

Auditor Reporting—Summary of ED Responses Related to Determining and Communicating Key Audit Matters (KAM) and Drafting Team Recommendations**Overview**

The following are the key themes arising from the responses to the July 2013 Exposure Draft (ED) in relation to the proposed requirements to determine and communicate KAM that have been considered by the ISA 701 Drafting Team (DT-701) in preparing the recommendations included in this paper.

- Although the concept of KAM and the use of judgment by the auditor in determining and communicating KAM were supported by the majority of respondents to the ED, there are a number of areas within proposed ISA 701¹ that need to be refined to ensure the concept is workable in practice while achieving the objective of enhancing the value of the auditor's report.
 - Some respondents, particularly regulators, expressed a desire for more specificity to help to strengthen the judgment framework to promote greater consistency in how KAM is determined and communicated.
 - Consideration will need to be given throughout the process of finalizing the standard to striking an appropriate balance between the use of judgment by the auditor, calls for consistency across entities, and the overarching objective of providing additional information in the auditor's report that will be relevant and useful to users.

Determining KAM

- There is a need to more clearly define the concepts of “matters of most significance” and “significant auditor attention,” as well as the factors included in the proposed requirement to determine KAM. Respondents indicated that this would help to ensure the judgment framework to be applied by auditors is sufficiently robust in light of the definition of KAM while, at the same time, appropriately principles-based.
 - It has also been suggested that the factors should be more closely linked to matters that would be relevant to users or that would enhance the credibility of the financial statements or the confidence that users have in them.
 - Clarification may also be needed to ensure the factors are viewed as a filter for the auditor's determination of KAM, rather than be seen as KAM in and of themselves.
- Concerns also continue to exist about the auditor providing “original information” about the entity. Clarity is therefore needed within proposed ISA 701 about circumstances in which sensitive matters may be determined to be KAMs and, if so, what should be communicated about them, in light of potential issues with confidentiality and other relevant ethical requirements, as well as unintended consequences in terms of market reaction to the communication of such matters.

¹ Proposed ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*. Proposed ISA 701 as included in the ED can be found here: [https://www.ifac.org/sites/default/files/publications/files/Proposed%20ISA%20701%20\(Revised\)-final.pdf](https://www.ifac.org/sites/default/files/publications/files/Proposed%20ISA%20701%20(Revised)-final.pdf).

Communicating KAM

- There is a need to ensure that the descriptions of matters determined to be KAM are concise, informative and relevant to users. Concerns continue to exist about KAM becoming boilerplate, or auditors communicating too many KAMs.
- Further consideration is also needed to address the mixed views about whether “the effect on the audit” (i.e., procedures, findings, conclusions or outcomes) should be included in the descriptions of individual KAMs.

Objectives of the IAASB Discussion

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

Determining KAM

- Obtain input on DT-701’s proposed revisions to the requirements to determine KAM, including how the proposed standard should address sensitive matters (i.e., matters that are not required to be or otherwise disclosed in the financial statements).

Communicating KAM

- Obtain input on DT-701’s proposed revisions to the requirements to communicate KAM, in light of the mixed views about whether it is appropriate to allow flexibility for the auditor to include information about audit procedures and outcomes.

I. Overall Comments on the Usefulness of KAM (Question 1 of the ED)

A. Feedback from Respondents to the ED

1. With the exception of one investor who did not support the proposed changes to the auditor’s report generally,² investors were very supportive of the proposals to require auditors to determine and communicate KAM. The following key points were raised by investors in support of KAM, and were echoed by the majority of the other respondents, including regulators and audit oversight bodies, audit firms and national auditing standard setters (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.

² This respondent (DA) felt the additions to the auditor’s report obscured the possibility of the auditor being able to answer the question of whether the auditor has found anything that the reader should be aware of when making economic decisions based on the financial statements. The respondent suggested that detailed reporting on what the auditor has done should be a separate document that could be included on the auditee’s webpage, and separate activities could be undertaken to educate investors about the value of an audit and the work the auditor is undertaking.

- The inclusion of KAM would also contribute to providing information that may assist users in understanding the entity and areas of significant management judgment, and focusing investors on key issues included in the financial statements.
 - The inclusion of KAM will help institutional shareholders in their dialogues with investee companies to discuss the appropriateness of financial information and hold them more accountable.
 - Including KAM would help restore and enhance the confidence of users in the auditor's report and the audited financial statements, thereby contributing to a robust and resilient capital markets infrastructure.
2. Monitoring Group (MG) members³ generally supported the IAASB in pursuing improvements to the auditor's report in response to users' demands for more transparency about the audit, the audited entity and the entity's financial statements. It was noted that improving auditor reporting should reduce the information and expectations gaps of auditors and users of audited financial statements and will be helpful in restoring market confidence. IFIAR also 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.
3. Audit firms, regulators and member bodies were generally supportive of the concept and usefulness of KAM. Nevertheless, many suggestions were made with regard to improving and clarifying the requirements and guidance for determining and communicating KAM, which are further elaborated in Sections II and III of this paper.
4. On the other hand, consistent with the Invitation to Comment (ITC), preparers⁴ 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, shared by some other respondents, with the possibility of the auditor communicating "original information" about the entity. Communication of KAM blurs the responsibilities of management, those charged with governance (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 discussion of KAMs could trigger an unwarranted negative response.
 - In their view, matters that met the criteria for KAM would have been appropriately disclosed in the financial statements, in particular in relation to significant accounting policies and accounting estimates. In addition, 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 and rather focus only on entity-specific matters, as investors would already be familiar with industry-specific matters. It would

³ *Regulators and Oversight Authorities:* BCBS, IAIS, IFIAR, IOSCO, WB

⁴ *Preparers:* AA, CFOF, Gof100-A, NN, SO, SPL, USCC

- 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. The diversity of those that may be considered as “users of the auditor’s report” and their respective needs and demands was also mentioned as a concern by other respondents, including NSS.
5. A minority of other respondents⁵ (17/125) raised similar points, some noting feedback that had been received through roundtables or other events they sponsored, and in particular questioned whether the concept of KAM as intended would achieve the desired effect of enhancing the value of the auditor’s report. While minimal feedback was received on this question from respondents representing TCWG, similar concerns were noted by both preparers and TCWG in IAASB outreach, field testing, and the US Public Company Accounting Oversight Board’s (PCAOB) November 2013 Standing Advisory Group meeting, as well as in media reports.

Consistency in Auditor Judgments in Determining and Communicating KAM across Different Entities

6. There were mixed views about whether the requirements in proposed ISA 701 would promote consistency in how auditors determine and communicate KAM and whether such consistency is desirable, with many being of the view that the IAASB would learn more over time through the post-implementation review and could make further changes to ISA 701 if considered necessary. Because proposed ISA 701 is intended to be principles-based, many respondents acknowledged that the judgments of auditors will (and, in some cases, should) differ, with some suggesting ways in which consistency may be enhanced within the judgment framework (as described in Sections II and III). It was widely acknowledged that a balance needs to be maintained between striving for consistency and comparability, in particular in what individual auditors determine to be KAM, and the need for KAMs to remain unique and entity-specific for them to have the impact and usefulness desired over the long-term.
7. The urge for greater consistency comes primarily from regulators and oversight authorities. However, other stakeholders mentioned that consistency (in particular in how a KAM is described) was less important than providing relevant information to users in the context of the specific entity under audit, with some (including preparers) suggesting KAM that were routine to an industry and not sufficiently entity-specific would be less relevant. Underlying this view was the fear of KAM becoming boilerplate after the first year, which is seen to be undesirable.
8. Many respondents also called upon the IAASB to continue to liaise with the PCAOB as they seek to refine their concept of “critical audit matters”. It was noted that both the IAASB and the PCAOB’s initiatives, as well as the UK Financial Reporting Council’s (UKFRC), are intended to be responsive to users’ needs, and it would be confusing to users, and disappointing for global convergence, if the concepts were not aligned, particularly in the case of entities listed on multiple exchanges.

Activities to Support Effective Implementation of the Final Standards

9. Some respondents urged the IAASB to consider how best to educate investors, as well as preparers and TCWG, about the intent of the auditor determining and communicating KAM, in

⁵ TCWG: AICD; Regulators and Oversight Authorities: IRBA, JSE; NSS: AUASB; Accounting Firms: BT, PP; Public Sector Organizations: AGA, AGO, CFQ, GAO; Member Bodies and Other Professional Organizations: CalCPA, IAA, ICAI, ICAZ, IMCP, NYSSCPA, PICPA

particular to alleviate their concerns about the potential negative effects of including KAM in the auditor's report. The IAASB was also asked to consider what other initiatives could be undertaken to ensure the final standards are achieving their intended objectives, including in relation to guidance and training for auditors. DT-701 intends to give further thought to how best to do so, for example what an appropriate "roll-out plan" for 2015 may look like, how this may be done in conjunction with firms, NSS, regulators and others to explain the purpose of KAM and the timing of such initiatives.

Post-Implementation Review

10. Support was also expressed for the planned post-implementation review, to understand if the information reported as KAM meets the expectations of users, how practical challenges and concerns are being overcome in practice (by auditors, management and TCWG), and whether further enhancements or refinements to the proposals are needed.
 - It was specifically noted that the post-implementation review would be useful to assist the IAASB in determining whether wider application of the proposals initially limited to audits of financial statements of listed entities would be in the public interest.⁶
 - It was also suggested that the post-implementation review could consider whether other means of narrowing the expectations gap, such as assurance on information in earnings announcements, KPIs or other operational and risk disclosures, would better meet users' expectations.
 - Respondents continue to voice strong support for the possibility of TCWG reporting externally in a manner similar to that required by the UKFRC. While recognizing the IAASB's mandate does not apply to audit committees, respondents urged the IAASB to work with others to encourage further strengthening of audit committees globally as well as reporting by them, due to their important role in relation to audit quality.

B. Drafting Team Recommendations

11. In light of the broad support received, DT-701 recommends the IAASB move forward with the concept of including KAM in the auditor's report. DT-701 also acknowledges the balance to be struck in terms of the goal of promoting consistency in auditor judgments in determining and communicating KAM with the risk that too much prescription could drive boilerplate disclosures that will not be meaningful to users. It intends to further consider this as it revises application material and illustrative examples, and considers further actions to support the effective implementation of the final standards.

⁶ Staff's initial analysis indicates that the majority of respondents support the IAASB's proposal for KAM to be limited to audits of financial statements of listed entities. However, two MG respondents (BCBS and IAIS) are of the view that the requirement should be expanded to public interest entities (PIEs), with suggestion for a definition of PIE. Further comments have been raised in the context of proposed ISA 701's approach to KAM for other than listed entities. DT-701 intends to further consider this matter and put forth recommendations to the Board at its June 2014 meeting.

Matter for IAASB Consideration

1. The IAASB is asked to share its initial views on whether striving for consistency in both the determination and communication of KAM by auditors is an important goal, recognizing that further specificity in requirements and application material may lead to concerns over KAM quickly becoming boilerplate.

II. Determining KAM (Question 2 of the ED)

The following are excerpts from the July 2013 ED:

Objective of Proposed ISA 701

6. The objectives of the auditor are to determine key audit matters and, having formed an opinion on the financial statements, communicate those matters by describing them in the auditor's report.

Definition of KAM

7. *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.

Determining KAM

8. 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: (Ref: Para. A1–A14, A24)
 - (a) Areas identified as significant risks in accordance with ISA 315 (Revised),⁷ or involving significant auditor judgment. (Ref: Para. A15–A19)
 - (b) Areas in which the auditor encountered significant difficulty during the audit, including with respect to obtaining sufficient appropriate audit evidence. (Ref: Para. A20–A21)
 - (c) Circumstances that required significant modification of the auditor's planned approach to the audit, including as a result of the identification of a significant deficiency in internal control. (Ref: Para. A22–A23)

A. Feedback from Respondents to the ED

12. The majority of respondents⁸ (61/98), including one MG member, who supported the concept of KAM and answered Question 2 of the ED generally supported the proposed requirement for KAM

⁷ ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

⁸ *Investors and Analysts*: ABI, BR, CII, EUMEDION, IMA, SAAJ; *Regulators and Oversight Authorities*: DFSA, EBA, MAOB, WB; *NSS*: CNCC-CSOEC, FAP, JICPA, MAASB, UKFRC; *Accounting Firms*: BDO, CHI, DTT, EYG, GTI, KI, KPMG, MAZARS, MSUK, PKF, RSM; *Public Sector Organizations*: ACAG, AGC, AGM, AGNZ, AGSA, CIPFA, NAOS, NAOUK, PA; *Preparers*: EI; *Member Bodies and Other Professional Organizations*: ACCA, AIA, ASSIREVI, CAI, EFAA, FACPCE, FAR, IBRACON,

being determined based on the auditor's judgment. The concept of this judgment being based on matters communicated with TCWG and focused on areas of significant auditor attention was also largely supported. It was widely acknowledged that allowing KAM to be determined based on the auditor's professional judgment, with guidance supporting the auditor's judgment, would allow KAM to be entity-specific based on the facts and circumstances of the audit that was performed. Respondents were of the view that this approach is responsive to investor demands and may lessen the risk of boilerplate.

13. Despite this broad support for the use of auditor judgment in determining KAM, there were mixed views in terms of the level of support for the requirement as drafted, with many respondents offering suggestions as to how the proposed requirement could be improved.⁹
14. Further, there were also many respondents,¹⁰ including two MG members, who expressly did not support the requirement as drafted (37/98).¹¹ Some believe the requirement should be strengthened, as explained below, or did not support one or more of the factors that were included in paragraphs 8(a)–8(c) (see paragraph 21) and suggested changes to them.
15. For example, two members of the MG, as well as other respondents representing regulators and audit oversight bodies,¹² explicitly noted that more prescription was needed to assist the auditor's judgment and promote consistency. IFIAR and IOSCO were of the view that further consideration is needed to provide for a more robust standard that is not only informative to users, but also practical for auditors and enforceable for regulators. IFIAR specifically noted that “auditing standards that leave the determination of procedures solely to the auditor's professional judgment do not provide appropriate safeguards to stakeholders that sufficient procedures will be performed.” IFIAR suggested greater specificity regarding the types of matters that constitute KAMs (i.e., “indicators of KAMs”) would be helpful to users and ensure greater consistency among auditor's reports. IOSCO questioned whether similar KAMs would be reported in identical facts and circumstances. Another MG member (BCBS) noted some of the proposals could be developed further to improve consistency in application and clarity of disclosures, and suggested areas where application material could be elevated to the requirements (e.g., in relation to accounting policy choices and areas of significant management judgment).

ICAEW, ICAG, ICAN, ICAP, ICAS, ICPAK, IPAR, ISCA, KICPA, SMPC, WPK, ZICA; *Academics*: HGortemaker; *Individuals and Others*: ANA, CBarnard, DJuvenal, Flirungu

⁹ *Investors and Analysts*: ABI, CII; *Regulators and Oversight Authorities*: EBA, MAOB; *NSS*: CNCC-CSOEC, MAASB, UKFRC; *Accounting Firms*: BDO, BT, CHI, DTT, GTI, KPMG, MAZARS, MSUK, PKF, RSM; *Public Sector Organizations*: AGC, PA; *Preparers*: EI, USCC; *Member Bodies and Other Professional Organizations*: ASSIREVI, CAI, EFAA, FACPCE, FAR, IBRACON, ICAEW, ICAG, ISCA, KICPA, SMPC, WPK

¹⁰ *Investors and Analysts*: CFA, ICGN, JCiesielecki; *Regulators and Oversight Authorities*: CPAB, CSA CAC, EAIG, ESMA, ICAC, IFIAR, IOSCO; *NSS*: CAASB, HKICPA, IDW, NBA, NZAuASB; *Accounting Firms*: CR, PWC; *Public Sector Organizations*: ECA; *Member Bodies and Other Professional Organizations*: CAQ, CICPA, CPAA, CPAC, DNR, FEE, FSR, IBR-IRE, ICAA, ICPAI, KACR, MIA, NZICA, SAICA; *Academics*: HC, JCarcello, MU; *Individuals and Others*: CMunnariz

¹¹ There were other respondents who did not support the requirement as drafted because they did not support the concept of KAM. These include: *Regulators and Oversight Authorities*: IRBA; *NSS*: AUASB; *Accounting Firms*: PP; *Public Sector Organizations*: AGA, GAO; *Preparers*: AA, Gof100-A, SO, SPL; *Member Bodies and Other Professional Organizations*: CalCPA, IAA, ICAI, NYSSCPA.

¹² *Regulators and Oversight Authorities*: CSA CAC, EAIG, ESMA, ICAC, IFIAR, IOSCO

16. On the other hand, two MG members,¹³ supported by many other respondents, expressed the view that the IAASB had developed adequate principles to help auditors exercise their judgment in determining the information and the level of detail to include in the auditor's report.

Calls to Ensure the Requirement to Determine KAM Is Focused on What Is Most Relevant to Users

17. A suggestion from many respondents,¹⁴ including one MG member, was the need to make sure that what the auditor determined to be KAM would result in the auditor providing information that was relevant and useful to investors and other users of the auditor's report (to understand what is "keeping the auditor up at night"). One investor respondent suggested that the standard should include a factor requiring the auditor to consider the most significant matters in the financial statements from the point of view of a reasonable investor, which was echoed by another investor who also highlighted this approach was raised by a PCAOB member when their proposals were issued.¹⁵ This theme was also noted in the responses to Question 3, which dealt with what is communicated in relation to an individual KAM.
18. Previous discussions of DT-701 and IAASB indicated that it may be difficult to expect individual auditors to determine what matters arising during the audit are likely to be relevant to users. However, some respondents were of the view that auditors make such judgments in determining materiality, and also suggested a stronger linkage to areas of significant complexity in the financial statements could be useful to benefit users.
19. A few respondents explicitly suggested a stronger linkage to matters communicated with TCWG in accordance with ISA 260 would be appropriate, in particular in relation to the requirement for the auditor to communicate his/her views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates, and financial statement disclosures.¹⁶ Investors generally supported this view, and have stressed that they are looking for insights related to areas in the financial statements that involve complex financial reporting estimates and significant management judgments.

¹³ *Regulators and Oversight Authorities:* IAIS, WB

¹⁴ *Investors and Analysts:* ABI, CFA, CII, ICGN, IMA, JCiesielewski; *Regulators and Oversight Authorities:* EAIG, EBA, IAIS, UKFRC; *NSS:* CAASB, IDW, NZAuASB; *Accounting Firms:* PWC; *Public Sector Organizations:* GAO; *Member Bodies and Other Professional Organizations:* DNR, FEE, FSR, IBR-IRE, NZICA; *Academics:* JCarcello; *Individuals and Others:* CMunnariz

¹⁵ See CII and CFA responses.

¹⁶ Proposed ISA 260 (Revised), *Communication with Those Charged with Governance*, paragraph 16(a). Paragraph A17 of proposed ISA 701 notes that, in many cases, this relates to critical accounting estimates and related disclosures, which are likely to be areas of significant auditor attention, and therefore may be identified as significant risks. Accounting estimates with high estimation uncertainty are of interest to users of the financial statements because, among other things, they are highly dependent on judgment, may require the involvement of both a management's expert and an auditor's expert, and may be identified as significant risks.¹⁶ As a result, these areas of the audit may be considered KAMs.

20. Investors supported the notion of KAM being left to the auditor's judgment but raised some suggestions as to how the judgment framework could be more aligned to focusing on matters of significance to shareholders. Specifically, a number of areas were raised by certain investors as matters that should be considered in determining KAMs:¹⁷
- Key financial statement, business, operational and audit risks the auditor has considered when conducting the audit, and the extent, if any, as to how the auditor addressed those risks.
 - The auditor's assessment of the critical accounting estimates and judgments made by management that materially affect the financial statements, whether those assumptions are at the low or high end of the range of possible outcomes and how the auditor arrived at that assessment.
 - The quality and appropriateness of the accounting policies and practices adopted by management, including accounting applications and practices uncommon to the industry.
 - Unusual transactions and significant changes to accounting policies that have a significant impact on the financial statements.
 - Methods and judgments made in valuing assets and liabilities.
 - Identification of any matters obtained in the course of their audit that the auditors believe are incorrect or inconsistent with the information contained in the financial statements or in other information (such as Management's Discussion and Analysis).
 - Key audit issues and their resolution, which the audit partner documents in a final audit memo to the Audit Committee or TCWG.
 - The quality and effectiveness of the governance structure of the board and risk management (including internal controls).
 - Completeness and reasonableness of the Audit Committee report, where applicable.
21. Although respondents generally supported the factor in paragraph 8(a) relating to significant risks, many respondents,¹⁸ including one MG member, did not believe that the factors in paragraphs 8(b)-(c) were appropriate, because:
- Matters that met these criteria would not always be relevant to investors.
 - Paragraph 8(c) was perceived to establish additional reporting responsibilities on the auditor to report on internal controls.
 - The factors in paragraphs 8(b)-(c) could be viewed as being already included in paragraph 8(a).
 - Some noted that disclosure of difficulties involved during the audit may appear to contradict a modified opinion, or are simply not interesting since the auditor resolved them, as evidenced by the unmodified opinion.

¹⁷ See ICGN, CFA and CII responses, as well as JCarcello.

¹⁸ *Regulators and Oversight Authorities:* IAIS, IRBA; *NSS:* AUASB, IDW, JICPA, NZAuASB; *Accounting Firms:* CR, PWC; *Preparers:* AA, SPL; *Member Bodies and Other Professional Organizations:* ASSIREVI, CICPA, FEE, IBRACON, ICAA, KACR, MIA, NZICA, SAICA, SMPC, WPK; *Academics:* MU; *Individuals and Others:* CMunnariz

22. Although the application material proposed to these paragraphs may help to mitigate these concerns, it was noted that further attention should be given to clarifying the intent of the factors for consideration through further changes to the drafting. For example, to some respondents, including IOSCO, it was not clear whether a matter would need to meet all of the factors to be considered a KAM, whether each factor was intended individually to be an indicator of KAM, or whether the factors were merely considerations to be taken into account in determining KAM.

Calls to Clarify the Concepts of “Significant Auditor Attention” and Matters of “Most Significance”

23. Some concern was expressed that the concept of “significant auditor attention” may be too broad, and may result in auditors communicating about matters that were important judgments relating to audit acceptance, scope and approach, but were not likely to result in decision-useful information being provided in the auditor’s report, as investors are largely concerned with the outcome of such processes.
24. As an alternative, some respondents¹⁹ (in particular, audit firms and member bodies) suggested enhancing the concept of “significant auditor attention” by anchoring the factors to the most significant financial statement areas. In their view, doing so would likely result in KAM being more focused on matters that were likely to be most relevant to users’ decision-making and alleviate some concerns about the auditor providing “original information” (see below). While it was noted that the definition of KAM makes reference to matters of *most* significance, more guidance to assist auditors in narrowing down the areas of significant auditor attention to the KAM may also be necessary.
25. IOSCO also questioned how matters of most significance would be measured, for example by the extent of firm-wide consultations, the degree of partner involvement, or total hours incurred. One audit firm (KPMG) noted that the standard should refrain from suggesting that a significant amount of hours may, on its own, be a trigger for a KAM. Other respondents agreed that the concept of “most significance” will be challenging to apply in practice, but suggested that the notion of the determination of KAM as “an objective analysis of the facts and circumstances”, and the need to consider the nature and extent of communication with TCWG, will be helpful to auditors in making judgments about KAMs.

Concerns about Communicating Original Information in the Auditor’s Report, Including about Sensitive Matters

26. Consistent with the ITC, there continues to be an overarching concern across all stakeholder groups²⁰ (in particular from preparers and audit firms) about the possibility of the auditor providing “original information” about the entity in the auditor’s report – further blurring the respective roles of management, TCWG, and the auditor. Feedback from field testing performed by some audit firms also highlighted this concern.

¹⁹ NSS: MAASB; *Accounting Firms*: EYG, GTI, KPMG, PWC; *Member Bodies and Other Professional Organizations*: ASSIREVI, CICPA, FEE, FSR, IBR-IRE, KHT, NZICA

²⁰ As noted in the following responses: *Regulators and Oversight Authorities*: EBA, IRBA, MAOB; *NSS*: ASB, AUASB, IDW, JICPA, MAASB, NBA, NZAuASB; *Accounting Firms*: BDO, BT, CR, DTT, EYG, GTI, KPMG, PWC, RSM; *Public Sector Organizations*: NAOS; *Preparers*: EI, Gof100-A, SO, USCC; *Member Bodies and Other Professional Organizations*: ASSIREVI, CalCPA, CAQ, DNR, FAR, FEE, FSR, HKICPA, IBR-IRE, ICAA, ICAP, ICAS, ISCA, KACR, NZICA, SAICA, WPK; *Academics*: MU; *Individuals and Others*: CMunnariz

27. Although some investors specifically noted the view that the auditor should be freely able to comment on any matter they believe would be of value to users,²¹ including matters related to the governance of an entity, other respondents are of the view that proposed ISA 701 should explicitly acknowledge that the auditor cannot or should not include a KAM about which the entity has not provided information in the financial statements to prevent the auditor from being in a situation where it would be necessary to provide original information about the entity (i.e., by scoping out certain topics).²² Still others suggested the matters determined to be KAMs are more likely to be linked to matters disclosed in the financial statements, with some acknowledging that matters beyond those disclosed in the financial statements may be determined to be KAM in relatively rare circumstances.²³
28. If the scope of KAM is not explicitly limited to matters disclosed in the financial statements, many respondents called for more specificity in proposed ISA 701 about how “sensitive” matters should be addressed, particularly in circumstances where the auditor would be seen to be providing original information about the entity. These respondents would like further 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, a number of respondents suggested the IAASB needed to do more to address the potential conflict between proposed ISA 701 and ethical requirements that prohibit the auditor from communicating confidential information.
29. For example, some of these respondents have suggested more guidance is needed in the standard to assist auditors in dealing with the practical challenges that would arise in these circumstances by:
- (i) Addressing circumstances when an auditor needs to recognize areas of conflicting obligations (due to commercial sensitivities, professional privilege and privacy).
 - (ii) Providing a logical sequence of steps to work through in dealing with the nature and scope of the KAM disclosures, consultations including legal advice and discussions with the engagement quality control reviewer.
 - (iii) Providing suggestions as to how the auditor can appropriately address and resolve disagreements with management and TCWG.

²¹ *Investors and Analysts:* ABI, CFA, CII, EUMEDION, ICGN. This mechanism exists today through the use of Other Matter (OM) paragraphs, which enables communication about any matter other than those that are presented or disclosed in the financial statements that, in the auditor’s judgment, is relevant to users’ understanding of the audit, the auditor’s responsibilities or the auditor’s report, unless prohibited by law or regulation, although it is recognized that OM paragraphs are rarely used voluntarily.

²² *Regulators and Oversight Authorities:* IRBA, MAOB; *NSS:* MAASB, NBA, NZAuASB; *Accounting Firms:* CR; *Preparers:* EI, SO; *Member Bodies and Other Professional Organizations:* ASSIREVI, DNR, FEE, FSR, IBR-IRE, ICAP

²³ *Regulators and Oversight Authorities:* EBA, IRBA; *NSS:* CAASB; *Accounting Firms:* BDO, DTT, EYG, GTI, KPMG, PWC; *Member Bodies and Other Professional Organizations:* CAQ, ISCA, KACR

30. It was noted that reporting of certain matters in the auditor's report could have the effect of lowering the threshold for disclosing information to markets, in the sense of triggering reporting at an earlier point and having unintended market consequences – today's reporting models reflect established consensus, with regard to the public interest, on the nature and timing of disclosure of particular information to users and by whom. Concerns were specifically expressed about the possibility of the auditor reporting on:
- Close calls related to going concern when a material uncertainty (MU) was not identified – some suggested the IAASB needed to form a view as to whether reporting as a KAM may be appropriate in some circumstances, given that it otherwise would appear to meet the “criteria” for KAM and such information would likely be of value to investors.²⁴
 - 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.

B. Drafting Team Recommendations

Proposed Changes to the Requirement to Determine KAM

31. Having considered various wording suggestions offered, DT-701 recommends that paragraph 8 of proposed ISA 701 be amended, and a new requirement be added to the standard to further assist auditors in narrowing the matters that required significant auditor attention to the KAMs, as follows:
8. The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit, with consideration given in particular to:
 - (a) Areas identified as significant risks in accordance with ISA 315 (Revised) or involving significant auditor judgment.
 - (b) Areas in the financial statements that involved the application of significant judgment or estimation by management.
 - (c) Significant events or transactions that occurred during the year.

²⁴ Discussions by the ISA 570 Drafting Team addressing feedback relating to the IAASB's going concern proposals have confirmed the need to explain the relationship between KAM and auditor reporting on going concern, in particular in relation to positioning of any such reporting. However, it was noted that feedback from the ITC largely did not favor requiring auditors to always provide additional information in the auditor's report about the judgments made in reaching the conclusion that no material uncertainty had been identified.

- 8.1. The auditor shall determine which of the matters determined in accordance with paragraph 8 were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.

Rationale for DT-701's Recommendation

32. DT-701 is of the view that these revisions better articulate the thought process an auditor may 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. New paragraph 8.1 serves as a second “filter” to better illustrate that KAM is a selection of the most significant matters (i.e., “big ticket” items) from the matters that required significant auditor attention.
33. The revised factors in paragraphs 8(a)-(c) are more closely linked to matters that are likely to be disclosed in the financial statements, and are intended to refine the auditor's consideration of areas of significant auditor attention to those areas about which users have expressed the most interest. The revised factors also take into account feedback from firms that performed field testing, and incorporate key aspects of the application material in the ED. DT-701 believes the matters identified through the revised factors required to be taken into account will more often than not lead to the auditor determining and communicating about matters that are already disclosed in the financial statements.
34. However, DT-701 generally did not consider it appropriate to explicitly scope out of the determination of KAM any matters that may arise during the audit of the financial statements. This is because some investors and regulators are of the view that there may be matters other than those required to be disclosed in the financial statements that would be of interest to them if they are determined to be matters of most significance in the audit (i.e., relevant to the *audit (of the financial statements)* that was conducted while not necessarily relevant to the *disclosures* in those financial statements). DT-701 continues to be 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.

Proposed New Requirement to Address Concerns about Communicating Original Information in the Auditor's Report, Including about Sensitive Matters

35. In the event that the auditor considers a matter other than a matter disclosed in the financial statements to be “of most significance”, DT-701 believes it is necessary to guide the auditor as to the appropriate actions to be taken in communicating about that matter in the auditor's report. DT-701 is of the view that the following questions need to be considered in determining an appropriate way forward in revising ISA 701:
 - Are there matters about which auditors may be precluded from communicating, for example due to law, regulation or relevant ethical requirements?
 - Are there matters of such a sensitive nature, or which raise the possibility of significant unintended market consequences or harm to an entity, that auditors should be permitted to use professional judgment to exclude disclosure about them in the auditor's report in the public interest (see paragraph 30)?

36. DT-701 interprets the concept of “original information” to be any information about the entity that is not in the public domain (i.e., in the financial statements, other information or other publicly available documents). Concerns about auditors providing “original information” are closely linked to the potential consequences of the auditor communicating about sensitive matters that are not otherwise required to be disclosed – namely, the effect of lowering the threshold for disclosing information to markets, in the sense of triggering reporting at an earlier point and having unintended market consequences.
37. Respondents variously highlighted the need to ensure that the requirements in proposed ISA 701 to determine and communicate KAM could operate in tandem with relevant ethical requirements in relation to confidentiality, including the current provisions of the *Code of Ethics for Professional Accountants* issued by the International Ethics Standards Board for Accountants (IESBA Code). DT-701 intends to consult with the IESBA Planning Committee to further understand circumstances in which the auditor may override the duty of confidentiality (Section 140 of the IESBA Code). The implications of this feedback will be further considered by the DT-701 and will be discussed in more detail with the IAASB at its June 2014 meeting.
38. As a first step to respond to concerns generally about the auditor providing original information and specifically about whether it would be appropriate for the auditor to communicate about certain sensitive matters, DT-701 has identified the need for a third (new) requirement to put a process in place when matters not disclosed in the financial statements are determined to be KAM.
39. Because it is not possible for proposed ISA 701 to contemplate all situations that may arise in practice, DT-701 is of the view that it is best for the requirement to address the need for communication with TCWG in these circumstances.²⁵ Doing so is seen to establish an “independent check” on the auditor’s judgment, and to limit the potential for auditors to abuse the notion of “sensitivity” to routinely decide not to communicate about matters determined to be KAM.
40. This new requirement would be intended to highlight the need for the auditor to carefully consider the facts and circumstances of the entity, the legal environment in which it operates, and the audit that was performed, in deciding how to communicate about KAM. Additional application material supporting this requirement could further outline actions auditors may take in evaluating the specific facts and circumstances for an engagement in order to determine whether to disclose entity-specific information not otherwise included in the financial statements (see paragraph 74). In particular, this application material could provide further guidance about the need for the auditor to obtain legal advice and provide guidance as to how auditors may address issues relating to confidentiality.
41. However, as part of developing the proposed requirement and related application material, DT-701 is also of the view that it may need to reconsider whether proposed ISA 701 should allow for the possibility that, in certain circumstances, there may be matters determined to be KAM that, in the auditor’s professional judgment and following discussion with TCWG, should not be communicated in the auditor’s report. This may be necessary in response to both of the questions posed in paragraph 35. For example, certain legal regimes allow for entities confidentiality rights and exempt them from making disclosures that would “prejudice the legitimate interests of the company.”

²⁵ While in some cases the auditor may have a preliminary view about the nature of the proposed description in accordance with paragraph 10, this may not always be the case – a point which could be addressed in application material.

Further, there may be cases in which, based on the facts and circumstances, the auditor ultimately concludes that communicating about a matter determined to be KAM is not appropriate. In both such cases, DT-701 sees that there may be a public interest argument, in particular upon receiving legal advice and considering the relevant ethical requirements specific to the jurisdiction in which the entity and auditor are operating, for the omission of disclosure in the auditor's report. How such circumstances can be operationalized in the auditor's report (e.g., whether this matter needs to be explicitly addressed in a requirement) would be a matter for further consideration by DT-701 and the IAASB. DT-701 would also need to consider whether and, if so, how the ISA could provide guidance about the types of matters or circumstances that may lead the auditor to conclude that a matter determined to be a KAM should not be communicated in the auditor's report.

Summary

42. DT-701 believes that these requirements in total, and the balance struck therein, appropriately responds to the calls from some investors to not limit KAM to matters only disclosed in the financial statements, while at the same time providing clarity on what matters that required significant auditor attention are likely to be. As a result of these proposed changes, revisions and restructuring will be needed to the corresponding application material, in particular to seek to address some of the practical challenges identified above (see paragraph 74).

Matters for IAASB Consideration

2. The IAASB is asked whether it agrees with DT-701's recommendation for revised requirements relating to the determination of KAM. If IAASB members do not agree with the manner in which these requirements have been articulated, they are asked to provide specific feedback on areas for further consideration by DT-701.
3. The IAASB is also asked for its initial views on the possibility that proposed ISA 701 may need to explicitly acknowledge circumstances in which, having considered all relevant facts and circumstances, the auditor may decide not to communicate in the auditor's report about a matter determined to be a KAM.

III. Communicating Key Audit Matters (Question 3 of the ED)

The following are excerpts from the July 2013 ED:

10. The auditor shall describe each key audit matter in the Key Audit Matters section using an appropriate subheading, except in the circumstances explained in paragraph 11. The description of each key audit matter shall include: (Ref: Para. A30)
 - (a) An explanation of why the auditor considered the matter to be one of most significance in the audit and, to the extent the auditor considers it necessary as part of this explanation, its effect on the audit; and (Ref: Para. A31–A41)
 - (b) A reference to the related disclosure(s), if any, in the financial statements. (Ref: Para. A42–A43)

A. Feedback from Respondents to the ED

43. The majority of respondents²⁶ (64/96), including one MG member, who supported the concept of KAM and answered Question 3 of the ED supported the proposed requirement for the description of KAM being based on the auditor's judgment. In particular:
- Many audit firms and the majority of other 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. Many respondents suggested that the flexibility in the description was necessary and appropriate to allow the auditor take into account the nature of the matter, how it had been described in the financial statements, as well as the possibility that a description of an individual KAM could be misinterpreted.
 - One audit firm suggested the overriding principle in disclosing KAMs should be to enhance effective communication through the provision of useful information in a succinct, insightful manner while emphasizing, when applicable, the importance of the disclosures provided by management through reference to the financial statement notes.
 - Respondents generally supported the requirement for the auditor to provide insight into why the matter was determined to be a KAM. It was also suggested that explicit mention of the factors in determining KAM in the description of an individual KAM would be useful.²⁷
 - Respondents generally supported the requirement to include a reference to the related disclosures in the financial statements, but some expressed concern that communication of KAM could be largely repetitive of disclosures management is already required to provide (or, in the case of the UK, matters disclosed by the Audit Committee), even if important aspects of these disclosures were highlighted in the description of KAM.

However, many of these respondents²⁸ offered suggestions as to how the proposed requirement could be improved.

44. The remaining respondents²⁹ (32/96), including three MG members, did not support the requirement as drafted, either because they felt it should be further strengthened to always require

²⁶ *Investors and Analysts:* ABI, BR, EUMEDION, ICGN, SAAJ, SLI; *Regulators and Oversight Authorities:* DFSA, EAIG, EBA, MAOB, WB; *NSS:* AUASB, FAP, IDW, NBA, NZAuASB; *Accounting Firms:* BDO, CHI, CR, DTT, EYG, GTI, KI, KPMG, PKF, PP, PWC, RSM; *Public Sector Organizations:* AGAC, AGC, AGM, AGNZ, CIPFA, NAOS, NAOUK, PA; *Preparers:* SPL; *Member Bodies and Other Professional Organizations:* ACCA, AIA, CAI, CalCPA, EFAA, FACPCE, IBR-IRE, IBRACON, ICAA, ICAG, ICAN, ICAP, ICAS, ICAZ, ICPAI, ICPAK, IPAR, ISCA, KICPA, SMPC, ZICA; *Academics:* ABurrowes, HC; *Individuals and Others:* ANA, CBarnard, DJuvenal, Flrungu

²⁷ This proposed approach appears consistent with the PCAOB's proposed requirement to "describe the considerations that lead the auditor to determine that the matter is a critical audit matter," although some have suggested that the description should focus on the "principal" considerations rather than infer that the auditor must report on each of the factors included in the PCAOB's proposals.

²⁸ *Investors and Analysts:* ABI, BR, ICGN, SAAJ, SLI; *Regulators and Oversight Authorities:* EAIG, EBA; *NSS:* AUASB, IDW, NBA, NZAuASB; *Accounting Firms:* BDO, CHI, CR, DTT, EYG, GTI, KPMG, PWC, RSM; *Public Sector Organizations:* AGAC, AGC, AGNZ, PA; *Preparers:* SPL; *Member Bodies and Other Professional Organizations:* CAI, CalCPA, FACPCE, IBR-IRE, ICAG, ICAS, IPAR, ISCA, KICPA

²⁹ *Investors and Analysts:* CFA, IMA; *Regulators and Oversight Authorities:* BCBS, CPAB, ESMA, IAIS, IOSCO; *NSS:* CAASB, CNCC-CSOEC, HKICPA, JICPA, MAASB, UKFRC; *Accounting Firms:* BT, MAZARS, MSUK; *Public Sector Organizations:*

the auditor to describe the effect on the audit, or alternatively had specific views that the auditor should be prohibited from doing so.³⁰ These views are further discussed below.

45. As noted in paragraphs 26–30, the concern that auditors could be providing original information about the entity when communicating KAM is closely linked to the question of how KAM should be determined. Changes to the proposed requirement to determine KAM may help alleviate these concerns to an extent (in particular if a stronger link is made to matters that have been disclosed in the financial statements as being candidates for KAMs), as may the proposed new requirement addressing how auditors should approach the communication about sensitive matters that may be determined to be KAM (see paragraph 38). Guidance developed to support those requirements may also be relevant to the proposed revised requirement to communicate KAM.

Views on the Flexibility Embedded in the Requirement

46. The challenges of balancing the calls for consistency in KAMs across entities and the concerns over such descriptions rapidly devolving into boilerplate are equally relevant in relation to communicating KAM. Many respondents, including two MG respondents,³¹ investors and audit firms, commented on the importance of the IAASB structuring the requirement appropriately and providing sufficient guidance such that the descriptions of KAM would be entity-specific and avoid boilerplate. Some respondents recommended that the IAASB encourage innovation in an evolving area and see how this could be addressed in guidance in the proposed standard and in drafting revised illustrative examples. 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.
47. Notwithstanding the overarching support for the judgment-based requirement in relation to communicating KAM, a minority of respondents³² (15/98), including three MG members and other regulators and audit oversight authorities, were specifically of the view that the required elements of the description of each KAM are minimal and may not provide sufficient useful information to users. It was suggested that certain application material (for example, paragraphs A31, A38 and A41 of proposed ISA 701) could be elevated to the requirement to encourage a more consistent, comprehensive and entity-specific description of KAMs in the auditor’s report. Specifically:
- One MG member (IOSCO), supported by other respondents, suggested three elements should be required: (i) the nature of the audit matter; (ii) the audit approach adopted with respect to the matter; and (iii) the outcome of the auditor’s work, provided the language used could not be viewed as in substance altering the content of the auditor’s responsibility for the

AGSA, ECA; *Preparers*: EI; *Member Bodies and Other Professional Organizations*: ASSIREVI, CAQ, CICPA, DNR, FAR, FEE, FSR, ICAEW, KHT, NZICA, SAICA, WPK; *Academics*: MU

³⁰ There were other respondents who did not support the requirement as drafted because they did not support the concept of KAM. These include: *TCWG: Public Sector Organizations*: AGA; *Preparers*: AA; *Member Bodies and Other Professional Organizations*: IAA, ICAI, IMCP, NYSSCPA

³¹ IOSCO, WB

³² *Investors and Analysts*: IMA; *Regulators and Oversight Authorities*: BCBS, DFSA, EAIG, ESMA, IAIS, IOSCO; *NSS*: CNCC-CSOEC, UKFRC; *Accounting Firms*: MAZARS; *Preparers*: EI; *Member Bodies and Other Professional Organizations*: FEE, FSR, ICAEW, WPK

KAM or the auditor’s opinion on the financial statements. CNCC-CSOEC and MAZARS also supported a more prescriptive approach, in line with what is required under the French Justification of Assessments model.

- Another MG member (IAIS) expressed the view that the auditor’s report should include a brief overview of procedures performed or the auditor’s approach to the matter, or should include an indication of the outcome of the auditor’s procedures with respect to the matter.

48. Investors variously noted that the description of a KAM should focus on:

- Why and how the audit addressed key financial statement areas.
- Why the matters described are of particular importance to the audit and, at a high level, how they were addressed 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.

49. DT-701’s understanding of the European Union Compromise Package is that they would require a description of the most significant assessed risks of material misstatement, including assessed risks of material misstatement due to fraud, a summary of the auditor’s response to those risks, and where relevant, key observations arising with respect to those risks, with a reference to the relevant disclosures in the financial statements.

Describing a Matter’s “Effect on the Audit”

50. 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”, “auditor’s approach”, or “a description of the auditor’s response”, would better signal to auditors what was expected to be disclosed.

51. A number of respondents, including one MG member (IOSCO), also highlighted that the manner in which the illustrative examples were presented was inconsistent in light of the flexibility that was permitted under paragraph 10 of proposed ISA 701, because three of the four examples describe the effect of the KAM on the audit, despite the optionality in the standard. Other respondents suggested that users may question the implications of auditors taking different approaches in describing a KAM.³³

52. Respondents across all stakeholder groups suggested that, if the flexibility is to be retained to allow the auditor to exercise judgment in communicating KAMs (i.e., in relation to the possibility of describing “the effect on the audit”), further guidance is necessary to assist auditors in determining when elements such as procedures and responses, or findings and outcomes, may be appropriate. Specifically, these respondents asked for guidance within the proposed standard as to when one approach to describing a matter may be more relevant than another.

³³ Detailed comments on the usefulness of the illustrative examples will be further considered by the DT subsequent to the March 2014 IAASB meeting.

Specific Feedback on Describing the Auditor's Procedures or Response

53. Feedback on the need to include a description of the auditor's procedures was consistent with that of the ITC, in particular from those who questioned the relevance of the information (including one investor) and those who highlighted the difficulties of conveying a summary of procedures in a succinct and meaningful way, which is often quite detailed when communicating with TCWG.
54. Although a strong majority (115/138) of respondents did not specifically express a view as to whether audit procedures or, more generally, the auditor's response to the matter, should be required to be included in the description of KAM, 15 respondents³⁴ (including one MG member) explicitly stated this should be required, whereas 10 respondents³⁵ were of the view that it would not be appropriate to require this in all cases.
- Some audit firms expressed concern that an overly brief description of two or three of the auditor's procedures out of dozens would run the risk of decreasing confidence in the rigor of the audit, as it may imply that the auditor's procedures were much less in scope than was actually the case, and may have unintended consequences on the perception of audit quality. One firm suggested additional clarification in the introductory language to the KAM section of the auditor's report would be helpful to mitigate this risk.
 - Audit firms and other respondents also noted that additional guidance on how to determine whether it was necessary to describe procedures and which procedures to describe would be useful – for example, those that addressed the most complex aspect of the KAM, and which were the most challenging or involved the most subjectivity. It was further suggested by one firm that in most cases, the auditor should not be expected to provide an overview of the procedures performed.

Specific Feedback on Describing the Findings, Outcomes, or Conclusions from the Auditor's Work

55. Feedback on the need to include a description of the auditor's findings, outcomes of the auditor's work, or the auditor's conclusion in relation to a KAM was consistent with that of the ITC, in particular in relation to the concern that KAM may be interpreted as a "piecemeal opinion" on individual matters or may undermine the opinion on the financial statements as a whole. While a significant majority (108/138) of respondents did not specifically express a view as to whether there should be a requirement for the auditor to discuss findings, outcomes or conclusions, in the description of KAM, 13 respondents³⁶ (including one MG member) explicitly stated this should be required, whereas 17 respondents³⁷ were of the view that it would not be appropriate to require this in all cases.

³⁴ *Investors and Analysts:* ABI, ICGN, IMA; *Regulators and Oversight Authorities:* EAIG, ESMA, IOSCO; *NSS:* CNCC-CSOEC; *Accounting Firms:* KPMG, MAZARS, PWC; *Public Sector Organizations:* AGA; *Preparers:* EI; *Member Bodies and Other Professional Organizations:* FEE, FSR, ICAEW

³⁵ *Investors and Analysts:* BR, CII; *NSS:* JICPA, NZICA; *Accounting Firms:* BDO, CR; *Preparers:* SPL; *Member Bodies and Other Professional Organizations:* FAR, IAA, ICAA

³⁶ *Investors and Analysts:* CFA, CII, ICGN, IMA; *Regulators and Oversight Authorities:* ESMA, IOSCO; *NSS:* CNCC-CSOEC; *Accounting Firms:* MAZARS; *Public Sector Organizations:* AGA, AGNZ; *Preparers:* EI; *Member Bodies and Other Professional Organizations:* FEE, ICAEW

³⁷ *Investors and Analysts:* BR; *NSS:* CAASB, JICPA, NBA; *Accounting Firms:* BDO, DTT, EYG, GTI, KPMG, PWC; *Preparers:* SPL; *Member Bodies and Other Professional Organizations:* CalCPA, CAQ, CICPA, FAR, FSR, IAA

- In particular, one investor expressed a strong opposing view that the auditor should always be required to discuss the outcome of the auditor's work, with another investor noting that a brief explanation regarding how the KAM was resolved could be beneficial to users. Another respondent who supported requiring a conclusion noted that a lack of information on the audit procedures performed and the conclusion reached may create anxiety for the users of the auditor's report who may not understand whether the matters has been resolved to the auditor's satisfaction. Other respondents noted the need to discuss "key findings", with a call for more guidance on when doing so may be appropriate and how the auditor could do so without such a description being read as a piecemeal opinion.

B. Drafting Team Recommendations

Changes to the Requirement to Communicate KAM

56. DT-701 notes the diversity in responses between the majority support for allowing flexibility for auditors to determine what would be most relevant in the context of describing a particular KAM, and a call from some for further specificity in the requirement for describing KAM (for example, by requiring discussion of how the matter was addressed in the audit in all cases).
57. As explained in the EM, in developing proposed ISA 701 the IAASB has already had significant debate on whether it would be necessary, or appropriate, in all cases to require auditors to include a discussion of the auditor's procedures or the outcome of such procedures. Respondents to the ITC had raised concerns about the possibility of KAMs being perceived as separate assurance or "piecemeal opinions," which they viewed as being inconsistent with the fact that the auditor's procedures are designed in the context of the audit of the financial statements as a whole. The EM also acknowledged that challenges are also likely to exist in summarizing the auditor's procedures in complex areas in a clear and succinct manner – auditors have expressed concern that users may incorrectly underestimate the work the auditor had actually performed, and investors have signaled that such information would be likely to become boilerplate over time. On balance, the IAASB believed it was necessary for proposed ISA 701 to allow for flexibility for the auditor to determine whether it may be necessary, in explaining why a matter was determined to be a KAM, for the auditor to describe its effect on the audit, rather than mandating a discussion of audit procedures or a conclusion in all cases. At the heart of this decision was the overall view that descriptions of individual KAMs should be as entity-specific as possible, and care should be taken to avoid KAM becoming boilerplate over time.
58. Notwithstanding the strong view from a minority of respondents that further specificity with regard to the content of individual descriptions should be mandated, the majority of DT-701 is of the view that the balance of responses (including from investors) indicates that retaining flexibility in proposed ISA 701 remains appropriate to allow auditors to tailor those descriptions to the facts and circumstances of the entity.
59. Nevertheless, DT-701 has also heard the calls for more guidance as to when the auditor may judge it necessary to describe "the effect on the audit", and is of the view that a viable alternative to additional prescription within the requirement could be for the application material to give a stronger steer for auditors to include such information and a more robust discussion of the matters to be taken into account when doing so.

60. Education and outreach activities, in particular with firms and users, will be useful in evaluating users' expectations of descriptions of KAM and auditors' and firms' responsiveness to these expectations as the proposals are implemented. Related, DT-701 also believes the findings from the planned post-implementation review, in particular feedback from investors and regulators and audit oversight bodies, will be highly relevant in determining whether there is a need to revisit the flexibility in communicating KAM.
61. DT-701 considered how best to present a revised requirement to communicate KAM, including clarifying which aspects of the description are always required. DT-701 believed it is also necessary to address calls for the IAASB to do more within the standard to assist auditors in developing descriptions of KAM, and for the standard to explain the need for KAM to be entity-specific and avoid boilerplate.
62. DT-701 first considered various wording suggestions offered, including those areas of application material that some have mentioned may be usefully elevated to the requirement, DT-701 recommends that paragraph 10 of proposed ISA 701 be amended as follows:
10. The auditor shall describe each key audit matter in the Key Audit Matters section using an appropriate subheading, except in the circumstances explained in paragraph 11. The description of each key audit matter shall include:
 - (a) An explanation of why, in accordance with paragraphs 8–9, the matter was considered to be one of most significance in the audit and therefore determined to be a key audit matter;
 - (b) A reference to the related disclosure(s), if any, in the financial statements; and
 - (c) To the extent the auditor considers it necessary, how the matter was addressed in the audit. The auditor's consideration of whether this additional information is necessary to support the explanation required by paragraph 10(a) is a matter of professional judgment, taking into account the facts and circumstances of the entity and the audit.
63. DT-701 also considered how best to respond to concerns about the manner in which KAM may be drafted (including the risk of boilerplate, "piecemeal opinions" and duplication of financial statements disclosures). It initially considered whether a new requirement, taking into account aspects of the UKFRC's requirements, might be useful to guide auditors in developing a description of KAM that would be useful and relevant to users of the financial statements.
64. DT-701 was of the view that demonstrating compliance with such a requirement would be difficult, and agreed that the premise of such a requirement could likely be addressed through a combination of application material and potentially changes to the required introductory language in the KAM section. DT-701 intends to further consider this guidance, and initially believes that the application material should explicitly acknowledge that:
- The more entity-specific the description of a KAM, the more likely it is that such description will be useful to investors.
 - KAM is not intended to be discrete opinions on separate elements of the financial statements; therefore care should be taken in developing the description so as not to imply that the auditor is concluding on an element or providing a "piecemeal opinion."

- KAM is not intended to be a substitute for a modified opinion, or a “hidden qualification”. Therefore, the description of KAM should not imply that a matter has not been appropriately resolved by the auditor in forming an opinion on the financial statements as a whole.
- KAM is not intended to merely repeat, or only provide reference to, the related disclosures in the financial statements, nor should the description of a KAM contradict the disclosures in the financial statements. Rather, the auditor may consider it helpful to draw attention to key aspects of those disclosures or summarize them in explaining why a matter was of most significance in the audit.

Other Corresponding Changes

65. A number of respondents offered suggestions as to how the requirement in paragraph 9 of proposed ISA 701, which addresses the introductory paragraph in KAM section in the auditor’s report, and the related illustrative wording, could be amended. DT-701 intends to further consider these comments as it further refines the requirement to communicate KAM and the illustrative examples, with plans to discuss relevant matters with the IAASB at its June 2014 meeting.

Matters for IAASB Consideration

4. The IAASB is asked whether it agrees with DT-701’s recommendations:
- (i) To retain the flexibility for the auditor to determine whether it is necessary to describe how a matter was addressed in the audit and
 - (ii) The revised requirement relating to the description of KAM. If IAASB members do not agree with the manner in which this requirement has been articulated, they are asked to provide specific feedback on areas for further consideration by DT-701.
5. The IAASB is also asked for its views on the proposed additional application material to guide auditors in terms of making the description of a KAM useful and relevant to users.

IV. Other Areas Discussed by DT-701

66. The following areas were also discussed by DT-701:
- *Range of KAM / Guidance on an appropriate number of KAM to be included in the auditor’s report* – Concern has been expressed about a possible proliferation of KAMs if ISA 701, auditors and audit oversight bodies are not clear about the intent of the concept of matters “of most significance”. Some are of the view that guidance on the number of KAMs that is generally appropriate should be included in the final standard, or at least in communications from the IAASB when finalizing the standard. DT-701 is of the view that, consistent with the IAASB’s decision in finalizing the ED, that it is not appropriate to explicitly signal a range in the auditing standard, as this may be seen to undermine the concept of the auditor’s judgment being tailored to the facts and circumstances of the entity. However, DT-701 believes it is useful to continue to signal its view that KAM will be a relatively few number of matters by the number of illustrative examples that are developed, and suggests the IAASB consider alternative means of communicating about its general expectations regarding the number of KAM when the proposed standard is finalized.

- *Guidance about matters that are likely to be determined as KAM* – Related to the call for an explicit mention of ranges, some have suggested the IAASB could be more explicit, potentially in application material, about matters that are likely to be determined to be KAM based on the revised factors. DT-701 intends to take the calls for additional guidance into account in refining the application material and will consider how best to address respondents’ concerns while ensuring the standard remains appropriately principles-based. On balance, DT-701 remains of the view that ISA 701 should not be seen as providing a “checklist” for determining KAM.

Materiality and Audit Strategy

67. The EM to the ED explained that the IAASB did not believe certain matters related to the planning and scoping of the audit (such as a description of the materiality applied to the engagement) would meet the definition of a KAM. In light of feedback from respondents to the ITC, the IAASB did not consider it appropriate to establish a requirement for the auditor to disclose such matters in the auditor’s report when issuing the ED. Nevertheless, the ED and proposed ISA 706 (Revised) acknowledged that the auditor may judge it appropriate, or be required by law or regulation, to do so in an Other Matter (OM) paragraph.³⁸
68. Although the ED did not ask a specific question about the possibility of requiring auditors to disclose materiality and audit strategy, 13 respondents³⁹ specifically called for auditor disclosure of materiality applied in the specific engagement and in light of the new requirements for disclosure in the UK. These respondents cited the benefits of such information in reducing the expectations gap, increased understanding of the concept of materiality and the relevancy for investors making investment decisions. One MG member (IOSCO), as part of its overall comment on the need for the IAASB to seek to achieve global consistency, made reference to the UK requirement and noted mixed views amongst IOSCO members about whether the IAASB should reconsider the areas of materiality and audit scoping in its redeliberations. One respondent (EAIG) encouraged the IAASB to take into account the development in Europe and understand the feedback to the UK’s proposals to determine whether to require disclosure. Another respondent (ICAEW) specifically questioned the value of such information.
69. DT-701’s understanding of the European Union Compromise package is that reporting on materiality and audit strategy (including the scope and timing of the audit) is contemplated as part of Article 23 of the Regulation, which relates to the auditor’s report to the audit committee of a PIE.
70. While DT-701 understands the rationale for those suggesting further disclosures about materiality and audit strategy in the auditor’s report, in light of the feedback from the ITC, it is of the view that there is not overarching support for such disclosures that would warrant a change in the way forward. However, DT-701 suggests that the matter of requiring auditors to disclose materiality or information about the audit strategy be considered in the context of the post-implementation review.

³⁸ Proposed ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report*, explains that law or regulation may require the auditor to communicate about planning and scoping matters in the auditor’s report, or the auditor may consider it necessary to communicate about such matters in an Other Matter paragraph (see paragraph A8 of proposed ISA 706 (Revised)).

³⁹ *Investors and Analysts*: ABI, CFA, ICGN, IMA, SLI; *Regulators and Oversight Authorities*: ICAC, UKFRC; *Accounting Firms*: DTT; *Public Sector Organizations*: AGA, AGNZ; *Academics*: BCEM; *Individuals and Others*: CMunnariz, KRuhnke

V. Other Areas to Be Addressed at Upcoming Meetings

71. DT-701 believed it was first necessary to focus the IAASB and the CAG on the principles and underlying requirements related to determining and communicating KAM and has therefore focused this paper and its analysis of the response to the ED on Questions 1–3. Taking into account the feedback from the March 2014 IAASB and CAG meetings, DT-701 will need to revise its proposals and present its views on the following remaining areas addressed in the ED relating to KAM at the June 2014 IAASB meeting:
- The informational value / usefulness of the individual examples of KAM, including areas for improvement.
 - The proposal to limit the applicability of KAM to audits of financial statements of listed entities, and the approach taken in relation to KAM for entities for which the auditor is not required to provide such communication, including the practical considerations that may affect the auditor's ability to decide to communicate KAM when not otherwise required to do so and the proposed changes to ISA 210.⁴⁰
 - The possibility that the auditor may determine that there are no KAMs to communicate.
 - The IAASB's intent to limit the auditor's communication of KAM to the audit of the most recent financial period when comparative financial information is presented.
 - The IAASB's decision to retain the concepts of Emphasis of Matter (EOM) paragraphs and OM paragraphs, even when the auditor is required to communicate KAM, and how such concepts have been differentiated in the Proposed ISAs.
72. DT-701 will also need to consider the appropriateness of the proposed changes to ISA 260 in light of the further refinements to proposed ISA 701 and the feedback from respondents to the ED. At such time, DT-701 will also consider the implications, if any, of Article 23 in the European Union Compromise Package, which addresses additional reporting by auditors to audit committees of PIEs. There also continues to be a suggestion from 2 MG members (BCBS and IAIS) 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 supervisors.
73. DT-701 intends to present a full revised draft of proposed ISA 701 for the IAASB's consideration at its June 2014 meeting. At that time, DT-701 will highlight feedback from respondents on the need for revision of the remaining requirements not addressed in this paper, including the proposed documentation requirement, as well as the application material.
74. While DT-701 has not considered revisions to application material in significant detail, feedback from the ED and discussions in relation to the revised requirements has suggested it will be useful to consider, among others, the following aspects:
- In Support of the Requirements in Paragraphs 8 and 8.1 to Determine KAM*
- The matters raised by investors as matters that should be considered in determining KAMs (see paragraph 20) to ensure these are addressed, to the extent practicable, in the application material. This includes the relationship between an entity's critical accounting estimates and KAM.

⁴⁰ ISA 210, *Agreeing the Terms of Audit Engagements*

- The need for further guidance on how the factors in paragraph 8 are taken into account, to explain that, while these factors are the principal drivers in determining KAM, there may be other areas of significant auditor attention that were of most significance in the audit (for example, areas of higher assessed risk of material misstatement).
- Clarification that the factors are not intended to be “indicators” of KAM, and how the new requirement in paragraph 8.1 further narrows areas of significant auditor attention to the KAM (e.g., by explaining whether a significant event or transaction is a KAM depends on whether, in the context of the entity and the audit, it is determined to be a matter of “most significance”).
- Explaining the effects of the significance of the interactions with TCWG about a matter⁴¹ (in terms of nature and extent), the complexity of the judgments of both management and the auditor, and the materiality of a matter to the financial statements as a whole on the auditor’s determination of matters “of most significance”.
- The concepts within the PCAOB’s proposal, including how “critical audit matters” are defined and the factors involved in determining them (see paragraphs 17–19 of **Agenda Item 4**)
- Further clarification about 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,⁴² including the risk of management override of controls⁴³); or
 - Presumed to be a significant risk of material misstatement due to fraud (revenue recognition⁴⁴).

In Support of the Proposed New Requirement to Address Concerns about Communicating Sensitive Matters

- How the auditor may consider “other information” and other publicly available information beyond what is disclosed in the financial statements in formulating the description of an individual KAM and determining whether the auditor is potentially providing other information or potentially harming the entity.
- What may be communicated with TCWG when the auditor determines a sensitive matter to be KAM, including the encouragement of additional disclosure by management and TCWG.
- Whether additional guidance is necessary to explain the interaction between the proposed requirement in Section 140 of the IESBA Code.

⁴¹ Focusing on the nature and extent of communications with TCWG is seen as responsive to investor requests for further insights into auditor-audit committee communications and is consistent with the audit committee’s role representing the interests of shareholders.

⁴² ISA 240, *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraph 27

⁴³ ISA 240, paragraph 31

⁴⁴ ISA 240, paragraph 26

- That the proposed requirement is also relevant in circumstances where a matter is adequately disclosed in the financial statements, but the auditor judges it necessary to provide additional information about the entity beyond those disclosures to explain why the matter was determined to be a KAM.

In Support of the Requirement in Paragraph 10 to Communicate KAM

- Ways in which proposed ISA 701 could be more definitive in explaining circumstances in which the auditor may consider it necessary to comment on how a matter was addressed in the audit in the description of a KAM.
- More adequately describing how the auditor might go about describing audit procedures at a high level and the outcome of the auditor's work, and why this information may be relevant to users, as a means of encouraging such disclosure.
- The interaction of the proposed new requirement and related application material addressing how the auditor would deal with sensitive matters that are determined to be KAM, and consideration of whether additional guidance is necessary to address overarching concerns about auditors providing "original information" (for example, about significant qualitative aspects of the entity's accounting practices, material misstatements identified during the audit, disclosure of significant deficiencies in internal control, etc.).
- Ensuring the application material included in proposed ISA 701 appropriately distinguishes between why the matter was of most significance (and therefore more usefully placed in support of the requirements to determine KAM) and how such a matter would be described in the auditor's report.