

Analysis of comments**Other Issues****Objectives of Agenda Item**

To review significant issues raised by commentators on matters not yet raised in the previous agenda papers and agree on the resolution of these significant issues.

The issues have been categorized in the three categories. The Task Force would like the Board's view in Copenhagen, in particular, on the issues in Sections A and B as these issues could have a significant influence on the way forward. The proposed issues in Section C and/or the responses to them are, in the Task Force's view, less controversial. The Task Force would welcome any comments on the proposed responses to these issues, but recognize that there might not be sufficient time at the meeting to discuss them in detail.

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A.1: Level of prescription

Three respondents (IOSCO, JICPA and RR) make similar comments regarding the development of the standards.

IOSCO note concern surrounding clarity of ISAs in general, observing that the required actions of the auditor are “now expressed in ISAs through a combination of bold and gray lettering and use of drafting conventions, but ...are concerned that the existing approaches are not consistently understood by auditors and others who use the standards.” IOSCO note they have observed differences in interpretation of the present formats and conventions even among members of the IAASB in Board meeting discussions, and it is not always clear to them what is intended to be a requirement in the standard. RR similarly suggests that by using language that is imprecise the reasoning behind the words is not clear. IOSCO urge the Board to address the clarity of standards issue as a matter of priority.

JICPA also make a comment that applies to the ISAs in general. They argue that the IAASB should be flexible in its interpretation of convergence and that convergence should be made based, not on the form of translation, but on the substance of the national auditing standards which reflect the intention of the ISAs.

With respect to the interpretation of this ISA in particular, a number of respondents supported the objective of making audit reports consistent and more understandable and applauded the IAASB principle of consistency in content and layout of the wording of the auditor's report.

IOSCO observe, however, that it is unclear to them if the requirements for certain statements to appear in the auditor's report are requirements for the exact wording, or whether the standard is only stating that these subjects or elements must be included in a statement made. They note that although paragraphs 14 and 57 seem to indicate that the wording used in the ISA is to be adopted in the absence of any national requirement to the contrary, those paragraphs are in grey lettering and are not mandatory. They add that if the intent is that only the exact wording shown in the bold lettered paragraphs should be used in the auditor's report, their members would be concerned that this is too high a level of prescription.

ACAG also seek clarity on the level of prescription. In particular, they ask that the ISA clearly state whether variations, such as the “plain English” presentation used in some jurisdictions in Australia, are either acceptable or unacceptable. Those reports use words that vary from those in the ISA but still address each of the elements. Those reports also put the opinion paragraph first because it represents the most important piece of information to readers of the report.

While supporting consistency in the ISA audit report wording in principle, some respondents expressed concern that it might discourage additional wording that is viewed as necessary in certain jurisdictions. In particular, five respondents (FEE, PwC, ICAS, LSCA, MICPA) note that wording to define the scope and limitations of the auditor's duty of care may be necessary in jurisdictions where the legal and regulatory definitions are not sufficient on their own without clarification. The respondents note that the “silence” in the proposed revised ISA with respect to whether or not including additional wording is permissible could be interpreted as allowing

explanatory wording to be added. The respondents are concerned, however, that some may argue that including additional wording does not seem to be in the “spirit” of the ISA and, for that reason, they ask for the ISA to explicitly acknowledge that additional wording can be included in such circumstances. The respondents accept that the ISA does offer guidance where the auditor has responsibilities to report on other matters but this guidance is not directly applicable because it is made very clear in the revised ISA that those matters are separate from the auditor's responsibility to report on the financial statements.

DISCUSSION

There are two aspects to this issue.

First, the level of prescription that IAASB intends for content, layout and wording of ISA audit reports (i.e., for audits conducted in accordance with ISAs alone). Responses indicate that the ISA was not sufficiently clear in its intent in this regard.

Second, even if the “standard” wording of an ISA audit report were to be mandated, the extent to which the ISA should allow flexibility for additional wording that may be appropriate in particular circumstances.

On the first point, the Task Force continues to believe that consistency in the content, the layout and the wording of the auditor's report when the audit has been conducted in accordance with the ISAs is desirable. It promotes credibility in the global marketplace by making more readily identifiable those audits that have been conducted in accordance with globally recognized standards. In fact, one respondent (PwC) points out that the two-part reporting model should be mandated for an audit conducted in accordance with ISAs alone rather than being the preferred way to clearly identify and distinguish the other reporting responsibilities. Given the degree of support in the responses for the two-part reporting model, the Task Force agrees with this point.

With respect to the second issue, the Task Force considered the following two examples of circumstances for which flexibility might be justified in the IAASB reporting model.

From the United Kingdom perspective, there is a strong desire to ensure that the guidance remains flexible enough to allow the “Bannerman” wording. Judgment was made in a UK Court that in the case of *Royal Bank of Scotland v Bannerman*, auditors could owe a duty of care in respect of their audit opinion to their client's lending bank based on knowledge deemed to have been acquired as part of performing necessary audit work required by auditing standards even though there had not been contact between the bank and the auditor. The court held that if the auditors had disclaimed liability to the bank then there would have been no duty of care, but the absence of such a disclaimer, when one could have been made, was a key factor in deciding that a duty ought to exist. With this ruling in the public domain, the auditor's duty of care in this jurisdiction now remains uncertain if there is not a disclaimer in the auditor's report. As a result, legal counsel advised that UK audit reports should include an appropriate disclaimer and UK audit reports now ordinarily include disclaimer wording in the description of the auditor's responsibilities. If prevented from including this wording in the audit report, IAASB may inadvertently expose auditors in the UK to unreasonable liability – beyond that intended by the relevant national law or regulation.

In France, the auditor's report needs to be flexible enough to respond to a new statutory obligation, set out in the first two subparagraphs of Article L.225-235 of the Code de Commerce (French Commercial Code), to provide a "justification for the auditor's assessments". This is a requirement for auditors to explain in their report the basis for the opinion they are expressing and to provide their judgment on significant choices made with regard to accounting policies, particularly when important decisions were made during the year. A Technical Opinion issued by CNCC proposes that the auditor should present the justification of assessments in a separate second section, after the opinion paragraph.

The Task Force recognizes that there is a very strong argument that the current guidance will not meet the needs of those jurisdictions where it is necessary to address such matters in the auditor's report. While national legal or regulatory issues should not drive ISA development, failing to allow for such circumstances in the ISAs might ultimately affect a jurisdiction's ability to adopt the ISAs and the auditor's ability to comply with the ISAs.

For these reasons, the Task Force suggest that ISA 700 acknowledge that, in certain jurisdictions, it may be appropriate – and, indeed, in the public interest – to expand the "standard" ISA audit report wording to accommodate these various provisions. The question is how best to accommodate that flexibility while continuing to promote consistency in an ISA audit report.

Some respondents made suggestions of how the IAASB might address the various examples noted above, (for example, in the case of the "Bannerman" wording, by introducing in the discussion of "addressee" in paragraph 18 the ability to add further explanation in the audit report of to whom the report is addressed). However, accommodating individually the provisions of different jurisdictions would be difficult at best and could result in different ad hoc solutions to different circumstances, undermining the goal of consistency.

Another alternative – the alternative supported by the majority of the Task Force – is to be prescriptive in the wording of the first part of the auditor's report (i.e., the report wording up to and including the auditor's opinion on the financial statements), but then to introduce the ability to include a section after the auditor's opinion to address any unique circumstances in a particular jurisdiction that relate to the audit of financial statements rather than to other reporting responsibilities. While this might not be the preferred location for the additional wording in all jurisdictions, it has the advantage of keeping the ISA audit report wording intact. This was the main argument in support of using the two-part reporting model for other reporting responsibilities too (which, as noted above, was well-received by respondents). The new section envisaged would, if deemed necessary in a particular jurisdiction, form part of the auditor's report on the financial statements and, therefore, would precede the section on other reporting responsibilities.

A different circumstance when flexibility may be required is when law or regulation mandates specific wording. For example, one respondent (DCCA) noted that one of the elements of the proposed revision to the EU 4th Directive is a requirement that there should be a reference to the financial reporting framework in the introductory paragraph of the audit report (4th Directive Article 51a). While the proposed audit report wording in the Exposure Draft includes references

to the financial reporting framework, the reference is not in the introductory paragraph. The financial reporting framework is referred to in management's responsibilities (and was believed to be important in the context of that paragraph) as well as in the auditor's opinion. A further reference in the introductory paragraph was viewed as being repetitive. Furthermore, in the current construct of the wording of the introductory paragraph, there is not obvious place to include a reference to the financial reporting framework.

Paragraphs 56 and 57 already provide flexibility when the auditor is obliged by national law or regulation to use a layout or wording in the auditor's report that differs from that described in the ISA. This would appear to address this circumstance. There will also be ongoing discussions with the EC on the audit report wording and the proposed requirement in the 4th Directive can be included in those discussions.

Task Force Recommendation:

Guidance should be expanded to accommodate the legal and regulatory provisions of different jurisdictions. However, from the perspective of global convergence, the principle of consistency in content and layout of the wording of the auditor's should be upheld. Therefore, the Task Force recommends that the guidance be reworded so there it is clear that the wording of the auditor's report on financial statements up to and including the opinion paragraph is consistent with the illustrative audit report. Then to accommodate the additional national reporting requirements, introduce new guidance that allows auditors to include a second section of the audit following the opinion paragraph report (and before the auditor's report on other reporting responsibilities).

A.2: Respective responsibilities of management and the auditor

Four respondents (BASEL, FEE, ICAS and JICPA) commented on the respective responsibilities of management and auditor.

Three respondents (FEE, ICAS and JICPA) argue that the revised ISA is inconsistent in how it describes, and uses the description of, the respective responsibilities of management and the auditor (in particular, in ISA 200, in paragraph 9 of ISA 700 and in the wording of the auditor's report). A particular concern is that the responsibilities of the auditor should not be wider than those of management.

Respondents also offered suggestions of additional responsibilities that could be included. For example, the following suggestions were made:

- The description of management's responsibility for the fair presentation of the financial statements in the auditor's report should explicitly include responsibility for disclosures.
- Paragraph 9 in ISA 700 should include consideration of management's selection of accounting policies used and the reasonableness of accounting estimates so that it is consistent with the description of management's responsibilities in the auditor's report.

- The auditor's report should include a reference to management's responsibility to assess the entity's ability to continue as a going concern (and, correspondingly in the description of the auditor's responsibilities, a reference to evaluating the appropriateness of management's use of the going concern assumption).
- The description of management's responsibilities should include specific reference to fair value estimates in order to emphasize the importance of management's responsibility in this area.
- The description of management's responsibilities should refer to management's responsibility for compliance with relevant laws and regulations, particularly when the auditor is including a report on other legal and regulatory requirements.

ACAG also propose that the auditor's report should include clarification of the scope of management's responsibilities with respect to internal control, but did not provide suggestions of the clarification that they believed could be useful.

BASEL suggested that the auditor's report should clearly identify that management's responsibility is summarized and represents only a component of the overall responsibilities discussed in the management report. For example, they suggest that the report should clarify that management's responsibility for internal controls related to financial reporting are only one component of the comprehensive system of controls required to be maintained by management.

Three respondents (APB, FSR and RR) argued including a description of the management's responsibilities in the auditor's report is not necessary in circumstances when management prepares a separate management report. Both FSR and APB argue that the auditor should have the option to refer to the "management report" in the annual report where management responsibilities are laid out in full. Some of the reasons given by APB and other respondents for not mandating a description of management's responsibilities include:

- The IAASB does not have the authority to mandate what management's responsibilities either are or should be.
- In many jurisdictions management has extensive responsibilities with respect to other legal and regulatory requirements. The possibility of having management's responsibilities described in two places in the auditor's report is unattractive to readers and will add unduly to their length.
- The degree of prescription in the proposed wording may limit the range of entities to which the requirements of the ISA can be applied in particular jurisdictions.
- Establishing the responsibilities as bold letter paragraphs may inhibit the evolution of management's responsibilities being appropriately reflected in auditor's reports.
- If included, management's responsibility should be described in full which would lengthen the report considerably.

DISCUSSION

The most significant challenge to the approach taken in the ED is the APB's assertion that IAASB does not have the authority to mandate management's responsibility. However, the Task Force continues to believe that the auditor should be entitled to share with the addressee those

management's requirements that are reflected in national law or regulations. While the proposed description of management's responsibilities in the Exposure Draft might not use the exact wording found in a particular jurisdiction's national law or regulations, responses did not suggest that the proposed description exceeded management's responsibilities in any jurisdiction. Respondents did provide suggestions for additional wording, but none of the responses argued that the proposed description included responsibilities that are not responsibilities of management in their jurisdiction.

The proposed wording in the Exposure Draft describes the responsibilities of management that are prerequisites to enabling the auditor to conduct an audit in accordance with ISAs—in effect, describing management's responsibilities from the auditor's perspective. This is important because it provides a basis for comparing management's responsibilities with those of the auditor.

For these reasons, the Task Force does not support the arguments put forward by FSR and APB for eliminating the description of management's responsibilities in the auditor's report or for limiting it to a cross reference to a report by management. The Task Force continues to believe that it is appropriate that the auditor's report includes a description of management's responsibilities and that the wording of that description should be consistent in all ISA audit reports.

The Task Force accepts, however, that there are some inconsistencies between the description of the auditor's responsibilities and the management responsibilities in ISA 200, ISA 700 and in the proposed wording of the auditor's report and will endeavor to eliminate the inconsistencies in finalizing the wording.

With respect to the list of management's responsibilities, the Task Force believes that IAASB should aim to keep the description as concise as possible and focus on those responsibilities that are prerequisites to being able to conduct an audit. There is a risk in adding further responsibilities to the list that it begins to look more and more like a complete description of all responsibilities, which is clearly not the intent (nor achievable). That being said, the Task Force will consider all of the suggestions in preparing revised wording of the auditor's report at the September meeting.

Task Force Recommendation:

The TF recommends that a description of management responsibilities should remain in the auditor's report. The TF also recommends that it is not appropriate to have a lengthy exhaustive list of management responsibilities, but as noted above, should focus on certain elements that are prerequisites to being able to conduct an ISA audit.

The guidance in ISA 200 and ISA 700 will be reviewed to ensure that they are internally consistent and that aspects of the auditor's responsibilities that are aligned with management's.

Thus, the TF will compare the management responsibility section in the illustrative audit report, with paragraphs 25 to 27 in ISA 700, paragraph 9 in ISA 700 and the description of management's responsibilities in paragraph 35 of ISA 200.

B.1: Clarification of reasonable assurance

Three respondents (FEE, PwC, FSR and BASEL) raised concern that the concept of reasonable assurance had not yet been sufficiently clarified or defined within the ISAs. The issue is exacerbated by the addition of the reference to fraud and error in the audit report (*“Those standards require that we plan and perform the audit to obtain reasonable, but not absolute, assurance whether the financial statements are free from material misstatement, whether due to fraud or error”*), because it is unclear whether the auditor seeks reasonable assurance that there are no material misstatements, whatever the cause, or whether what is “reasonable” with respect to error is different than what is “reasonable” with respect to fraud.

PwC suggest that the varying views within the profession could result in different interpretations of the ISAs and how they are implemented in practice. By virtue of its reference in the auditor's report, the visibility to users of the phrase “reasonable assurance” is heightened and, without clarification, users of auditors' reports may interpret the concept differently, “which will only serve to exacerbate the expectation gap”. This is supported by FSR who believe stakeholders continue to be confused by many of the terms used in the ISAs and, in particular, point to the Exposure Draft's use of “reasonable”, “reasonable assurance” and “reasonable, but not absolute assurance” without explanation of why these different phrases are used in different places. IDW also encourage the IAASB to accelerate the IAASB's agenda for considering projects related to reasonable assurance in connection with a conceptual framework so that timely and practical solutions can be developed. BASEL similarly encourage IAASB to give priority to both the projects on reasonable assurance and materiality and recommend that IAASB seek the views of the Consultative Advisory Group and give proper weight to their views when contemplating changes to current guidance.

Task Force Recommendation:

IAASB should place high priority on resolving the concerns surrounding the term reasonable assurance. We understand the Steering Committee is considering this project during the course of the June IAASB meeting in Copenhagen.

B.2: Reasonable, but not absolute, assurance

Five respondents (ACCA, FSR IDW, RR and BASEL) have reservations about the introduction of the term “but not absolute [assurance]” in the auditor's responsibility paragraph (paragraph 30).

ACCA suggests it is inconsistent to report by reference to 'reasonable, but not absolute, assurance' when this term is not used throughout and suggest that the inclusion of the term would require conforming amendments to be made throughout the ISAs. IDW also suggest removing the phrase from the auditor's report. IDW believe that "reasonable" assurance obtained in audits of financial statements must ordinarily be significantly less than absolute assurance, and by stating that reasonable assurance is not absolute assurance, the auditor's report intimates that reasonable assurance is only somewhat less than absolute assurance, which is, in their view, not the case. They believe that the use of the term "reasonable" alone adequately conveys the thought that absolute is not attained.

FSR suggest that the linking of new terms, "but not absolute" to "reasonable" makes no sense to stakeholders, as the words cannot be interpreted in context. The term "reasonable, but not absolute" only makes sense to auditors who are familiar with the implicit meaning of reasonable, namely that it is "high". Similarly, BASEL point out that the glossary definition of "reasonable assurance" is "high but not absolute". They do not support the amendment to ISA 200 paragraph 18 and to the auditor's report to modify "reasonable assurance" by "but not absolute". This, in their view, creates ambiguity as to which level of assurance an audit report is expected to convey.

RR writes that the addition of the comment that the auditor is not required to obtain absolute assurance is self-serving.

DISCUSSION

The Task Force considered the following alternatives:

- Leaving "reasonable, but not absolute, assurance"
- Adopting "high, but not absolute assurance"
- Deleting the reference to "but not absolute" and referring to "reasonable assurance" alone

Neither the glossary nor ISA 120 were not updated when the new Assurance Framework was issued (because the ISAE does not come into effect until later), which is causing some confusion.

At present, ISA 120 paragraph 6 says that in "an audit engagement the auditor provides a high, but not absolute, level of assurance that the information subject to audit is free from material misstatement", but it also states that "this is expressed in the audit report as "reasonable assurance". It could be argued that in modifying "reasonable assurance" by "but not absolute", the exposure draft did inadvertently confuse concepts.

On the other hand, adopting the phrase "high, but not absolute, assurance" instead would be a significant change from extant ISA 700 and audit reporting in other jurisdictions. Pending the outcome of the IAASB's project on reasonable assurance, proposing such a significant change now seems premature.

For these reasons, reverting to "reasonable assurance" unmodified seems the preferred option.

Task Force Recommendation:

Delete the modifier “but not absolute” in the proposed revised ISA 700 and ISA 200.

B.3: Reasonable assurance in relation to fraud and error

Seven respondents (ACCA, BASEL CNCC/OEC, FEE, IDW, KIBR and PwC) commented on the introduction of the term “whether due to fraud or error” in the auditor’s responsibility paragraph.

In supporting the direction taken by IAASB to expand and update the wording of the auditor’s report, BASEL noted that they were pleased that the auditor’s report will be explicit about the auditor’s responsibilities with regard to fraud and error and encouraged IAASB to retain the report’s proposed language as this relates to the planning and performance of the audit.

On the other hand, three respondents (KIBR, CNCC/OEC and ACCA) specifically request that the phrase is removed from the auditor’s responsibility paragraph. A number of respondents comment that it reopens the debate about whether reasonable assurance that the financial statements are free from material misstatements due to error, is the same as reasonable assurance that they are free from material misstatements due to fraud (noted above).

ACCA observes that the intention of the change from extant ISA 700 is not addressed in the explanatory memorandum, “nor is there any clarification in the guidance material in the proposed revised ISA 700”. The ACCA do respect the fact that the Audit Risk ISAs introduce the phrase, but raise the point that this is not something the “user” of the reports would be familiar with.

Both KIBR and CNCC/OEC suggest that if the phrase has to be raised “at all” then it should be inserted in the second sentence of the paragraph that describes the audit. This would certainly be more consistent with the requirements of Audit Risk ISAs.

FEE suggest that the reference alone does not adequately convey the inherent limitations of the audit (in the context of fraud)—in particular the fact that, with regard to levels of risk, risk due to error is not as high as risk due to fraud. FEE believe the user should be made aware of this. FEE recommend that the phrase might remain in the responsibility paragraph but further explanation should be included that, “owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements will not be detected; the risk resulting from fraud is higher than the risk resulting from error”.

IDW are supportive of the introduction of the term “whether due to fraud and error”. However, they believe that by adding this phrase without any additional explanation, the auditor’s report

will mislead the public into believing that auditors can detect fraud and error with equal facility and propose the addition of similar wording as follows: “Due to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements may not be detected; this risk resulting from fraud is generally greater than that resulting from error”.

DISCUSSION

The alternatives that IAASB could consider include:

- Leaving the reference to fraud and error in the description of the auditor's responsibilities
- Moving the reference to the paragraph describing the audit in relation to risk assessment
- Adding the additional wording proposed by FEE/IDW
- Deleting the reference altogether.

ISA 315 “Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement”, and the recently approved revision to ISA 240, “The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements” both make reference to “material misstatements whether due to fraud or error”. Accordingly, the phrase is an integral part of the auditing literature in defining the auditor's responsibilities. However, the reference to “whether due to fraud or error” was not included in the description of the auditor's overall responsibilities in the extant ISA 700 audit report nor is it included in the audit reports of the majority of jurisdictions around the world. Therefore, its addition could be perceived as a change in the auditor's responsibilities (although not intended to be).

If the reference to fraud and error were, instead, moved to the paragraph on the description of the audit in describing the auditor's risk assessments, the wording in the audit report would be consistent with the auditor's responsibility as set out in ISA 315 (paragraph 2). This would have the advantage of aligning the audit report with the Audit Risk ISAs, which was an objective of the revision of the report.

Task Force Recommendation:

The expression “whether due to fraud or error” should be removed from the first paragraph of the auditor's responsibility and inserted in the second sentence of the paragraph describing the audit, as follows: “*The audit procedures selected depend on the auditor's assessment of the risks of material misstatement of the financial statements, whether due to fraud or error*”.

B.4: Auditor's independence

Two respondents suggest in their comment letters (FEE and NIVRA) that it would be appropriate to refer in the ‘Auditor's Responsibility’ paragraph not only to compliance with ISAs but also to independence requirements/Code of Ethics/relevant ethical requirements the auditor has to follow in performing an audit of financial statements. ACAG make reference to “independence” and “ethical requirements” in their example audit report.

DISCUSSION

IAASB had debated the advantages and disadvantages of expanding the auditor's report to discuss the auditor's independence in the development of the Exposure Draft.

In its survey of audit report wording from around the world, the Task Force had found that five of the audit reports refer to independence other than in the title of the report. Three of them do so by way of referring to an independent audit (Australia) or independent opinion (Japan, New Zealand, Portugal) in the description of the auditor's responsibilities.

In developing the Exposure Draft, IAASB opted to recommend that a reference to "independent" be made in the title of the audit report, but not to include further discussion of the auditor's independence in the body of the report. The reasons for this included that fact that doing so would put specific emphasis on only one of the auditor's professional qualities, despite the fact that the auditor's integrity, competence, technical proficiency etc. are equally important. IAASB was also concerned that, in many cases, it would be difficult to identify all of the sources that impose professional and regulatory independence requirements that are relevant in any particular engagement and that was unclear what information readers gain by such a list. Where differences in governing rules exist, readers might assume differences in the auditor's independence that may not, in fact, exist.

It may be possible to make a more generic reference to, for example, "relevant laws, regulations and Code of Ethics applicable to the audit" that would convey the message while avoiding some of the difficulties of identifying more specifically the particular references. It may also be relevant to consider a positive statement regarding the auditor's independence (within the meaning of those Codes and regulations).

Task Force Recommendation:

The Task Force believes that adding reference to the auditor's compliance with ethical standards has merits and that further consideration could be given to how it might be accomplished but seeks the Board's views on the proposal.

B.5: Limitations of an audit and internal control

A number of respondents (ACCA, ACAG, BDO, EYN, FEE, IDW and PwC) discuss the inherent limitations of an audit and whether the audit report should explain those limitations.

IDW and FEE recommend that the IAASB deal with the matter by consider inserting additional wording at the end of the first scope paragraph in the auditor's report that clarifies the limitations of audits (as discussed in B.3 re: fraud). ACCA also comment on the inherent limitations of the audit in the context of fraud. AuASB suggest that additional wording should be added to reflect that the nature of an audit is influenced by factors such as the use of professional judgment, selective testing, the inherent limitations of internal control, and

the availability of persuasive rather than conclusive evidence—and that, as a result, an audit cannot guarantee that all material misstatements have been detected.

BDO comment that whilst a caveat on the limitations of an audit may not seem appropriate in the current regulatory environment, the reality cannot be ignored and suggest that the IAASB should consider taking bolder steps to communicate the objectives, mechanics, and limitations of an audit.

The illustrative audit report in ACAG's response, which they describe as a "Plain English" report, makes reference to inherent limitations of an audit and states that the opinion does not provide assurance about the future viability of the company; that it has carried out its activities effectively, efficiently and economically; or about the effectiveness of its internal controls.

DISCUSSION

In developing the Exposure Draft, various suggestions for additional wording to better explain the inherent limitations of audit were considered. Some of the options were discussed with CAG, but on balance, CAG members were not supportive of including such explanations in the audit report. They advised that it is better to describe the auditor's responsibilities in a positive manner, rather than by describing their limitations.

The engagement letter in ISA 210 includes the sentence, "Because of the test nature and other inherent limitations of an audit, together with the inherent limitations of any accounting and internal control system, there is an unavoidable risk that even some material misstatements may remain undiscovered". If IAASB did decide to include some explanatory wording in the auditor's report, this wording has the advantage of already being in an illustrative communication in the ISA auditing literature.

Task Force Recommendation:

In light of the comments received, the Task Force would appreciate IAASB members' views on whether or not we should be exploring additional wording that could be added to the auditor's report to better explain the inherent limitations of audit.

B.6: Description of the auditor's responsibilities with respect to internal control

Two respondents (BASEL, AICPA) suggest that the illustrative auditor's report should refer to the fact that the auditor is expected to communicate any material weaknesses in internal control come to the auditor's attention to those charged with governance.

AICPA raise this as the first of their serious concerns with the Exposure Draft. They are concerned that the proposed statement in the auditor's report that an audit includes considering internal control, especially in environments where some audits include a report on internal controls, may confuse users as to the level of work done on internal controls. In addition, they believe that users will be left wondering what was found in the auditor's consideration of

internal control. They argue that acknowledging the auditor's responsibility to report material weaknesses in internal control to management and those charged with governance will complete the discussion on the auditor's responsibility with respect to internal control and would inform the users of the auditor's report that there may be important information that is not contained in the financial statements and the auditor's report. They also argue that another benefit would be that the general user would better understand that the auditor is not the only "source of information" from where to obtain information. For these reasons, they suggest adding the following sentence: "Communication of material weaknesses in internal control that come to the auditor's attention is made to management and those charged with governance."

BASEL note that the sentence added with respect to the limitations of the auditor's responsibilities with respect to internal control, while factually correct, is potentially misleading in isolation. In view of the importance of the auditor's responsibility to communicate material weaknesses to those charged with governance, BASEL believe that the audit report should make specific reference to it. They suggest replacing the sentence in paragraph 33 (b) that had been proposed in the Exposure Draft with the following sentence and to use similar wording in the auditor's report: "The auditor is not required to form and express an opinion as to the effectiveness of the entity's internal control system but is expected to communicate any material weaknesses in internal control which come to the auditor's attention to those charged with governance." BASEL would also like to add a further footnote to paragraph 33 (b) explaining that, even though the auditor may not be required to form and express an opinion on the effectiveness of internal control, they do have to obtain an understanding of internal control in order to assess the extent to which they can rely on controls in determining the nature, timing and extent of their own procedures.

DISCUSSION

IAASB debated the pros and cons of including this reference to the auditor's responsibility to communicate material weaknesses in internal control to those charged with governance at length in developing the Exposure Draft. The primary reason that the Board decided not to include this reference was because, in the Board's view, it could raise more questions than it answers in the minds of readers. Readers would be left wondering whether the auditor did identify any material weaknesses and what they were. While it could be argued that readers could enquire of the auditor and those charged with governance, it is unclear how this would work in practice (i.e., the auditor would be bound by confidentiality requirements and individual investors may only have the ability to enquire of those charged with governance in an annual meeting). Furthermore, readers might be confused how the auditor can express an opinion without reservation on the financial statements when there is a material weakness in internal control.

On the other hand, the fact that the auditor reports material weaknesses to those charged with governance on a timely basis could be reassuring to readers because those charged with governance are then able to consider the potential impact of identified weaknesses while preparing the financial statements – thus, in a sense, reinforcing the checks and balances that help to promote a sound financial reporting regime.

In light of the strong views expressed by these two respondents, it is important to reflect on the Board's original decision and the Task Force seeks confirmation of the Board's position on this issue.

Task Force Recommendation:

The Task Force seeks IAASB's confirmation of its position in the Exposure Draft that the auditor's report should not refer to management's responsibility to inform those charged with governance of any identified material weaknesses in internal control.

B.7: Using the assurance framework for other reporting responsibilities

The AICPA argue that the auditor should be required to comply with the ISAE when reporting on other legal or regulatory requirements. They believe that this requirement would have the following benefits:

- It would emphasise that the auditor should only be associated with subject matter that can be consistently evaluated against suitable criteria. They argue that it is not in the public interest to be reporting on subject matters that do not meet this threshold.
- It would provide the profession with a tool that would be helpful to educate legislators and regulators who attempt, in future, to impose reporting requirements on auditors that might not comply with the ISAEs. The AICPA has found this very valuable in their experience.
- It would raise awareness of the ISAEs.

DISCUSSION

There were a number of reasons why IAASB did not impose a requirement that reporting on other reporting responsibilities be in accordance with the ISAEs. In practice, these reporting requirements vary widely. While some might involve providing assurance, others may be more in the nature of agreed upon procedures, or derivative reporting responsibilities ("derivative" in the sense that the auditor is simply asked to report if certain matters come to the auditor's attention in the course of the audit (with no responsibility to design additional procedures to identify them) – neither of which are within the scope of the Assurance Framework and ISAEs.

AICPA counter that some "grandfathering" may be needed. But in their view, ignoring the new Assurance Framework and related ISAE renders this proposed standard flawed. In their view, allowing the auditor to report on subject matter without complying with the ISAEs would set a troubling precedent and would render the ISAEs ineffective and unenforceable.

The proposed guidance in ISA 700 did not, in any way, represent complete guidance to auditors on the nature and scope of work involved in these reporting responsibilities. In fact, it does not attempt to define the auditor's work effort at all – arguably, that would best be addressed in a separate ISA or IAPS. Its intention was merely to establish how the auditor should report on those responsibilities if required to do so in the auditor's report.

In light of the AICPA's strong views on this issue, the Task Force seeks the Board's input on whether it wishes to revisit this decision and, if so, whether further guidance on reporting on

these other reporting responsibilities (perhaps with appropriate grandfathering provisions) should be part of the ISA 700 revision or perhaps addressed more fully in a separate project.

Task Force Recommendation:

The Task Force seeks IAASB's view on how best to address performance guidance in relation to the auditor's responsibilities with respect to other reporting responsibilities.

C.1: Scope of the Audit

Three respondents (BASEL, EYN and HKSA) had concerns regarding the definition of the scope of the audit. BASEL suggested that the definition of the scope of the audit in paragraph 10 currently implies that the scope of the audit is entirely dependent on the auditor's judgment and recommend that the section is amended to suggest that "scope" refers to the nature, timing and extent of the audit procedures based on the auditor's risk assessment and the requirement for the auditor to obtain sufficient appropriate audit evidence. HKSA suggest that the definition could be expanded to refer to ISAs.

EYN have a different concern. They note that the scope of the audit refers to procedures deemed appropriate to achieve the audit objective. However, they argue that the boundaries of the scope of an audit are defined by the subject matter of the audit, the audit objectives and the level of assurance. Based on that scope, all procedures necessary to obtain sufficient evidence to support the opinion have to be performed. The scope of the audit is therefore the starting point for the procedures to be performed. They suggest changing the guidance accordingly.

BASEL comment that a restriction on the auditor's access to information by the entity, another auditor or an expert may be considered a "limitation in scope". Therefore, they recommend that the concept of the auditor's free access to all required information should also be included in the discussion of "scope of an audit" in ISA 200.

DISCUSSION

In proposing revisions to ISA 200 and 700, IAASB did not change the concept of the "scope" of the audit that was in the extant ISAs – i.e., that "scope" relates to the procedures performed and is conveyed in the auditor's report by virtue of the reference to conducting the audit in accordance with the ISAs. The changes made were designed to bring the wording in line with the new Preface and to introduce the concept that the judgment is involved in determining the audit procedures that are appropriate in the circumstances.

However, the Task Force agrees that the wording proposed in the Exposure Draft is not as clear as it could be and suggests the alternative wording below.

The Task Force does not believe that the guidance regarding limitation in scope should be introduced in this ISA, as it may only serve to confuse readers who may then expect other types

of qualification to be addressed in this ISA. The Task Force believes that it is more appropriate that the guidance on limitations in scope remains in ISA 701.

Task Force Recommendation:

The Task Force proposes to amend the wording in ISA 200 as follows:

10. In determining the audit procedures to be performed in conducting an audit in accordance with ISAs, the auditor should comply with each of the ISAs relevant to the audit. The term “scope of an audit” refers to the audit procedures deemed appropriate in the circumstances, in the auditor’s judgment, to achieve the objective of the audit. The audit procedures required to conduct an audit in accordance with ISAs should be determined by the auditor having regard to the requirements of ISAs, relevant professional bodies, legislation, regulations and, where appropriate, the terms of the audit engagement and reporting requirements.

11. In determining the audit procedures to be performed in conducting an audit in accordance with ISAs, the auditor should comply with each of the ISAs relevant to the audit. The term “scope of an audit” refers to the audit procedures deemed appropriate in the circumstances to achieve the objective of the audit. The ISAs govern audits of historical financial information and provide a framework of reference for the auditor’s judgments in determining audit procedures that are appropriate in the circumstances.

C.2: Linkage between the ISAs and the code of ethics.

One respondent (APB) noted that in certain jurisdictions (the APB cited the UK as an example) the standard setter may wish to adopt ISAs but have established ethical standards that differ from the IFAC Code. This issue is exacerbated by the lack of guidance as to what 'compliance with the code' means. The APB note that recently some support on this issue in recent exposure drafts of the IFAC Statements of Membership Obligations (SMOs). SMO4 which state, “Member bodies should use their best endeavors to incorporate the fundamental principles set out in the IFAC Code in their national code...”. The APB suggest that certain words such as 'best endeavors' reflect the reality of the situation but paragraph 4 of ISA 200 appears more demanding by suggesting that the “auditor should comply with the relevant ethical requirements relating to audit engagements, which ordinarily comprise Parts A and B of the IFAC Code of Ethics...” i.e. it introduces words such as 'ordinarily' without suggesting what the circumstances might exist that would allow the auditor not to apply Parts A and B of the Code. The APB further note that this issue also arises in the ISQC but is better addressed.

DISCUSSION

The wording in ISA 700 is consistent with the wording in recently approved ISQC 1, with the exception of deleting the reference to “applicable national requirements” – a change proposed in the final editing of ISQC 1 by the plain English editor. Although it is split into two sentences in

ISQC 1 (referring to “comply with relevant ethical requirements” in the bold lettered paragraph and defining them in the following sentence), it is hard to see a discernable difference in intent.

Furthermore, although the final approved SMO requires “member bodies should use their best endeavors to implement the IFAC Code and other pronouncements developed by the Ethics Committee, when and to the extent possible under local circumstances,” it also says: “The basic intent of the IFAC Code, however, should always be respected. Section 8, “Independence for Assurance Engagements,” of the IFAC Code establishes a conceptual framework for independence requirements for assurance engagements that is the international standard on which national standards should be based. Accordingly, no member body is allowed to apply less stringent standards than those stated in that section. However, if member bodies are prohibited from complying with certain parts of Section 8 by law or regulation, they should comply with all other parts of that section.” Similar wording was also proposed in the Exposure Draft of the Code of Ethics and the SMO notes that the wording in it will be updated on final approval of the Code.

Arguably, then, the wording in ISA 200 and ISQC 1 is appropriate.

Task Force Recommendation:

The Task force proposes that the wording be fully aligned with the wording with ISQC 1 and, therefore, delete the reference to “~~applicable~~ national requirements”.

C.3 Inclusion of sub-headings

Five respondents (DCCA, EYN, LSCA, KPMG and PAAB) supported the use of sub-headings within the auditor's report and recommended that they should be included as part of the list of elements of the auditor's report laid out in paragraph 13 in order to promote consistency in the layout of the report. NIVRA and EYN suggested some additional sub-headings, such as introducing the sub-heading “scope of the audit” above the first paragraph of the section on the auditor's responsibilities.

DISCUSSION

Whilst the Task Force has included sub-headings in the illustrative audit report, the Task Force does not necessarily agree mandating the use sub-headings in paragraph 13 is critical to improving or promoting consistency in the layout of the report. The Task Force is of the view that key to consistency is the main body of the auditor's report and that the sub-headings are merely a reference point. By having them in the illustrative report, it is likely that the practice of using sub-headings will be widely adopted.

However, the Task Force does feel there is some benefit in mandating sub-headings for modifications to the auditor's report (ISA 701). Communication with the reader is enhanced by the use of an appropriate sub-heading differentiating the qualified or emphasis of matter paragraphs from the other matters.

Task Force Recommendation:

ISA 701 Task Force should be encouraged to consider the use of sub-headings in the audit report when the report is modified.

C.4: Including the level of audit materiality in the auditor's report

BDO suggested that there might be merit in including the concept of materiality in the auditor's report.

DISCUSSION

The Task Force is not supportive of including the planning level of materiality in the auditor's report. There are a number of reasons for this view.

It would be very difficult to explain in a meaningful way in the auditor's report the complex judgments involved in applying the concept of materiality in planning, performing risk assessments and evaluating misstatements. As discussed in the draft revision to ISA 320, *Materiality in the Identification and Evaluation of Misstatements*, presented at the April meeting, the determination of what is material is a matter of professional judgment. While the auditor is expected to determine a "materiality level" for the financial statements as a whole for the purposes of planning and risk assessments, the April draft suggested that different levels of materiality might be appropriate in certain circumstances (i.e., if there are specific circumstances that cause the auditor to believe that misstatements of particular items of lesser amounts than the materiality level determined for the financial statements taken as a whole would reasonably change or influence economic decisions of users). The auditor is also expected to take into account qualitative considerations, particularly in evaluating whether identified misstatements are material, individually or in aggregate.

While the auditor may discuss materiality judgments in its discussions with those charged with governance, those discussions need not be restricted to identifying the "level of materiality". In those discussions, the auditor can engage in a dialogue in which the judgments involved can be conveyed more fully.

The Task Force is also concerned that including a "level of materiality" in the auditor's report might encourage an inappropriate over-emphasis on quantitative considerations. Indeed, if a "level of materiality" is included in the auditor's report, readers of the auditor's report are likely to misunderstand the nature of materiality.

Task Force Recommendation:

Do not include the level of materiality for the financial statements as a whole in the auditor's report.

C.5: Unqualified audit report

DCCA requested that the fact that the report is unqualified should be clearly stated – specifically quoting the term “our audit has not resulted in any qualification” in an unmodified audit report. This forms part of Danish regulatory requirements.

DISCUSSION

The Task Force is not convinced that including a statement in the auditor's report that the audit has not resulted in any qualification is necessary. This should be readily apparent from the content of the report and the wording of the auditor's opinion. It is a reasonable expectation that the audit report is unqualified unless the report wording is modified. An alternative might be to show the report is not qualified in the title – an option that could be considered by the ISA 701 Task Force. However, the ISA 700 Task Force is not convinced of the merits of that option either.

Task Force Recommendation:

An unmodified audit report does not need to include reference to the fact that the audit has not resulted in any qualification.

C.6: The auditor's responsibilities for other information

The APB propose that the auditor's responsibility regarding “other information in the financial statements”, as described in ISA 720, should be referred to in the description of the auditor's responsibilities in the auditor's report.

DISCUSSION

This issue was debated in developing the Exposure Draft. The objective and scope of the audit as defined by the ISAs is formulated on the premise that the auditor's responsibility is restricted to information identified in the auditor's report. ISA 720, *Other Information in Documents Containing Audited Financial Statement*, states that the auditor has no obligation to report on other information in documents that contains the audited financial statements. If the audit report made reference to the “other information”, even if explaining that the auditor's responsibility is merely to “read” the other information, there is a risk that users will confuse the scope of audit and potentially draw unwarranted assurance with respect to that other information. This problem could further complicated when the financial statements and the auditor's report are communicated through a website. Thus, while some might argue that describing the auditor's responsibilities for other information will help to manage readers' expectations, the Task Force is of the view that there is a greater risk that readers will be confused by a reference to other information in the auditor's report.

Task Force Recommendation:

Do not include reference to the auditor's responsibilities with respect to other information

C.7: Acceptability of the financial reporting framework

BASEL recommended in their response that the auditor should report on the acceptability of the financial reporting framework identified by management.

DISCUSSION

Given that the auditor cannot accept the engagement if the framework used by management is not acceptable (and therefore, the audit report in and of itself conveys the auditor's willingness to be associated with that framework) and the fact that, in most jurisdictions, the applicable financial reporting framework for general purpose financial statements will be specified in company law and presumed to be acceptable under ISA 200, there appears to be little value in adding a reference in the auditor's report on general purpose financial statements regarding the acceptability of the financial reporting framework. Therefore, no change recommended

Task Force Recommendation:

Do not include reference to the acceptability of the financial reporting framework.

C.8: Redundant statement in the audit report

Three respondents (DT, LSCA and PwC) suggested that the whole paragraph directly above the "Opinion" paragraph that begins, "We believe that the audit evidence that we have obtained...", is redundant and should be removed. The respondents suggest that whilst this paragraph originated from the new ISA 330, "The Auditor's Procedures in Response to Assessed Risks", the auditor would not be able to express an opinion on the financial statements if the auditor had not obtained a reasonable basis for the opinion. DT further suggests that the auditor's report will contain a modified opinion if the auditor believes that the audit evidence obtained is not sufficient and appropriate.

DISCUSSION

The Task Force believes that whilst the comment might be considered a predictable statement and somewhat redundant, most respondents did not comment on it and, therefore, appear to support its inclusion in the audit report. Therefore, no change recommended.

Task Force Recommendation:

Retain the sentence in the auditor's report regarding the fact that the audit evidence obtained is sufficient and appropriate to provide a reasonable basis for the opinion.

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