Implementation Guide to
Standard on Auditing (SA) 701,
Communicating Key Audit Matters in
the Independent Auditor’s Report

The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi
Standards on Auditing issued by the Institute of Chartered Accountants of India (ICAI) are critical in ensuring and enhancing audit quality. It is essential that the auditors understand and implement the requirements of these Standards in their audit engagements. The Implementation Guides to Standards on Auditing are an important resource for the auditors to appropriately understand the requirements of these Standards and help them implement these Standards appropriately. These Implementation Guides also provide solutions to various practical problems faced by the auditors in implementing these Standards in real life audit situations.

In the year 2016, ICAI revised the extant suite of auditor’s reporting standard (i.e. SAs 700, 705, 706) and also issued a new standard SA 701, “Communicating Key Audit Matters in the Independent Auditor’s Report”. These set of standards has changed the paradigm of auditor’s reporting. Moreover, these standards are expected to reinvigorate the audit and change the manner in which auditors communicate their work in their key deliverable i.e. auditor’s report.

Earlier these standards were applicable for audits of financial statements for periods beginning on or after April 1, 2017. However considering the magnitude of changes driven by these standards, the Council of ICAI felt the urgent need to create awareness on the standards and accordingly decided to defer the applicability of these standards by a year. Now these standards are effective for audits of financial statements for periods beginning on or after April 1, 2018.

I am happy that the Auditing and Assurance Standards Board of ICAI has brought out this “Implementation Guide to Standard on Auditing (SA) 701, “Communicating Key Audit Matters in the Independent Auditor’s Report” for the benefit of the members. The Implementation Guide has been written in an easy to understand language in the form of frequently asked questions (FAQs) and contains detailed and focused guidance on various issues involved. The aim of this Implementation Guide is to provide
appropriate guidance on SA 701 to the members so as to enable them to discharge their reporting responsibilities smoothly and effectively under this Standard.

I compliment CA. Shyam Lal Agarwal, Chairman, AASB, CA. Sanjay Vasudeva, Vice-Chairman, AASB and all the members of the Auditing and Assurance Standards Board for bringing out this Implementation Guide for the benefit of the members. I am sure that the members and other interested readers would find this Implementation Guide immensely useful.

February 2, 2018
New Delhi

CA. Nilesh S. Vikamsey
President, ICAI
As the members are aware that ICAI in 2016 issued a series of new/revised standards on auditor reporting comprising Revised SAs 700, 705, 706, 260, 570 and a new SA 701, “Communicating Key Audit Matters in the Independent Auditor’s Report”. SA 701 is mandatory in the case of audit of listed entities and casts a new reporting requirement on auditors of listed entities to communicate key audit matters in their audit reports. This Standard is also applicable in audit of unlisted entities in situations where law or regulation requires communication of key audit matters in the audit report. SA 701 is effective for audits of financial statements for periods beginning on or after April 1, 2018. SA 701 has strong interrelationship with other elements of the audit report e.g. emphasis of matter/ other matter paragraphs, modified opinion, going concern aspect. As a proactive measure, the Auditing and Assurance Standards Board (AASB) of ICAI decided to develop an Implementation Guide on SA 701 to provide appropriate guidance to the members so that they can discharge their reporting responsibilities under this Standard in an effective manner.

It gives me immense pleasure to place in hands of the members, this “Implementation Guide to SA 701, Communicating Key Audit Matters in the Independent Auditor’s Report” brought out by AASB. The Implementation Guide has been written in simple and easy to understand language and contains detailed guidance on various issues involved in this new reporting requirement. For ease of usage and understanding of the readers, the Implementation Guide has been written in a “Question – Answer” format containing frequently asked questions (FAQs) on SA 701 and responses to those questions.

At this juncture, I wish to express my sincere gratitude to CA. Abhijit Bandyopadhyay, Board member and his team for their dedicated efforts in developing the basic draft of this Implementation Guide despite their other pressing preoccupations. I would also like to thank CA. Deepa Agarwal, Board member and her team who have updated and aligned this
Implementation Guide in line with the discussion held in the Board.

I wish to express my sincere thanks to CA. Nilesh S. Vikamsey, Honourable President, ICAI and CA. Naveen N.D. Gupta, Honourable Vice President, ICAI for their guidance and support to the activities of the Board.

I wish to place on record high appreciation of CA. Sanjay Vasudeva, Vice Chairman of the Board for his whole-hearted support. I also wish to place on record my sincere thanks to all the Board Members and all the Council Members for their suggestions, support and guidance in finalising this Implementation Guide as well as other pronouncements of the Board. I also wish to thank CA. Megha Saxena, Secretary, AASB and other officers and staff of AASB for their continued co-operation.

I am confident that the Implementation Guide would be well received by the members and other interested readers.

February 4, 2018
Jaipur

CA. Shyam Lal Agarwal
Chairman,
Auditing and Assurance Standards Board
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Introduction

The purpose of communicating key audit matters (KAM) 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 statements 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.

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 and does not constitute a separate opinion on individual matters. Communicating key audit matters in the auditor’s report 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.
- a substitute for expressing a modified opinion when required by the circumstances of a specific audit in accordance with SA 705 (Revised), “Modifications to the Opinion in the Independent Auditor’s Report”.
- a substitute for reporting in accordance with SA 570 (Revised), “Going Concern” 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.
- a separate opinion on individual matters.

SA 701 requires the communication of key audit matters in the auditor’s report for audits of complete sets of general purpose financial statements of listed entities or when required by law or regulation.

Key audit matters are defined as those matters that, in the
From the matters that required significant auditor attention, the auditor determines matters which were of the most significance in the audit of the financial statements of the current period and therefore are KAMs. In most cases, KAMs will relate to significant or complex matters disclosed in the financial statements. Examples of KAMs might include valuation of goodwill and other long-term assets, valuation of financial instruments, difficult or unique aspects of revenue recognition, or accounting for significant acquisitions. KAMs are included in a separate section of the auditor’s report with introductory language explaining the nature and intent of KAMs, including that the matters were addressed in the context of the audit as a whole and that the auditor does not provide a separate opinion on these matters.

It will be important for KAMs to be relevant and useful for investors and other users. To accomplish this, auditors must make sure that the information is as entity-specific as possible, and related to the facts and circumstances of the audit of the current period. However, it remains the responsibility of management, with the oversight of those charged with governance, to communicate relevant information to users about entity and its financial performance, including providing adequate disclosures in accordance with the applicable financial reporting framework.
Frequently Asked Questions (FAQs)

Given below are the responses on key issues of SA 701 in a Question – Answer format.

Question 1: What is the applicability date of SA 701, new reporting standard?

Response 1: The new reporting standard SA 701 is applicable for audits of financial statements for periods beginning on or after April 1, 2018.

Question 2: For which audits does the auditor need to follow the SA 701 mandatorily?

Response 2: SA 701 mandatorily applies to audits of complete sets of general purpose financial statements of listed entities for period beginning on or after April 1, 2018.

Question 3: Since SA 701 is mandatory only for listed entities, whether it is applicable on audits of unlisted entities?

Response 3: Yes, SA 701 is applicable for audit of unlisted entities under the following circumstances:

- When the auditor decides to communicate key audit matters in the auditor’s report, or
- When the auditor is required by law or regulation to communicate key audit matters in the auditor’s report.

For example, it can be given by the auditors on voluntary basis when communication of KAM will:

- promote consistency and comparability in auditor’s reporting; and
- assist intended users of the financial statements 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.

When an auditor is not mandatorily required to communicate key audit matters under SA 701, the discussions with those charged with governance for such entities may highlight interest or value in
the communication of matters to the intended users of the financial statements. The auditor’s report is a deliverable by the auditors and hence the decision to communicate key audit matters is to be taken by the auditors only.

**Question 4:** Is SA 701 applicable for audits of complete sets of general purpose financial statements for periods beginning before April 1, 2018, wherein the audit reports are signed after April 1, 2018?

**Response 4:** SA 701 applies to audits of complete sets of general purpose financial statements of listed entities for periods beginning on or after April 1, 2018. Hence, audit reports signed after April 1, 2018 which pertain to financial statements for periods beginning before April 1, 2018 will not be governed by SA 701.

**Question 5:** Does SA 701 apply for audits of interim financial statements or when an auditor does an audit of financial results in accordance with the requirements of Regulation 33 or Regulation 52 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015?

**Response 5:** SA 701 applies only to audits of complete set of general purpose financial statements of a listed entity. Therefore, if an audit report on interim financial statements is submitted only to the Board of Directors, the same cannot be construed as general purpose financial statements and hence SA 701 will not apply in such cases. However, if such interim financial statements are complete in all respects and are hosted on the company’s website, the same can be construed to be general purpose financial statements and hence SA 701 will apply in such cases. Financial results under SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 are not a complete set of financial statements and hence in audit of these financial results, SA 701 is not applicable.

**Question 6:** Is early adoption of reporting under SA 701 permissible?

**Response 6:** No, SA 701 does not provide for early adoption and hence it is interpreted that early adoption of SA 701 is not permissible.
Question 7: Is reporting under SA 701 applicable for audit reports provided for tax financial statements for periods beginning on or after April 1, 2018?

Response 7: SA 701 is applicable for audits of complete set of general purpose financial statements of listed entities. Although tax financial statements are considered as general purpose financial statements since they are provided to a regulator, they are not intended to meet the common financial information needs of a wide range of users. Therefore, SA 701 does not apply to tax financial statements.

Question 8: Since SA 701 applies for audits of listed entities, the status of listing is to be determined as of which date?

Response 8: SA 701 would apply to an entity which is listed as on the reporting date (Balance Sheet date). Consequently, if during the reporting period, a listed entity gets delisted, SA 701 would not apply to such entity, since as at the reporting date it is not a listed entity.

Question 9: Whether SA 701 applies to the entities which are in the process of getting listed as at the reporting date?

Response 9: SA 701 is applicable to only listed entities. Hence, if an entity is in the process of getting listed as at the reporting date then SA 701 is not applicable to it. However, it will be applicable from the financial year in which the entity is listed.

Question 10: If a company has its securities listed on a foreign stock exchange, but has no listing in India, is the auditor required to communicate key audit matters as per SA 701?

Response 10: SA 701 applies to audits of complete sets of general purpose financial statements of listed entities. Therefore, SA 701 should be applied when the securities of an entity are listed on any stock exchange in India or outside India. The securities include shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature.
Question 11: What is the purpose for bringing in the requirement for reporting on key audit matters in the auditor’s report?

Response 11: 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 statements 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.

Question 12: What are key audit matters?

Response 12: Key audit matters are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

Question 13: Is providing key audit matters in an auditor’s report in the nature of providing a separate opinion on individual matters reported as key audit matter?

Response 13: No. 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.

Further, 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;
- A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised);
• A substitute for reporting in accordance with SA 570 (Revised) 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
• A separate opinion on individual matters.

Question 14: When an auditor disclaims his opinion on the financial statements, can communication of key audit matters as per SA 701 be made?

Response 14: When an auditor disclaims his overall opinion on the financial statements, he is prohibited from communicating key audit matters, unless such reporting is required by law or regulation (As per Paragraph 29 of SA 705(Revised)). However, if the auditor disclaims an area in the financial statements and provides an overall qualified 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.

Question 15: When an auditor expresses a qualified or adverse opinion on the financial statements, can communication of key audit matters as per SA 701 be made?

Response 15: Yes. If the auditor determines one of more key audit matters in addition to the matter which is giving rise to qualified or adverse opinion, the auditor can communicate those matter(s) as KAM.

Question 16: How should an auditor determine what a key audit matter is?

Response 16: A funnel approach may be adopted to determine which matters are required to be reported as key audit matter in the auditor’s report. The starting point would be the matters that are communicated to those charged with governance, filtered for those matters that required significant auditor attention and then finally filtered for matters of most significance in the audit, which then would be the key audit matter for inclusion in the auditor’s report.