This publication has been developed to illustrate how the concept of Key Audit Matters (KAM) may be applied in practice in accordance with ISA 701, Communicating Key Audit Matters in the Independent Auditor’s Report. It builds upon matters highlighted in the January 2015 publication Auditor Reporting – Key Audit Matters. The KAM examples contained herein are presented for illustrative purposes. ISA 701 requires the description of a KAM to be tailored to the facts and circumstances of the individual audit engagement and the entity in order to provide relevant and meaningful information to investors and other users of the auditor’s report. It is expected that KAM will vary in terms of the number and selection of topics addressed and the nature in which they may be described.

The IAASB recognizes the importance of the concept of KAM evolving over time to respond to investors’ needs. The KAM examples included in this publication are based on auditor’s reports issued in the Netherlands, where a national auditing standard incorporating concepts similar to ISA 701 is in effect, and the United Kingdom, where extended auditor reporting is now in its second year, as well as the illustrative examples in the IAASB’s July 2013 Exposure Draft, Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs).

Contextual Information Required to Be Included in the Auditor’s Report in Relation to KAM

Unless law or regulation prescribes otherwise, when KAM are communicated, auditors are required to include the following introductory language under the heading “Key Audit Matters” in a separate section of the auditor’s report:

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**Key Audit Matters**

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Although standardized in nature, this language is intended to provide an appropriate context for users of the auditor’s report to understand the new concept of KAM – in particular that the communication of KAM:

- Is not intended to imply that the matter has not been appropriately resolved by the auditor in forming the opinion on the financial statements; and
- Is not intended to represent or imply discrete opinions on separate elements of the financial statements (a “piecemeal opinion”).

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1. In March 2015, the UK Financial Reporting Council published a survey “Extended auditor’s reports: A review of experience in the first year”. The Survey explores both whether the new requirements appear to have been complied with and areas of innovation.

2. See paragraph 11 of ISA 701.
In addition, the Auditor’s Responsibilities for the Audit of the Financial Statements section of the auditor’s report will include the following description in relation to KAM:\(^3\)

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

**Determining KAM, Including the Number of KAM for a Particular Engagement**

KAM should be specific to the entity and the audit that was performed in order to provide relevant and meaningful information to users. Therefore, ISA 701 includes a judgment-based decision-making framework to help auditors determine which matters, from those communicated with those charged with governance, are KAM:\(^4\) This decision-making framework was developed to focus auditors on areas about which investors and other users have expressed interest – in particular, areas of the financial statements that involved the most significant or complex judgments by management and areas of auditor focus in accordance with the risk-based approach in the ISAs.

The number of KAM that will be communicated in the auditor’s report may be affected by the complexity of the entity, the nature of the entity’s business and environment, and the facts and circumstances of the audit engagement. It is envisaged that there will be at least one KAM for an audit of a listed entity.

**Required Elements in the Description of a KAM**

The description of a KAM is always required to include a reference to the related disclosures, if any, in the financial statements and address:

- Why the matter was considered to be one of most significance in the audit and therefore determined to be a KAM; and
- How the matter was addressed in the audit.\(^5\)

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\(^3\) See paragraphs 40–41 of ISA 700 (Revised), Forming an Opinion and Reporting on Financial Statements. Paragraph 40 requires this statement only for audits of financial statements of listed entities and any other entities for which KAM are communicated in accordance with ISA 701. Paragraph 41 of ISA 700 (Revised) permits the auditor to include this language within an appendix to the auditor’s report, in which case the auditor’s report shall include a reference to the location of the appendix, or by a specific reference within the auditor’s report to the location of such a description on a website of an appropriate authority, where law, regulation or national auditing standards expressly permit the auditor to do so.

\(^4\) See paragraphs 9–10 and A9–A30 of ISA 701. ISA 260 (Revised), Communication with Those Charged with Governance, and other ISAs set out requirements for auditors to communicate with those charged with governance about specific matters, including significant audit findings.

\(^5\) See ISA 701, paragraphs 13 and A34–A51.
The requirement in ISA 701 relating to the description of a KAM is intended to provide a succinct and balanced explanation about the matter. However, the level of detail in the description of each KAM is a matter of professional judgment, and may vary depending on the specific facts and circumstances of the particular engagement. The IAASB was of the view that this flexibility is important to enable auditors to be as entity-specific and audit-specific as possible in the description of a KAM, in order to mitigate concerns from investors and others that communication of KAM could quickly result in more standardized or “boilerplate” communications.

**Order of Presentation**

The order of presentation of individual matters within the KAM section of the auditor’s report is a matter of professional judgment. For example, such information may be organized in order of relative importance, based on the auditor’s judgment, or may correspond to the manner in which matters are disclosed in the financial statements. The auditor is also required to include subheadings for each individual KAM to further differentiate the matters.

**Illustrative KAM Examples**

In finalizing ISA 701, the IAASB agreed to develop a limited number of KAM examples to illustrate how the requirements of ISA 701 may be applied. The examples below represent extracts of what may be included in a KAM description and are intentionally diverse to illustrate the flexibility afforded to auditors in ISA 701 regarding the level of detail that may be included in the description of a KAM in the auditor’s report.

*Why the Matter Was Determined to Be a KAM*

The description of a KAM in the auditor’s report is intended to provide insight to intended users as to why the matter was determined to be a KAM (i.e., why it was a matter of most significance in the audit of the financial statements of the current period). ISA 701 also provides robust guidance to support the judgment-based decision-making framework in determining the relative significance of a matter communicated with those charged with governance and whether such a matter is a KAM.6

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6 ISA 701, paragraphs A42–A45
The following are intended to illustrate how an auditor may describe why a matter was determined to be a KAM:

- **Goodwill**
  Under IFRSs, the Group is required to annually test the amount of goodwill for impairment. This annual impairment test was significant to our audit because the balance of XX as of December 31, 20X1 is material to the financial statements. In addition, management’s assessment process is complex and highly judgmental and is based on assumptions, specifically [describe certain assumptions], which are affected by expected future market or economic conditions, particularly those in [name of country or geographic area].

- **Valuation of Financial Instruments**
  The Company’s investments in structured financial instruments represent [x%] of the total amount of its financial instruments. Due to their unique structure and terms, the valuation of these instruments are based on entity-developed internal models and not on quoted prices in active markets. Therefore, there is significant measurement uncertainty involved in this valuation. As a result, the valuation of these instruments was significant to our audit.

- **Effects of New Accounting Standards**
  As of January 1, 2013, IFRS 10 (Consolidated Financial Statements), 11 (Joint Arrangements) and 12 (Disclosure of Interests in Other Entities) became effective. IFRS 10 requires the Group to assess for all entities whether it has: power over the investee; exposure, or rights, to variable returns from its involvement with the investee; and the ability to use its power over the investee to affect the amount of the investor's returns. The complex structure, servicing and ownership of each vessel, requires the Group to assess and interpret the substance of a significant number of contractual agreements.

- **Valuation of Defined Benefit Pension Assets and Liabilities**
  The Group has recognized a pension surplus of [monetary value] as of December 31, 20X1. The assumptions that underpin the valuation of the defined benefit pension assets and liabilities are important, and also subjective, judgments as the surplus/deficit balance is volatile and affects the Group’s distributable reserves. Management has obtained advice from actuarial specialists in order to calculate this surplus, and uncertainty arises as a result of estimates made based on the Group’s expectations about long-term trends and market conditions. As a result, the actual surplus or deficit realized by the Group may be significantly different to that recognized on the balance sheet since small changes to the assumptions used in the calculation materially affect the valuation.
Revenue Recognition

The amount of revenue and profit recognized in the year on the sale of [name of product] and aftermarket services is dependent on the appropriate assessment of whether or not each long-term aftermarket contract for services is linked to or separate from the contract for sale of [name of product]. As the commercial arrangements can be complex, significant judgment is applied in selecting the accounting basis in each case. In our view, revenue recognition is significant to our audit as the Group might inappropriately account for sales of [name of product] and long-term service agreements as a single arrangement for accounting purposes and this would usually lead to revenue and profit being recognized too early because the margin in the long-term service agreement is usually higher than the margin in the [name of product] sale agreement.

Going Concern Assessment

As disclosed in Note 2, the Group is subject to a number of regulatory capital requirements, which are a key determinant of the Group’s ability to continue as a going concern. We identified that the most significant assumption in assessing the Group’s and [significant component’s] ability to continue as a going concern was the expected future profitability of the [significant component], as the key determinant of the forecasted capital position. The calculations supporting the assessment require management to make highly subjective judgments and also require adjustment to accounting figures to reflect regulatory requirements stipulated by the [name of applicable regulatory framework(s)]. The calculations are based on estimates of future performance, and are fundamental to assessing the suitability of the basis adopted for the preparation of the financial statements. We have therefore spent significant audit effort, including the time of senior members of our audit team, in assessing the appropriateness of this assumption.

How the Matter Was Addressed in the Audit

The description of a KAM in the auditor’s report is also intended to describe how the matter was addressed in the audit. The amount of detail to be provided in the auditor’s report to do so is a matter of professional judgment. ISA 701 explains that auditors may describe how a KAM was addressed in the audit by describing 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. If the auditor provides an indication of the outcome of the auditor’s procedures in the description of a KAM, care is needed to avoid the auditor giving the impression that the description is conveying a separate opinion on an individual KAM or that in any way may call into question the auditor’s opinion on the financial statements as a whole.

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7 See ISA 701, paragraphs A46–A51
The following are intended to illustrate how an auditor may describe how a KAM was addressed in the audit:

- **Goodwill**
  
  Our audit procedures included, among others, using a valuation expert to assist us in evaluating the assumptions and methodologies used by the Group, in particular those relating to the forecasted revenue growth and profit margins for [name of business line]. We also focused on the adequacy of the Group’s disclosures about those assumptions to which the outcome of the impairment test is most sensitive, that is, those that have the most significant effect on the determination of the recoverable amount of goodwill.

- **Revenue Recognition**
  
  Our audit procedures to address the risk of material misstatement relating to revenue recognition, which was considered to be a significant risk, included:
  
  - Testing of controls, assisted by our own IT specialists, including, among others, those over: input of individual advertising campaigns’ terms and pricing; comparison of those terms and pricing data against the related overarching contracts with advertising agencies; and linkage to viewer data; and
  
  - Detailed analysis of revenue and the timing of its recognition based on expectations derived from our industry knowledge and external market data, following up variances from our expectations.

- **Disposal of a Component**
  
  We have involved our valuation, financial instruments and tax specialists in addressing this matter and focused our work on:
  
  - Assessing the appropriateness of the fair values assigned to each element of the consideration received by referring to third-party data as applicable;
  
  - Evaluating management's assessment of embedded derivatives within the sale and purchase agreement; and
  
  - Critically assessing the fair value of [name of component] and the related allocation of the purchase price to the assets and liabilities acquired by evaluating the key assumptions used.

  We also evaluated the presentation and disclosure of the transactions within the consolidated financial statements.
• **Restructuring Provision and Organizational Changes**

In our audit we addressed the appropriateness and timely recognition of costs and provisions in accordance with IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets*. These recognition criteria are detailed and depend upon local communication and country-specific labor circumstances. Recognition criteria can be an agreement with the unions, a personal notification or a settlement agreement. The component audit teams have performed detailed audit procedures on the recognition and measurement of the restructuring provisions related to their respective components. The Group audit team has identified the completeness and accuracy of the restructuring provisions as a significant risk in the audit, has reviewed the procedures performed by the component audit teams and discussed with the component teams the recognition criteria. The restructuring provisions at the head office were audited by the Group audit team. We found the criteria and assumptions used by management in the determination of the restructuring provisions recognized in the financial statements to be appropriate.

• **Restructuring Provision and Disposition of a Mine**

Our audit procedures included, among others: examining the correspondence between the Group and the [name of government] and discussing with management the status of negotiations; examining announcements made by management to assess whether these currently commit the Group to redundancy costs; analyzing internal and third party studies on the social impact of closure and the related costs; recalculating the provision for closure and rehabilitation costs for the mine in the context of the accelerated closure plans; and reassessing long term supply agreements for the existence of any onerous contracts in the context of the Group’s revised requirements of the accelerated closure plans. We assessed the potential risk of management bias and the adequacy of the Group's disclosures.

We found that the assumptions and resulting estimates to be balanced and that the Group's disclosures appropriately describe the significant degree of inherent imprecision in the estimates and the potential impact on future periods of revisions to these estimates. We found no errors in calculations.

**Reference to the Related Disclosure(s) in the Financial Statements**

The auditor’s communication of KAM in the auditor’s report is not intended to be a substitute for the inclusion of appropriate and relevant financial statement disclosures, because management is responsible for providing information about the financial statements and the entity. The description of a KAM in the auditor’s report will always refer to any related disclosures in the financial statements. Reference to any related disclosures enables intended users to further understand how management has addressed the matter in preparing the financial statements. In addition to referring to related disclosure(s), the auditor’s description of a KAM may draw attention to key aspects of such disclosures. Therefore, the extent of disclosure by management about specific aspects of a particular matter in the financial statements may help the auditor in describing how those specific aspects were addressed in the audit such that intended users can understand why the matter is a KAM.

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8 See ISA 701, paragraphs 13 and A40–A41
The following are intended to illustrate how the auditor may refer to the related disclosures in the description of a KAM:

- **Valuation of Financial Instruments**
  The Company’s disclosures about its structured financial instruments are included in Note 5.

- **Goodwill**
  The Company's disclosures about goodwill are included in Note 3, which specifically explains that small changes in the key assumptions used could give rise to an impairment of the goodwill balance in the future.

For access to the new and revised Auditor Reporting standards, more information about the changes to the auditor's report, and other Auditor Reporting Toolkit materials, please visit The New Auditor's Report webpage at [www.iaasb.org/auditor-reporting](http://www.iaasb.org/auditor-reporting).