This document was prepared by the Staff of the International Auditing and Assurance Standards Board (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 objective of the IAASB is to serve the public interest by setting high-quality auditing, assurance, and other related standards and by facilitating the convergence of international and national auditing and assurance standards, thereby enhancing the quality and consistency of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

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REPORTING ON AUDITED FINANCIAL STATEMENTS – NEW AND REVISED AUDITOR REPORTING STANDARDS AND RELATED CONFORMING AMENDMENTS

This Basis for Conclusions has been prepared by staff of the International Auditing and Assurance Standards Board (IAASB). It relates to, but does not form part of, the new and revised Auditor Reporting Standards and related conforming amendments. These standards and related conforming amendments comprise:

- ISA 700 (Revised), Forming an Opinion and Reporting on Financial Statements
- New ISA 701, Communicating Key Audit Matters in the Independent Auditor’s Report
- ISA 705 (Revised), Modifications to the Opinion in the Independent Auditor’s Report
- ISA 706 (Revised), Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report
- ISA 570 (Revised), Going Concern
- ISA 260 (Revised), Communication with Those Charged with Governance
- Conforming amendments to ISAs 210, 220, 230, 510, 540, 580, 600, and 710.

The new and revised Auditor Reporting standards and related conforming amendments were approved with the affirmative votes of 17 out of 17 IAASB members present at the September 2014 IAASB meeting.

Background

1. The topic of auditor reporting has been on the IAASB’s agenda for some time. While users of the financial statements have signaled that the auditor’s opinion on the financial statements is valued, many have called for the auditor’s report to be more informative – in particular, for auditors to provide more relevant information to users based on the audit that was performed. The IAASB therefore set out to develop new and revised Auditor Reporting standards aimed at enhancing the informational value of the auditor’s report.

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1 ISA 210, Agreeing the Terms of Audit Engagements
2 ISA 220, Quality Control for an Audit of Financial Statements
3 ISA 230, Audit Documentation
4 ISA 510, Initial Audit Engagements—Opening Balances
5 ISA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures
6 ISA 580, Written Representations
7 ISA 600, Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)
8 ISA 710, Comparative Information—Corresponding Figures and Comparative Financial Statements
9 For a full record of the voting on the new and revised Auditor Reporting standards and related conforming amendments, see the minutes of the September 15–19, 2014 IAASB meeting at www.ifac.org/auditing-assurance/meetings/new-york-usa-7 under the heading “Minutes.” One IAASB member was not present at the September 2014 meeting and was therefore ineligible to vote.
2. The IAASB’s deliberations on the topic of auditor reporting broadly, and specifically in developing these standards, have been informed by international research, public consultation, and stakeholder outreach undertaken by the IAASB, including:

- Jointly commissioned international academic research on user perceptions of the standard auditor’s report;
- The May 2011 Consultation Paper, Enhancing the Value of Auditor Reporting: Exploring Options for Change, which incorporated findings from the above-mentioned research and input obtained from the IAASB’s dialogue with stakeholders around the world, and explored options in light of this feedback and other national developments;
- The June 2012 Invitation to Comment (“the ITC” or “the June 2012 ITC”), Improving the Auditor’s Report, which sought views on the IAASB’s indicative direction to improve how and what auditors communicate to users through the auditor’s report;
- Three global roundtables and additional outreach to solicit feedback on the indicative direction outlined in the June 2012 ITC;
- Continued monitoring of, and interaction with, policymakers and national auditing standard setters (NSS) with auditor reporting initiatives; and
- The July 2013 Exposure Draft (“the ED” or “the July 2013 ED”), Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs).

3. The comment period for the ED closed on November 22, 2013. Comment letters were received from 139 respondents, including investors and analysts, those charged with governance (TCWG), regulators and audit oversight authorities, NSS, accounting firms, public sector organizations, preparers, IFAC Member Bodies and other professional organizations, academics and individuals. Included in the responses are responses from five Monitoring Group (MG) members.

4. This Basis for Conclusions explains the more significant issues raised by respondents to the ED, and how the IAASB has addressed them. In many cases, respondents continued to support the direction proposed by the IAASB in the June 2012 ITC. As a result, the changes made to the proposed ISAs were mostly to further refine the approach to the application of the proposed concepts rather than fundamentally revisiting them.

5. The IAASB has also discussed this project with the IAASB Consultative Advisory Group (CAG) on nine separate occasions, six of which occurred since the approval of the project proposal in December 2011, including prior to the issuance of the ED and prior to the finalization of the standards.

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10 For example, the UK Financial Reporting Council (FRC), the European Commission (EC), and the US Public Company Accounting Oversight Board (PCAOB)

11 Where necessary in this document, reference is made to individual ISAs included in the ED, for example ED-ISA 700, ED-ISA 701, etc.

12 The Monitoring Group comprises the Basel Committee on Banking Supervision (BCBS), the EC, the Financial Stability Board (FSB), the International Association of Insurance Supervisors (IAIS), the International Forum of Independent Audit Regulators (IFIAR), the International Organization of Securities Commissions (IOSCO), and the World Bank (WB). BCBS, IAIS, IFIAR, IOSCO and WB responded to the ED.
Overview of Enhancements to Auditor Reporting

6. The following table compares the proposals to enhance the auditor’s report included in the ED with the positions taken by the IAASB in agreeing the final standards. The rationale for these changes is discussed in further detail within this Basis for Conclusions.

<table>
<thead>
<tr>
<th>July 2013 ED</th>
<th>Final Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td>New section in the auditor’s report to address Key Audit Matters (KAM) for</td>
<td>• Continue to require for financial statements of listed entities. ISA 701 also applies when law or regulation requires communication of KAM for other entities or when the auditor decides to communicate KAM on a voluntary basis.</td>
</tr>
<tr>
<td>audits of complete sets of general purpose financial statements of listed</td>
<td>• Retain the definition of KAM as set out in ED-ISA 701</td>
</tr>
<tr>
<td>entities (referred to herein as “audits of financial statements of listed</td>
<td>• Refinements to requirements in ISA 701 for determining and communicating KAM and new application material developed in response to comments on exposure</td>
</tr>
<tr>
<td>entities”) 13</td>
<td>• New requirement and related application material for circumstances in which a matter determined to be a KAM is not communicated in the auditor’s report</td>
</tr>
<tr>
<td>(See paragraphs 10–78.)</td>
<td>(See paragraphs 10–78.)</td>
</tr>
<tr>
<td>New section to address reporting on Going Concern (GC) in all auditor’s</td>
<td>• In light of continued concerns across all stakeholder groups that a more holistic approach to GC is needed, no longer require a new section addressing GC in all auditor’s reports</td>
</tr>
<tr>
<td>reports, including a conclusion on the appropriateness of management’s use</td>
<td>• Rather, include a separate section in the auditor’s report only when a MU exists (i.e., an exception-based reporting model similar to extant ISA 570), under the heading “Material Uncertainty Related to Going Concern,” and continue to modify the opinion when required under the circumstances of the engagement</td>
</tr>
<tr>
<td>of the GC basis of accounting in preparing the financial statements and a</td>
<td>• New requirements to describe the respective responsibilities of management and the auditor for GC in all auditor’s reports</td>
</tr>
<tr>
<td>statement as to whether a material uncertainty (MU) that may cast</td>
<td>• If events or conditions have been identified that may cast significant doubt on the entity’s ability to continue as a GC but the auditor concludes that no MU exists, new requirement to evaluate the adequacy of disclosure about these events or conditions in view of the requirements of the applicable financial reporting framework</td>
</tr>
<tr>
<td>significant doubt on the entity’s ability to continue as a GC has been</td>
<td>• Acknowledgment in ISA 701 and ISA 570 (Revised) that matters related to GC may be determined to be KAM, which</td>
</tr>
<tr>
<td>identified</td>
<td></td>
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</tbody>
</table>

13 For the purposes of this document, references to audits of financial statements of listed entities should be understood as audits of complete sets of general purpose financial statements of listed entities. Paragraph 9 of this Basis for Conclusions notes the IAASB’s separate consideration of the applicability of certain requirements in ISA 700 (Revised) to special purpose financial statements.
### BASIS FOR CONCLUSIONS: REPORTING ON AUDITED FINANCIAL STATEMENTS

*Prepared by the Staff of the IAASB*

| Explicit statement in all auditor’s reports that the auditor is independent of the entity and has fulfilled the auditor’s other relevant ethical responsibilities, with disclosure of the source(s) of those requirements | • Continue to require in all auditor’s reports an explicit statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor’s other ethical responsibilities in accordance with these requirements  
• Rather than require identification of the specific source(s) of the relevant ethical requirements, require identification of the jurisdiction of origin of those requirements or reference to the International Ethics Standards Board for Accountants’ Code of Ethics for Professional Accountants (IESBA Code), with new application material in support of this requirement  
(See paragraphs 79–115.) |
|---|---|
| Disclosure of the name of the engagement partner (EP) in the auditor’s report for audits of financial statements of listed entities, with a “harm’s way” exemption | • Continue to require naming of the EP for audits of financial statements of listed entities  
• Refinements to the requirement in ISA 700 (Revised) and new application material developed to further explain the concept of the “harm’s way” exemption and establish appropriate safeguards for its use  
(See paragraphs 116–125.) |
| Prominent placement of the auditor’s opinion in the auditor’s report | Opinion section required to be presented first, followed by the Basis for Opinion section, unless law or regulation prescribe otherwise  
(See paragraphs 126–130.) |
| Improved description of the responsibilities of the auditor and key features of an audit (together with the provision for certain components of this description to be relocated to an appendix to the auditor’s report, or for reference to be made to such description on the website of an appropriate authority) | • Continue to require for all auditor’s reports  
• Continue to allow for such information to be presented in either an appendix to the auditor’s report or, where law, regulation or national auditing standards expressly permit, for reference to be made to a website of an appropriate authority that contains a description that addresses, and is not inconsistent with, the description required by ISA 700 (Revised)  
(See paragraphs 136–141.) |
Effective Date
7. The IAASB agreed to set the effective date of the new and revised Auditor Reporting standards to be for audits of financial statements for periods ending on or after December 15, 2016. The effective date provides a period of approximately 12 months after issuance of the final standards for purposes of translation, national adoption, and implementation activities (including training and changes to firms’ audit methodologies) before the commencement of planning for audits of December 31, 2016 reporting periods. Early adoption of the standards is permitted, though as a matter of practice, the IAASB does not explicitly state so in its standards.

Other Initiatives and Anticipated Changes to Other ISAs Relevant to Auditor Reporting
8. In April 2014, the IAASB issued a second Exposure Draft of proposed ISA 720 (Revised).14 Conforming amendments will be made to ISA 700 (Revised) and other standards as necessary in connection with the finalization of ISA 720 (Revised) to require the auditor to report in accordance with proposed ISA 720 (Revised), when applicable (i.e., when other information is included in documents containing the audited financial statements). The illustrative auditor’s reports across all of the Auditor Reporting standards will also be amended to illustrate the inclusion of the section on Other Information in accordance with ISA 720 (Revised). Upon finalization, the IAASB’s intent is that ISA 720 (Revised) (and therefore the inclusion of an Other Information section in the auditor’s report) will be effective at the same time as the new and revised Auditor Reporting ISAs.

9. The IAASB also intends to propose changes to ISA 80015 and ISA 80516 as a result of the changes made to the new and revised Auditor Reporting ISAs through a separate Exposure Draft.17 The intent of the IAASB is to align the effective dates of these standards with the effective date of the new and revised Auditor Reporting standards to the extent practicable. In relation to ISA 810,18 the IAASB intends to gather additional information to better understand when and how ISA 810 is used in practice to separately report on summary financial statements, and will further consider an appropriate approach for making revisions to ISA 810 (including the timing thereof) in view of the results from these information-gathering activities.

Key Audit Matters
Overall Feedback on the Concept of KAM
10. The concept of KAM in ED-ISA 701 built further upon the notion of “auditor commentary” described in the June 2012 ITC, which was largely supported by most stakeholder groups (with the exception of preparers). Although there was widespread support for the auditor to include additional information in the auditor’s report, many respondents indicated that it was the auditor’s role to provide information about the audit but not the entity or the financial statements.

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14 Proposed ISA 720 (Revised), The Auditor's Responsibilities Relating to Other Information
15 ISA 800, Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks
16 ISA 805, Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement
17 The IAASB approved the ED of conforming changes to ISA 800 and ISA 805 at its December 2014 meeting.
18 ISA 810, Engagements to Report on Summary Financial Statements
11. Paragraph 7 of ED-ISA 701 therefore defined KAM as follows:

Key audit matters—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.

12. The following key points were raised by investors in support of KAM being communicated in auditor’s reports, and were echoed by other respondents, including regulators and audit oversight authorities, accounting firms, and NSS:

- Users will be able to better understand the conclusions of the audit as reflected in the opinion. These respondents were also of the view that including KAM in the auditor’s report will contribute to improving the quality of the audit and financial reporting, as it requires an auditor to provide additional transparency about the auditing process and highlight important matters that are already being communicated to TCWG.

- The inclusion of KAM would also contribute to providing information that may assist users in understanding the entity and financial statement areas involving significant management judgment, and focus investors on key issues included in the financial statements.

- The inclusion of KAM will help institutional shareholders in their dialogues with management and TCWG of companies in which they have invested.

- Including KAM would help restore and enhance the confidence of users in the auditor’s report and the audited financial statements, thereby contributing to robust and resilient capital markets.

13. MG members generally supported the IAASB in pursuing improvements to the auditor’s report in response to users’ demands for more transparency about the audit, noting that enhanced auditor reporting should reduce the information and expectations gaps about the audit and will be helpful in restoring market confidence. It was specifically noted that increased transparency might improve audit quality, as additional focus on matters to be reported could indirectly result in an increase in professional skepticism and additional attention by the auditor on significant audit risks.

14. It was suggested by some MG members that the IAASB should explore whether changes to the definition of KAM or objective of ISA 701 should be revised to incorporate reference to communicating matters that are likely to be relevant to users. Although other respondents also acknowledged the importance of considering the needs of users to determine the relevance of information to be provided in the auditor’s report, some specifically noted that it would be difficult for the auditor to always be aware of the respective needs and demands of users given the diversity in the needs of those who are considered to be “users of the auditor’s report”.

15. On the other hand, consistent with the ITC, preparers and a minority of other respondents generally were not supportive of the auditor communicating KAM and questioned the usefulness and appropriateness of the auditor doing so, noting:

- There is an overarching concern, also shared by some other respondents, with the possibility of the auditor communicating “original information” about the entity in the auditor’s report. In their view, communication of KAM blurs the responsibilities of management, TCWG and auditors and could undermine the opinion on the financial statements as a whole. Concerns were also expressed about how the information will be interpreted by investors and markets,
in particular the possibility that the communication of KAM could trigger a negative market response.

- In their view, matters that met the criteria for KAM would already have been appropriately disclosed in the financial statements, particularly in relation to significant accounting policies and accounting estimates. Therefore, KAM would be redundant to the disclosures already made; would potentially contribute to an already existing “disclosure overload;” and would amount to boilerplate disclosures, which is inconsistent with the work of accounting standard setters to “cut clutter.”

- KAM should specifically exclude industry-specific matters, as investors would already be familiar with such matters. Moreover, it would be more appropriate to “educate” small private investors and the public about what an audit is, and which audit procedures have been performed, through means other than the auditor’s report.

**IAASB Decisions**

16. In light of the strong support for the concept of KAM from most stakeholder groups, in particular investors, the IAASB agreed to retain the proposed definition of KAM and the objectives as set out in ED-ISA 701 (see paragraphs 7–8 of ISA 701). In making further changes to ISA 701, the IAASB sought to address concerns, to the extent practicable, of those that did not support the concept of KAM, in particular in relation to the auditor communicating “original information” about the entity and the need for the description of a KAM to be as entity-specific as possible, as discussed further below.

17. In addition, the IAASB acknowledged the importance of the information provided about KAM in the auditor’s report being responsive to users’ needs, but agreed with the practical challenges identified by some respondents of requiring the auditor to explicitly determine the relevance of KAM to users, either via an explicit requirement to do so or by including a reference to user needs in the objective of ISA 701. The Board continued to believe that the determination of KAM should be focused on the auditor’s point of view as to the significance of matters in the audit, but agreed that references to users’ needs within the application material in ISA 701 would be a useful way to provide important context to the auditor’s judgments in determining and communicating KAM (e.g., in determining the relative significance of matters and also as it relates to the information included in the descriptions of KAM).

**Determining KAM**

**Calls to Balance Consistency in Auditor Judgments in Determining KAM with the Goal of Providing Relevant Information to Users**

18. Paragraph 8 of ED-ISA 701 addressed the determination of KAM as follows:

The auditor shall determine which of the matters communicated with those 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:

(a) Areas identified as significant risks in accordance with ISA 315 (Revised)\(^{19}\) or

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\(^{19}\) ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*
involving significant auditor judgment.

(b) Areas in which the auditor encountered significant difficulty during the audit, including with respect to obtaining sufficient appropriate audit evidence.

(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.

19. Consistent with the views expressed in response to the ITC, respondents to the ED, including investors, accounting firms and NSS, as well as the CAG, supported the proposed requirement for KAM being determined based on the auditor’s judgment in light of the relative significance of matters communicated with TCWG, with a focus in particular on areas of significant auditor attention. It was widely acknowledged that allowing KAM to be determined based on the auditor’s professional judgment, with robust guidance to inform that judgment, would allow KAM to be as entity-specific as possible based on the facts and circumstances of the audit that was performed. Respondents generally did not believe it would be useful to specify required KAM – i.e., matters that would be reported in all circumstances – as this would lead to boilerplate and was viewed as providing less relevant information for users.

20. The IAASB encouraged, and sought feedback from, field testing of proposed ISA 701 as part of the comments in response to the ED. Those accounting firms that conducted field testing did so on a retrospective basis for selected audits, and incorporated high-level findings and observations from the field testing into their responses to the ED. Feedback indicated that, generally speaking, the determination of KAM would largely be an intuitive process and would be based on the knowledge and experience of the EP and other more senior members of the engagement team. These firms believed that certain refinements to the requirements and guidance in the ED-ISA 701 were necessary to ensure that application of the standard would lead to the determination of matters that were intuitively expected to be KAM. Overall, the firms also indicated support for a “decision framework,” and provided some suggestions as to how the framework could be further refined to drive greater consistency in the way auditors think about the areas that required significant auditor attention, and the matters that are deemed to be of “most significance” in the audit, and therefore the KAM.

21. Notwithstanding the overall support for allowing KAM to be determined based on auditor judgment, other respondents, including four MG members, explicitly noted that more prescription was needed to inform the auditor’s judgment and promote consistency in determining KAM. These respondents were of the view that further consideration was needed to provide for a more robust standard that would not only lead to auditor reporting that was informative to users, but would also be practical for auditors to apply and enforceable for regulators. For example, it was suggested that greater specificity regarding the types of matters likely to constitute KAM (i.e., “indicators of KAM”), via the elevation of certain application material in ED-ISA 701, would help to ensure greater consistency, in particular when similar facts and circumstances exist.

22. Specific areas within ED-ISA 701 where refinements to the proposed requirements and application material were suggested included:

- Further clarification and illustration of the concepts of “matters of most significance” and “significant auditor attention” – Some concern was expressed that the concept of “significant auditor attention” may be too broad, and may result in auditors communicating about matters that might be important judgments relating to audit acceptance, scope and approach, but
which would not likely result in decision-useful information being provided in the auditor’s report.

- Revision of the factors included in the requirement in paragraph 8 of ED-ISA 701 and clarification as to their intent – Feedback from field testing and other responses suggested that linking these factors more closely to matters disclosed in the financial statements would result in KAM that would be more relevant to users (i.e., would help users understand what is “keeping the auditor up at night”). Respondents, including two MG members, expressed concern about whether significant difficulties encountered during the audit were likely to result in a scope limitation, for which a modified opinion would be more appropriate. Some respondents also did not support linking KAM explicitly to significant deficiencies in internal control, as the auditor is not required by ISA 265 to communicate such matters in the auditor’s report.20

IAASB Decisions

23. The IAASB agreed to retain a principles-based approach to determining KAM, but was of the view that the requirement in paragraph 8 of ED-ISA 701 could be revised, and that a new requirement should be added to better describe and clarify the decision-making framework to be applied in determining KAM.

24. Throughout its deliberations, the IAASB acknowledged the importance of achieving an appropriate balance between prescription in the standard to promote consistency in which matters are determined and communicated as KAM, with the need to allow for auditor judgment to ensure that the KAM communicated in the auditor’s report are as entity-specific and relevant as possible – a point continuously stressed by investors as essential to the success of the project.

25. However, the IAASB also acknowledged that communicating KAM does not change the auditor’s underlying responsibilities in accordance with ISAs to conduct a thorough risk assessment and design and perform procedures that are appropriate to respond to those risks, and to form an opinion based on the audit evidence obtained – i.e., to conduct a high-quality audit. The application of a risk-based approach in an ISA audit is such that, while entities themselves may have similar sets of facts and circumstances, audits of similar entities may not be conducted in the same manner. Therefore, KAM may differ depending on the approach taken by the auditor because certain entity-specific or audit-specific factors may influence the auditor’s judgment as to which matters were of “most significance” in the audit of the current period.

26. Paragraph 9 of ISA 701 (with related application material in paragraphs A9–A26) requires the auditor to determine which matters required significant auditor attention as the initial step in the revised decision-making framework to determine KAM. In fulfilling this requirement, the auditor is always required to take into account (i.e., explicitly consider):

- Areas of higher assessed risks of material misstatement, or significant risks identified in accordance with ISA 315 (Revised).

20 ISA 265, Communicating Deficiencies in Internal Control with Those Charged with Governance and Management. One MG member was of the view that additional communication in the auditor’s report might be necessary if any significant deficiencies in internal control or a combination of deficiencies is such that there a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented or detected on a timely basis.
• 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.

• The effect on the audit of significant events or transactions that occurred during the year.

27. The IAASB believes this revised requirement better articulates the thought process an auditor should go through to consider the “drivers” of areas of significant auditor attention during the audit, while prominently noting that, as defined, KAM are always selected from matters communicated with TCWG. The revised factors are intended to focus the auditor’s consideration of areas of significant auditor attention to those areas about which users have expressed the most interest, which responds to suggestions from respondents that a more explicit acknowledgment of the relevance of KAM to users would be helpful. The IAASB believes that the application of these revised factors will more often than not lead to matters that are already disclosed in the financial statements being determined as KAM. Importantly, the IAASB was of the view that the factors are helpful considerations in assisting the auditor in determining KAM, but of themselves are not “indicators” of KAM, nor do any or all three factors have to apply for a matter to be determined to be a KAM. In addition, nothing in ISA 701 precludes the auditor from determining other matters to be KAM (see paragraphs A17–A18 of ISA 701).

28. The IAASB also agreed to add a new requirement to the standard to further assist auditors in determining KAM to be communicated in the auditor’s report (see paragraph 10 of ISA 701 and related application material). This new requirement serves as a second “filter” or step in the decision-making framework to highlight that KAM is a selection of the most significant matters from the matters that were determined to have required significant auditor attention. The IAASB was of the view that this new requirement, taken together with the revised requirement in paragraph 9 of ISA 701 (paragraph 8 of ED-ISA 701), more clearly articulates the decision-making framework.

29. In addition to some reordering of the application material to better align with the requirements in paragraphs 9–10 of ISA 701, the IAASB has developed new and revised application material to further strengthen the decision-making framework and provide further context for the proper application of these requirements. This was done, at least in part, to:

• Further clarify the concepts of “significant auditor attention” and “matters of most significance” (see paragraphs A12–A18 and A27–A30, respectively, of ISA 701).

• Provide guidance for each of the revised factors in paragraphs 9(a)–9(c) and, where applicable, highlight the linkage between them (see paragraphs A17 and A19–A26 of ISA 701).

• Explain the effects of the significance (in terms of nature and extent) of the interactions with TCWG about a matter21 on the auditor’s determination of matters “of most significance.” This includes the importance of the matter to intended users’ understanding of the financial statements as a whole (in particular its materiality to the financial statements) and the nature and extent of audit effort needed to address the matter (see paragraph A29 of ISA 701).

21 Focusing on the nature and extent of communications with TCWG was seen as responsive to investor requests for further insights into auditor communications with the audit committee and is consistent with the audit committee’s role representing the interests of shareholders.
• Highlight matters raised by investors as matters that should be considered in determining KAM, while also giving consideration, to the extent practicable, to concepts addressed by the FRC revised auditor reporting standards, the EC audit reforms, and the PCAOB’s auditor reporting proposals (e.g., paragraphs A2, A13, A14, A23, A24, and A26 of ISA 701).

• Further clarify the relationship between KAM and those risks of material misstatement that are always:
  - Required to be treated as significant risks of material misstatement in an audit (the risk of material misstatement due to fraud,\(^\text{22}\) including the risk of management override of controls);\(^\text{23}\) or
  - Presumed to be a significant risk of material misstatement due to fraud (revenue recognition)\(^\text{24}\) (see paragraph A21 of ISA 701).

Documentation

30. Paragraph 14 of ED-ISA 701 included a requirement for the auditor to document the matters that will be communicated as KAM, and the significant professional judgments made in reaching this determination, in accordance with ISA 230. Application material in ED-ISA 701 explained that the professional judgments for the matters determined to be KAM are likely to be supported by the written communications with TCWG and other audit documentation, and that such communications and documentation may assist the auditor in developing a description of KAM that explains the significance of the matter. Proposed application material was included in ED-ISA 701 to assist the auditor’s consideration of documentation of professional judgments, and amendments were proposed to the application material in ISA 230 to support the documentation requirement in ED-ISA 701.

31. Paragraph A49 of ED-ISA 701 also noted that the documentation of significant professional judgments made in determining the KAM draws upon this documentation and may also provide an indication that other matters communicated with TCWG are not KAM. However, the intent of the proposed documentation requirement was not to require the auditor’s documentation to explain why each of the other matters communicated with TCWG was not determined to be a key audit matter, although one MG member was of the view that the Board could consider including a requirement to this effect.

32. The documentation required by ED-ISA 701 also included, where applicable, the rationale for the auditor’s determination that there are no KAM to communicate in the auditor’s report.

IAASB Decisions

33. Respondents generally supported the proposed documentation requirements in ED-ISA 701. In addition, the IAASB’s view was that the overarching requirements in ISA 230 for the documentation of significant professional judgments made in reaching conclusions on significant matters arising during the audit appropriately address the documentation of significant judgments made in determining KAM. Nevertheless, the IAASB acknowledged the importance of the professional

\(^{22}\) ISA 240, The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements, paragraph 27

\(^{23}\) ISA 240, paragraph 31

\(^{24}\) ISA 240, paragraph 26
judgments made by the auditor regarding KAM and therefore decided to reconsider the documentation requirements in ISA 701.

34. The IAASB was of the view that a more specific documentation requirement could be a useful response to the views of regulators and audit oversight authorities about the importance of the ability of the standard to be appropriately inspected or enforced. The IAASB believed this could be achieved by requiring documentation of the auditor’s judgments in determining the matters that required significant auditor attention, as well as the rationale for the auditor’s determination as to whether or not each of these matters is a KAM (see paragraphs 18 and A64 of ISA 701).

35. The IAASB also agreed to retain the requirement, where applicable, for the auditor to document the rationale for the auditor’s determination that there were no KAM to communicate in the auditor’s report, which would include circumstances where the only KAM relate to situations when the auditor modifies the opinion on the financial statements or draws attention to a material uncertainty that may cast significant doubt on the entity’s ability to continue as a going concern (a “MU related to GC”). Finally, a new documentation requirement addresses the extremely rare circumstances in which the auditor determines that a KAM should not be communicated in the auditor’s report (see paragraphs 37–38 and 40–44 below).

Concerns about Communicating Original Information in the Auditor’s Report, Including in Relation to “Sensitive Matters”

36. As noted above, respondents to the ITC raised concerns about the auditor providing original information about the entity. In response to those concerns, ED-ISA 701 indicated that it is the responsibility of the entity’s management and TCWG to provide information about the entity, and suggested that the auditor seeks to avoid doing so unless, in the auditor’s judgment, the additional information is critical to the auditor’s description of the KAM and providing such information is not prohibited by law or regulation. Notwithstanding the IAASB’s focus in ED-ISA 701 on matters of most significance in the audit and application material cautioning the auditor against providing original information about the entity, feedback to the ED indicated a continued overarching concern across all stakeholder groups (in particular from preparers and accounting firms) related to matters determined to be KAM for which no information has been publicly disclosed by the entity.

“Sensitive Matters”

37. Throughout the IAASB’s deliberations, key audit matters for which no information has been publicly disclosed were referred to as “sensitive matters,” in light of respondents’ concern that unintended consequences could result from the communication of such matters in the auditor’s report. Respondents indicated that guidance should be provided in the standard as to whether such matters should be communicated and, if so, what should be communicated about them. Feedback from field testing performed by some accounting firms also highlighted this concern.

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Examples of “sensitive matters” raised variously by respondents included: “close calls” related to GC when a MU does not exist, possible illegal acts or possible fraud, significant deficiencies in internal control, breaches of independence, complex tax strategies or disputes, problems with management or TCWG, including views on the quality and effectiveness of the governance and risk management structures, regulatory investigations, a contingent liability that did not meet the requirements for disclosure under the applicable financial reporting framework, or other litigation or commercial disputes; and the evaluation of identified / uncorrected misstatements.
38. Respondents had mixed views about how best to do so, including possibly scoping out certain topics entirely, limiting KAM only to matters already disclosed in the financial statements, or specifically noting in the standard that matters beyond those disclosed in the financial statements may be determined to be KAM in relatively rare circumstances. In any event, respondents called for ISA 701 to provide clarity about how to deal with the practical challenges of allowing for the possibility that auditors may comment on matters for which disclosure is not required in the financial statements. Specifically, some respondents suggested the IAASB needed to do more to address the potential conflict between ED-ISA 701 and ethical requirements that may prohibit the auditor from communicating confidential information.

IAASB Decisions

Original Information

39. To alleviate the concerns about the auditor including original information in the auditor’s report, the IAASB, after a substantial amount of discussion, agreed it was necessary to address the concept of “original information” within ISA 701 as follows:

- Explaining that original information is any information about the entity that has not otherwise been made publicly available by the entity (e.g., has not been included in the financial statements or other public information available at the date of the auditor’s report or addressed in other oral or written communications by management or TCWG, such as a preliminary announcement of financial or investor briefings) (see paragraph A35 of ISA 701).
- Reiterating that it is appropriate for the auditor to seek to avoid the description of a KAM inappropriately providing original information about the entity, and that the description of a KAM is not usually of itself original information about the entity, as it describes the matter in the context of the audit (see paragraph A36 of ISA 701).
- Indicating that the auditor may encourage management or TCWG to include new or enhanced disclosures in the financial statements or elsewhere in the annual report to which the auditor could refer in formulating the description of a KAM (see paragraphs A36–A38 of ISA 701).

Sensitive Matters

40. The IAASB accepted the need to address the specific concerns raised by respondents about the communication of matters for which information has not been publicly disclosed by the entity, including sensitive matters. Accordingly, the IAASB agreed to add a new requirement in ISA 701 to allow for the possibility in certain circumstances that the auditor might decide to not communicate a matter determined to be a KAM 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.

41. The CAG was also supportive of including such a requirement in the standard, but expressed a view that the circumstances in which the auditor might decide not to communicate a KAM should be very restrictive. As such, the IAASB sought to find an appropriate balance between the auditor providing useful information about the matters of most significance in the audit that was performed and concerns over doing so in certain circumstances.
42. Further, the IAASB agreed that the principles-based requirement in ISA 701 needed to highlight very clearly that, unless law or regulation precludes public disclosure about the matter, circumstances in which the auditor would not communicate a KAM in the auditor’s report are extremely rare, with the decision to not communicate being based on whether the adverse consequences of such communication would reasonably be expected to outweigh the public interest benefits of doing so. The IAASB also agreed that the new requirement would not apply if the entity has publicly disclosed information about the matter (see paragraph 14 of ISA 701).

43. Application material focuses the auditor on the principles to be taken into account in determining not to communicate a KAM in the auditor’s report, recognizing the practical challenges of providing specific detailed guidance in ISA 701 due to differing legal and regulatory frameworks and relevant ethical requirements that may apply in various jurisdictions (see paragraph A55 of ISA 701). Of note:

- ISA 701 highlights the presumption that there is a public interest benefit in providing greater transparency about the audit for intended users (see paragraph A53 of ISA 701).
- The determination not to communicate a KAM takes into account the facts and circumstances related to the matter, and is premised on the need for communication with management and TCWG to understand management’s assertion as to why public disclosure about the matter is not appropriate, as well as any communications with applicable regulatory, enforcement or supervisory authorities (see paragraph A54 of ISA 701).
- ISA 701 also highlights the possibility of the auditor encouraging management or TCWG to make public disclosure of relevant information about the matter and, if not possible, that the auditor may consider it necessary to obtain a written representation as to why public disclosure about the matter is not appropriate, including management’s view about the significance of the adverse consequences that may arise as a result of such communication (see paragraph A54 of ISA 701).
- ISA 701 acknowledges that the issues considered by the auditor regarding a decision not to communicate a matter are complex and involve significant auditor judgment and, accordingly, the auditor may consider it appropriate to obtain legal advice (see paragraph A56 of ISA 701).
- Safeguards such as a documentation requirement to address the rationale for the determination not to communicate a matter (see paragraph 18(c) of ISA 701) and the required review by the engagement quality control reviewer of selected audit documentation relating to the significant judgments the engagement team made and conclusions it reached are also likely to be help in practice by limiting the application of this requirement to extremely rare circumstances.

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26 Input from the IESBA Planning Committee was that communication of KAM would not be prohibited by the IESBA Code, because the duty of confidentiality under the IESBA Code would not override a professional duty to disclose client information to comply with technical standards (e.g., the ISAs). However, notwithstanding this input, discussion with NSS and the Board highlighted the need to allow for flexibility for the auditor to consider the interactions and relationships between the requirements in ISA 701 and relevant ethical requirements other than the IESBA Code, as other codes might not be interpreted or applied in the same manner.

27 See paragraphs 20 and A27a of ISA 220.
44. On balance, the IAASB believes the new requirement and related application material in ISA 701 appropriately respond to the concerns expressed both by the IAASB and the CAG about making this requirement sufficiently restrictive (i.e., only in extremely rare circumstances) and with sufficient process and documentation around the determination not to communicate a matter in the auditor’s report.

Communicating KAM

45. Paragraph 10 of ED-ISA 701 addressed the communication of individual KAM as follows:

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:

(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

(b) A reference to the related disclosure(s), if any, in the financial statements.

46. The challenges of balancing the calls for consistency in KAM across entities and the concerns over the descriptions of KAM rapidly devolving into boilerplate were noted in the responses to the ED. The overarching theme across all respondent groups was that the description of a KAM should be relatively clear, concise, understandable, and entity-specific, and should not be viewed as competing with management’s disclosures or providing original information about the entity. Many respondents, including two MG members as well as investors and accounting firms, commented on the importance of the IAASB structuring the requirement to communicate KAM appropriately and providing sufficient guidance such that the descriptions of KAM would be as entity-specific as possible to provide relevant information for users. Some respondents recommended that the IAASB avoid prescription in order to encourage innovation in an evolving area. One MG member suggested actions to support effective implementation of ISA 701 could be taken to mitigate the risk of KAM becoming boilerplate and to promote ongoing relevance of KAM in the auditor’s report.

47. Respondents generally supported the requirement in paragraph 10 of ED-ISA 701 for the description of KAM being based on the auditor’s judgment. In particular, respondents welcomed the balance between the requirement to explain why the auditor considered each matter identified as a KAM to be one of most significance in the audit and the flexibility allowed in describing “the effect on the audit.” However, a number of respondents were of the view that the concept of describing a matter’s “effect on the audit” and the IAASB’s underlying intent in this regard was not clear. Respondents variously suggested that using different words in the requirement, such as “how the matter was addressed in the audit,” “the auditor’s approach,” or “a description of the auditor’s response,” would better signal what was expected to be disclosed.

48. Notwithstanding the overarching support for allowing judgment and flexibility in the descriptions of KAM, some respondents, including three MG members and other regulators and audit oversight authorities, were specifically of the view that the required elements of the description of a KAM may not provide sufficient useful information to users.

49. In this regard, investors noted that the description of a KAM should focus on:

- Why the matters described are of particular importance to the audit.
• How the auditor addressed these matters in the audit (i.e., an indication of the auditor’s response).
• The outcome of the audit process, with some investors suggesting information about the sensitivity of management’s judgments and valuations should be included.

50. CAG Representatives variously encouraged the IAASB to consider what would be responsive to investor needs and also to consider the recent UK auditor’s reports in determining how best to address the description of an individual KAM, while at the same time recognizing the challenges cited by respondents of summarizing or describing procedures in a succinct and meaningful way, and noting the risk that describing an outcome or a conclusion could be misinterpreted as a “piecemeal opinion.”

IAASB Decisions

51. The IAASB considered the feedback from the ED and the CAG, particularly relating to the importance of the description of a KAM providing an indication of how the auditor responded to the matter in order to provide meaningful information to investors and others. Accordingly, the IAASB amended its position in ISA 701 to require the auditor to describe, in all cases, how a matter determined to be a KAM was addressed in the audit, in addition to retaining the required explanation of why the matter was considered to be one of most significance in the audit (see paragraph 13 of ISA 701). However, the flexibility intended in ED-ISA 701 has been retained by referring more broadly to describing “how the matter was addressed in the audit” rather than specifically requiring a description of the auditor’s response, findings, or procedures. Such flexibility has been supported 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.

52. Paragraph A46 of ISA 701 notes that, in order to explain how the matter was addressed in the audit in accordance with paragraph 13(b), the auditor may describe:

• 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; or
• Key observations with respect to the matter,

or some combination of these elements.

Law or regulation or national auditing standards may prescribe a specific form or content for the description of a KAM, or may specify the inclusion of one or more of these elements. Additional application material provides further guidance as to what may be included in the description of a KAM (see paragraphs A48–A51 of ISA 701).

53. The IAASB also considered it necessary to include application material in the ISA to address concerns raised by preparers and others about the potential unintended consequences that may result from communicating KAM in the auditor’s report, particularly the risk that such communication could be misunderstood. Paragraph A47 of ISA 701 notes that, in order for intended users to understand the significance of a KAM in the context of the audit of the financial statements as a whole, as well as the relationship between KAM and other elements of the auditor’s report,
including the auditor’s opinion, care may be necessary so that language used in the description of a KAM:

- Does not imply that the matter has not been appropriately resolved by the auditor in forming the opinion on the financial statements.
- Relates the matter directly to the specific circumstances of the entity, while avoiding generic or standardized language.
- Takes into account how the matter is addressed in the related disclosure(s) in the financial statements, if any.
- Does not contain or imply discrete opinions on separate elements of the financial statements.

**Applicability of ISA 701**

**Applicability of ISA 701 beyond Listed Entities**

54. The Explanatory Memorandum (EM) of the ED articulated the IAASB’s decision to initially limit the application of ISA 701 to audits of financial statements of listed entities, noting the absence of a globally accepted definition of public interest entities (PIEs) in the ISAs. This decision was widely supported by respondents to the ITC. However, the ED 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.

55. It was also acknowledged by respondents to the ITC that auditors of financial statements of entities other than listed entities may wish to communicate KAM on a voluntary basis. To facilitate this, a new requirement was proposed as a conforming amendment to ISA 210 for the auditor to include a statement in the audit engagement letter regarding such intent. 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 KAM 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).

56. The ED did not pose a specific question about the IAASB’s approach to limiting the applicability of ED-ISA 701 to listed entities. Nevertheless, acknowledging that the matter will be considered further in the context of the post-implementation review (see paragraphs 147–149 below), respondents expressed views as follows:

- Two MG members, supported by others, were of the view that ISA 701 should apply to PIEs (specifically in order to scope in banks and insurance companies, regardless of whether they were listed entities); and
- Certain other respondents 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 across entities of different sizes. Others suggested the IAASB should at least promote voluntary application for entities other than listed entities if the IAASB continued to believe mandating ISA 701 for all entities was not appropriate.
57. Respondents generally supported the concept that, when not otherwise required, KAM may be communicated on a voluntary basis but, if so, ISA 701 should be followed. Respondents noted that the use of 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.

However, some concern was expressed about the practical challenges of the new requirement proposed in ISA 210.

IAASB Decisions

58. The IAASB agreed to continue to limit the requirement to communicate KAM to audits of financial statements of listed entities, but allow for voluntary application for audits of financial statements of other entities. If so, the IAASB agreed that ISA 701 should be followed.

59. The IAASB also believed it was 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 therefore has been included in ISA 700 (Revised), building upon how PIEs are addressed in ISA 260 (Revised) as well as the IESBA Code, with application material relating to public sector entities also retained (see paragraphs A35–A38 of ISA 700 (Revised)).

60. Reflecting on concerns about the practicalities of always requiring the auditor to signal the intent to apply ISA 701 voluntarily in the audit engagement letter, the IAASB reconsidered whether this needed to be explicitly addressed in the requirement in paragraph 10 of ISA 210 for the agreed terms of the audit engagement to make reference to the expected form and content of any reports to be issued by the auditor. The IAASB was also of the view that it may not be possible to address all the practical considerations that may arise and that a balance is needed between providing useful guidance and simply allowing practice to emerge in this area.

61. Accordingly, the IAASB agreed to remove the proposed new requirement in ISA 210. Application material in ISA 210 now highlights that, when the auditor is not required to communicate KAM, it may be helpful for the auditor to make reference in the terms of the audit engagement to the possibility of communicating KAM in the auditor’s report and, in certain jurisdictions, it may be necessary for the auditor to include a reference to such possibility in order to retain the ability to do so (see paragraph A23a of ISA 210).

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

62. Paragraph 29 of ED-ISA 705 prohibited the auditor from communicating KAM when the auditor disclaimed an opinion on the financial statements, with application material 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.

63. ED-ISA 701 required the auditor to communicate KAM when the auditor expressed an adverse opinion, explaining that a discussion of any other KAM would still be relevant to enhancing users’ understanding of the audit. Some respondents were of the view that communicating KAM when the auditor expresses an adverse opinion may imply the financial statements are more credible than is
BASIS FOR CONCLUSIONS: REPORTING ON AUDITED FINANCIAL STATEMENTS
Prepared by the Staff of the IAASB

64. In finalizing ISA 701, the IAASB considered how KAM should be treated when the auditor disclaims an opinion or expresses an adverse opinion. The IAASB agreed to continue to prohibit communication of KAM when the auditor disclaims an opinion on the financial statements, but decided to retain the position in ED to require communication of KAM when the auditor expresses an adverse opinion, notwithstanding the fact that adverse opinions for audits of financial statements of listed entities are not permitted by some securities regulators. The IAASB was generally of the view that, because the auditor is able to complete the audit in such circumstances, there may be additional matters that may be relevant to the intended users’ understanding of the audit. However, such matters may not be “of most significance” when considered in relation to the significance of the matter(s) giving rise to the adverse opinion (i.e., the auditor may not determine any other matters to be KAM). New application material has also been included to acknowledge that, when the auditor has expressed an adverse opinion on the financial statements and communicates other KAM, it is important that the descriptions of such KAM do not imply the financial statements as a whole are more credible in relation those matters in view of the adverse opinion (see paragraph A7 of ISA 701).

Other Significant Changes to ISA 701 and ISA 700 Related to KAM since Exposure

65. Respondents variously raised suggestions as to how the requirements and application material in ED-ISA 701 could be improved. The IAASB considered these suggestions with the aim of clarifying the final standard, making revisions as follows:

- Required language in the introductory paragraph of the KAM section in the auditor’s report has been streamlined in light of concerns about lengthy standardized language. Some of the material proposed to be required by paragraph 9 of ED-ISA 701 is now required to be presented in the section of the auditor’s report describing the auditor’s responsibilities. See paragraphs 11 of ISA 701, 39(c) of ISA 700 (Revised) and Illustration 1 in the Appendix to ISA 700 (Revised). Two MG members were of the view that a more positive reference could be made in the introductory paragraph of the KAM section to explain that the determination of KAM has contributed to the formation of the auditor’s opinion as a whole. This suggestion was not accepted because a primary rationale for the language in the introductory paragraph is to respond to concerns that descriptions of individual KAM may be incorrectly interpreted as piecemeal opinions.

- A new requirement has been added to acknowledge explicitly that KAM is not a substitute for a modified opinion, a concept that was previously articulated in the application material in ED-ISA 701 and is similarly expressed in a requirement in ISA 706 (Revised) (see paragraph 12 of ISA 701). This change is also responsive to concerns from IAASB members, as well as a MG member, that auditors may view KAM as an alternative to a modified opinion.

- The IAASB has retained the possibility that the auditor may determine that there are no KAM to communicate. However, application material has been added to clarify that it may be rare 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. ED-ISA 701 included a requirement to discuss with the engagement quality control reviewer (where one has been appointed) the conclusion that there are no KAM to communicate in the auditor’s report. Although it is no longer a specific requirement in ISA 701, the concept 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 evaluation of the conclusions reached by the engagement team in formulating the auditor’s report. See paragraphs 16 and A57–A59 of ISA 701 and A27a of ISA 220.

- Respondents variously provided feedback on the illustrative examples of KAM included in the ED. The IAASB agreed that a limited number of examples of KAM could be provided in non-authoritative Staff guidance to be issued concurrently with the final standards, rather than include such examples in ISA 700 (Revised) or ISA 701. Doing so would allow flexibility for the IAASB to refine the examples over time, if necessary, and also highlight other national developments and real-time examples.

66. A strong majority of respondents, 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. One MG member suggested it was unclear how auditors in determining KAM are to consider audit work done in the current period that relates to a restatement of prior period financial statements for which there was no effect on the financial statements of the current period. Although the determination and communication of KAM is based on the audit of the financial statements of the current period, nothing in ISA 701 would preclude the auditor from determining that a restatement of prior period amounts was a KAM to be communicated in the auditor’s report if matters relating to the restatement were determined to be of most significance in the audit of the current period (i.e., in accordance with paragraph 10 of ISA 701).

Interaction of ISA 701 with ISA 706 (Revised)

67. Respondents generally supported the IAASB’s decision to retain the concepts of Emphasis of Matter (EOM) paragraphs and Other Matter (OM) paragraphs, even when the auditor is required to communicate KAM. Respondents in favor of the IAASB’s proposal highlighted that retaining 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). It was also noted that the retention of EOM paragraphs and OM paragraphs was needed for audits of financial statements of other than listed entities for which communication of KAM is not required. The CAG also was supportive of retaining the concepts of EOM paragraphs and OM paragraphs for these reasons but, like some other respondents, suggested more could be done within the ISAs to seek to differentiate the separate concepts.

68. A minority of respondents were strongly of the view that an auditor’s report that includes KAM and an EOM paragraph or an OM paragraph 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. However, investors were of the view that it would be possible for auditors to differentiate the concepts through their presentation in the auditor’s report, also noting that the information itself is more important to users rather than the "labeling" of such information.
69. One MG member, supported by a few other respondents, 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 because of the uncertainty of the outcome, but it could also be a KAM given that it involves significant auditor judgment. Another MG member was of the view that it should be clarified that an EOM paragraph relates to an item included in the financial statements that is considered fundamental to users’ understanding of them.

IAASB Decisions

70. In light of the support for retaining the separate concepts of EOM paragraphs and OM paragraphs, the focus of the IAASB’s deliberations was on the most appropriate way to differentiate the concepts in ISA 706 (Revised). The IAASB noted that, in many cases, matters determined to be KAM will relate to matters presented or disclosed in the financial statements. In such cases, the IAASB was of the view that communicating the matter under the requirements of ISA 701 serves as the most useful and meaningful mechanism for highlighting the importance of the matter. This is because communication as a KAM is intended to provide additional information to intended users of the financial statements beyond what is included in an EOM paragraph (i.e., more than a reference to the matter being emphasized and to relevant disclosures in the financial statements). As such, the IAASB agreed that ISA 706 (Revised) should:

- Prohibit the auditor from using an EOM paragraph or OM paragraph when the matter has been determined to be a KAM and explain that, when ISA 701 applies, the use of EOM paragraphs is not a substitute for a description of individual KAM (see paragraphs 8(b), 10(b) and A1 of ISA 706 (Revised)).
- Provide further guidance on the definition and purpose of KAM and the relationship with EOM paragraphs noting that, when KAM are communicated, there may be a matter not determined to be a KAM for which an EOM paragraph may be considered necessary, or a matter determined to be a KAM that is also fundamental to users’ understanding of the financial statements (see paragraphs A1–A3 of ISA 706 (Revised)).
- Provide illustrative examples that clearly distinguish the concepts in circumstances in which KAM, an EOM paragraph and an OM paragraph are included in the same auditor’s report, with guidance on the possible placement of the respective elements in such cases (see paragraph A16 and Appendix 3 of ISA 706 (Revised)).
- Require the use of the term “Emphasis of Matter” in the heading when an EOM paragraph is included in the auditor’s report, with flexibility for the auditor to provide greater specificity in the heading tailored to the matter (see paragraph 9(a) of ISA 706 (Revised) and Appendices 3 and 4).

71. The IAASB considered whether to require additional wording to be included in an EOM paragraph to explain the purpose of such communication in the auditor’s report. However, the IAASB decided against doing so, as investors, who are viewed to be already familiar with EOM paragraphs, stressed the importance of the information about a matter being included in the auditor’s report over its presentation, and because additional standardized language in the auditor’s report was viewed as unhelpful.
72. The IAASB is of the view that the changes made to ISA 706 (Revised) now more clearly articulate the Board’s intent with respect to the relationship between KAM and EOM paragraphs. The IAASB also noted there may be further opportunities to educate users and others on how the concepts of KAM and EOM paragraphs are intended to be applied and their relationship when both elements are included in an auditor’s report, and will consider how best to do so in its efforts to promote awareness and understanding of the new and revised Auditor Reporting standards.

Changes to ISA 260 (Revised) Arising from ISA 701

73. In approving ED-ISA 260, the IAASB determined that limited amendments to the required auditor communications with TCWG were necessary in light of ED-ISA 701. The most significant proposed change to ISA 260 (Revised) related to the existing requirement for the auditor to communicate with TCWG 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 ED-ISA 260). Respondents who commented on the proposed changes to ISA 260 (Revised) generally supported this change.

74. Two MG members continued to suggest that the communication of all significant audit findings to TCWG in accordance with ISA 260 should be in writing, due to the importance of these communications to the work of prudential regulators.

IAASB Decisions

75. The IAASB considered the need for any further changes to ISA 260 in light of feedback received on ED-ISA 260 and the revisions made to ISA 701 since exposure, and agreed a limited number of revisions to ISA 260. The changes being proposed are primarily to align with the revised considerations included in paragraphs 9(a)–(c) of ISA 701.

76. In addition, the IAASB was of the view that it would be helpful to have one single requirement in ISA 260, with related application material, for all required communications with TCWG about circumstances that affect the form and content of the auditor’s report. This includes circumstances in which the auditor is required or may otherwise consider it necessary to include additional information in the auditor’s report in accordance with the ISAs, and for which communication with TCWG is required.

77. Given the various circumstances in which communication with TCWG about the form and content of the auditor’s report may be required, the IAASB agreed to include a new conditional requirement in paragraph 16(d) of ISA 260, with application material included in paragraphs A23–A25, to more clearly make reference to the required communications throughout the Auditor Reporting ISAs.

78. Although the IAASB did not consider it appropriate within the scope of the Auditor Reporting project to reconsider whether communication of significant audit findings should be required to be in writing, the IAASB agreed to include application material in ISA 260 (Revised) to acknowledge that, when KAM are communicated in the auditor’s report, the auditor may consider it necessary to communicate in writing about the matters determined to be KAM (see paragraph A47 of ISA 260 (Revised)).
Going Concern

Overall Feedback on Auditor Reporting on GC

79. As noted in the EM of the ED, respondents to the ITC acknowledged a need for heightened attention on GC, particularly in light of the global financial crisis and the EC audit reforms. However, respondents across stakeholder groups had mixed views as to whether the proposed statements on GC that were illustrated in the ITC would have sufficient value to users or be appropriate in light of the auditor’s work effort under extant ISA 570.

80. Concerns also were expressed about a lack of consistent understanding of certain concepts within the different financial reporting frameworks, in particular “material uncertainty”, “ability to continue as a going concern”, and “going concern assumption,” and the threshold for management disclosures about a MU related to GC. Respondents who expressed these concerns were of the view that clarification or additional guidance from the accounting standard setters would be necessary in order to mitigate the possibility that the IAASB’s proposed statements about GC in the auditor’s report could widen the expectations gap and potentially be misunderstood or misinterpreted by users of the financial statements.

81. The IAASB was therefore encouraged to work together with the accounting standard setters as part of a holistic approach to reporting on GC, and has actively liaised with the International Accounting Standards Board (IASB) throughout the project. In developing ED-ISA 570, the IAASB acknowledged that it would need to carefully consider the status and planned actions of the accounting standard setters when finalizing its auditor reporting proposals to determine the best course of action.

82. However, the IAASB continued to be of the view that auditor reporting related to GC would be appropriate and in the public interest, and could be pursued based on the underlying work effort established by ISA 570. Accordingly, ED-ISA 570 included a requirement for the auditor to include a section relating to GC in every auditor’s report that would provide a conclusion about the appropriateness of the use of the GC basis of accounting in the preparation of the entity’s financial statements and a statement by the auditor as to whether a MU related to GC was identified. It also was proposed that this section include a statement that neither the company nor the auditor could guarantee the entity’s ability to continue as a GC (the “guarantee statement”).

83. Feedback received on ED-ISA 570 was generally consistent with that received on the ITC, whereby respondents across all stakeholder groups, including four members of the MG, continued to stress the importance of a holistic approach to be taken in order to improve disclosures about, and reporting on, GC, which would also involve changes to the financial reporting framework. In particular, the regulatory and audit oversight community expressed strong views that changes to extant ISA 570 should be made in concert with, or subsequent to, updates to the accounting standards. Respondents variously noted that communication about GC issues should primarily be the responsibility of management and TCWG, with such communications driven by the applicable financial reporting framework. Accordingly, a number of the respondents that supported the holistic approach were of the view that any changes to the auditing standard should be deferred until the topic of GC had been addressed by the accounting standard setters. As a result, consideration of developments by the IASB and others continued to be an important part of the IAASB’s way forward in revising ISA 570 and establishing requirements addressing GC in auditor’s reports.
Liaison with Accounting Standard Setters and Other Policymakers

84. The IAASB continued its liaison activities with accounting standard setters and other policymakers throughout the period leading up to the approval of ISA 570 (Revised), including active engagement with Board members and Staff of the IASB and the IFRS Interpretations Committee (the Interpretations Committee), as well as following relevant developments of the EC and the US Financial Accounting Standards Board (FASB).

85. Prior to issuing the ED, the IAASB wrote to the IASB encouraging timely progress on proposals to clarify and provide guidance on the disclosure of MU relating to GC and the entity’s ability to continue as a GC to complement the IAASB’s proposed requirements for auditor reporting on GC. However, the IASB concluded at its November 2013 meeting not to pursue amendments to IAS 1\textsuperscript{28} to clarify concepts and required disclosures related to GC.

86. However, the need for clarification relating to GC was further considered by the Interpretations Committee, and ultimately led to the issuance of an Agenda Decision. The Agenda Decision, which was finalized in July 2014,\textsuperscript{29} observes a situation where management, after considering all relevant information, including the feasibility and effectiveness of any planned mitigation, concludes that there are no material uncertainties relating to going concern. In such a situation, the Agenda Decision highlights that paragraph 122\textsuperscript{30} of IAS 1 would apply to GC situations in respect of the disclosure of significant judgments made by management in determining and assessing the events or conditions around the MU and the mitigating factors which led to the conclusion that there was no MU relating to GC ("close call" situations). While the IAASB viewed the Agenda Decision as a positive step forward, the IAASB acknowledged in its response to the Interpretations Committee that it would be more useful if the Agenda Decision also provided guidance or clarification on the underlying GC concepts and how the Agenda Decision would be expected to be applied.

87. The IAASB also monitored other relevant developments in respect of GC as follows:

- The final EC legislation on audit reform with respect to GC requires a statement in the auditor’s report on any MU related to events or conditions that may cast significant doubt on an entity’s ability to continue as a GC. Unlike the original proposals, the final legislation does not require a statement about the appropriateness of the use of the GC basis of accounting in the preparation of the financial statements. However, member states of the European Union may set additional requirements in relation to the contents of the auditor’s report in relation to GC or other matters.

- In August 2014, the FASB issued new requirements and guidance about disclosures in the financial statements in situations where there is substantial doubt about an entity’s ability to continue as a GC, including in circumstances where such substantial doubt has been mitigated.\textsuperscript{31} A definition of substantial doubt also was included. The PCAOB has indicated

\textsuperscript{28} International Accounting Standard (IAS) 1, Presentation of Financial Statements

\textsuperscript{29} The finalized decision can be found on the IASB’s website http://media.ifrs.org/2014/IFRIC/July/IFRIC-Update-July-2014.pdf.

\textsuperscript{30} Paragraph 122 of IAS 1 states, “An entity shall disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations (see paragraph 125), that management has made in the process of applying the entity’s accounting policies and that have the most significant effect on the amounts recognised in the financial statements.”

\textsuperscript{31} Presentation of Financial Statements—Going Concern (Subtopic 205-40), Disclosures of Uncertainties about an Entity’s Ability to Continue as a Going Concern.
that it plans to update its auditing standard on GC as part of a future project to align with the FASB’s approach to GC.

Feedback on the Proposal to Require Two Statements on GC in All Auditor’s Reports

88. Support was expressed by respondents to the ED, including three members of the MG, for inclusion of the explicit statements about GC in the auditor’s report, although many of these respondents, including some investors, were of the view this should only be done as part of a holistic approach to GC. In light of concerns over the need for a more holistic approach to GC and acknowledgment that, in many audits, GC would likely not be an issue, more respondents, including one MG member, were in favor of some form of reporting only when an issue related to GC issue had been identified (i.e., exception-based reporting), either through the use of an EOM paragraph, through KAM or through a separate GC section in the auditor’s report. Exception-based reporting was viewed by these respondents as preferable to the two statements proposed in the ED due to the potential for obscuring the signal, when relevant, about GC issues and desensitizing users to GC matters if such statements became part of every auditor’s report.

89. A few respondents also expressed concern that singling out GC by requiring both statements may:

- Imply a different level of assurance on GC compared to the rest of the financial statements;
- Imply greater comfort to users on the entity’s future prospects than is warranted;
- Give undue prominence over other assertions considered in the audit of the financial statements; or
- Represent a “piecemeal opinion.”

90. Respondents, including a member of the MG, were of the view that the statement with respect to the appropriateness of management’s use of the GC basis of accounting had limited value, citing that this was already implicit in the preparation of the financial statements and was essentially boilerplate language.

91. In addition to the views expressed about the boilerplate nature of both of the proposed statements about GC, views were expressed specifically about the statement as to whether management had identified a MU related to GC, as follows:

- The auditor should not be, or appear to be, speaking on behalf of management. Several of the respondents that expressed this concern suggested that this statement also blurred the respective responsibilities of management and the auditor, as management is responsible for assessing the entity’s ability to continue as a GC and disclosing any MU in accordance with the applicable financial reporting framework.
- Any statement by the auditor about the absence of a MU related to GC should only be made when management has included a similar statement in its financial statement disclosures.
- Absent further clarification of, and guidance about, the meaning of the underlying terminology, the statement could be misinterpreted by users of the financial statements, thus increasing the existing expectations gap. It was considered possible that this statement could be confused with business risks that were identified and managed by management on a regular basis.
92. Regarding the guarantee statement:

- Several respondents, including three members of the MG, expressed the view that the statement was overly negative or defensive and that it detracted from the value of the explicit statements about GC;
- Other respondents expressed concern around the suggested wording of the statement and specifically noted an issue with the use of the word “guarantee;” and
- Other respondents expressed the view that, similar to the two explicit statements about GC, users of the financial statements would find the guarantee statement confusing and misleading.

The CAG expressed similar concerns and suggested that, if included, the language for any such statement be as balanced and factual as possible.

**IAASB Decisions**

93. Given these comments and the overall majority view supporting a holistic approach to GC, the IAASB has found it necessary to adapt how the auditor’s report addresses GC, and has pursued an alternative approach to the inclusion of the two explicit statements about GC. In addition, to further respond to the public interest call for greater auditor attention to GC, the IAASB has enhanced the auditor’s responsibilities with respect to GC disclosures (see paragraphs 105–112 below).

94. The topic of auditor reporting on GC was of significant interest to the CAG in light of the global financial crisis. Some concern was initially expressed by the CAG that reverting to exception-based reporting could be seen a taking a step backwards, although recognition was given to the fact that changes to the auditing standards would necessarily be limited absent changes in the accounting standards. The CAG therefore encouraged the IAASB to consider what more could be done within the Auditor Reporting ISAs to respond to calls for greater auditor attention on GC, and provided input on the Board’s alternative approach as explained below. On balance, the CAG was generally satisfied that taking an alternative approach to drawing auditor attention to GC was appropriate, in light of the Board’s decision not to require a GC section in all auditors’ reports.

**Exception-Based Reporting Using a Required Heading**

95. First, in order to address concerns that the explicit statement about the non-existence of a MU related to GC adds standardized language in the auditor’s report and desensitizes users to GC matters when they actually exist, the IAASB determined that it was appropriate to revert to the extant exception-based reporting model, in which reporting on a MU related to GC would be limited to situations when it is determined that a MU exists related to events or conditions that cast significant doubt on the entity’s ability to continue as a GC.

96. However, the IAASB was cognizant of the calls by users of the financial statements for a greater prominence of GC matters, when they exist, in the auditor’s report. Therefore, the IAASB determined that, in situations when a MU related to GC exists, and for which adequate disclosure has been made in the financial statements, a separate section should be included in the auditor’s report entitled, “Material Uncertainty Relating to Going Concern” (see paragraph 22 of ISA 570 (Revised)).

32 The Appendix to ISA 570 (Revised) includes an illustrative example of an auditor’s report with a separate GC section.
or other appropriate heading. The IAASB believes that requiring a separate section with a specific heading will give more prominence to a MU related to GC than the extant ISA 570 requirement to include an EOM paragraph in these circumstances.

97. The IAASB also considered mandating the inclusion of this section when a MU related to GC exists and the auditor expresses either an adverse or disclaimer of opinion due to the inadequacy of disclosures in the financial statements related to the MU (i.e., in addition to the required description of the matter in the Basis for Adverse Opinion or Disclaimer of Opinion section of the auditor’s report). However, the IAASB determined that, in such situations, describing the same matter in two places in the auditor’s report was unnecessarily duplicative, and would add to the length of the auditor’s report without adding to its value.

98. Notwithstanding this, the IAASB did see merit in the Basis for Opinion section clearly conveying that the adverse opinion or disclaimer of opinion is as a result of inadequate disclosures in the financial statements regarding a MU related to GC. As such, the IAASB determined that the Basis for Opinion section should include a required statement to this effect (see paragraph 23(b) of ISA 570 (Revised)).

Required Descriptions of Management’s and the Auditor’s Responsibilities for GC

99. The CAG expressed strong support for describing the respective responsibilities of management and the auditor in relation to GC in the auditor’s report, citing the educational value of these descriptions.

100. The IAASB believed that including the descriptions of the responsibilities in all auditor’s reports in the Management’s Responsibilities and Auditor’s Responsibilities sections, respectively, was a useful means to draw attention to the auditor’s work in relation to GC, and to management’s underlying responsibilities, as a means of addressing the expectations gap and providing an additional focus on GC.

101. The aim of including such descriptions in the Management’s Responsibilities and Auditor’s Responsibilities sections is to retain key aspects of the wording originally proposed to be included via the two statements set out in the ED, specifically to:

- Highlight management’s responsibilities for: assessing the entity’s ability to continue as a GC; assessing the appropriateness of the use of GC basis of accounting, including a description of when the GC basis of accounting is appropriate; and disclosing, if applicable, matters relating to GC (see paragraph 33(b) of ISA 700 (Revised)).

- Highlight the auditor’s responsibilities in accordance with ISA 570 (Revised) to conclude on the appropriateness of management’s use of the GC basis of accounting and, based on the audit evidence obtained, whether a MU related to GC exists. Also included is a description of the auditor’s responsibilities when the auditor concludes a MU related to GC exists (see paragraph 38(b)(iv) of ISA 700 (Revised)).

102. In drafting the illustrative wording for the respective responsibilities, the IAASB referred to both extant ISA 570 and to accounting standards to ensure that this description did not result in

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33 The Appendix to ISA 570 (Revised) also includes illustrative examples of auditor’s reports when the auditor has modified the opinion due to inadequate disclosure regarding a MU related to GC.

34 ISA 570, paragraph 4
responsibilities that did not already exist. Paragraph A43 of ISA 700 (Revised) notes that the wording included in the illustrative auditor's reports is intended to illustrate how the requirement in paragraph 33(b) of ISA 700 (Revised) would be applied when IFRSs is the applicable financial reporting framework. If an applicable financial reporting framework other than IFRSs is used, the illustrative statements presented in the Appendix to ISA 700 (Revised) may need to be adapted to reflect the application of the other financial reporting framework in the circumstances (see paragraph A29 of ISA 570 (Revised)).

103. Concerning the guarantee statement, the IAASB continued to believe that this statement provides relevant information to users to place both management’s and the auditor’s responsibilities in the appropriate context. However, the IAASB acknowledged the perceived issues with the use of the word “guarantee” and, based on the views of respondents and the CAG, sought to find alternative wording for the statement that is balanced and factual in nature. As a result, the statement required by paragraph 38(b)(iv) of ISA 700 (Revised) factually acknowledges that future events or conditions may cause the entity to cease to continue as a GC. No such statement was deemed necessary in the description of management’s responsibilities.

104. The IAASB also considered a concern expressed by some CAG Representatives that there may be a disconnect in circumstances when the description of the auditor’s responsibilities is moved to an appendix to the auditor’s report, or reference is made in the auditor’s report to a website including a description of the auditor’s responsibilities, as management’s responsibilities will always appear in the auditor’s report. On balance, the IAASB determined that it was important to continue to allow the relocation of the description of the auditor’s responsibilities, including those related to GC, in response to calls to provide the auditor with the ability to reduce standardized language in the auditor’s report in certain circumstances.

Enhancing the Auditor’s Work Effort on Disclosures Related to GC Matters

105. As part of the call by respondents to the ED for increased focus on GC matters, there were requests by investors and others for earlier warning of potential issues that may exist with respect to an entity’s ability to continue as a GC. This was related, in particular, to situations where there were events or conditions identified that may cast significant doubt on the entity’s ability to continue as a GC, but after considering management’s plans to deal with these events or conditions, management and the auditor concludes that no MU exists (often referred to as “close call” situations). Also, a MG member suggested that the standard address the need for disclosures about the liquidity and solvency requirements for financial institutions and the duty that an auditor of a regulated entity may have to communicate GC issues to applicable authorities.

106. However, it was recognized that such disclosures are predicated on the requirements of the applicable financial reporting framework, that is, the auditor cannot require management to make disclosures that are not required by the financial reporting framework. Further, as discussed in the KAM section above, concerns were raised about the auditor providing original information about “close calls” related to GC in the auditor’s report in the absence of related disclosures in the financial statements. As a result, the IAASB did not propose in the ED to require auditor reporting on “close calls”.

35 IAS 1, paragraphs 25–26
BASIS FOR CONCLUSIONS: REPORTING ON AUDITED FINANCIAL STATEMENTS
Prepared by the Staff of the IAASB

IAASB Decisions

107. As part of its reassessment of an appropriate approach in response to comments received on exposure, the IAASB considered whether enhanced auditor work effort in such circumstances could be useful to respond to the public interest call for greater auditor attention to GC. While the IAASB agrees that disclosures relating to GC are firstly the responsibility of management and are dictated by the underlying requirements of the applicable financial reporting framework, the IAASB also believes that there is a role for auditors to play in considering the adequacy of management’s disclosures in view of the requirements of the framework. As such, the IAASB considered how the requirements in ED-ISA 570 could be strengthened to require the auditor to give additional consideration to such disclosures, both in situations when a MU exists and when events or conditions have been identified but it is determined that no MU exists.

108. Specifically, the IAASB sought to first support and strengthen the extant requirement in paragraph 19 of ISA 570 (Revised) for the auditor to evaluate disclosures when a MU exists by providing further application material regarding the consideration of appropriate disclosures in this situation. Paragraphs A22–A23 of ISA 570 (Revised) therefore provide guidance to the auditor around the disclosure considerations when a MU exists. Importantly, this consideration is in light of the definition of MU and disclosure requirements in paragraph 19 of ISA 570 (Revised), and is in addition to the auditor determining whether disclosures about a MU, required by the applicable financial reporting framework, are adequate.

109. In addition, a more substantial enhancement was the creation of a new requirement for the auditor to evaluate the adequacy of disclosures when events or conditions have been identified, but the auditor concludes that no MU exists (see paragraph 20 of ISA 570 (Revised)). There was very strong support from the CAG for the inclusion of this new requirement. While it was viewed as clarifying (rather than increasing) the auditor’s responsibilities in relation to GC disclosures, the CAG considered the new requirement to be an important step forward in further focusing the auditor’s attention on the area of GC.

110. However, because of concerns of some Board members that the requirement could be viewed as setting accounting requirements, the IAASB agreed to explicitly specify in the new requirement that the auditor’s evaluation is in view of the requirements of the applicable financial reporting framework.

111. Application material was developed in support of this new requirement. Paragraph A24 of ISA 570 (Revised) provides guidance on the types of disclosures that may be required by the applicable financial reporting framework in “close call” situations. Such guidance takes into account the requirement in paragraph 13 of ISA 700 (Revised) for the auditor to evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements. This guidance also incorporates concepts from the Interpretation Committee’s Agenda Decision, as well as the FASB’s new accounting standard on GC. In addition, new application material is provided in:

• Paragraph A25 of ISA 570 (Revised) to provide guidance in situations where the applicable financial reporting framework is a fair presentation framework, in consideration of the requirement in paragraph 14 of ISA 700 (Revised) for the auditor to evaluate whether the financial statements achieve fair presentation.
Paragraphs A3 and A34 of ISA 570 (Revised) to encourage auditors to highlight liquidity and solvency requirements of financial institutions, and to remind the auditor of the duty to communicate GC issues as appropriate with applicable regulatory authorities.

112. The IAASB is of the view that these enhancements to ISA 570 (Revised) focus the auditor on requirements that already exist within the accounting standards and extant ISA 700, but now specifically highlight their relevance in relation to GC disclosures. As a result of an enhanced focus by auditors, there is also the potential that management’s disclosures related to GC will be improved, which also would be in the public interest.

Acknowledgement that Matters Related to GC May Be Determined to be KAM

113. Feedback from ED-ISA 570 and discussion with the CAG indicated that the IAASB needed to clarify whether matters related to GC could be determined to be a KAM in “close call” situations when issues related to GC required significant auditor attention, but the auditor ultimately determines that a MU does not exist.

114. Concerns expressed by respondents, including from one member of the MG, about the possibility of including a KAM relating to GC were that:

- If management was not otherwise required to provide disclosures about the underlying events or conditions, or management’s plans to deal with them, the auditor may be seen to be providing original information about the entity.
- It was unclear whether such matters would be included in the GC section or the KAM section, with the view expressed that discussion of GC matters in the KAM section of the auditor’s report may undermine the separate GC section of the auditor’s report.

IAASB Decisions

115. Paragraph 15 of ISA 701 highlights that a MU related to GC is, by its nature, a KAM. However, reporting on the MU is not included in the KAM section but is done in accordance with ISA 570 (Revised). The IAASB agreed that any communication about “close calls” would be included in the KAM section of the auditor’s report for a listed entity only if such matters were determined to be of most significance in the audit that was performed (i.e., in accordance with paragraph 10 of ISA 701). To respond to concerns about how “close calls” may be described in the auditor’s report, the IAASB agreed to include new application material in ISA 701 (see paragraph A41 of ISA 701) explaining the information to which the auditor may refer in the auditor’s description of the KAM, including the auditor’s consideration of information that may be included in the annual report. Paragraph A1 of ISA 570 also acknowledges the interaction with ISA 701.

Other Suggested Improvements to the Auditor’s Report

Statement about Independence and Other Ethical Requirements, Including Listing of Source(s) of Those Requirements

116. In light of the increased focus on auditor independence, the ED proposed that all auditor’s reports include (i) an explicit statement about auditor independence and other ethical requirements and (ii) disclosure of the source(s) of those requirements.

117. Respondents across all stakeholder groups, including investors and MG members, were generally supportive of the IAASB’s proposed requirement to include a statement in the auditor’s report about
compliance with independence and other ethical requirements. Those who supported the IAASB’s proposal indicated that the statement about independence in the auditor’s report would enhance financial statement users’ understanding of the auditor’s obligations related to independence and other relevant ethical requirements, thereby increasing users’ confidence in the quality of the audit of the financial statements. They also suggested that such a statement would help better focus auditors on independence matters, thereby contributing to an overall increase in auditors’ accountability with respect to independence and other ethical responsibilities. On the other hand, a minority of the respondents were not supportive of the explicit statement. These respondents believed that the title “Independent Auditor’s Report” would be sufficient to convey that the auditor is independent.

118. There was considerably less support, however, for the proposed requirement to list the source(s) of the independence and other ethical requirements in the auditor’s report. Concerns were expressed about the practical application of the requirement, particularly in the context of multi-jurisdiction or group audits. There was also a concern that users of financial statements may not be sufficiently familiar with the application of the independence and other relevant ethical requirements to an audit of financial statements in a given jurisdiction, and therefore may not fully appreciate or understand the more complex disclosures that would be necessary (e.g., when relevant ethical requirements are included in multiple laws or regulations or ethical codes).

119. As an alternative, it was suggested that the IAASB require auditors to refer to the IESBA Code when it applies. Some respondents who put forward this suggestion, as well as some CAG Representatives, pointed out that a significant number of accounting firms are members of the Forum of Firms and, as such, are already required to comply with the IESBA Code.

120. The EM of the ED explained that, consistent with the position taken by the IESBA in its project to revise requirements in the IESBA Code relating to breaches of relevant ethical requirements, the IAASB was not proposing to require disclosure of breaches of independence in the auditor’s report. However, a few respondents, including one MG member, continued to suggest that disclosure of breaches of independence (including potentially as a KAM) may be appropriate, provided this could be presented in a manner that does not confuse a user as to the auditor’s objectivity.

IAASB Decisions

121. The IAASB agreed to retain the proposed requirement for an explicit statement to be included in the auditor’s report indicating that the auditor is independent of the entity and has fulfilled the auditor’s other ethical responsibilities. The IAASB also agreed to require the auditor to provide additional details about the sources of the relevant ethical requirements in the auditor’s report. However, in light of the concerns expressed about the practical challenges of listing all relevant sources in certain circumstances, including the possibility that the outcome of the application of the proposed requirement in ED-ISA 700 may be that the sources are not conveyed in a clear or understandable manner, the IAASB agreed to revise the proposed requirement in order to allow for flexibility in how such sources are referenced. The IAASB sought input from the IESBA, which expressed support for the IAASB’s revised approach explained further below.
122. Accordingly, paragraph 28(c) of ISA 700 now requires the auditor, based on the facts and circumstances of the engagement, to include in the auditor’s report:

- An identification of the jurisdiction of origin of the relevant ethical requirements;
- A reference to the IESBA Code; or
- A reference to both.

123. In support of the revised requirement, revised application material in paragraphs A29–A34 of ISA 700 (Revised):

- Explains that the identification of the jurisdiction of origin of relevant ethical requirements increases transparency about those requirements relating to the particular audit engagement;
- Reiterates that ISA 200 explains that relevant ethical requirements ordinarily comprise Parts A and B of the IESBA Code related to an audit of financial statements together with national requirements that are more restrictive;
- Notes that when the relevant ethical requirements include those of the IESBA Code, the statement may also make reference to the IESBA Code;
- Explains that if the IESBA Code constitutes all of the ethical requirements relevant to the audit, the statement need not identify a jurisdiction of origin; and
- Addresses circumstances when there are multiple sources of relevant ethical requirements (e.g., in a group audit).

124. Paragraph A30 of ISA 700 (Revised) explains that, when the relevant ethical requirements are contained in a limited number of sources, the auditor may elect to list those sources, or refer to a term that is commonly understood and that appropriately summarizes those sources. The application material also explains that law, regulation or national auditing standards or terms of the engagement may require the auditor to provide in the auditor’s report more specific information about the sources of the independence and other ethical requirements.

125. With respect to public disclosure of breaches of independence in the auditor’s report, the IAASB reaffirmed its position in the ED to not require disclosure of any breaches of independence in the auditor’s report. However, such communication is not precluded by the ISAs.

Naming the Engagement Partner in the Auditor’s Report

126. Respondents, in particular investors, regulators and audit oversight authorities, expressed support for requiring the name of the EP to be disclosed in the auditor’s report. Consistent with the ITC, these respondents indicated that having the name of the EP in the auditor’s report contributed to increased transparency for users and may provide the EP with a greater sense of personal responsibility and accountability, which would translate to improved audit quality.

127. Also consistent with the ITC, some respondents, in particular respondents from jurisdictions in which the name of the EP is not currently required to be included in the auditor’s report, continued to disagree with the IAASB’s proposal. These respondents variously:

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36 ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing

37 ISA 200, paragraph A14
• Noted that because legal frameworks, cultural norms, and safety and security laws among jurisdictions differ, it is likely that requiring naming of the EP in the auditor’s report could potentially result in increased actual and perceived liability for auditors. Some of these respondents explicitly expressed the view that necessary safeguards against inappropriately increasing such risks to auditors would need to be instituted at the jurisdiction level.

• Challenged the view that naming the EP in the auditor’s report would affect the EP’s accountability or the conduct of the audit.

Harm’s Way Exemption

128. ED-ISA 700 included a harm’s way exemption that would permit the name of EP to be excluded from the auditor’s report in rare circumstances, consistent with what is done in certain jurisdictions. There was strong support among respondents, in particular accounting firms and NSS respondents, for such an exemption. Notwithstanding this support, respondents suggested that the IAASB:

- Clarify the meaning of the term “significant security threat” by providing additional guidance or examples to explain circumstances that the IAASB determine to be “significant security threats” to the auditor.

- Seek to avoid overuse or inappropriate use of the harm’s way exemption by auditors by refining the proposed requirement and related application material.

IAASB Decisions

129. The IAASB agreed to retain the proposed requirement to name of the EP in the auditor’s report for audits of financial statements of listed entities (see paragraph 45 of ISA 700 (Revised)). The IAASB also agreed to retain the harm’s way exemption, but revised the requirement to explain that the auditor is permitted to not disclose the name of the EP in rare circumstances when such disclosure is reasonably expected to lead to a significant personal security threat. In an effort to make the requirement even more robust, and avoid the potential abuse of the harm’s way exemption, the IAASB also agreed to require the auditor to discuss with TCWG the intention of invoking this exemption.

130. Corresponding new application material has been developed to explain that:

- Discussing with TCWG the circumstances that may result in physical harm to the EP, other engagement team members or other closely related individuals may provide the auditor with additional information to assess the likelihood or severity of the significant personal security threat (see paragraph A58 of ISA 700 (Revised)).

- The auditor may also be required by law, regulation or national auditing standards, or may decide to include additional information beyond the EP’s name in the auditor’s report to further identify the EP (e.g., the EP’s professional license number that is relevant to the jurisdiction where the auditor practices) (see paragraph A57 of ISA 700 (Revised)).

- Non-disclosure of the EP’s name is expected to be rare, and that “threats” as used in the ISA do not refer to threats of legal liability, or legal, regulatory or professional sanctions (see paragraph A58 of ISA 700 (Revised)).
Prominent Placement of the Auditor’s Opinion in the Auditor’s Report

131. It was suggested in the ITC that the IAASB would mandate the ordering and placement of the required elements in the auditor’s report. As a result of feedback from respondents to the ITC, the IAASB reconsidered its position and did not propose mandatory ordering of any of the elements in the auditor’s report. In the ED, the IAASB explained the importance of jurisdictions having the flexibility to accommodate national reporting requirements and tailor the auditor’s report based on specific user needs (e.g., some jurisdictions have suggested a need to describe the auditor’s responsibilities first to provide users with the necessary context to understand the auditor’s opinion).

132. Respondents to the ED, including two MG members, suggested that the IAASB be more proactive in encouraging a preferred presentation for the ISA auditor’s report, a point which was also supported by the CAG. There was a view that the level of flexibility proposed in the ED may have the unintended consequence of losing consistency entirely across ISA auditor’s reports, and that, at a minimum, the Opinion section should be required to be the first section in the auditor’s report given its importance to users.

IAASB Decisions

133. The IAASB reconsidered its position in the ED not to mandate ordering of any elements in the auditor’s report and agreed to establish a new requirement to mandate that the Opinion section be presented first in the auditor’s report. Because of the important context that the Basis for Opinion section provides to the auditor’s opinion, the IAASB also believed it was appropriate to mandate that the Opinion section be immediately followed by the Basis for Opinion section (see paragraphs 23 and 28 of ISA 700 (Revised)).

134. Except for the requirement to mandate the placement of the Opinion and Basis for Opinion sections in the auditor’s report, the IAASB agreed that the ordering of the remaining sections and elements in the auditor’s report need not be mandated, thereby allowing flexibility in the presentation of the auditor’s report. However, to promote a certain degree of consistency and recognition of ISA auditor’s reports, the IAASB agreed to continue to require the use of specific headings in the auditor’s report. Furthermore, the illustrative reports in the Appendices to ISAs 700 and 705 provide an indication of how the IAASB believes it may be useful to structure an auditor’s report.

135. The IAASB also acknowledged that paragraph 49 of ISA 700 (Revised) would continue to allow auditors to refer to the ISAs in their auditor’s reports in circumstances where law or regulation prescribes a specific layout or wording of the auditor’s report provided that certain minimum elements are included within the auditor’s report. Revisions were also made to the requirements in paragraph 49 of ISA 700 (Revised) to further align with the revisions made to paragraphs 21–48 of ISA 700 (Revised) and other reporting ISAs based on the comments received on the ED. These changes also apply to situations in which an auditor’s report refers to both national auditing standards and the ISAs (see paragraph 50 of ISA 700 (Revised)).

Improved Description of the Responsibilities of the Auditor and Key Features of an Audit, Including the Location of Such Description

136. Consistent with the feedback to the ITC, respondents to the ED were generally supportive of having an improved description of the responsibilities of the auditor and key features of an audit (improved description) in the auditor’s report. Respondents generally agreed with the content of the improved
description, and provided relatively few suggestions to improve or expand on certain matters (e.g., internal control, materiality, fraud, group audits, and other auditor responsibilities).

137. However, respondents to the ED continued to express mixed views about whether the improved description should be permitted to be relocated from the body of the auditor’s report, either to an appendix to the auditor’s report or, where law, regulation or national auditing standards permit, for reference to be made to a website of an appropriate authority (website) that contains a description that is not inconsistent with the description required by ISA 700 (Revised). The respondents who expressed support for permitting flexibility in the placement of the improved description indicated that the approach was an appropriate way to deal with concerns about the increased length and standardized language of the auditor’s report. On the other hand, some respondents, including one MG member, expressed the view that the improved description provided important context to the auditor’s opinion and therefore should always be included in the body of the auditor’s report, citing concerns that users would not read an improved description located outside of the auditor’s report, especially on a website.

IAASB Decisions

138. The IAASB affirmed its decision in ED-ISA 700 to require that, at a minimum, the Auditor’s Responsibilities for the Audit of the Financial Statements section in the auditor’s report always include the following:

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

139. The IAASB also agreed to continue to provide options for the description of the remaining auditor responsibilities to be included: (i) in the body of the auditor’s report; (ii) within an appendix to the auditor’s report; or (iii) by specific reference within the auditor’s report to the location of such a description on a website of an appropriate authority, where expressly permitted by law, regulation or national auditing standards.

140. The IAASB acknowledged that certain jurisdictions (e.g., the UK) already provide auditors with the option of referring to a description of responsibilities located on a website. The IAASB continues to believe, consistent with ED-ISA 700, that referring to a website only when expressly permitted by law or regulation or national auditing standards is an appropriate safeguard against potential abuse by auditors. However, in response to concerns about the term “…not inconsistent with…” being unclear, the IAASB developed new application material in paragraph A51 of ISA 700 (Revised) that explains that the description on the website may be more detailed, or may address other matters relating to an audit of financial statements, provided that such wording reflects, and does not contradict, the matters addressed in the requirements in paragraphs 38–39 of ISA 700 (Revised). Further, application material has been included in paragraph A25 of ISA 260 (Revised) to indicate that the auditor may communicate with TCWG in circumstances when the auditor elects not to include the description of the auditor’s responsibilities in the body of the auditor’s report as permitted by ISA 700 (Revised).
Other Changes to the Description of the Auditor’s Responsibilities for the Audit of the Financial Statements Section

141. In finalizing ISA 700 (Revised), the IAASB also agreed the following changes to the description of auditor’s responsibilities:

- Revision of the requirement to provide a description of materiality in the auditor’s responsibilities section of the auditor’s report to allow auditors the ability to tailor such description based on the applicable financial reporting framework (see paragraphs 37(c) and A47 of ISA 700 (Revised)).
- When ISA 701 applies, inclusion of a description of the auditor’s responsibilities with respect to KAM (see discussion in paragraph 65 above and paragraphs 39(b)–(c) of ISA 700 (Revised)).
- Inclusion of a description of the auditor’s responsibilities with respect to GC (see discussion in paragraphs 99–104 above and paragraph 38(b)(iv) of ISA 700 (Revised)).

Changes to ISA 705 (Revised)

142. ISA 705 (Revised) deals with the auditor’s responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with ISA 700 (Revised), the auditor concludes that a modification to the auditor’s opinion on the financial statements is necessary. ISA 705 (Revised) continues to address how the form and content of the auditor’s report is affected when the auditor expresses a modified opinion. Accordingly, the reporting requirements in ISA 700 (Revised) all apply, and are not repeated in ISA 705 (Revised) unless they are explicitly addressed or amended within ISA 705 (Revised).

143. For example, paragraph 29 of ED-ISA 705 prohibited the auditor from including the required sections addressing reporting requirements for GC and KAM, as well as the enhanced description of the auditor’s responsibilities for the audit of the financial statements, in circumstances when the auditor disclaimed an opinion on the financial statements. Application material in support of this requirement explained the IAASB’s view that such information may overshadow the disclaimer of opinion on the financial statements as a whole. Respondents to the ED had mixed views on whether such a prohibition was appropriate. On one hand, some respondents (particularly public sector organizations) challenged the appropriateness of the prohibitions (in particular, when a MU related to GC has been identified), while others raised questions about whether the prohibitions (KAM, in particular) should also extend to situations when the auditor expresses an adverse opinion.

144. The IAASB’s decisions related to applicability of KAM when the auditor expresses an adverse opinion or disclaims an opinion on the financial statements are discussed further in paragraphs 62–64 above. With respect to GC, the IAASB did not consider it necessary to explicitly prohibit reporting on a MU related to GC when the auditor disclaims an opinion on the financial statements if, based on the audit evidence obtained, the auditor had concluded that a MU exists. The IAASB noted that neither extant ISA 570 nor extant ISA 705 explicitly addressed how the extant requirement for an EOM paragraph for a MU related to GC might apply in circumstances when the auditor disclaimed an opinion on the financial statements.
Conforming Amendments to Other ISAs

145. The ED included proposed changes to a number of ISAs as a result of the changes proposed to ISA 700 (Revised) and ISA 706 (Revised), and the concept of KAM as articulated in ISA 701. Respondents did not raise specific concerns with these conforming amendments. Accordingly, only minor changes were proposed to these conforming amendments to align with the final standards.

146. The EM of the ED also noted that illustrative auditor’s reports within ISAs 510, 600 and 710 would need to be conformed to the presentation as illustrated in ISA 700 (Revised) and ISA 705 (Revised). Such changes have been made in light of the final requirements and illustrative auditor’s reports in ISA 700 (Revised).

Post-Implementation Review and Other Activities to Promote Awareness and Understanding and Support Effective Implementation of the New and Revised Auditor Reporting Standards

147. The IAASB intends to undertake a post-implementation review of the new and revised Auditor Reporting standards after a period of two years from the effective date. The objective of this review will be to assess whether the new and revised Auditor Reporting standards have achieved their intended effect, and to assist the IAASB in, among other matters:

- Determining whether requiring wider application of the proposals initially limited to audits of financial statements of listed entities would be in the public interest;
- Understanding the way in which the requirements in the standards have been adopted and implemented by various jurisdictions in light of their national frameworks; and
- Considering whether further enhancements to auditor reporting are necessary, for example as a result of developments at the national level.

148. The post-implementation review may also identify how practical challenges and concerns are being addressed in practice (by auditors, management and audit committees), and whether further enhancements or refinements to the standards, or additional implementation support, is needed.

149. At its September 2014 meeting, the IAASB discussed a number of other activities to promote awareness and understanding and support effective implementation of the new and revised Auditor Reporting standards. For more information as these efforts progress, please visit www.iaasb.org/auditor-reporting.