



Agenda Item 1B (clean)

Proposed SAS, *Communicating Key Audit Matters in the Independent Auditor’s Report (AU-C 701)*

Requirements	Application Material
Introduction	
Scope of this Proposed SAS	
<p>1. This proposed Statement on Auditing Standards (SAS) addresses the auditor’s responsibility when key audit matters are communicated in the auditor’s report. It is intended to address both the auditor’s judgment as to what to communicate in the auditor’s report and the form and content of such communication.</p>	
<p>2. The purpose of communicating key audit matters is to provide greater transparency about the audit that was performed. The communication of key audit matters in the auditor’s report may also provide intended users of the financial statements (“intended users”) a basis to further engage with management and those charged with governance about certain matters relating to the entity, the audited financial statements, or the audit that was performed. (Ref: par. .A1–.A3)</p>	<p>Scope of this Proposed SAS (Ref: par. 2)</p> <p>A1. Communicating key audit matters provides additional information to intended users to assist them in understanding those matters that, in the auditor’s professional judgment, were of most significance in the audit of the financial statements of the current period. Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements. The communication of key audit matters may be particularly relevant to users for certain entities, including those that may be of significant public interest, for example</p>

	because they have a large number and wide range of stakeholders and considering the nature and size of the business.
	A2. The communication of key audit matters in the auditor’s report also may enhance communications about those matters between the auditor and those charged with governance, and may increase attention by management and those charged with governance to the disclosures in the financial statements to which reference is made in the auditor’s report.
	A3. AU-C section 320 ¹ , <i>Materiality in Planning and Performing an Audit</i> , explains that it is reasonable for the auditor to assume that users of the financial statements:
	a. Have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;
	b. Understand that the financial statements are prepared, presented and audited to levels of materiality;
	c. Recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment and the consideration of future events; and
	d. Make reasonable economic decisions on the basis of the information in the financial statements.

¹ AU-C section 320, *Materiality in Planning and Performing the Audit*, paragraph 4

	<p>Because the auditor’s report accompanies the audited financial statements, the users of the auditor’s report are considered to be the same as the intended users of the financial statements.</p>
<p>3. Communicating key audit matters in the auditor’s report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor’s report is not:</p>	
<p>a. A substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;</p>	
<p>b. A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with proposed SAS, <i>Modifications to the Opinion in the Independent Auditor’s Report</i>.</p>	
<p>c. A substitute for reporting in accordance with proposed AU-C section 570, <i>The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern</i>, if, after considering identified conditions or events and management’s plans, the auditor concludes that substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time remains; or</p>	
<p>d. A separate opinion on individual matters. (Ref: par. A4–A6)</p>	<p><i>Relationship between Key Audit Matters, the Auditor’s Opinion and Other Elements of the Auditor’s Report</i> (Ref: par. 3, 11, 14)</p> <p>A4. Proposed SAS, <i>Forming an Opinion and Reporting on Financial Statements</i> establishes requirements and provides guidance on forming</p>

an opinion on the financial statements.² Communicating key audit matters is not a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation. Proposed SAS, *Modifications to the Opinion in the Independent Auditor's Report*, addresses circumstances in which the auditor concludes that there is a material misstatement relating to the appropriateness or adequacy of disclosures in the financial statements.³

A5. When the auditor expresses a qualified opinion in accordance with proposed SAS, *Modifications to the Opinion in the Independent Auditor's Report*, communicating key audit matters would still be relevant to enhancing intended users' understanding of the audit. In these circumstances, presenting the description of the matter giving rise to a qualified opinion in the Basis for Qualified Opinion section gives it the appropriate prominence in the auditor's report (see paragraph 14) and separates the communication of this matter from any other key audit matters described in the Key Audit Matters section. The Exhibit in proposed SAS, *Modifications to the Opinion in the Independent Auditor's Report*, includes illustrative examples of how the introductory language in the Key Audit Matters section is affected when the auditor expresses a qualified opinion and other key audit matters are communicated in the auditor's report. Paragraph A57 of this proposed SAS 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 Opinion section or Going Concern section of the auditor's report.

² Proposed SAS, *Forming an Opinion and Reporting on Financial Statements*, paragraphs 10–15 and A4–A14

³ Proposed SAS, *Modifications to the Opinion in the Independent Auditor's Report*, paragraph A7.

	<p>A6. Proposed SAS, <i>Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report</i> establishes mechanisms for auditors of financial statements 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. However, when proposed SAS, <i>Communicating Key Audit Matters in the Independent Auditor’s Report</i>, applies, the use of an emphasis-of-matter or other-matter paragraph is not a substitute for including a matter in the Key Audit Matters section of the auditor’s report if it meets the definition of a key audit matter. Proposed SAS, <i>Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report</i>, provides further guidance on the relationship between key audit matters and emphasis-of-matter paragraphs and other-matter paragraphs.⁴</p>
<p>4. This proposed SAS applies to audits of complete sets of general purpose financial statements when key audit matters are communicated in the auditor’s report. However, proposed SAS, <i>Modifications to the Opinion in the Independent Auditor’s Report</i>, prohibits the auditor from communicating key audit matters when the auditor expresses an adverse opinion or disclaims an opinion on the financial statements, unless such reporting is required by law or regulation.⁵</p>	
<p>Effective Date</p>	
<p>5. This proposed SAS is effective for audits of financial statements for periods ending on or after December 15, 20xx.</p>	

⁴ Proposed SAS, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor’s Report*, paragraphs A1–A2.

⁵ Proposed SAS, *Modifications to the Opinion in the Independent Auditor’s Report*, paragraph 30.

Objectives	
6. The objectives of the auditor are to determine key audit matters, and communicate those matters by describing them in the auditor’s report. (Ref. par. A7)	A7. When the auditor communicates key audit matters in the auditor’s report, it is done so having formed an opinion on the financial statements. However, the communication of key audit matters is prohibited when the auditor expresses an adverse opinion or disclaims an opinion on the financial statements.
Definition	
7. For purposes of GAAS, the following term has the meaning attributed below:	
Key audit matters—Those matters that, in the auditor’s professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.	
Determining Key Audit Matters	Determining Key Audit Matters (Ref: par. 8–9)
8. The auditor should 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 should take into account the following: (Ref: Par. A8–A17)	A8. The auditor’s decision-making process in determining key audit matters begins with the determination of the matters that required significant auditor attention in performing the audit. This process is designed to assist the auditor in selecting, from among the matters communicated with those charged with governance, those matters that, based on the auditor’s judgment, were of most significance in the audit of the financial statements of the current period.
	A9. The auditor’s determination of key audit matters is limited to those matters of most significance in the audit of the financial statements of the current period, even when comparative financial

	statements are presented (i.e., even when the auditor’s opinion refers to each period for which financial statements are presented).
	A10. This proposed SAS does not require the auditor to update key audit matters included in the prior period’s auditor’s report. However, 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 statements of the prior period continues to be a key audit matter in the audit of the financial statements of the current period.
	<i>Matters that Required Significant Auditor Attention</i> (Ref: par. 8)
	A11. The concept of significant auditor attention recognizes that an audit is risk-based and focuses on identifying and assessing the risks of material misstatement of the financial statements, 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 judgment is often involved in planning and performing the audit procedures and evaluating the results thereof.
	A12. 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 statements may be particularly relevant in the auditor’s determination of key audit matters.
	A13. Areas of significant auditor attention often relate to areas of complexity and significant management judgment in the financial statements, and therefore often involve difficult or complex auditor judgments. In turn, this often affects the auditor’s overall audit strategy, the allocation of resources and extent of audit effort in relation to such

	<p>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 specialized area of accounting or auditing, whether engaged or employed by the firm to address these areas.</p>
	<p>A14. Various AU-C sections require specific communications with those charged with governance and others that may relate to areas of significant auditor attention. For example:</p>
	<ul style="list-style-type: none"> • Proposed SAS, <i>The Auditor’s Communication With Those Charged With Governance</i>, requires the auditor to communicate significant difficulties, if any, encountered during the audit with those charged with governance.⁶
	<ul style="list-style-type: none"> • AU-C section 220 establishes requirements for the engagement partner in relation to undertaking appropriate consultation on difficult or contentious matters.⁷ 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.⁸
	<ul style="list-style-type: none"> • Related party transactions, 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.

⁶ Proposed SAS, *The Auditor’s Communication With Those Charged With Governance*, paragraphs 14(b) and A32

⁷ AU-C section 220, *Quality Control for an Audit of Financial Statements*, paragraph 20

⁸ AU-C section 220, paragraph 21

	<ul style="list-style-type: none"> • Limitations on the group audit, for example, when the group engagement team’s access to information may have been restricted.
	<p><i>Considerations in Determining Those Matters that Required Significant Auditor Attention (Ref: par. 8)</i></p>
	<p>A15. 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 proposed SAS, <i>The Auditor’s Communication With Those Charged With Governance</i>. However, the auditor’s determination of key audit matters is based on the results of the audit or evidence obtained throughout the audit.</p>
	<p>A16. Paragraph 8 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 statements, and are intended to reflect areas of the audit of the financial statements 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 9. As the considerations may be interrelated (e.g., matters relating to the circumstances described in paragraphs 8b-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</p>

	with governance may increase the likelihood of the auditor identifying that matter as a key audit matter.
	A17. In addition to matters that relate to the specific required considerations in paragraph 8, 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 9. 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 statements. 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 (for example, changes to a system affecting revenue recognition).
	Areas of Higher Assessed Risk of Material Misstatement, or Significant Risks Identified in Accordance with AU-C section 315 (Ref: par. 8a)
a. Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with AU-C section 315, <i>Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement</i> . (Ref: par. A18–A21)	A18. Proposed SAS, <i>The Auditor’s Communication With Those Charged With Governance</i> , requires the auditor to communicate with those charged with governance about the significant risks identified by the auditor. ⁹ Proposed SAS, <i>The Auditor’s Communication With Those Charged With Governance</i> explains that the auditor may also communicate with those charged with governance about areas of higher assessed risks of material misstatement. ¹⁰
	A19. AU-C section 315 defines a significant risk as an identified and assessed risk of material misstatement that, in the auditor’s judgment,

⁹ Proposed SAS, *The Auditor’s Communication With Those Charged With Governance*, paragraph 11.

¹⁰ Proposed SAS, *The Auditor’s Communication With Those Charged With Governance*, paragraph A21.

	<p>requires special audit consideration. Areas of significant management judgment and significant unusual transactions may often be identified as significant risks. Significant risks are therefore often areas that require significant auditor attention.</p>
	<p>A20. However, this may not be the case for all significant risks. For example, AU-C section 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.¹¹ In addition, AU-C section 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.¹² 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 9.</p>
	<p>A21. AU-C section 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.¹³ Revision to the auditor’s risk assessment and reevaluation of the planned audit procedures with respect to a particular area of the financial statements may result in an area being determined as one requiring significant auditor attention, particularly when the revision results in a higher assessed risk of material misstatement. For example, the auditor’s risk assessment may have been based on an expectation that certain controls were operating effectively but the audit evidence obtained may indicate that such controls were not operating effectively</p>

¹¹ AU-C section 240, Consideration of Fraud in a Financial Statement Audit, paragraphs 26–27

¹² AU-C section 240, paragraph 31

¹³ AU-C section 315, paragraph xx

	throughout the audit period, leading to a change in audit strategy and additional audit effort.
	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 (Ref: par. 8b)
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. (Ref: par. A22–A23)	A22. Proposed SAS, <i>The Auditor’s Communication With Those Charged With Governance</i> , 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. ¹⁴ In particular, this may include accounting policies that have a significant effect on the financial statements (and significant changes to those policies), especially in circumstances when an entity’s practices are not consistent with others in its industry.
	A23. In many cases, the auditor’s communication with those charged with governance relates to critical accounting estimates and related disclosures, which are likely to be areas of significant auditor attention, and may be identified as significant risks. However, some critical accounting estimates may not be significant risks, even if such estimates have been identified as having high estimation uncertainty. Among other things, such estimates are highly dependent on management judgment and are often the most complex areas of the financial statements, and may require the involvement of both a management’s expert and an auditor’s expert.

¹⁴ Proposed SAS, *The Auditor’s Communication With Those Charged With Governance*, paragraph 12(a).

	The Effect on the Audit of Significant Events or Transactions that Occurred during the Period (Ref: par. 8c)
c. The effect on the audit of significant events or transactions that occurred during the period. (Ref: Par. A24–A25)	A24. Events or transactions that had a significant effect on the financial statements 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 statements 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. ¹⁵ Management may have made difficult or complex judgments in relation to recognition, measurement, presentation or disclosure of such transactions, which may have had a significant effect on the auditor’s overall strategy.
	A25. Significant economic, accounting, regulatory, industry, or other developments that affected management’s assumptions or judgments may also affect the auditor’s overall approach to the audit and result in a matter requiring significant auditor attention.
	<i>Matters of Most Significance</i> (Ref: par. 9)
9. The auditor should determine which of the matters determined in accordance with paragraph 8 were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters. (Ref: par. A8–A10, A26–A30)	A26. The concept of matters of most significance is applicable in the context of the entity and the audit that was performed. As such, the intent is for the auditor to identify matters specific to the audit and to make a judgment about their relative importance.

¹⁵ Proposed SAS, *The Auditor’s Communication With Those Charged With Governance*, paragraphs 12(a), 14, and A36, and Exhibit X.

	<p>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 judgment.</p>
	<p>A28. 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:</p>
	<ul style="list-style-type: none"> • The importance of the matter to intended users’ understanding of the financial statements as a whole, in particular, its materiality to the financial statements
	<ul style="list-style-type: none"> • 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.
	<ul style="list-style-type: none"> • The nature and materiality, quantitatively or qualitatively, of corrected and accumulated uncorrected misstatements due to fraud or error related to the matter, if any.
	<ul style="list-style-type: none"> • The nature and extent of audit effort needed to address the matter, including:

	<ul style="list-style-type: none"> ○ 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.
	<ul style="list-style-type: none"> ○ The nature of consultations outside the engagement team regarding the matter.
	<ul style="list-style-type: none"> ● 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.
	<ul style="list-style-type: none"> ● The severity of any control deficiencies identified relevant to the matter.
	<ul style="list-style-type: none"> ● 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
	<p>A29. 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</p>

	may be contrary to the notion of such matters being those of most significance in the audit.
	A30. Paragraph 15 addresses the form and content of the key audit matters section of the auditor’s report when the auditor determines that there are no key audit matters to be communicated.
Communicating Key Audit Matters	Communicating Key Audit Matters
10. The auditor should 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 13 or 14 apply. The introductory language in this section of the auditor’s report should state that:	
	<i>Separate Key Audit Matters Section in the Auditor’s Report</i> (Ref: par. 10)
a. Key audit matters are those matters that were communicated with those charged with governance and, in the auditor’s professional judgment, were of most significance in the audit of the financial statements [of the current period]; and	
b. These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor’s opinion thereon, and the auditor does not provide a separate opinion on these matters. (Ref: par. A31–A33)	A31. Placing the separate Key Audit Matters section in close proximity to the Opinion and Basis for Opinion sections may give prominence to such information.
	A32. The order of presentation of individual matters within the Key Audit Matters section is a matter of professional judgment. For example, such information may be organized in order of relative importance, based on the auditor’s judgment, or may correspond to the

	manner in which matters are disclosed in the financial statements. The requirement in paragraph 10 to include subheadings is intended to further differentiate the matters.
	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 statements of the current period, and may include reference to the specific period covered by those financial statements (for example, “for the year ended December 31, 20X1”).
<i>Key Audit Matters Not a Substitute for Expressing a Modified Opinion</i>	
11. The auditor should 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 proposed SAS, <i>Modifications to the Opinion in the Independent Auditor’s Report</i> , as a result of the matter. (Ref: par. A4)	
<i>Descriptions of Individual Key Audit Matters</i>	<i>Descriptions of Individual Key Audit Matters</i> (Ref: par. 12)
12. The description of each key audit matter in the Key Audit Matters section of the auditor’s report should include a reference to the related disclosure(s), if any, in the financial statements and should address: (Ref: par. A34–A41)	A34. The adequacy of the description of a key audit matter is a matter of professional judgment. The description of a key audit matter is meant 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 may 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

	<p>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).</p>
	<p>A35. Original information is any information about the entity that has not otherwise been made publicly available by the entity (for example, has not been included in the financial statements 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.</p>
	<p>A36. It is appropriate for the auditor to seek to avoid the inclusion of original information about the entity in the description of a key audit matter. 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.</p>
	<p>A37. Management or those charged with governance may decide to include new or enhanced disclosures in the financial statements or</p>

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. Additional disclosures by management also may be helpful when the auditor considers it necessary to include additional information to explain why a matter was determined to be a key audit matter, and how the matter was addressed in the audit.

A38. Although the auditor’s opinion on the financial statements does not extend to the other information addressed by proposed SAS, *The Auditor’s Responsibilities Relating to Other Information Included in Annual Reports*, 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 proposed AU-C section 230 is intended to address the significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments 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 17.
	Reference to Where the Matter Is Disclosed in the Financial Statements (Ref: par. 12)
	A40. Paragraphs 12a-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 statements. However, a reference to any related disclosures enables intended users to further understand how management has addressed the matter in preparing the financial statements.
	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 statements 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:
	<ul style="list-style-type: none"> • 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.

	<ul style="list-style-type: none"> When the auditor concludes, in accordance with proposed AU-C section 570, that substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time has been alleviated by management’s plans, the auditor may nevertheless determine that one or more matters relating to this conclusion arising from the auditor’s work effort under proposed AU-C section 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 statements, such as substantial operating losses, available borrowing facilities and possible debt refinancing, or non-compliance with loan agreements, and related mitigating factors.¹⁶
	<p>Why the Auditor Considered the Matter to Be One of Most Significance in the Audit (Ref: par. 12a)</p>
<p>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: Par. A42–A44)</p>	<p>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 8–9 and the application material in paragraphs A11–A28 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.</p>
	<p>A43. Relating a matter directly to the specific circumstances of the entity may also help to minimize the potential that such descriptions become overly standardized and less useful over time. For example,</p>

¹⁶ Proposed AU-C section 570, *The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern*, paragraph xx.

	<p>certain matters may be determined as key audit matters in a particular industry 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 judgments made in the financial statements 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.</p>
	<p>A44. 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:</p>
	<ul style="list-style-type: none"> • Economic conditions that affected the auditor’s ability to obtain audit evidence, for example illiquid markets for certain financial instruments.
	<ul style="list-style-type: none"> • New or emerging accounting policies, for example entity-specific or industry-specific matters on which the engagement team consulted.
	<ul style="list-style-type: none"> • Changes in the entity’s strategy or business model that had a material effect on the financial statements.
	<p>How the Matter Was Addressed in the Audit (Ref: par. 12b)</p>
<p>b. How the matter was addressed in the audit. (Ref: par. A45–A50)</p>	<p>A45. 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 judgment. In accordance with paragraph 12(b), the auditor may describe:</p>

	<ul style="list-style-type: none"> Aspects of the auditor’s response or approach that were most relevant to the matter or specific to the assessed risk of material misstatement;
	<ul style="list-style-type: none"> A brief overview of procedures performed;
	<ul style="list-style-type: none"> An indication of the outcome of the auditor’s procedures; or
	<ul style="list-style-type: none"> Key observations with respect to the matter,
	<p>or some combination of these elements.</p> <p>Law or regulation 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.</p>
	<p>A46. In order for intended users to understand the significance of a key audit matter in the context of the audit of the financial statements 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:</p>
	<ul style="list-style-type: none"> Does not imply that the matter has not been appropriately resolved by the auditor in forming the opinion on the financial statements.
	<ul style="list-style-type: none"> Relates the matter directly to the specific circumstances of the entity, while avoiding generic or standardized language.

	<ul style="list-style-type: none"> • Takes into account how the matter is addressed in the related disclosure(s) in the financial statements, if any.
	<ul style="list-style-type: none"> • Does not contain or imply discrete opinions on separate elements of the financial statements.
	<p>A47. 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 assist intended users in understanding unusual circumstances and significant auditor judgment 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.</p>
	<p>A48. 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 statements and is therefore not inconsistent with paragraphs 14–15 of AU-C section 620 <i>Using the Work of an Auditor’s Specialist</i>.</p>
	<p>A49. There may be challenges in describing the auditor’s procedures, particularly in complex, judgmental areas of the audit. In particular, it may be difficult to summarize 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 judgments involved. Nonetheless, the auditor may</p>

	consider it necessary to describe certain procedures that were performed to explain how the matter was addressed in the audit. Such description may typically be at a high level (i.e., those procedures that are most relevant to the unique facts and circumstances of the entity and the current-period audit), rather than a detailed description of all procedures performed regarding the matter.
	A50. As noted in paragraph A45, 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 statements as a whole.
<i>Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor’s Report</i>	<i>Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor’s Report</i> (Ref: par. 13)
13. The auditor should describe each key audit matter in the auditor’s report unless:	
a. Law or regulation precludes disclosure about the matter; or (Ref: par. A51)	A51. Law or regulation may preclude disclosure by either management or the auditor about a specific matter determined to be a key audit matter. For example, disclosure about a matter related to a defense contractor may be precluded due to the nature of the matter and security clearance provisions that may apply to the auditor.
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 does not apply if	A52. As indicated by paragraph 13b, 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 judgment not to communicate a key audit matter is appropriate only in cases when the adverse consequences

<p>information about the matter is available outside the entity. (Ref: par. A52–A55)</p>	<p>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.</p>
	<p>A53. 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 judgment in determining whether to communicate the matter by:</p>
	<ul style="list-style-type: none"> • Assisting the auditor in understanding why the matter has not been disclosed by the entity (for example, if law, regulation or certain financial reporting frameworks permit delayed disclosure or non-disclosure of the matter) and management’s views as to the 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 (for example, 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 13b.

	<ul style="list-style-type: none">• 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.
	<ul style="list-style-type: none">• Enabling the auditor, when appropriate, to encourage management and those charged with governance to disclose 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. <p>The auditor also may consider it necessary to obtain a written representation from management as to why 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.</p>
	<p>A54. 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.</p>

	A55. The issues considered by the auditor regarding a decision to not communicate a matter are complex and involve significant auditor judgment. Accordingly, the auditor may consider it appropriate to obtain legal advice.
<i>Interaction between Descriptions of Key Audit Matters and Other Elements Required to Be Included in the Auditor's Report</i>	
14. A matter giving rise to a modified opinion in accordance with proposed SAS, <i>Modifications to the Opinion in the Independent Auditor's Report</i> , or when substantial doubt exists about an entity's ability to continue as a going concern for a reasonable period of time in accordance with proposed AU-C section 570, are by their nature key audit matters. However, in such circumstances, these matters should not be described in the Key Audit Matters section of the auditor's report and the requirements in paragraphs 12–13 do not apply. Rather, the auditor should:	
a. Report on these matter(s) in accordance with the applicable AU-C sections; and	
b. Include a reference to the Basis for Qualified Opinion or the Going Concern section(s) in the Key Audit Matters section. (Ref: par. A5)	
<i>Form and Content of the Key Audit Matters Section in Other Circumstances</i>	<i>Form and Content of the Key Audit Matters Section in Other Circumstances</i> (Ref: par. 15)
15. 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 14, the auditor	A56. The requirement in paragraph 15 applies in three circumstances:

<p>should include a statement to this effect in a separate section of the auditor’s report under the heading “Key Audit Matters.” (Ref: par. A56)</p>	
	<ul style="list-style-type: none"> • The auditor determines in accordance with paragraph 9 that there are no key audit matters. This may be the case because there were no matters that required significant auditor attention.
	<ul style="list-style-type: none"> • The auditor determines in accordance with paragraph 13 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.
	<ul style="list-style-type: none"> • The only matters determined to be key audit matters are those communicated in accordance with paragraph 14.
	<p>A57. The following illustrates the presentation in the auditor’s report if the auditor has determined there are no key audit matters to communicate:</p> <p style="text-align: center;">Key Audit Matters</p> <p>[Except for the matter described in the <i>Basis for Qualified Opinion</i> section or <i>Going Concern</i> section,] We have determined that there are no [other] key audit matters to communicate in our report.</p>
<p>Communication with Those Charged with Governance</p>	<p>Communication with Those Charged with Governance (Ref: par. 16)</p>
<p>16. The auditor should communicate with those charged with governance:</p>	

<p>a. Those matters the auditor has determined to be the key audit matters; or</p>	
<p>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: par. A58–A61)</p>	<p>A58. Proposed SAS, <i>The Auditor’s Communication With Those Charged With Governance</i>, requires the auditor to communicate with those charged with governance on a timely basis. The appropriate timing for communications with those charged with governance 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 an adequate two-way dialogue about key audit matters at the time the financial statements are being finalized for issuance.</p>
	<p>A59. 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 when 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 recognizes 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.</p>

	A60. The communication with those charged with governance required by paragraph 16a 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 13 and A53).
	A61. The requirement in paragraph 16b 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, when 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	Documentation (Ref: par. 17)
17. The auditor should include in the audit documentation: ¹⁷ (Ref: Par. A62)	A62. Paragraph 8 of AU-C section 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, among other things, significant professional judgments. In the context of key audit matters, these professional judgments 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 judgments 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 (for example, a completion memorandum). However, this proposed SAS does not require the

¹⁷ AU-C section 230, *Audit Documentation*, paragraphs 8–11 and A6

	auditor to document why other matters communicated with those charged with governance were not matters that required significant auditor attention.
a. The matters that required significant auditor attention as determined in accordance with paragraph 8, 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 9;	
b. When 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 14; and	
c. When 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.	