# PROPOSED INTERNATIONAL STANDARD ON AUDITING 706

## (REVISED AND REDRAFTED)

## EMPHASIS OF MATTER PARAGRAPHS AND OTHER MATTER(S) PARAGRAPHS IN THE INDEPENDENT AUDITOR'S REPORT

(Effective for audits of financial statements for periods beginning ~~auditors' reports dated~~ on or after [date][*])

**[MARK-UP FROM FEB 07 IAASB MEETING]**

## CONTENTS


| | Paragraph |
|---|---|
| **Introduction** | |
| Scope of this ISA | 1-4~~3~~ |
| Effective Date | 5~~4~~ |
| **Objective** | 6~~5~~ |
| **Requirements** | |
| Form and Placement of an Emphasis of Matter Paragraph in the Auditor's Report | 7~~6~~ |
| Other Matter(s) in the Auditor's Report | 8~~7~~ |
| Communication with Those Charged with Governance | 9~~8~~ |
| **Application and Other Explanatory Material** | |
| Nature of an Emphasis of Matter Paragraph | A1 - A2 |
| Form and Placement of an Emphasis of Matter Paragraph in the Auditor's Report | A3 - A5 |
| Other Matter(s) in the Auditor's Report | A6 - A~~7~~8 |
| Communication with Those Charged with Governance | A9~~8~~ |
| Appendix: Example of an Auditor's Report that Includes an Emphasis of Matter Paragraph | |


International Standard on Auditing (ISA) 706 (Revised and Redrafted), "Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor's Report" should be read in the context of the "Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services," which sets out the application and authority of ISAs.

[*] See footnote 1.

**(Note to IAASB: References to the main IAASB comments from the February 2007 meeting (Agenda Item 7-E) are highlighted in italicized square brackets.)**

# Introduction

## Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's consideration of the inclusion in the auditor's report of:

   (a) An Emphasis of Matter paragraph to draw users' attention to a matter presented and disclosed *[See Issue 3 in cover note]* in the financial statements that the auditor judges important to their understanding of the financial statements; or

   (b) An Other Matter(s) paragraph to draw users' attention to any other matter the auditor considers necessary to communicate to the users.

2. The inclusion of an Emphasis of Matter paragraph or an Other Matter(s) paragraph in the auditor's report may arise in the circumstances of an engagement to report on general purpose financial statements prepared and presented in accordance with a fair presentation or compliance framework, or an engagement to report on special purpose financial statements or specific elements, accounts or items of a financial statement. The requirements and guidance in this ISA are established in the context of engagements to report on general purpose financial statements prepared and presented in accordance with a fair presentation framework. In all other cases, these requirements and guidance are to be applied, adapted as necessary. *[See IAASB comments #10-12]*

*Nature of an Emphasis of Matter Paragraph*

3~~2~~. In rare circumstances, the auditor may consider a matter presented and disclosed in the financial statements to be of such importance to users' understanding of the financial statements as a whole that it would be appropriate to draw their attention to it. An Emphasis of Matter paragraph in the auditor's report provides the means for the auditor to do so. However, a widespread use of Emphasis of Matter paragraphs diminishes the effectiveness of the auditor's communication of such matters. (Ref: Para. A1-A2)

*Nature of an Other Matter(s) Paragraph*

4~~3~~. The auditor may consider it necessary to use the auditor's report as a means of communicating information relating to matters other than those that are presented and disclosed in the financial statements. Such information is referred to in this ISA as "Other Matter(s)" in order to distinguish it from a matter highlighted in an Emphasis of Matter paragraph.

## Effective Date

5~~4~~. This ISA is effective for audits of financial statements for periods beginning ~~auditors' reports dated~~ on or after [date].[1]

[1] This date will not be earlier than December ~~31~~15, 200~~9~~8.

## Objective

6~~5~~. The objective of the auditor is to include ~~determine whether~~ clear additional communication in the auditor's report ~~is appropriate~~ when, in the auditor's judgment, such communication is appropriate to draw users' attention to a matter presented and disclosed in the financial statements or to any other matter which may be of relevance to their understanding of the ~~report~~financial statements or the audit. *[See IAASB comments #13-20]*

## Requirements

### Form and Placement of an Emphasis of Matter Paragraph in the Auditor's Report

6~~7~~. When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:

(a) ~~i~~Include it immediately after the opinion paragraph in the auditor's report;

(b) ~~and~~ ~~u~~Use the heading "Emphasis of Matter;~~.~~"

(c) Include in the ~~The Emphasis of Matter~~ paragraph ~~shall~~ a clear~~ly~~ ~~highlight~~ reference to the matter being emphasized and ~~indicate~~ to where relevant disclosures that fully describe the matter can be found in the financial statements; and~~.~~

(d) ~~The Emphasis of Matter paragraph shall also i~~Indicate that the auditor's opinion is not modified in respect of the matter emphasized. (Ref: Para. A3-A5)

### Other Matter(s) in the Auditor's Report

7~~8~~. ~~Where standards, laws or generally accepted practice in a jurisdiction require or permit the auditor to elaborate on matters that provide further explanation of the auditor's responsibilities in the audit of the financial statements or of the auditor's report thereon, [proposed] ISA 700 (Redrafted), "The Independent Auditor's Report on General Purpose Financial Statements," requires the auditor to address such matters in a separate Other Matter(s) paragraph following the auditor's opinion.~~ *[See IAASB comment #21; text moved to para A6]* If ~~, in other circumstances,~~ the auditor considers it necessary to communicate matter~~(s)~~ other than those that are presented and disclosed in the financial statements ~~and this is not prohibited by law or regulation~~, *[See IAASB comments #21-25]* the auditor shall ~~also~~ use an Other Matter(s) paragraph for such matters with the subheading "Other Matter(s)," placed after the auditor's opinion and any Emphasis of Matter Paragraph. (Ref: Para. A6-A8~~7~~)

### Communication with Those Charged with Governance

8~~9~~. When the auditor expects to include an Emphasis of Matter or an Other Matter(s) paragraph in the auditor's report, the auditor shall communicate with those charged with governance regarding this expectation, and the proposed wording of this paragraph. (Ref: Para. A9~~8~~)

* * *

## Application and Other Explanatory Material

**Nature of an Emphasis of Matter Paragraph** (Ref: Para. 3~~2~~)

A1. The auditor may determine it is appropriate to emphasize in the auditor's report a matter presented and disclosed in the financial statements when, in the auditor's judgment, the matter is of such importance that it is fundamental to the users' understanding of the financial statements, provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements. For example:

- If the auditor has determined that the applicable financial reporting framework is unacceptable, ~~In accordance with~~ [p~~P~~roposed] ISA 210 (Redrafted), "Agreeing the Terms of Audit Engagements," permits the auditor to accept the engagement on condition that management agrees that the auditor will ~~in circumstances the auditor has determined to be otherwise unacceptable, it would be appropriate for the auditor to~~ include an Emphasis of Matter paragraph in the auditor's report to draw~~ing~~ users' attention to the additional disclosures management will present ~~included~~ in the financial statements regarding the matter ~~by management~~ to avoid misleading the users. *[See IAASB comment #26]*
- Where it is necessary for the auditor to issue a new auditor's report on amended financial statements as a result of the auditor becoming aware of a fact that existed at the date of the auditor's report that, if known at that date, would have caused the financial statements to be amended or the auditor to modify the auditor's opinion, [p~~P~~roposed] ISA 560 (Redrafted), "Subsequent Events," requires the auditor to include an Emphasis of Matter paragraph in ~~a~~the new auditor's report ~~on financial statements that are amended to highlight the reason~~ referring to a note to the financial statements that more extensively discusses the reason for the amendment of the previously issued financial statements and to the earlier report issued by the auditor.
- [Proposed] ISA 570 (Redrafted), "Going Concern," requires the auditor to include an Emphasis of Matter paragraph in the auditor's report on financial statements to highlight the existence of a material uncertainty regarding an entity's ability to continue as a going concern. The Emphasis of Matter paragraph draws attention to the disclosure in the financial statements that discusses the going concern uncertainty.

A2. Examples of other circumstances where the auditor may determine that an Emphasis of Matter paragraph is appropriate include:

- An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.
- Application of a new accounting standard (for example, a new International Financial Reporting Standard) that has a pervasive effect on the financial statements in advance of its effective date (i.e., where early application is permitted).

- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

**Form and Placement of an Emphasis of Matter Paragraph in the Auditor's Report** (Ref: Para. ~~6~~7)

A3. To include more information in an ~~Making disclosures in the~~ Emphasis of Matter paragraph ~~beyond those included~~ than is presented and disclosed in the financial statements may imply that the matter has not been appropriately disclosed or that there is a disagreement with management. Accordingly, such ~~disclosures~~ a paragraph refers only to ~~those included~~ disclosures presented in the financial statements.

A4. The inclusion of an Emphasis of Matter paragraph in the auditor's report does not affect the auditor's opinion. An emphasis of matter is not a substitute for either:

~~(~~(a) ~~t~~The auditor expressing a qualified opinion or an adverse opinion, or disclaiming an opinion, when required by the circumstances of a specific audit engagement (see [proposed] ISA 705 (Revised and Redrafted), "Modifications to the Opinion in the Independent Auditor's Report");~~,~~ or

(b) ~~d~~Disclosures in the financial statements that the applicable financial reporting framework requires management to make.

A5. The example report in the Appendix provides an illustration of an Emphasis of Matter paragraph in an auditor's report that contains a qualified opinion.

**Other Matter(s) in the Auditor's Report** (Ref: Para. ~~7~~8)

A6. When law, regulation or generally accepted practice in a jurisdiction require or permit the auditor to elaborate on matters that provide further explanation of the auditor's responsibilities in the audit of the financial statements or of the auditor's report thereon, [proposed] ISA 700 (Redrafted), "The Independent Auditor's Report on General Purpose Financial Statements," requires the auditor to address such matters in one or more Other Matter(s) paragraphs under one or more descriptive headings that follow the opinion paragraph. *[See IAASB comment #21 – text moved from para 8]*

A7~~6~~. ~~Examples of o~~Other matters to which the auditor may wish to refer in an Other Matter(s) paragraph but which ~~that~~ are not required to be recognized or disclosed in the financial statements by the applicable financial reporting framework include, for example, the following:

(a) ~~Avoidance of auditor association with~~ Information in a document containing audited financial statements that is materially inconsistent with those ~~information in a document containing audited~~ financial statements (see [proposed] ISA 720 (Redrafted), "The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements").

(b) ~~Circumstances where the incoming auditor is permitted to refer to the~~ A predecessor auditor's report on the corresponding figures in the incoming auditor's report for the current period where the incoming auditor is permitted to make such a reference (see [proposed] ISA 710 (Redrafted), "Comparatives").

(c) In rare circumstances, other matters that the auditor considers necessary to communicate to the user, for example, where the auditor judges it necessary to explain why the auditor is unable to resign from the engagement even though the possible effect of an inability to obtain sufficient appropriate audit evidence due to a scope limitation imposed by management is pervasive.

A8~~7~~. An Other Matter(s) paragraph does not deal with circumstances where the auditor has additional reporting responsibilities that are supplementary to the auditor's responsibility to express an opinion on the financial statements, or where the auditor has been asked to perform and report on additional specified procedures, or to express an opinion on specific matters (see ~~paragraphs [29 and A24-A26] of~~ "Other Reporting Responsibilities" section in [proposed] ISA 700 (Redrafted)).

**Communication with Those Charged with Governance** (Ref. Para. 9~~8~~)

A9~~8~~. Such communication enables those charged with governance to be made aware of the nature of any specific matters that the auditor intends to highlight in the auditor's report, and provides them with an opportunity to obtain further clarification from the auditor where necessary. Where the inclusion of an Other Matter(s) paragraph on a particular matter in the auditor's report recurs on each successive engagement, the auditor may determine that it is unnecessary to repeat the communication on each engagement.

# Appendix

## Example of an Auditor's Report that Includes an Emphasis of Matter Paragraph

*Auditor's report with a modified opinion due to materially misstated financial statements arising from a ~~disagreement with management~~ departure from the applicable financial reporting framework [See IAASB comment # 7]; the report also contains an Emphasis of Matter paragraph referring to a major uncertainty related to a pending exceptional litigation matter.*

INDEPENDENT AUDITOR'S REPORT

*[Appropriate Addressee]*

**Report on the Financial Statements**[2]

We have audited the accompanying financial statements of ABC Company, which comprise the balance sheet as at December 31, 20X6, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

*Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and the fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

*Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial

[2] The subheading "Report on the Financial Statements" is unnecessary in circumstances when the second subheading "Report on Other Legal and Regulatory Requirements" is not applicable.

statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.[3] An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence that we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

*Basis for Qualified Opinion*

The company's short-term marketable securities are carried in the balance sheet at xxx. ~~We do not agree with management regarding the amounts at which these marketable securities are stated.~~ Management has not marked these~~m~~ securities *[See IAASB comment # 7]* to market but has instead stated them at cost, which constitutes a departure from International Financial Reporting Standards. The company's records indicate that had management marked the marketable securities to market, the company would have recognized an unrealized loss of xxx in the income statement for the year. The carrying amount of the securities in the balance sheet would have been reduced by the same amount at December 31, 20X6, and income tax, net income and shareholders' equity would have been reduced by xxx, xxx and xxx, respectively.

*Qualified Opinion*

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of *(or "present fairly, in all material respects,")* the financial position of ABC Company as ~~of~~ at December 31, 20X6, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

*Emphasis of Matter*

We draw attention to Note X to the financial statements, which describes the major uncertainty[4] related to the outcome of the lawsuit filed against the company by XYZ Company. Our opinion is not qualified in respect of this matter.

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[3] In circumstances when the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances."

[4] In highlighting the uncertainty, the auditor uses the same terminology that is used in the note to the financial statements.

**Report on Other Legal and Regulatory Requirements (see "Other Reporting Responsibilities" section in [proposed] ISA 700 (Redrafted), paragraphs 29 and [A24-A26])**

[*Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Auditor's signature*]

[*Date of the auditor's report*]

[*Auditor's address*]

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