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This publication has been developed to illustrate the key similarities and differences between the IAASB's [new and revised Auditor Reporting standards](#) issued in January 2015 and the PCAOB May 2016 reproposed standard, [The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion](#) (the PCAOB Reproposal).

In particular, this publication focuses on a comparison between the IAASB's concept of Key Audit Matters (KAM), as set out in **ISA 701**, *Communicating Key Audit Matters in the Independent Auditor's Report*, and the PCAOB's concept of Critical Audit Matters (CAM). While developing ISA 701, the IAASB's deliberations were informed by international research, public consultations, global roundtables and additional outreach to stakeholders, which included ongoing monitoring of, and coordination with, policymakers and national auditing standard setters (NSS) with auditor reporting initiatives, including the European Union (EU), the United Kingdom (UK) Financial Reporting Council (FRC), the PCAOB, and others. This coordination was pivotal in developing standards that are relevant, practical and internationally harmonious.

It is therefore positive and in the public interest that the IAASB and PCAOB have taken a relatively similar approach to enhancing the auditor's report, in particular by providing greater transparency to investors and others about audit-related matters and building on the two-way communications throughout the audit with those charged with governance (TCWG) (e.g., the audit committee). The approaches in other jurisdictions, such as the EU and UK, are highlighted later in this publication.

Comparing the IAASB and PCAOB Approaches

Under the IAASB's standards, auditors of financial statements of listed entities¹ are required to communicate KAM. Law, regulation or auditing standards in a particular jurisdiction may extend the requirement to communicate KAM to other entities, such as public interest entities (PIEs), public sector entities, entities in a particular industry, or all entities. The ISAs also allow for auditors to communicate KAM on a voluntary basis for entities other than listed entities in the absence of a requirement to do so.

The PCAOB Reproposal would require CAM to be communicated for audits conducted under PCAOB standards, except for audits of brokers and dealers reporting under Rule 17a-5 of the Securities Exchange Act of 1934, investment companies registered under the Investment Company Act of 1940 (other than business development companies), and employee stock purchase, savings, and similar plans.

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

Definition	
IAASB's Standards	PCAOB Reproposal
Key Audit Matters: Key audit matters are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.	<p>Critical Audit Matter: Any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that:</p> <ul style="list-style-type: none"> • Relates to accounts or disclosures that are material to the financial statements, and • Involved especially challenging, subjective, or complex auditor judgment.

Determining Whether a Matter Is a KAM / CAM

KAM should be specific to the entity and the audit that was performed in order to provide relevant and meaningful information to users. Therefore, ISA 701 includes a two-step process using a **judgment-based decision-making framework** to help auditors determine which matters, from those communicated with TCWG, are KAM. This decision-making framework was developed to focus auditors on areas 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 framework for determining CAM under the PCAOB Reproposal is substantially similar to the IAASB's Standards and starts with those matters communicated or required to be communicated to the audit committee. As defined, a CAM also relates to accounts or disclosures that are material to the financial statements.

Although not included in the definition of KAM, paragraph A29 of ISA 701 provides for the consideration of materiality by noting that the importance of the matter to the intended users' understanding of the financial statements as a whole and, in particular, its materiality to the financial statements, may be relevant to determining the relative significance of a matter communicated with TCWG and whether such a matter is a KAM. Some might believe that the inclusion of a materiality consideration in the definition of CAM may result in a narrower population of matters that may be a CAM under the PCAOB Reproposal than under the IAASB's Standards or approaches in other jurisdictions.

However, the PCAOB Reproposal explicitly notes that "although the processes of identifying these matters would vary across jurisdictions, there are commonalities in the underlying criteria regarding matters to be communicated and the communication requirement, such that expanded auditor reporting could result in the communication of many of the same matters under the various approaches".

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

Considerations in Determining Whether a Matter Is a KAM / CAM

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

Requirements in Determining KAM / CAM	
IAASB's Standards	PCAOB Reproposal
<p>The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:</p> <ul style="list-style-type: none"> (a) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with ISA 315 (Revised).² (b) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty. (c) The effect on the audit of significant events or transactions that occurred during the period. <p>(Paragraph 9 of ISA 701)</p> <p>The auditor shall determine which of the matters determined in accordance with the requirement above were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.</p> <p>(Paragraph 10 of ISA 701)</p>	<p>In determining whether a matter involved especially challenging, subjective, or complex auditor judgment, the auditor should take into account, alone or in combination, the following factors, as well as other factors specific to the audit:</p> <ul style="list-style-type: none"> (a) The auditor's assessment of the risks of material misstatement, including significant risks; (b) The degree of auditor subjectivity in determining or applying audit procedures to address the matter or in evaluating the results of those procedures; (c) The nature and extent of audit effort required to address the matter, including the extent of specialized skill or knowledge needed or the nature of consultations outside the engagement team regarding the matter; (d) The degree of auditor judgment related to areas in the financial statements that involved the application of significant judgment or estimation by management, including estimates with significant measurement uncertainty;

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

	<p>(e) The nature and timing of significant unusual transactions and the extent of audit effort and judgment related to these transactions; and</p> <p>(f) The nature of audit evidence obtained regarding the matter.</p> <p>Note: It is expected that, in most audits, the auditor would determine that at least one matter involved especially challenging, subjective, or complex auditor judgment.</p> <p>(Paragraph .12 of PCAOB Proposed AS 3101, <i>The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion</i>)</p>
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Because the determination of KAM / CAM is linked to principles-based requirements and relies on auditor judgment, both the IAASB and PCAOB have set out specific requirements to assist auditors in documenting those important judgments.

Communication of KAM / CAM

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

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

The IAASB and PCAOB both require the communication of matters determined to be KAM / CAM. However, ISA 701 acknowledges that, in extremely rare circumstances, the auditor may decide that a matter determined to be KAM should not be communicated.³

Descriptions of KAM / CAM in the Auditor's Report

Under both the IAASB and PCAOB approaches, the description of KAM / CAM is intended to provide a succinct and balanced explanation about the matter that is tailored to the audit to avoid standardized language and to reflect the specific circumstances of the matter, while limiting the use of highly technical accounting and auditing terms. The 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 and PCAOB are of the view that this flexibility is important to enable auditors to be as entity-

³ See paragraph 14 of ISA 701

specific and audit-specific as possible in the description of a KAM / CAM, in order to mitigate concerns from investors and others that communication of KAM / CAM could quickly result in more standardized or “boilerplate” communications. Introductory language would be included under both the IAASB and the PCAOB approaches to give context to readers of the auditor’s report, which explains what is considered to be a KAM / CAM and that the auditor is not providing discrete opinions on separate elements of the financial statements (a “piecemeal opinion”).⁴

Required Descriptions in the Auditor’s Report	
IAASB’s Standards	PCAOB Reproposal
<p>The description of a KAM is always required to include a reference to the related disclosures, if any, in the financial statements and address:</p> <ul style="list-style-type: none"> • 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. <p>(Paragraph 13 of ISA 701)</p>	<p>For each critical audit matter communicated in the auditor's report the auditor must:</p> <ul style="list-style-type: none"> • Identify the critical audit matter; • Describe the principal considerations that led the auditor to determine that the matter is a critical audit matter; • Describe how the critical audit matter was addressed in the audit; and • Refer to the relevant financial statement accounts and disclosures that relate to the critical audit matter. <p>(Paragraph .14 of PCAOB Proposed AS 3101)</p>

ISA 701 provides further guidance for auditors in providing insight into the audit through the description of how the matter was addressed in the audit, by explaining, for example, a brief overview of the procedures performed, key aspects of the auditor’s response or approach, an indication of the outcome of the auditor’s procedures or key observations with respect to the matter. The PCAOB Reproposal also provides similar guidance.⁵ Both approaches are clear that the communication in the auditor’s report about KAM / CAM should not imply that the matter has not been appropriately resolved by the auditor in forming the opinion on the financial statements.

Illustrative KAM

In finalizing ISA 701, the IAASB agreed to develop a limited number of KAM examples to illustrate how the requirements of ISA 701 may be applied. These are included in the publication, [Auditor Reporting – Illustrative Key Audit Matters](#). The PCAOB has also provided illustrative examples in its Release to show

⁴ The IAASB’s standards also require the following in the section of the auditor’s report describing the auditor’s responsibilities: “From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor’s report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.”

⁵ See page 31 of the PCAOB Reproposal

how a CAM could be communicated in the auditor's report.⁶ The IAASB and PCAOB note that these examples are for illustrative purposes only, since KAM / CAM need to be tailored to the facts and circumstances of the individual audit engagement and the entity.

Other Enhancements to Auditor Reporting

The IAASB's Standards and the PCAOB Reproposal include a number of other enhancements to Auditor Reporting, many of which are similar in principle, with some differences in specific wording or placement within the auditor's report.

IAASB's Standards	PCAOB Reproposal
The Opinion section is required to be presented first, followed by the Basis for Opinion section, unless law or regulation prescribes a different placement.	The Opinion section is required to be presented first, followed by the Basis for Opinion section.
In the Basis for Opinion section, there is identification of the relevant ethical requirements and a statement indicating that the auditor is independent and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.	In the Basis for Opinion section, a statement is required that the auditor is a public accounting firm registered with the PCAOB (United States) and is required to be independent with respect to the company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the US Securities and Exchange Commission (SEC) and the PCAOB.
When the auditor modifies the opinion, the basis for the modification is included in the Basis for Opinion section.	When the auditor modifies the opinion, the basis for the modification is included in the Opinion section.
Expanded descriptions of the responsibilities of management and those charged with governance, as well as the auditor's responsibilities and the key features of an audit, are required in separate sections of the auditor's report.	Enhancements to certain standardized language, including reference to "whether due to fraud or error" when describing the auditor's responsibilities under PCAOB standards to obtain reasonable assurance that the financial statements are free of material misstatements. The enhanced wording is not as extensive as the changes included in ISA 700 (Revised). ⁷ Also, the responsibilities of management and the auditor are included in the Basis for Opinion section, rather than as separate sections.
Disclosure of the name of the engagement partner is required to be included in the auditor's report for audits of financial statements of listed entities.	Disclosure of the name of the engagement partner and other accounting firms participating in the audit is required to be summarized for all entities

⁶ See page 32 of the PCAOB Reproposal

⁷ ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

	that are audited and reported by the audit firm on PCAOB Form AP, Auditor Reporting of Certain Audit Participants . The auditor may include this information in the auditor's report for an individual engagement but is not required to do so.
Emphasis of Matter and Other Matter paragraphs are required in certain circumstances ⁸ and are otherwise permitted at the auditor's discretion, unless the matter has been determined to be a KAM, in which case it is communicated as a KAM.	There is permission to include emphasis paragraphs, although no requirement exists, and these may not be a substitute for CAM. There is a continued requirement to include explanatory paragraphs in certain circumstances. ⁹

The PCAOB has proposed requirements for the auditor to disclose the tenure in the auditor's report. This is not required under the IAASB's Standards.

Going Concern and Other Information

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

- In relation to going concern, if the disclosure of a material uncertainty related to going concern in the financial statements is adequate, the auditor is required to include a separate section in the auditor's report that draws attention to those disclosures, under the heading "Material Uncertainty Related to Going Concern". If the disclosures are inadequate, the auditor is required to express a modified opinion and describe the issues related to going concern in the Basis for Opinion section of the auditor's report. The IAASB has also developed additional requirements for auditors in relation to evaluating the financial statement disclosures in going concern "close call" situations. Further information on reporting on going concern is available in the publication [Auditor Reporting on Going Concern](#).
- Explicit reporting in the auditor's report in a separate Other Information section. This section is intended to explain the responsibilities of management and the auditor in respect of the other information, including the auditor's work effort. It also identifies the other information obtained by the auditor (e.g., the management's report and chairman's statement in an annual report) and includes either a statement that the auditor has concluded that there is no uncorrected material misstatement of the other information or, if such an uncorrected material misstatement exists, a statement that describes the uncorrected material misstatement.

The PCAOB is addressing these topics under separate initiatives with a different timeline. The PCAOB already requires auditors to include an explanatory paragraph in the auditor's report when there is substantial doubt about the company's ability to continue as a going concern,¹⁰ and when the other

⁸ See Appendix 2 of ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*, regarding ISAs that require the auditor to include an Emphasis of Matter paragraph

⁹ See paragraph .18 of Proposed AS 3101

¹⁰ See paragraph .12 of AS 2415, *Consideration of an Entity's Ability to Continue as a Going Concern*

information in a document containing audited financial statements is materially inconsistent with information appearing in the financial statements.¹¹ The PCAOB Reproposal continues to require an explanatory paragraph in these circumstances.

Approaches in Other Jurisdictions

Certain jurisdictions, such as the UK and the Netherlands, have already implemented enhanced auditor reporting, with the EU 2014 Regulation¹² coming into effect for June 2017 year-ends. The IAASB's Auditor Reporting standards will become effective for audits of financial statements for periods ending on or after December 15, 2016, with early adoption permitted. The IAASB is pleased to see some early adoption of the ISAs in Australia, Germany, Poland, Singapore, South Africa, and Switzerland, while Zimbabwe has imposed a requirement for auditors to pilot the new requirements for audits of listed entities leading up to the implementation date.

The UK FRC introduced changes to its Corporate Governance Code and Auditing Standards, which came into effect for periods commencing on or after October 1, 2012 in respect of audits of certain listed entities, to require the description of the risks of material misstatement that had the greatest effect on the audit, an explanation of how the concept of materiality was applied in the audit and a summary of the audit scope.¹³ The FRC has performed reviews of the extended auditor's reports in the UK and has issued two publications¹⁴ reporting their findings, indicating the existence of considerable innovation and diversity in the way in which auditors have addressed the requirements. The UK FRC noted that investors clearly value the additional insight offered by extended auditor reporting, and have since encouraged the adoption of greater transparency, particularly in respect of auditor's judgments and their findings.

In April 2016, the UK FRC issued "final drafts" of the revised International Standards on Auditing (UK and Ireland). These complete the FRC's implementation of the EU Audit Regulation and Directive, and alignment with the IAASB's Standards. The UK FRC requirements apply to all PIEs (in addition to listed companies) and also include the additional disclosures required by the EU 2014 Regulation discussed below, in conjunction with the existing reporting requirements in the UK, for example materiality and audit scope. The principle of KAM under the ISAs (UK and Ireland) align with the IAASB's Standards, but also include a requirement to communicate the most significant assessed risks of material misstatement in order to be compliant with the EU 2014 Regulation. Furthermore, there are some additional requirements contained in the ISAs (UK and Ireland). For example, key observations with respect to the most significant assessed risks of material misstatement must be communicated in the auditor's report where applicable (as required by the EU 2014 Regulation), and there is also a requirement, in circumstances where there is no material uncertainty related to going concern, to determine whether a KAM relating to going concern exists that should be communicated in the auditor's report.

The requirements in the Netherlands in respect of enhanced auditor's reports are consistent with the ISAs, and came into effect for financial years ending on December 31, 2014.

¹¹ See paragraph .04 of AS 2710, *Other Information in Documents Containing Audited Financial Statements*

¹² Regulation No 2014 of the European Parliament and of the Council on Specific Requirements Regarding Statutory Audit of Public-Interest Entities

¹³ Neither the IAASB's standards nor the PCAOB Reproposal require disclosure of materiality in the auditor's report or a description of the audit scope

¹⁴ The two publications issued by the UK FRC are [Extended Auditor's Reports: A Review of Experience in the First Year](#) and [Extended Auditor's Reports: A Review of Further Experience](#)

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

Way Forward

The PCAOB is seeking comments on its Reproposal by August 15, 2016. After the closure of the comment period, the PCAOB will determine whether to adopt final rules, with or without changes from the Reproposal. Any final rules adopted are then submitted to the US SEC for approval.

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

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

The IAASB will also continue to undertake extensive outreach to support the implementation of the IAASB's standards, and evaluate whether there is a need for the IAASB to provide other forms of implementation support. The IAASB has already developed an [Auditor Reporting Toolkit](#) to assist with the implementation of the new standards.

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About the IAASB

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

Appendix A

Selected Relevant Application Material Supporting the Determination of KAM under the IAASB's Standards

The IAASB's principles-based requirements to determine which matters are KAM are supported by robust guidance to assist the auditor in applying judgment in determining which matters are of most significance in the audit. In determining KAM, ISA 701 provides guidance on identifying the matters that required significant auditor attention. The next step of the process, which requires the auditor to identify the matters which are of most significance in the audit, is supported by the following guidance:

Matters that required significant auditor attention also may have resulted in significant interaction with those charged with governance. The nature and extent of communication about such matters with those charged with governance often provides an indication of which matters are of most significance in the audit. For example, the auditor may have had more in-depth, frequent or robust interactions with those charged with governance on more difficult and complex matters, such as the application of significant accounting policies that were the subject of significant auditor or management judgment.

(Paragraph A27 of ISA 701)

The concept of matters of most significance is applicable in the context of the entity and the audit that was performed. As such, the auditor's determination and communication of key audit matters is intended to identify matters specific to the audit and to involve making a judgment about their importance relative to other matters in the audit.

(Paragraph A28 of ISA 701)

Other considerations that may be relevant to determining the relative significance of a matter communicated with those charged with governance and whether such a matter is a key audit matter include:

- The importance of the matter to intended users' understanding of the financial statements as a whole, in particular, its materiality to the financial statements.
- The nature of the underlying accounting policy relating to the matter or the complexity or subjectivity involved in management's selection of an appropriate policy compared to other entities within its industry.
- The nature and materiality, quantitatively or qualitatively, of corrected and accumulated uncorrected misstatements due to fraud or error related to the matter, if any.
- The nature and extent of audit effort needed to address the matter, including:
 - The extent of specialized skill or knowledge needed to apply audit procedures to address the matter or evaluate the results of those procedures, if any.
 - The nature of consultations outside the engagement team regarding the matter.
- The nature and severity of difficulties in applying audit procedures, evaluating the results of those procedures, and obtaining relevant and reliable evidence on which to base the auditor's opinion, in particular as the auditor's judgments become more subjective.
- The severity of any control deficiencies identified relevant to the matter.

- Whether the matter involved a number of separate, but related, auditing considerations. For example, long-term contracts may involve significant auditor attention with respect to revenue recognition, litigation or other contingencies, and may have an effect on other accounting estimates.

(Paragraph A29 of ISA 701)

Determining which, and how many, of those matters that required significant auditor attention were of most significance in the audit of the financial statements of the current period is a matter of professional judgment. The number of key audit matters to be included in the auditor's report may be affected by the size and complexity of the entity, the nature of its business and environment, and the facts and circumstances of the audit engagement. In general, the greater the number of matters initially determined to be key audit matters, the more the auditor may need to reconsider whether each of these matters meets the definition of a key audit matter. Lengthy lists of key audit matters may be contrary to the notion of such matters being those of most significance in the audit.

(Paragraph A30 of ISA 701)

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