

Key Audit Matters Insights for Stakeholders

Frequently Asked Questions (FAQs)

April 2021

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Introduction

Key audit matters (KAMs) are being communicated in the auditor's report as Canada enters the last phase of its enhanced auditor reporting project. Communicating KAMs in the auditor's report has important implications for the dialogue between auditors, management and audit committees.

This FAQ document addresses key questions that management, the audit committee and users may have related to KAM reporting requirements.

What are KAMs and how are they communicated?

KAMs are matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. The auditor selects KAMs from all the matters communicated with those charged with governance of the entity.

KAMs are **not**:

- a substitute for appropriate disclosures in the financial statements;
- a substitute for the auditor expressing a modified opinion when required by the circumstances; or
- a separate opinion on individual matters.

They are communicated in the "Key Audit Matters" section of the auditor's report. When reading this section, you will notice every KAM includes:

- a separate subheading, a description of the KAM and a reference to the appropriate note disclosure in the financial statements;
- an explanation of why the matter was considered to be one of most significance in the audit of the current period and why it was determined to be a KAM; and
- an explanation of how the matter was addressed in the audit.

Who is required to communicate KAMs in the auditor's report?

Auditors of entities listed on the Toronto Stock Exchange (TSX), excluding those required to comply with National Instrument (NI) 81-106, *Investment Fund Continuous Disclosure*, are required to communicate KAMs in the auditor's report for audits of financial statements for periods ending on or after December 15, 2020.

Auditors of other listed entities,¹ excluding those required to comply with NI 81-106, are required to communicate KAMs in the auditor's report for audits of financial statements for periods ending on or after December 15, 2022.

How many KAMs are communicated in an auditor's report?

It depends.

No specific number of KAMs are required to be communicated in the auditor's report. The auditor judges the relative importance of matters that required significant auditor attention. If the auditor identifies no KAMs, the auditor's report will include a sentence to this effect in the KAM section of the auditor's report.

Will there be a KAM for all significant risks of material misstatement?

Not necessarily.

The auditor is required to presume there is a significant risk of fraud in revenue recognition and a significant risk of management override of controls. However, depending on the nature of the significant risks, they may not require significant auditor attention. So, the auditor may judge them to not be KAMs.

Should I expect the same types of KAMs in the auditor's report of entities in the same or similar industries?

Not necessarily.

The requirements for communicating KAMs depend on each entity's facts and circumstances. Several entities in an industry, may have the same or similar KAMs due to the industry's circumstances or the underlying complexity in financial reporting, however, the auditing standards do not prescribe KAMs for industries.

KAMs benefit users when they relate to the specific circumstances of the entity and the audit performed for the current period. A KAM is significant relative to other matters dealt with in the audit of the current period. When explaining why, the auditor may highlight aspects specific to the entity.

¹ The CPA Canada Handbook – Assurance, Glossary of Terms, defines a “listed entity” as “an entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.” Other listed entities include all entities listed on an exchange other than the TSX (i.e., TSX Venture Exchange, Canadian Securities Exchange, Aequitas NEO Exchange).

Will the auditor communicate the same KAM(s) year after year?

It depends on the circumstances of each audit and the nature of the potential KAM.

Each year, auditors determine and communicate matters with those charged with governance. Those matters may change from year to year, therefore, different KAMs may be identified each year. However, it is not necessary (or required) that the auditor identify different KAMs each year. Even though the auditor may communicate a KAM for the same matter year over year, the reason for identifying the KAM and how it was addressed in the audit may vary from the previous year.

Will a description of the KAMs contain any original information about the entity?

No.

Original information is any information about the entity that management or those charged with governance has not otherwise made publicly available at the date of the auditor's report, or addressed in other oral or written communications, such as a preliminary announcement of financial information or investor briefing. The auditor will seek to avoid communicating original information by encouraging management and those charged with governance to disclose additional information.

However, management or those charged with governance may decide to include new or enhanced disclosures related to the KAM in the financial statements or other documents because the matter will be communicated in the auditor's report. For example, such new or enhanced disclosures 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.

Will KAMs include the outcome of the audit procedures performed?

Not necessarily.

The amount of detail to be provided in the auditor's report to describe how a KAM was addressed in the audit is a matter of professional judgment. The auditor may describe the outcome of the auditor's procedures or key observations with respect to the matter, however, the auditor is not required to.

Is management and/or the audit committee required to approve KAMs before the auditor's report is issued?

No.

Neither management nor the audit committee approve KAMs. KAMs are identified by the auditor and communicated in the auditor's report. However, the auditor is required to communicate KAMs with those charged with governance. Management and/or the audit committee will usually discuss the KAMs with the auditor before the auditor's report is issued.

What are the expected benefits of KAM communications?

Experience in jurisdictions that have implemented the KAM-communication requirements suggests that communicating KAM has benefited parties in the financial reporting ecosystem.

KAM reporting drives earlier, enhanced and more frequent dialogue among auditors, management and the audit committee throughout the year. Communication becomes more structured, requiring greater attention and preparation by everyone involved.

Academic and other literature reviews note that KAM communications promote focused and robust audit committee discussions with auditors and management about financial reporting risks. Audit committees report that these discussions put them in a stronger position to fulfill their responsibilities for accountability on behalf of investors.

Having to consider whether to communicate KAMs has helped many auditors re-emphasize matters in the audit that require judgment and significant attention. Discussions of these matters with management may result in management reassessing the adequacy of disclosures related to matters identified as KAMs. This improves audit quality and financial reporting.

Investors have indicated they gained more insight into the financial reporting risks of the companies they invest in, as well as the audit process.

In addition, indirect benefits noted from KAM reporting include company internal process improvements like strengthening internal controls, improving risk management, and identifying new risks.

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