matter is a KAM. The PCAOB has clarified that a significant deficiency in internal control over financial reporting, in and of itself, cannot be a CAM since such determination does not relate to an account or disclosure that is material to the financial statements as no disclosure of the determination is required. Nevertheless, the PCAOB notes that a significant deficiency in internal control could be among the principal considerations that lead the auditor to determine that a matter is a CAM

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

Requirements in Determining KAM / CAM	
IAASB Standard	**PCAOB Standard**
accounting estimates that have been identified as having high estimation uncertainty. (c) The effect on the audit of significant events or transactions that occurred during the period. (Paragraph 9 of ISA 701) The auditor shall determine which of the matters determined in accordance with the requirement above were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters. (Paragraph 10 of ISA 701)	including estimates with significant measurement uncertainty; (c) The nature and timing of significant unusual transactions and the extent of audit effort and judgment related to these transactions; (d) The degree of auditor subjectivity in applying audit procedures to address the matter or in evaluating the results of those procedures; (e) The nature and extent of audit effort required to address the matter, including the extent of specialized skill or knowledge needed or the nature of consultations outside the engagement team regarding the matter; and (f) The nature of audit evidence obtained regarding the matter. Note: It is expected that, in most audits, the auditor would determine that at least one matter involved especially challenging, subjective, or complex auditor judgment. (Paragraph .12 of the PCAOB Standard AS 3101)

Documentation

Because the determination of KAM / CAM is linked to principles-based requirements and relies on auditor judgment, both the IAASB and PCAOB have set out specific requirements to assist auditors in documenting those important judgments. However, these requirements differ in terms of the matters for which such documentation is required. The IAASB Standard requires documentation of the matters that required significant auditor attention, and the rationale for the auditor's determination as to whether or not each of these matters is a KAM. Under the PCAOB Standard, for each matter arising from the audit of the financial statements that was communicated to the audit committee and relates to accounts or disclosures that are material to the financial statements, the auditor must document whether or not the matter was determined to be a CAM and the basis for such determination.

Communication of KAM / CAM

The number of KAM / CAM that will be communicated in the auditor's report may be affected by the complexity of the entity, the nature of the entity's business and environment, and the facts and circumstances of the audit engagement. Under both approaches, it is expected that there will be at least one KAM / CAM communicated by the auditor in the auditor's report. However, the IAASB and PCAOB acknowledge that there may be circumstances where there are no KAM / CAM to report, and both require inclusion of a statement to that effect in the auditor's report in such cases.

The IAASB and PCAOB require the communication of KAM / CAM only for the audit of the current period. Guidance in ISA 701 indicates that it nevertheless may be useful for the auditor to consider whether a KAM in the prior period continues to be a KAM in the audit of the current period. The PCAOB Standard notes that the auditor may communicate CAM relating to a prior period and includes examples of circumstances when this may be appropriate.

The IAASB and PCAOB both require the communication of matters determined to be KAM / CAM. However, ISA 701 acknowledges that, in extremely rare circumstances, the auditor may decide that a matter determined to be KAM should not be communicated.[7] The PCAOB acknowledges that the auditor is not expected to provide information about the company that has not been made publicly available by the company unless such information is necessary to describe the principal considerations that led the auditor to determine that the matter is a CAM or how it was addressed in the audit.

The IAASB and PCAOB preclude the communication of KAM/CAM when the auditor disclaims an opinion on the financial statements. The PCAOB does not permit the communication of CAM when the auditor expresses an adverse opinion, whereas the IAASB requires the communication of KAM despite the adverse opinion.

Descriptions of KAM / CAM in the Auditor's Report

Under the IAASB and PCAOB approaches, the description of a KAM / CAM is intended to provide a succinct and balanced explanation about the matter that is tailored to the audit. This is meant to avoid standardized language and to reflect the specific circumstances of the matter, while limiting the use of highly technical accounting and auditing terms. The IAASB notes that the level of detail in the description of each KAM is a matter of professional judgment, and may vary depending on the specific facts and circumstances of the particular engagement. Regarding CAM, the PCAOB indicates that the descriptions should be at a level that users would understand and further notes that the objective is to provide a useful summary and not to detail every aspect of how the matter was addressed. The IAASB and PCAOB are of the view that flexibility is important to enable auditors to be as entity-specific and audit-specific as possible in the description of a KAM / CAM, in order to mitigate concerns from users that communication of KAM / CAM could quickly result in more standardized or "boilerplate" communications. Introductory language is required to be included under both the IAASB and the PCAOB approaches to give context to readers of the auditor's report, which explains what is considered to be a KAM / CAM and that the auditor is not providing discrete opinions on separate elements of the financial statements (a "piecemeal opinion").[8]

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7 See paragraph 14 of ISA 701.

8 The IAASB Standards also require the following language to be included in the section of the auditor's report describing the auditor's responsibilities: "From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication."

Required Descriptions in the Auditor's Report	
IAASB Standards	**PCAOB Standard**
The description of a KAM is required to include a reference to the related disclosures, if any, in the financial statements and address: • Why the matter was considered to be one of most significance in the audit and therefore determined to be a KAM; and • How the matter was addressed in the audit. (Paragraph 13 of ISA 701)	For each critical audit matter communicated in the auditor's report the auditor must: • Identify the critical audit matter; • Describe the principal considerations that led the auditor to determine that the matter is a critical audit matter; • Describe how the critical audit matter was addressed in the audit; and • Refer to the relevant financial statement accounts and disclosures that relate to the critical audit matter. (Paragraph .14 of the PCAOB Standard AS 3101)

ISA 701 provides further guidance for auditors in providing insight into the audit through the description of how the matter was addressed in the audit, by explaining, for example, (i) a brief overview of the procedures performed, (ii) key aspects of the auditor's response or approach, or (iii) an indication of the outcome of the auditor's procedures or key observations with respect to the matter. The PCAOB Standard provides similar guidance.[9] Both approaches are clear that the communication in the auditor's report about KAM / CAM should not imply that the matter has not been appropriately resolved by the auditor in forming the opinion on the financial statements, or that a separate opinion is being expressed with respect to the matter.

Illustrative KAM

In finalizing ISA 701, the IAASB agreed to develop a limited number of KAM examples to illustrate how the requirements of ISA 701 may be applied. These are included in the publication, *Auditor Reporting – Illustrative Key Audit Matters*. The IAASB notes in this publication that these examples are for illustrative purposes only, since KAM need to be tailored to the facts and circumstances of the individual audit engagement and the entity. The PCAOB has not provided illustrative examples because it believes that auditors should provide tailored, audit-specific information when communicating CAM in the auditor's report.

Other Enhancements to Auditor Reporting

The IAASB Standards and the PCAOB Standard include a number of other enhancements to auditor reporting, many of which are similar in principle, with some differences in specific wording or placement within the auditor's report. These enhancements apply to all audits that are conducted under the respective standards of the IAASB and PCAOB.

[9] See Note 1 to paragraph .14c of the PCAOB Standard.

IAASB Standards	PCAOB Standard
The Opinion section is required to be presented first, followed by the Basis for Opinion section, unless law or regulation prescribes a different placement.	The Opinion section is required to be presented first, followed by the Basis for Opinion section.
In the Basis for Opinion section, there is identification of the relevant ethical requirements and a statement indicating that the auditor is independent and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.	In the Basis for Opinion section, a statement is required that indicates the auditor is a public accounting firm registered with the PCAOB (United States) and is required to be independent with respect to the company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the US Securities and Exchange Commission (SEC) and the PCAOB.
When the auditor modifies the opinion, the basis for the modification is included in the Basis for Opinion section. A KAM cannot be a substitute for a modified opinion.	When there is a departure from an unqualified opinion, the substantive reasons for the opinion are included in one or more separate paragraphs immediately following the opinion paragraph of the auditor's report. Additional information is also required to be included in these paragraphs in the case of an adverse opinion or disclaimer of opinion.
Expanded descriptions of the responsibilities of management and those charged with governance, as well as the auditor's responsibilities and the key features of an audit, are required in separate sections of the auditor's report.	Enhancements to certain standardized language, including reference to "whether due to fraud or error" when describing the auditor's responsibilities under PCAOB standards to obtain reasonable assurance that the financial statements are free of material misstatement. The description of the responsibilities of the auditor, management and those charged with governance are not as detailed under the PCAOB Standard. Also, under the PCAOB Standard, these responsibilities are included in the Basis for Opinion section, rather than as separate sections.
The name of the engagement partner is required to be included in the auditor's report for audits of financial statements of listed entities.	The name of the engagement partner and information about the involvement of other accounting firms participating in the audit is required to be reported by the audit firm on PCAOB Form AP, Auditor Reporting of Certain Audit Participants. The auditor may include this information in the auditor's report for an individual engagement but is not required to do so.
There are no requirements regarding the disclosure of the auditor's tenure.	A statement containing the year the auditor began serving consecutively as the company's auditor is required to be included in the auditor's report.

IAASB Standards	PCAOB Standard
Emphasis of Matter (EOM) and Other Matter (OM) paragraphs are required in certain circumstances[10] and are otherwise permitted at the auditor's discretion. If ISA 701 applies, a matter may only be communicated as an EOM or OM if it has not been determined to be a KAM. However, in circumstances when an EOM or OM paragraph is required by the ISAs[11] and the matter is also a KAM, it is communicated in both sections. When there is a material uncertainty related to going concern, although the matter is by its nature a KAM, it is not included in the KAM section of the auditor's report and the requirements relating to the description of KAM do not apply (see further discussion on going concern below).	The PCAOB standard permits the inclusion of emphasis paragraphs, although no requirement exists; however these paragraphs may not serve as a substitute for CAM. There is a continued requirement to include explanatory language (or an explanatory paragraph) in certain circumstances.[12] CAM are not a substitute for required explanatory paragraphs. However, there could be situations in which a matter meets the definition of a CAM and also requires an explanatory paragraph, such as going concern. In these situations, both the explanatory paragraph and CAM would be required. The auditor may however include the description of the matter in both the explanatory paragraph and the CAM section with a cross-reference between them, or may include the required communication in the explanatory paragraph with a cross-reference in the CAM section to the explanatory paragraph.

Going Concern and Other Information

In addition to other enhancements, **ISA 570 (Revised)**, *Going Concern*, and **ISA 720 (Revised)**, *The Auditor's Responsibilities Relating to Other Information*, contain new or revised requirements regarding the communication of going concern and other information in the auditor's report, including:

- In relation to going concern, if the disclosure of a material uncertainty related to going concern in the financial statements is adequate, the auditor is required to include a separate section in the auditor's report that draws attention to those disclosures, under the heading "Material Uncertainty Related to Going Concern". If the disclosures are inadequate, the auditor is required to express a modified opinion and describe the issues related to going concern in the Basis for Opinion section of the auditor's report. The IAASB has also developed additional requirements for auditors in relation to evaluating the financial statement disclosures in going concern "close call" situations. Further information on reporting on going concern is available in the publication *Auditor Reporting on Going Concern*.
- Explicit reporting in the auditor's report in a separate Other Information section. This section is intended to explain the responsibilities of management and the auditor in respect of the other information, including the auditor's work effort. It also identifies the other information obtained by the auditor (e.g., the management's report and chairman's statement in an annual report) and

10 See Appendix 2 of ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report,* regarding ISAs that require the auditor to include an EOM or OM paragraph.

11 See Appendix 2 of ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report,* regarding ISAs that require the auditor to include an EOM or OM paragraph.

12 See paragraph .18 of Proposed AS 3101.

includes either a statement that the auditor has concluded that there is no uncorrected material misstatement of the other information or, if such an uncorrected material misstatement exists, a statement that describes the uncorrected material misstatement.

The PCAOB is addressing these topics under separate initiatives. The PCAOB's standards already require auditors to include an explanatory paragraph in the auditor's report when there is substantial doubt about the company's ability to continue as a going concern and the disclosure in the financial statements is adequate,[13] and when the other information in a document containing audited financial statements is materially inconsistent with information appearing in the financial statements.[14]

Other Standards Affected

The IAASB and PCAOB have addressed how the amendments to the auditor reporting requirements impact the engagement quality control (EQC) review and communications with those charged with governance. The PCAOB requires the EQC reviewer to evaluate the engagement team's determination, communication and documentation of CAM. Under the IAASB Standards, the EQC reviewer is required to perform an evaluation of the conclusions reached in formulating the auditor's report and consider whether the proposed auditor's report is appropriate, and the application material explains that such conclusions include various matters relating to KAM.

The PCAOB also requires the auditor to provide to, and discuss with, the audit committee a draft of the auditor's report. The IAASB Standards include a similar requirement for the auditor to discuss circumstances that affect the form and content of the auditor's report, if any, with those charged with governance, supported by application material that indicates that it may be useful to provide those charged with governance with a draft of the auditor's report.

Approaches in Other Jurisdictions

The EU 2014 Regulation,[15] which applies to audits of PIEs, requires a description of the most significant assessed risks of material misstatement, as well as a summary of the auditor's response to those risks and, where relevant, key observations arising from those risks and reference to the disclosure in the financial statements. These descriptions are in addition to other matters the auditor is required to communicate, such as matters relating to the auditor's appointment, the consistency of the auditor's opinion with the report to the audit committee and statements regarding auditor independence and the provision of non-audit services.

The UK Financial Reporting Council revised its International Standards on Auditing (UK and Ireland) to implement the EU 2014 Regulation, and align its standards with the IAASB Standards. The ISAs (UK and Ireland) contain additional requirements, including:

- An explanation in the auditor's report of how the concept of materiality was applied in the audit;
- A summary in the auditor's report of the audit scope; and
- In circumstances where there is no material uncertainty related to going concern, a determination of whether a KAM relating to going concern exists that should be communicated in the auditor's report.

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13 See paragraph .12 of AS 2415, *Consideration of an Entity's Ability to Continue as a Going Concern.*

14 See paragraph .04 of AS 2710, *Other Information in Documents Containing Audited Financial Statements.*

15 Regulation (EU) No 537/2014 of the European Parliament and of the Council on *Specific Requirements Regarding Statutory Audit of Public-Interest Entities*. This came into effect for June 2017 year ends.

Way Forward

The IAASB intends to undertake a post-implementation review after a period of two years from the effective date. The objective will be to assess if the IAASB Standards have achieved their intended effect, and to assist the IAASB in, among other matters:

- Understanding the way in which the requirements in the standards have been adopted and implemented by jurisdictions;
- Determining whether wider application of the enhancements to auditor reporting would be in the public interest;
- Identifying implementation challenges and possible areas for improvement within the standards; and
- Considering whether further enhancements to auditor reporting are necessary, particularly in light of the experience from other jurisdictions with respect to additional matters that are communicated.

The IAASB will also continue to undertake extensive outreach to support the implementation of the IAASB Standards, and evaluate whether there is a need for the IAASB to provide other forms of implementation support. The IAASB has developed an *Auditor Reporting Toolkit* to assist with the implementation of the standards.

The PCAOB has also indicated its intention to monitor the results of implementation, including consideration of any unintended consequences.

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About the IAASB

The IAASB develops auditing and assurance standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance. The structures and processes that support the operations of the IAASB are facilitated by the International Federation of Accountants (IFAC).

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