

EXPOSURE DRAFT

**ED 05/15**

(April 2015)

# **Proposed Auditing Standard ASA 701** *Communicating Key Audit Matters in the Independent Auditor's Report*

Issued for Comment by the **Auditing and Assurance Standards Board**

Draft

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**Australian Government**

**Auditing and Assurance Standards Board**

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A copy of all non-confidential submissions will be placed on public record on the Auditing and Assurance Standards Board (AUASB) website: [www.auasb.gov.au](http://www.auasb.gov.au)

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## PREFACE

### Reasons for Issuing ED 05/15

The AUASB issues exposure draft ED 05/15 of proposed Auditing Standard ASA 701 *Communicating Key Audit Matters in the Independent Auditor's Report* pursuant to the requirements of the legislative provisions and the Strategic Direction explained below.

The AUASB is an independent statutory committee of the Australian Government established under section 227A of the *Australian Securities and Investments Commission Act 2001*, as amended (ASIC Act). Under section 336 of the *Corporations Act 2001*, the AUASB may make Auditing Standards for the purposes of the corporations legislation. These Auditing Standards are legislative instruments under the *Legislative Instruments Act 2003*.

Under the Strategic Direction given to the AUASB by the Financial Reporting Council (FRC), the AUASB is required, inter alia, to develop auditing standards that have a clear public interest focus and are of the highest quality.

### Main Proposals

This proposed Auditing Standard represents the Australian equivalent of ISA 701 *Communicating Key Audit Matters in the Independent Auditor's Report* (January 2015).

This proposed Auditing Standard contains differences from the ISA 701, which have been made to accord with the Australian legislative environment and to maintain audit quality where the AUASB has considered there are compelling reasons to do so.

This proposed Auditing Standard establishes requirements and provides application and other explanatory material regarding the communication of key audit matters in the independent auditor's report.

### Proposed Operative Date

It is intended that this proposed Auditing Standard will be operative for financial reporting periods ending on or after 15 December 2016.

### New Auditing Standard

This proposed Auditing Standard is a new pronouncement of the AUASB and accordingly does not supersede a pre-existing Auditing Standard.

### Request for Comments

Comments are invited on this Exposure Draft of the proposed issuance of ASA 701 *Communicating Key Audit Matters in the Independent Auditor's Report* by no later than 26 June 2015. The AUASB is seeking comments from respondents on the following questions:

1. Have applicable laws and regulations been appropriately addressed in the proposed standard?
2. Are there any laws or regulations that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
3. What, if any, are the additional significant costs to/benefits for auditors and the business community arising from compliance with the requirements of this proposed standard? If there are significant costs, do these outweigh the benefits to the users of audit services?
4. Are there any other significant public interest matters that constituents wish to raise?

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The AUASB prefers that respondents express a clear opinion on whether the proposed Auditing Standard, as a whole, is supported and that this opinion be supplemented by detailed comments, whether supportive or critical, on the above matters. The AUASB regards both supportive and critical comments as essential to a balanced review of the proposed Auditing Standard.

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### **AUTHORITY STATEMENT**

The Auditing and Assurance Standards Board (AUASB) makes this Auditing Standard ASA 701 *Communicating Key Audit Matters in the Independent Auditor's Report* pursuant to section 227B of the *Australian Securities and Investments Commission Act 2001* and section 336 of the *Corporations Act 2001*.

This Auditing Standard is to be read in conjunction with ASA 101 *Preamble to Australian Auditing Standards*, which sets out the intentions of the AUASB on how the Australian Auditing Standards, operative for financial reporting periods commencing on or after 1 January 2010, are to be understood, interpreted and applied. This Auditing Standard is to be read also in conjunction with ASA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards*.

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## **Conformity with International Standards on Auditing**

This Auditing Standard conforms with International Standard on Auditing ISA 701 *Communicating Key Audit Matters in the Independent Auditor's Report* issued by the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting board of the International Federation of Accountants (IFAC).

Paragraphs that have been added to this Auditing Standard (and do not appear in the text of the equivalent ISA) are identified with the prefix "Aus".

This Auditing Standard incorporates terminology and definitions used in Australia.

The equivalent requirements and related application and other explanatory material included in ISA 701 in respect of "relevant ethical requirements", have been included in Auditing Standard, ASA 102 *Compliance with Ethical Requirements when Performing Audits, Reviews and Other Assurance Engagements*. There is no international equivalent to ASA 102.

Compliance with this Auditing Standard enables compliance with ISA 701.

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## AUDITING STANDARD ASA 701

### *Communicating Key Audit Matters in the Independent Auditor's Report*

#### Application

- Aus 0.1 This Auditing Standard applies to:
- (a) an audit of a financial report for a financial year, or an audit of a financial report for a half-year, in accordance with the *Corporations Act 2001*; and
  - (b) an audit of a financial report, or a complete set of financial report, for any other purpose.
- Aus 1.2 This Auditing Standard also applies, as appropriate, to an audit of other historical financial information.

#### Operative Date

- Aus 0.3 This Auditing Standard is operative for financial reporting periods ending on or after 15 December 2016.

#### Introduction

##### Scope of this Auditing Standard

1. This Auditing Standard deals with the auditor's responsibility to communicate key audit matters in the auditor's report. It is intended to address both the auditor's judgement as to what to communicate in the auditor's report and the form and content of such communication.
2. The purpose of communicating key audit matters is to enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed. Communicating key audit matters provides additional information to intended users of the financial report ("intended users") to assist them in understanding those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial report of the current period. Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgement in the audited financial report. (Ref: Para. A1–A4)
3. The communication of key audit matters in the auditor's report may also provide intended users a basis to further engage with management and those charged with governance about certain matters relating to the entity, the audited financial report, or the audit that was performed.
4. Communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial report as a whole. Communicating key audit matters in the auditor's report is not:
  - (a) A substitute for disclosures in the financial report that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;
  - (b) A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with ASA 705;<sup>1</sup>

<sup>1</sup> See ASA 705 *Modifications to the Opinion in the Independent Auditor's Report*.



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- (c) A substitute for reporting in accordance with ASA 570<sup>2</sup> when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern; or
  - (d) A separate opinion on individual matters. (Ref: Para. A5–A8)
5. This Auditing Standard applies to audits of complete sets of general purpose financial report of listed entities and circumstances when the auditor otherwise decides to communicate key audit matters in the auditor's report. This Auditing Standard also applies when the auditor is required by law or regulation to communicate key audit matters in the auditor's report.<sup>3</sup> However, ASA 705 prohibits the auditor from communicating key audit matters when the auditor disclaims an opinion on the financial report, unless such reporting is required by law or regulation.<sup>4</sup>

**Effective Date**

6. This Auditing Standard is effective for audits of financial reports for periods ending on or after 15 December 2016.

**Objective**

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

**Definition**

8. For the purposes of this Auditing Standard, the following term has the meaning attributed below:

Key audit matters—Those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial report of the current period. Key audit matters are selected from matters communicated with those charged with governance.

**Requirements**

**Determining Key Audit Matters**

9. 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:  
(Ref: Para. A9–A18)
- (a) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with ASA 315.<sup>5</sup> (Ref: Para. A19–A22)
  - (b) Significant auditor judgements relating to areas in the financial report that involved significant management judgement, including accounting estimates that have been identified as having high estimation uncertainty. (Ref: Para. A23–A24)
  - (c) The effect on the audit of significant events or transactions that occurred during the period. (Ref: Para. A25–A26)

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<sup>2</sup> See ASA 570 *Going Concern*, paragraphs 22–23.

<sup>3</sup> See ASA 700 *Forming an Opinion and Reporting on a Financial Report*, paragraphs 30–31.

<sup>4</sup> See ASA 705, paragraph 29.

<sup>5</sup> See ASA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*.

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10. The auditor shall determine which of the matters determined in accordance with paragraph 9 of this Auditing Standard were of most significance in the audit of the financial report of the current period and therefore are the key audit matters. (Ref: Para. A9–A11, A27–A30)

**Communicating Key Audit Matters**

11. The auditor shall describe each key audit matter, using an appropriate subheading, in a separate section of the auditor's report under the heading "Key Audit Matters," unless the circumstances in paragraphs 14 or 15 of this Auditing Standard apply. The introductory language in this section of the auditor's report shall state that:
- (a) Key audit matters are those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial report [of the current period]; and
  - (b) These matters were addressed in the context of the audit of the financial report as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters. (Ref: Para. A31–A33)

*Key Audit Matters Not a Substitute for Expressing a Modified Opinion*

12. The auditor shall not communicate a matter in the Key Audit Matters section of the auditor's report when the auditor would be required to modify the opinion in accordance with ASA 705 as a result of the matter. (Ref: Para. A5)

*Descriptions of Individual Key Audit Matters*

13. The description of each key audit matter in the Key Audit Matters section of the auditor's report shall include a reference to the related disclosure(s), if any, in the financial report and shall address: (Ref: Para. A34–A41)
- (a) Why the matter was considered to be one of most significance in the audit and therefore determined to be a key audit matter; and (Ref: Para. A42–A45)
  - (b) How the matter was addressed in the audit. (Ref: Para. A46–A51)

*Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor's Report*

14. The auditor shall describe each key audit matter in the auditor's report unless: (Ref: Para. A53–A56)
- (a) Law or regulation precludes public disclosure about the matter; or (Ref: Para. A52)
  - (b) In extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication. This shall not apply if the entity has publicly disclosed information about the matter.

*Interaction between Descriptions of Key Audit Matters and Other Elements Required to Be Included in the Auditor's Report*

15. A matter giving rise to a modified opinion in accordance with ASA 705, or a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with ASA 570, are by their nature key audit matters. However, in such circumstances, these matters shall not be described in the Key Audit Matters section of the auditor's report and the requirements in paragraphs 13–14 of this Auditing Standard do not apply. Rather, the auditor shall:

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- (a) Report on these matter(s) in accordance with the applicable Australian Auditing Standards; and
- (b) Include a reference to the Basis for Qualified (Adverse) Opinion or the Material Uncertainty Related to Going Concern section(s) in the Key Audit Matters section.  
(Ref: Para. A6–A7)

*Form and Content of the Key Audit Matters Section in Other Circumstances*

16. If the auditor determines, depending on the facts and circumstances of the entity and the audit, that there are no key audit matters to communicate or that the only key audit matters communicated are those matters addressed by paragraph 15 of this Auditing Standard, the auditor shall include a statement to this effect in a separate section of the auditor's report under the heading "Key Audit Matters." (Ref: Para. A57–A59)

**Communication with Those Charged with Governance**

17. The auditor shall communicate with those charged with governance:
- (a) Those matters the auditor has determined to be the key audit matters; or
  - (b) If applicable, depending on the facts and circumstances of the entity and the audit, the auditor's determination that there are no key audit matters to communicate in the auditor's report. (Ref: Para. A60–A63)

**Documentation**

18. The auditor shall include in the audit documentation:<sup>6</sup> (Ref: Para. A64)
- (a) The matters that required significant auditor attention as determined in accordance with paragraph 9 of this Auditing Standard, and the rationale for the auditor's determination as to whether or not each of these matters is a key audit matter in accordance with paragraph 10 of this Auditing Standard;
  - (b) Where applicable, the rationale for the auditor's determination that there are no key audit matters to communicate in the auditor's report or that the only key audit matters to communicate are those matters addressed by paragraph 15 of this Auditing Standard; and
  - (c) Where applicable, the rationale for the auditor's determination not to communicate in the auditor's report a matter determined to be a key audit matter.

\* \* \*

**Application and Other Explanatory Material**

**Scope of This Auditing Standard** (Ref: Para. 2)

- A1. Significance can be described as the relative importance of a matter, taken in context. The significance of a matter is judged by the auditor in the context in which it is being considered. Significance can be considered in the context of quantitative and qualitative factors, such as relative magnitude, the nature and effect on the subject matter and the expressed interests of intended users or recipients. This involves an objective analysis of the facts and circumstances, including the nature and extent of communication with those charged with governance.

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<sup>6</sup> See ASA 230 *Audit Documentation*, paragraphs 8–11 and A6.

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- A2. Users of financial reports have expressed an interest in those matters about which the auditor had the most robust dialogue with those charged with governance as part of the two-way communication required by ASA 260<sup>7</sup> and have called for additional transparency about those communications. For example, users have expressed particular interest in understanding significant judgements made by the auditor in forming the opinion on the financial report as a whole, because they are often related to the areas of significant management judgement in preparing the financial report.
- A3. Requiring auditors to communicate key audit matters in the auditor's report may also enhance communications between the auditor and those charged with governance about those matters, and may increase attention by management and those charged with governance to the disclosures in the financial report to which reference is made in the auditor's report.
- A4. ASA 320<sup>8</sup> explains that it is reasonable for the auditor to assume that users of the financial report:
- (a) Have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial report with reasonable diligence;
  - (b) Understand that the financial report is prepared, presented and audited to levels of materiality;
  - (c) Recognise the uncertainties inherent in the measurement of amounts based on the use of estimates, judgement and the consideration of future events; and
  - (d) Make reasonable economic decisions on the basis of the information in the financial report.

Because the auditor's report accompanies the audited financial report, the users of the auditor's report are considered to be the same as the intended users of the financial report.

*Relationship between Key Audit Matters, the Auditor's Opinion and Other Elements of the Auditor's Report* (Ref: Para. 4, 12, 15)

- A5. ASA 700 establishes requirements and provides guidance on forming an opinion on the financial report.<sup>9</sup> Communicating key audit matters is not a substitute for disclosures in the financial report that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation. ASA 705 addresses circumstances in which the auditor concludes that there is a material misstatement relating to the appropriateness or adequacy of disclosures in the financial report.<sup>10</sup>
- A6. When the auditor expresses a qualified or adverse opinion in accordance with ASA 705, presenting the description of a matter giving rise to a modified opinion in the Basis for Qualified (Adverse) Opinion section helps to promote intended users' understanding and to identify such circumstances when they occur. Separating the communication of this matter from other key audit matters described in the Key Audit Matters section therefore gives it the appropriate prominence in the auditor's report (see paragraph 15). The Appendix in ASA 705 includes illustrative examples of how the introductory language in the Key Audit Matters section is affected when the auditor expresses a qualified or adverse opinion and other key audit matters are communicated in the auditor's report. Paragraph A58 illustrates how the Key Audit Matters section is presented when the auditor has determined that there are no other key audit matters to be communicated in the auditor's report beyond matters addressed in the Basis for Qualified (Adverse) Opinion section or Material Uncertainty Related to Going Concern section of the auditor's report.

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<sup>7</sup> See ASA 260 *Communication with Those Charged with Governance*.

<sup>8</sup> See ASA 320 *Materiality in Planning and Performing the Audit*, paragraph 4.

<sup>9</sup> See ASA 700, paragraphs 10–15 and A1–A10.

<sup>10</sup> See ASA 705, paragraph A7.

- A7. When the auditor expresses a qualified or adverse opinion, communicating other key audit matters would still be relevant to enhancing intended users' understanding of the audit, and therefore the requirements to determine key audit matters apply. However, as an adverse opinion is expressed in circumstances when the auditor has concluded that misstatements, individually or in the aggregate, are both material and pervasive to the financial report:<sup>11</sup>
- Depending on the significance of the matter(s) giving rise to an adverse opinion, the auditor may determine that no other matters are key audit matters. In such circumstances, the requirement in paragraph 15 applies (see paragraph A58).
  - If one or more matters other than the matter(s) giving rise to an adverse opinion are determined to be key audit matters, it is particularly important that the descriptions of such other key audit matters do not imply that the financial report as a whole are more credible in relation to those matters than would be appropriate in the circumstances, in view of the adverse opinion (see paragraph A47).
- A8. ASA 706<sup>12</sup> establishes mechanisms for auditors of financial reports of all entities to include additional communication in the auditor's report through the use of Emphasis of Matter paragraphs and Other Matter paragraphs when the auditor considers it necessary to do so. In such cases, these paragraphs are presented separately from the Key Audit Matters section in the auditor's report. When a matter has been determined to be a key audit matter, the use of such paragraphs is not a substitute for the description of the individual key audit matter in accordance with paragraph 13.<sup>13</sup> ASA 706 provides further guidance on the relationship between key audit matters and Emphasis of Matter paragraphs in accordance with that Auditing Standard.<sup>14</sup>

**Determining Key Audit Matters** (Ref: Para. 9–10)

- A9. The auditor's decision-making process in determining key audit matters is designed to select a smaller number of matters from the matters communicated with those charged with governance, based on the auditor's judgement about which matters were of most significance in the audit of the financial report of the current period.
- A10. The auditor's determination of key audit matters is limited to those matters of most significance in the audit of the financial report of the current period, even when the comparative financial report is presented (i.e., even when the auditor's opinion refers to each period for which the financial report is presented).<sup>15</sup>
- A11. Notwithstanding that the auditor's determination of key audit matters is for the audit of the financial report of the current period and this Auditing Standard does not require the auditor to update key audit matters included in the prior period's auditor's report, it may nevertheless be useful for the auditor to consider whether a matter that was a key audit matter in the audit of the financial report of the prior period continues to be a key audit matter in the audit of the financial report of the current period.

**Matters that Required Significant Auditor Attention** (Ref: Para. 9)

- A12. The concept of significant auditor attention recognises that an audit is risk-based and focuses on identifying and assessing the risks of material misstatement of the financial report, designing and performing audit procedures responsive to those risks, and obtaining audit evidence that is sufficient and appropriate to provide a basis for the auditor's opinion. For a particular account balance, class of transactions or disclosure, the higher an assessed risk of material misstatement at the assertion level, the more judgement is often involved in planning

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<sup>11</sup> See ASA 705, paragraph 8.

<sup>12</sup> See ASA 706 *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*.

<sup>13</sup> See ASA 706, paragraphs 8(b) and 10(b).

<sup>14</sup> See ASA 706, paragraphs A1–A3.

<sup>15</sup> See ASA 710 *Comparative Information—Corresponding Figures and Comparative Financial Reports*.

and performing the audit procedures and evaluating the results thereof. In designing further audit procedures, the auditor is required to obtain more persuasive audit evidence the higher the auditor's assessment of risk.<sup>16</sup> When obtaining more persuasive audit evidence because of a higher assessment of risk, the auditor may increase the quantity of the evidence, or obtain evidence that is more relevant or reliable, for example, by placing more emphasis on obtaining third party evidence or by obtaining corroborating evidence from a number of independent sources.<sup>17</sup>

- A13. Accordingly, matters that pose challenges to the auditor in obtaining sufficient appropriate audit evidence or pose challenges to the auditor in forming an opinion on the financial report may be particularly relevant in the auditor's determination of key audit matters.
- A14. Areas of significant auditor attention often relate to areas of complexity and significant management judgement in the financial report, and therefore often involve difficult or complex auditor judgements. In turn, this often affects the auditor's overall audit strategy, the allocation of resources and extent of audit effort in relation to such matters. These effects may include, for example, the extent of involvement of senior personnel on the audit engagement or the involvement of an auditor's expert or individuals with expertise in a specialised area of accounting or auditing, whether engaged or employed by the firm to address these areas.
- A15. Various Australian Auditing Standards require specific communications with those charged with governance and others that may relate to areas of significant auditor attention. For example:
- ASA 260 requires the auditor to communicate significant difficulties, if any, encountered during the audit with those charged with governance.<sup>18</sup> The Australian Auditing Standards acknowledge potential difficulties in relation to, for example:
    - Related party transactions,<sup>19</sup> in particular limitations on the auditor's ability to obtain audit evidence that all other aspects of a related party transaction (other than price) are equivalent to those of a similar arm's length transaction.
    - Limitations on the group audit, for example, where the group engagement team's access to information may have been restricted.<sup>20</sup>
  - ASA 220 establishes requirements for the engagement partner in relation to undertaking appropriate consultation on difficult or contentious matters.<sup>21</sup> For example, the auditor may have consulted with others within the firm or outside the firm on a significant technical matter, which may be an indicator that it is a key audit matter. The engagement partner is also required to discuss, among other things, significant matters arising during the audit engagement with the engagement quality control reviewer.<sup>22</sup>

*Considerations in Determining Those Matters that Required Significant Auditor Attention* (Ref: Para. 9)

- A16. The auditor may develop a preliminary view at the planning stage about matters that are likely to be areas of significant auditor attention in the audit and therefore may be key audit matters. The auditor may communicate this with those charged with governance when discussing the planned scope and timing of the audit in accordance with ASA 260. However, the auditor's determination of key audit matters is based on the results of the audit or evidence obtained throughout the audit.

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<sup>16</sup> See ASA 330 *The Auditor's Responses to Assessed Risks*, paragraph 7(b).

<sup>17</sup> See ASA 330, paragraph A19.

<sup>18</sup> See ASA 260, paragraphs 16(b) and A21.

<sup>19</sup> See ASA 550 *Related Parties*, paragraph A42.

<sup>20</sup> See ASA 600 *Special Considerations—Audits of a Group Financial Report (Including the Work of Component Auditors)*, paragraph 49(d).

<sup>21</sup> See ASA 220 *Quality Control for an Audit of a Financial Report*, paragraph 18.

<sup>22</sup> See ASA 220, paragraph 19.

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- A17. Paragraph 9 includes specific required considerations in the auditor's determination of those matters that required significant auditor attention. These considerations focus on the nature of matters communicated with those charged with governance that are often linked to matters disclosed in the financial report, and are intended to reflect areas of the audit of the financial report that may be of particular interest to intended users. The fact that these considerations are required is not intended to imply that matters related to them are always key audit matters; rather, matters related to such specific considerations are key audit matters only if they are determined to be of most significance in the audit in accordance with paragraph 10. As the considerations may be interrelated (e.g., matters relating to the circumstances described in paragraphs 9(b)-(c) may also be identified as significant risks), the applicability of more than one of the considerations to a particular matter communicated with those charged with governance may increase the likelihood of the auditor identifying that matter as a key audit matter.
- A18. In addition to matters that relate to the specific required considerations in paragraph 9, there may be other matters communicated with those charged with governance that required significant auditor attention and that therefore may be determined to be key audit matters in accordance with paragraph 10. Such matters may include, for example, matters relevant to the audit that was performed that may not be required to be disclosed in the financial report. For example, the implementation of a new IT system (or significant changes to an existing IT system) during the period may be an area of significant auditor attention, in particular if such a change had a significant effect on the auditor's overall audit strategy or related to a significant risk (e.g., changes to a system affecting revenue recognition).

*Areas of Higher Assessed Risk of Material Misstatement, or Significant Risks Identified in Accordance with ASA 315 (Ref: Para. 9(a))*

- A19. ASA 260 requires the auditor to communicate with those charged with governance about the significant risks identified by the auditor.<sup>23</sup> Paragraph A13 of ASA 260 explains that the auditor may also communicate with those charged with governance about how the auditor plans to address areas of higher assessed risks of material misstatement.
- A20. ASA 315 defines a significant risk as an identified and assessed risk of material misstatement that, in the auditor's judgement, requires special audit consideration. Areas of significant management judgement and significant unusual transactions may often be identified as significant risks. Significant risks are therefore often areas that require significant auditor attention.
- A21. However, this may not be the case for all significant risks. For example, ASA 240 presumes that there are risks of fraud in revenue recognition and requires the auditor to treat those assessed risks of material misstatement due to fraud as significant risks.<sup>24</sup> In addition, ASA 240 indicates that, due to the unpredictable way in which management override of controls could occur, it is a risk of material misstatement due to fraud and thus a significant risk.<sup>25</sup> Depending on their nature, these risks may not require significant auditor attention, and therefore would not be considered in the auditor's determination of key audit matters in accordance with paragraph 10.
- A22. ASA 315 explains that the auditor's assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit evidence is obtained.<sup>26</sup> Revision to the auditor's risk assessment and re-evaluation of the planned audit procedures with respect to a particular area of the financial report (i.e., a significant change in the audit approach, for example, if the auditor's risk assessment was based on an expectation that certain controls were operating effectively and the auditor has obtained audit evidence that they were not operating effectively throughout the audit period, particularly in an area

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<sup>23</sup> See ASA 260, paragraph 15.

<sup>24</sup> See ASA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report*, paragraphs 26–27.

<sup>25</sup> See ASA 240, paragraph 31.

<sup>26</sup> See ASA 315, paragraph 31.

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with higher assessed risk of material misstatement) may result in an area being determined as one requiring significant auditor attention.

Significant Auditor Judgements Relating to Areas in the Financial Report that Involved Significant Management Judgement, Including Accounting Estimates that Have Been Identified as Having High Estimation Uncertainty (Ref: Para. 9(b))

- A23. ASA 260 requires the auditor to communicate with those charged with governance the auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.<sup>27</sup> In many cases, this relates to critical accounting estimates and related disclosures, which are likely to be areas of significant auditor attention, and also may be identified as significant risks.
- A24. However, users of the financial report have highlighted their interest in accounting estimates that have been identified as having high estimation uncertainty in accordance with ASA 540<sup>28</sup> that may have not been determined to be significant risks. Among other things, such estimates are highly dependent on management judgement and are often the most complex areas of the financial report, and may require the involvement of both a management's expert and an auditor's expert. Users have also highlighted that accounting policies that have a significant effect on the financial report (and significant changes to those policies) are relevant to their understanding of the financial report, especially in circumstances where an entity's practices are not consistent with others in its industry.

The Effect on the Audit of Significant Events or Transactions that Occurred during the Period  
(Ref: Para. 9(c))

- A25. Events or transactions that had a significant effect on the financial report or the audit may be areas of significant auditor attention and may be identified as significant risks. For example, the auditor may have had extensive discussions with management and those charged with governance at various stages throughout the audit about the effect on the financial report of significant transactions with related parties or significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual.<sup>29</sup> Management may have made difficult or complex judgements in relation to recognition, measurement, presentation or disclosure of such transactions, which may have had a significant effect on the auditor's overall strategy.
- A26. Significant economic, accounting, regulatory, industry, or other developments that affected management's assumptions or judgements may also affect the auditor's overall approach to the audit and result in a matter requiring significant auditor attention.

*Matters of Most Significance* (Ref: Para. 10)

- A27. 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 judgement.
- A28. 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 judgement about their importance relative to other matters in the audit.

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<sup>27</sup> See ASA 260, paragraph 16(a).

<sup>28</sup> See ASA 540 *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, paragraphs 10-11.

<sup>29</sup> See ASA 260, paragraphs 16(a), 16(c) and A22, and Appendix 2.



- A29. 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 report as a whole, in particular, its materiality to the financial report.
  - 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 specialised 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 judgements 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.
- A30. Determining which, and how many, of those matters that required significant auditor attention were of most significance in the audit of the financial report of the current period is a matter of professional judgement. 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.

### **Communicating Key Audit Matters**

*Separate Key Audit Matters Section in the Auditor's Report* (Ref: Para. 11)

- A31. Placing the separate Key Audit Matters section in close proximity to the auditor's opinion may give prominence to such information and acknowledge the perceived value of engagement-specific information to intended users.
- A32. The order of presentation of individual matters within the Key Audit Matters section is a matter of professional judgement. For example, such information may be organised in order of relative importance, based on the auditor's judgement, or may correspond to the manner in which matters are disclosed in the financial report. The requirement in paragraph 11 to include subheadings is intended to further differentiate the matters.

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- A33. When comparative financial information is presented, the introductory language of the Key Audit Matters section is tailored to draw attention to the fact that the key audit matters described relate to only the audit of the financial report of the current period, and may include reference to the specific period covered by that financial report (e.g., “for the year ended 30 June 20X1”).

*Descriptions of Individual Key Audit Matters* (Ref: Para. 13)

- A34. The adequacy of the description of a key audit matter is a matter of professional judgement. The description of a key audit matter is intended to provide a succinct and balanced explanation to enable intended users to understand why the matter was one of most significance in the audit and how the matter was addressed in the audit. Limiting the use of highly technical auditing terms also helps to enable intended users who do not have a reasonable knowledge of auditing to understand the basis for the auditor's focus on particular matters during the audit. The nature and extent of information provided by the auditor is intended to be balanced in the context of the responsibilities of the respective parties (i.e., for the auditor to provide useful information in a concise and understandable form, while not inappropriately being the provider of original information about the entity).
- A35. Original information is any information about the entity that has not otherwise been made publicly available by the entity (e.g., has not been included in the financial report or other information available at the date of the auditor's report, or addressed in other oral or written communications by management or those charged with governance, such as a preliminary announcement of financial information or investor briefings). Such information is the responsibility of the entity's management and those charged with governance.
- A36. It is appropriate for the auditor to seek to avoid the description of a key audit matter inappropriately providing original information about the entity. The description of a key audit matter is not usually of itself original information about the entity, as it describes the matter in the context of the audit. However, the auditor may consider it necessary to include additional information to explain why the matter was considered to be one of most significance in the audit and therefore determined to be a key audit matter, and how the matter was addressed in the audit, provided that disclosure of such information is not precluded by law or regulation. When such information is determined to be necessary by the auditor, the auditor may encourage management or those charged with governance to disclose additional information, rather than the auditor providing original information in the auditor's report.
- A37. Management or those charged with governance may decide to include new or enhanced disclosures in the financial report or elsewhere in the annual report relating to a key audit matter in light of the fact that the matter will be communicated in the auditor's report. Such new or enhanced disclosures, for example, may be included to provide more robust information about the sensitivity of key assumptions used in accounting estimates or the entity's rationale for a particular accounting practice or policy when acceptable alternatives exist under the applicable financial reporting framework.
- A38. Although the auditor's opinion on the financial report does not extend to the other information addressed by ASA 720<sup>30</sup> the auditor may consider this information, as well as other publicly available communications by the entity or other credible sources, in formulating the description of a key audit matter.
- A39. Audit documentation prepared during the audit can also be useful to the auditor in formulating the description of a key audit matter. For example, written communications, or the auditor's documentation of oral communications, with those charged with governance and other audit documentation provides a useful basis for the auditor's communication in the auditor's report. This is because audit documentation in accordance with ASA 230 is intended to address the significant matters arising during the audit, the conclusions reached thereon, and significant

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<sup>30</sup> See ASA 720 *The Auditor's Responsibilities Relating to Other Information*.

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professional judgements made in reaching those conclusions, and serves as a record of the nature, timing and extent of the audit procedures performed, the results of those procedures, and the audit evidence obtained. Such documentation may assist the auditor in developing a description of key audit matters that explains the significance of the matter and also in applying the requirement in paragraph 18.

Reference to Where the Matter Is Disclosed in the Financial Report (Ref: Para. 13)

- A40. Paragraphs 13(a)-(b) requires the description of each key audit matter to address why the auditor considered the matter to be one of most significance in the audit and how the matter was addressed in the audit. Accordingly, the description of key audit matters is not a mere reiteration of what is disclosed in the financial report. However, a reference to any related disclosures enables intended users to further understand how management has addressed the matter in preparing the financial report.
- A41. In addition to referring to related disclosure(s), the auditor may draw attention to key aspects of them. The extent of disclosure by management about specific aspects or factors in relation to how a particular matter is affecting the financial report of the current period may help the auditor in pinpointing particular aspects of how the matter was addressed in the audit such that intended users can understand why the matter is a key audit matter. For example:
- When an entity includes robust disclosure about accounting estimates, the auditor may draw attention to the disclosure of key assumptions, the disclosure of the range of possible outcomes, and other qualitative and quantitative disclosures relating to key sources of estimation uncertainty or critical accounting estimates, as part of addressing why the matter was one of most significance in the audit and how the matter was addressed in the audit.
  - When the auditor concludes in accordance with ASA 570 that no material uncertainty exists relating to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, the auditor may nevertheless determine that one or more matters relating to this conclusion arising from the auditor's work effort under ASA 570 are key audit matters. In such circumstances, the auditor's description of such key audit matters in the auditor's report could include aspects of the identified events or conditions disclosed in the financial report, such as substantial operating losses, available borrowing facilities and possible debt refinancing, or non-compliance with loan agreements, and related mitigating factors.<sup>31</sup>

Why the Auditor Considered the Matter to Be One of Most Significance in the Audit (Ref: Para. 13(a))

- A42. The description of a key audit matter in the auditor's report is intended to provide insight as to why the matter was determined to be a key audit matter. Accordingly, the requirements in paragraphs 9–10 and the application material in paragraphs A12–A29 related to determining key audit matters may also be helpful for the auditor in considering how such matters are to be communicated in the auditor's report. For example, explaining the factors that led the auditor to conclude that a particular matter required significant auditor attention and was of most significance in the audit is likely to be of interest to intended users.
- A43. The relevance of the information for intended users is a consideration for the auditor in determining what to include in the description of a key audit matter. This may include whether the description would enable a better understanding of the audit and the auditor's judgements.
- A44. Relating a matter directly to the specific circumstances of the entity may also help to minimise the potential that such descriptions become overly standardised and less useful over time. For example, certain matters may be determined as key audit matters in a particular industry

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<sup>31</sup> See ASA 570, paragraph A3.

across a number of entities due to the circumstances of the industry or the underlying complexity in financial reporting. In describing why the auditor considered the matter to be one of most significance, it may be useful for the auditor to highlight aspects specific to the entity (e.g., circumstances that affected the underlying judgements made in the financial report of the current period) in order to make the description more relevant for intended users. This also may be important in describing a key audit matter that recurs over periods.

- A45. The description may also make reference to the principal considerations that led the auditor, in the circumstances of the audit, to determine the matter to be one of most significance, for example:
- Economic conditions that affected the auditor's ability to obtain audit evidence, for example illiquid markets for certain financial instruments.
  - New or emerging accounting policies, for example entity-specific or industry-specific matters on which the engagement team consulted within the firm.
  - Changes in the entity's strategy or business model that had a material effect on the financial report.

How the Matter Was Addressed in the Audit (Ref: Para. 13(b))

- A46. The amount of detail to be provided in the auditor's report to describe how a key audit matter was addressed in the audit is a matter of professional judgement. In accordance with paragraph 13(b), the auditor may describe:
- Aspects of the auditor's response or approach that were most relevant to the matter or specific to the assessed risk of material misstatement;
  - A brief overview of procedures performed;
  - An indication of the outcome of the auditor's procedures; or
  - Key observations with respect to the matter,

or some combination of these elements.

Law or regulation or national auditing standards may prescribe a specific form or content for the description of a key audit matter, or may specify the inclusion of one or more of these elements.

- A47. In order for intended users to understand the significance of a key audit matter in the context of the audit of the financial report as a whole, as well as the relationship between key audit matters and other elements of the auditor's report, including the auditor's opinion, care may be necessary so that language used in the description of a key audit matter:
- Does not imply that the matter has not been appropriately resolved by the auditor in forming the opinion on the financial report.
  - Relates the matter directly to the specific circumstances of the entity, while avoiding generic or standardised language.
  - Takes into account how the matter is addressed in the related disclosure(s) in the financial report, if any.
  - Does not contain or imply discrete opinions on separate elements of the financial report.
- A48. Describing aspects of the auditor's response or approach to a matter, in particular when the audit approach required significant tailoring to the facts and circumstances of the entity, may

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assist intended users in understanding unusual circumstances and significant auditor judgement required to address the risk of material misstatement. In addition, the audit approach in a particular period may have been influenced by entity-specific circumstances, economic conditions, or industry developments. It may also be useful for the auditor to make reference to the nature and extent of communications with those charged with governance about the matter.

- A49. For example, in describing the auditor's approach to an accounting estimate that has been identified as having high estimation uncertainty, such as the valuation of complex financial instruments, the auditor may wish to highlight that the auditor employed or engaged an auditor's expert. Such a reference to the use of an auditor's expert does not reduce the auditor's responsibility for the opinion on the financial report and is therefore not inconsistent with paragraphs 14–15 of ASA 620.<sup>32</sup>
- A50. There may be challenges in describing the auditor's procedures, particularly in complex, judgemental areas of the audit. In particular, it may be difficult to summarise the procedures performed in a succinct way that adequately communicates the nature and extent of the auditor's response to the assessed risk of material misstatement, and the significant auditor judgements involved. Nonetheless, the auditor may consider it necessary to describe certain procedures performed to communicate how the matter was addressed in the audit. Such description may typically be at a high level, rather than include a detailed description of procedures.
- A51. As noted in paragraph A46, the auditor may also provide an indication of the outcome of the auditor's response in the description of the key audit matter in the auditor's report. However, if this is done, care is needed to avoid the auditor giving the impression that the description is conveying a separate opinion on an individual key audit matter or that in any way may call into question the auditor's opinion on the financial report as a whole.

*Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor's Report* (Ref: Para. 14)

- A52. Law or regulation may preclude public disclosure by either management or the auditor about a specific matter determined to be a key audit matter. For example, law or regulation may specifically prohibit any public communication that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act (e.g., matters that are or appear to be related to money laundering).
- A53. As indicated by paragraph 14(b), it will be extremely rare for a matter determined to be a key audit matter not to be communicated in the auditor's report. This is because there is presumed to be a public interest benefit in providing greater transparency about the audit for intended users. Accordingly, the judgement not to communicate a key audit matter is appropriate only in cases when the adverse consequences to the entity or the public as a result of such communication are viewed as so significant that they would reasonably be expected to outweigh the public interest benefits of communicating about the matter.
- A54. The determination not to communicate a key audit matter takes into account the facts and circumstances related to the matter. Communication with management and those charged with governance helps the auditor understand management's views about the significance of the adverse consequences that may arise as a result of communicating about a matter. In particular, communication with management and those charged with governance helps to inform the auditor's judgement in determining whether to communicate the matter by:
- Assisting the auditor in understanding why the matter has not been publicly disclosed by the entity (e.g., if law, regulation or certain financial reporting frameworks permit delayed disclosure or non-disclosure of the matter) and management's views as to the

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<sup>32</sup> See ASA 620 *Using the Work of an Auditor's Expert*.

adverse consequences, if any, of disclosure. Management may draw attention to certain aspects in law or regulation or other authoritative sources that may be relevant to the consideration of adverse consequences (e.g., such aspects may include harm to the entity's commercial negotiations or competitive position). However, management's views about the adverse consequences alone do not alleviate the need for the auditor to determine whether the adverse consequences would reasonably be expected to outweigh the public interest benefits of communication in accordance with paragraph 14(b).

- Highlighting whether there have been any communications with applicable regulatory, enforcement or supervisory authorities in relation to the matter, in particular whether such discussions would appear to support management's assertion as to why public disclosure about the matter is not appropriate.
- Enabling the auditor, where appropriate, to encourage management and those charged with governance to make public disclosure of relevant information about the matter. In particular, this may be possible if the concerns of management and those charged with governance about communicating are limited to specific aspects relating to the matter, such that certain information about the matter may be less sensitive and could be communicated.

The auditor also may consider it necessary to obtain a written representation from management as to why public disclosure about the matter is not appropriate, including management's view about the significance of the adverse consequences that may arise as a result of such communication.

- A55. It may also be necessary for the auditor to consider the implications of communicating about a matter determined to be a key audit matter in light of relevant ethical requirements. In addition, the auditor may be required by law or regulation to communicate with applicable regulatory, enforcement or supervisory authorities in relation to the matter, regardless of whether the matter is communicated in the auditor's report. Such communication may also be useful to inform the auditor's consideration of the adverse consequences that may arise from communicating about the matter.
- A56. The issues considered by the auditor regarding a decision to not communicate a matter are complex and involve significant auditor judgement. Accordingly, the auditor may consider it appropriate to obtain legal advice.

*Form and Content of the Key Audit Matters Section in Other Circumstances* (Ref: Para. 16)

- A57. The requirement in paragraph 16 applies in three circumstances:
- (i) The auditor determines in accordance with paragraph 10 that there are no key audit matters (see paragraph A59).
  - (ii) The auditor determines in accordance with paragraph 14 that a key audit matter will not be communicated in the auditor's report and no other matters have been determined to be key audit matters.
  - (iii) The only matters determined to be key audit matters are those communicated in accordance with paragraph 15.

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- A58. The following illustrates the presentation in the auditor's report if the auditor has determined there are no key audit matters to communicate:

**Key Audit Matters**

[Except for the matter described in the *Basis for Qualified (Adverse) Opinion* section or *Material Uncertainty Related to Going Concern* section,] We have determined that there are no [other] key audit matters to communicate in our report.

- A59. The determination of key audit matters involves making a judgement about the relative importance of matters that required significant auditor attention. Therefore, it may be rare that the auditor of a general purpose financial report of a listed entity would not determine at least one key audit matter from the matters communicated with those charged with governance to be communicated in the auditor's report. However, in certain limited circumstances (e.g., for a listed entity that has very limited operations), the auditor may determine that there are no key audit matters in accordance with paragraph 10 because there are no matters that required significant auditor attention.

**Communication with Those Charged with Governance** (Ref: Para. 17)

- A60. ASA 260 requires the auditor to communicate with those charged with governance on a timely basis.<sup>33</sup> The appropriate timing for communications about key audit matters will vary with the circumstances of the engagement. However, the auditor may communicate preliminary views about key audit matters when discussing the planned scope and timing of the audit, and may further discuss such matters when communicating about audit findings. Doing so may help to alleviate the practical challenges of attempting to have a robust two-way dialogue about key audit matters at the time the financial report are being finalised for issuance.
- A61. Communication with those charged with governance enables them to be made aware of the key audit matters that the auditor intends to communicate in the auditor's report, and provides them with an opportunity to obtain further clarification where necessary. The auditor may consider it useful to provide those charged with governance with a draft of the auditor's report to facilitate this discussion. Communication with those charged with governance recognises their important role in overseeing the financial reporting process, and provides the opportunity for those charged with governance to understand the basis for the auditor's decisions in relation to key audit matters and how these matters will be described in the auditor's report. It also enables those charged with governance to consider whether new or enhanced disclosures may be useful in light of the fact that these matters will be communicated in the auditor's report.
- A62. The communication with those charged with governance required by paragraph 17(a) also addresses the extremely rare circumstances in which a matter determined to be a key audit matter is not communicated in the auditor's report (see paragraphs 14 and A54).
- A63. The requirement in paragraph 17(b) to communicate with those charged with governance when the auditor has determined there are no key audit matters to communicate in the auditor's report may provide an opportunity for the auditor to have further discussion with others who are familiar with the audit and the significant matters that may have arisen (including the engagement quality control reviewer, where one has been appointed). These discussions may cause the auditor to re-evaluate the auditor's determination that there are no key audit matters.

**Documentation** (Ref: Para. 18)

- A64. Paragraph 8 of ASA 230 requires the auditor to prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand,

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<sup>33</sup> See ASA 260, paragraph 21.

among other things, significant professional judgements. In the context of key audit matters, these professional judgements include the determination, from the matters communicated with those charged with governance, of the matters that required significant auditor attention, as well as whether or not each of those matters is a key audit matter. The auditor's judgements in this regard are likely to be supported by the documentation of the auditor's communications with those charged with governance and the audit documentation relating to each individual matter (see paragraph A39), as well as certain other audit documentation of the significant matters arising during the audit (e.g., a completion memorandum). However, this Auditing Standard does not require the auditor to document why other matters communicated with those charged with governance were not matters that required significant auditor attention.

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