

Auditor Reporting—Issues and Task Force Proposals**I. Key Messages from Roundtables and Other Outreach Activities**

1. A number of outreach activities are planned before the September 2012 IAASB meeting, feedback from which will form the basis for a presentation by the TF Chair to introduce the topic of auditor reporting at the meeting.
 - European Commission – Meeting July 30 with Cameron Smith (Legal Affairs) and August 23 with Nathalie Berger (new Head of Audit Unit)
 - Company Reporting and Auditing Group (CRAG) – Meeting August 22
 - North American Roundtable – September 10
 - European Roundtable – September 14
 - Corporate Reporting Users Forum (CRUF), Council for Institutional Investors (CII), Global Auditor Investor Dialogue (GAID) (TBD)

Roundtables

2. As of August 24, 2012, invitations have been sent to over 100 potential participants for the New York roundtable – there are 57 confirmed attendees. Many Consultative Advisory Group (CAG) representatives are expected to either participate in or observe the event, with 15 CAG members already confirmed. Invitations have been sent to 80 potential participants for Brussels – there are 36 confirmed attendees. The October 8 roundtable in Kuala Lumpur is being co-hosted by the Malaysian Institute of Certified Public Accountants (MICPA), the Malaysian Institute of Accountants (MIA) and the Institute of Chartered Accountants in Australia (ICAA). Save the Dates and invitations have been sent out to 80 potential participants, with 34 confirmed attendees with an anticipated total of 40–50 participants.
3. Details of the two roundtables that will occur in advance of the September 2012 IAASB meeting, including the program, panelists and confirmed participants, will be made available on the IAASB's website at www.iaasb.org/auditor-reporting when finalized.

II. Scoping for Standard-Setting Proposals

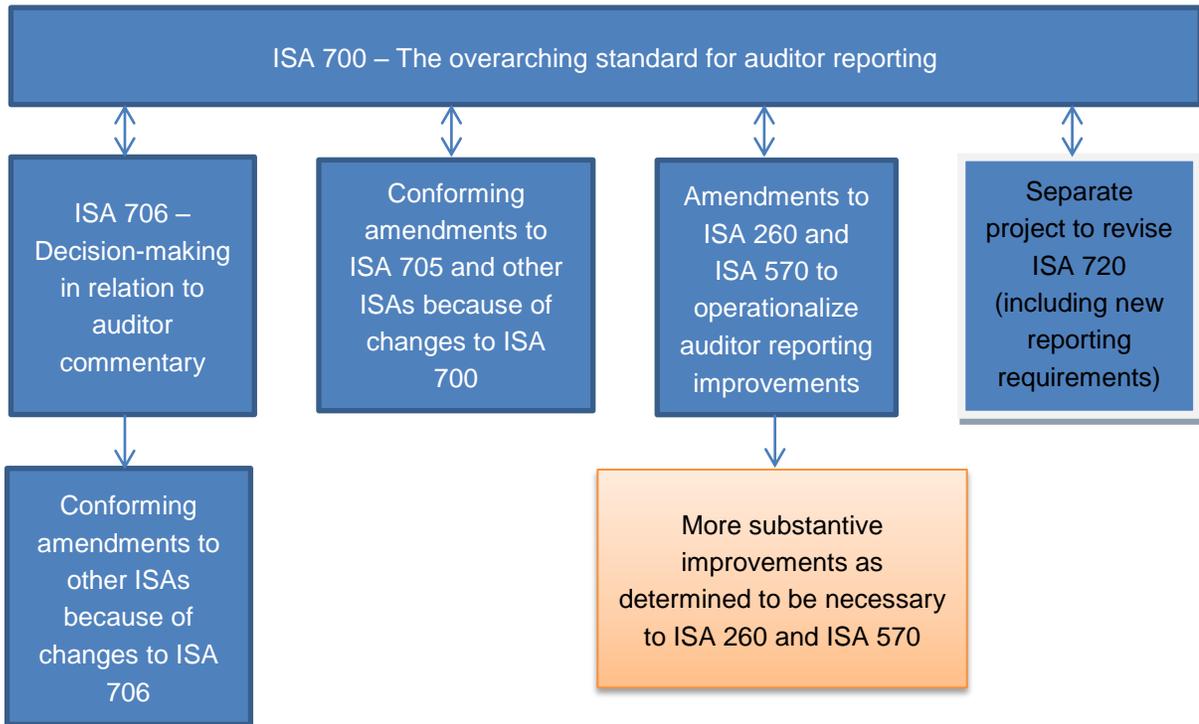
4. In order to advance standard-setting proposals, it will be essential for the IAASB to determine the preferred approach to standard-setting, in particular as it relates to the need to revise ISA 700¹ and other ISAs. While the comment period for the June 2012 Invitation to Comment (ITC) does not close until October 8, 2012, the TF is of the view that it is necessary to take advantage of the opportunity to discuss key issues with the IAASB at its September 2012 meeting in order to advance to a June 2013 Exposure Draft (ED). The discussion in this paper is therefore based on the indicative direction outlined in the ITC. However, it will be important not to prejudge responses to the ITC.

¹ ISA 700, *Forming an Opinion and Reporting on Financial Statements*

5. The following sections outline the three main issues that will be addressed with the IAASB at its September 2012 meeting, in advance of detailed drafting of revised ISAs commencing:
- The placement of new requirements arising from the IAASB’s suggested improvements to auditor reporting;
 - The scope of revisions to ISA 260 and ISA 570 (see **Agenda Item 9-C**); and
 - The treatment of the “minimum elements” of ISA 700 when law or regulation prescribe the form and content of the auditor’s report.

As the revision of ISA 720² is a separate ongoing project, it is envisaged that coordination between that project and the auditor reporting project will be necessary to ensure that the suggested improvements to auditor reporting related to other information are addressed in the appropriate ISAs (see paragraph 9).

6. The graphic below is intended to illustrate how the revisions of the ISAs could be considered.



² Proposed ISA 720 (Revised), *The Auditor’s Responsibilities Relating to Other Information in Documents Containing or Accompanying Audited Financial Statements and the Auditor’s Report Thereon*

7. Based on the suggested improvements outlined in the ITC, the IAASB will need to agree a number of new requirements and develop additional application material to operationalize these suggested improvements. A fundamental question is where such new requirements should reside. The TF believes there is merit in further enhancing the current structure of ISA 700 as the overarching standard (i.e., that which provides the baseline reporting requirements) for auditor reporting, which would focus primarily on the form of the auditor's report (for example, the use of headings and subheadings, ordering, and implications of law or regulation).³ The objective would be to help ensure that auditors would look to a revised ISA 700 as the primary resource in preparing their auditors' reports in accordance with ISAs, with appropriate direction as to where more specific requirements are included in other ISAs (e.g. ISA 260,⁴ ISA 570,⁵ ISA 705,⁶ ISA 706⁷ and ISA 720) that are intended to complement the overarching requirements in a revised ISA 700. This is consistent with the approach taken by the IAASB in developing, for example, ISA 230⁸ and ISA 706.
8. The TF believes the benefit of continuing with this approach is to ensure that the reporting implications are considered concurrently with the audit work performed by including specific requirements in standards other than ISA 700. A revised ISA 700 would compile requirements to include all of the elements of the auditor's report applicable for the particular engagement, address the concept of minimum elements (see paragraph 27) and provide one or more illustrative reports, as well as address requirements for the auditor to form an opinion on the financial statements and other requirements and guidance as necessary in light of the suggested improvements in the ITC.⁹ In addition, this option is in line with the "building blocks" approach, as it introduces a level of modularity that will be useful, in particular if auditor commentary is to be required only for public interest entities (PIEs), by not automatically scoping in entities if such reporting does not apply.
9. The current draft of ISA 720 (Revised), which is up for approval at the September 2012 IAASB meeting, illustrates this approach. Paragraph 16 of **Agenda Item 2-C** includes a proposed requirement relating to the auditor's statement in the auditor's report about other information. This requirement was developed based on the suggested improvements on the auditor's report included in the ITC. The ISA 720 TF has also developed application guidance to support this requirement to align with the suggested wording in the illustrative auditor's report (see paragraphs A52–A53 of **Agenda Item 2-C**). A similar approach could be taken in ISA 570 to incorporate auditor reporting on going concern. If such an approach is supported by the TF, ISA 700 could then contain high-

³ The TF and IAASB will be asked to consider whether any revisions are needed to the material on forming an opinion and the form of the auditor's opinion in ISA 700 (paragraphs 10–19) at a later date.

⁴ ISA 260, *Communication with Those Charged with Governance*

⁵ ISA 570, *Going Concern*

⁶ ISA 705, *Modifications to the Opinion in the Independent Auditor's Report*

⁷ ISA 706, *Emphasis of Matter and Other Matter Paragraphs in the Auditor's Report*

⁸ ISA 230, *Audit Documentation*

⁹ For example, in relation to going concern, a revised ISA 700 could also include a requirement to explain management's responsibilities for going concern in accordance with the applicable financial reporting framework. Guidance specific to smaller entities could be included in ISA 700 to explain when reporting on other information would not apply (i.e., when no other information is included in documents containing or accompanying the financial statements.)

level requirements to direct auditors' attention to the topic-specific standards, for example as follows:

- The auditor shall report on other information in accordance with proposed ISA 720 (Revised).
 - The auditor shall report on going concern in accordance with proposed ISA 570 (Revised).
10. The alternative would be to evolve from the current structure of ISA 700 and develop a more comprehensive, all-inclusive reporting standard. For example, a revised ISA 700 could contain all detailed reporting requirements and application material relating to auditor commentary, going concern, and other information, in addition to the baseline requirements regarding the form of the auditor's reports and other suggested improvements to increase transparency about the audit. While there may be benefits to having a single resource on auditor reporting (e.g., mainly to ensure the auditor takes all relevant matters into consideration when developing the auditor's report), the TF is of the view that any benefits would be outweighed by the fact that this would likely result in a revised ISA 700 being rather lengthy with duplication of relevant guidance within the topic-specific standards (e.g., see the discussion in paragraph 18 in relation to ISA 260). The TF believes this would be cumbersome and would detract from what the IAASB is trying to achieve by using a building blocks approach to standard setting.

Matter for IAASB Discussion

1. Does the IAASB support the TF's proposal to continue to use a revised ISA 700 as the overarching/baseline standard for auditor reporting?

Auditor Commentary

11. The ITC highlighted the IAASB's view that the new concept of auditor commentary (AC) is consistent with, and builds upon, the existing concepts of Emphasis of Matter (EOM) and Other Matter (OM) paragraphs. As a result, the TF believes new requirements relating to AC belong in a revised ISA 706. The ITC suggested AC should be required for auditors of PIEs, although further information from responses is likely to inform the IAASB's final decision in this regard. The ITC also notes that auditors who are not required to provide AC but who judge it appropriate to do so would include AC in the same manner as auditors of PIEs.
12. Based on the views expressed in the ITC, the simplest way therefore to address AC in the ISAs is to develop requirements for a revised ISA 700 that appropriately scope auditors into ISA 706 (i.e., whether required to include for PIEs or at the auditor's discretion for non-PIEs). A revised ISA 700 could also establish requirements and provide guidance on headings and subheadings, introductory language to AC, and ordering of matters within AC. Revised ISA 706 would then include requirements to guide auditors' decision-making in determining what should be addressed in AC, including the consideration of matters that are likely to be included when such circumstances exist (or more detailed criteria, should this be appropriate in light of responses to the ITC) and at what level of detail, along with considerations for small- and medium-sized entities (SMEs) and public sector audits. A revised ISA 706 could also include documentation requirements, as well as a required statement of "nothing to report", should the TF's consideration of ITC responses result in a conclusion that this is necessary.

13. The ITC also highlighted the view that requirements or guidance for auditors to include EOM and OM paragraphs in the auditor's report would likely be subsumed into AC, subject to responses to the ITC. The TF will need to conduct a detailed review to determine the nature and extent of conforming amendments necessary for the following ISAs:

- ISA 210¹⁰
- ISA 560¹¹
- ISA 710¹²
- ISA 800¹³

In proposing these amendments, the TF will need to determine whether the information in the auditor's report relating to these matters should be considered AC or whether it warrants separate reporting, depending on the nature of the matter.

Matters for IAASB Discussion

2. Does the IAASB support the TF's proposal to develop requirements and guidance for AC in a revised ISA 706? If not, what alternative(s) might be appropriate?
3. Does the IAASB agree with the TF's proposal regarding the need to evaluate those ISAs that contain requirements and guidance relating to EOM and OM paragraphs in light of the IAASB's preliminary view that these concepts should be replaced by the more holistic concept of AC?

Conforming Amendments to ISA 705 and Other ISAs

14. A fundamental revision of ISA 705 or reconsideration of the principles that lead to the auditor expressing a modified opinion is not anticipated. However, as a result of the suggested improvements to auditor reporting, the TF believes that some conforming amendments to ISA 705 will be necessary to operationalize these improvements. The TF is of the view that the IAASB will need to consider how the building blocks approach and preferred format of the auditor's report would be affected when the auditor expresses a modified opinion (e.g., a qualified opinion, adverse opinion, or disclaimer of opinion). Accordingly, there will likely be changes necessary to the requirements governing the form and structure of modified reports, for example, in relation to the need for auditor commentary in certain circumstances,¹⁴ the information to be included in the Basis for Opinion paragraph, further implications of reporting on going concern and other information, and

¹⁰ ISA 210, *Agreeing the Terms of Audit Engagements*

¹¹ ISA 560, *Subsequent Events*

¹² ISA 710, *Comparative Information—Corresponding Figures and Comparative Financial Statements*

¹³ ISA 800, *Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*

¹⁴ Paragraph A20 of ISA 705 notes that an adverse opinion or a disclaimer of opinion relating to a specific matter described in the Basis for Modification paragraph does not justify the omission of a description of other identified matters that would have otherwise required a modification of the auditor's opinion. In such cases, the disclosure of such other matters of which the auditor is aware may be relevant to users of the financial statements. Drawing from this, the TF will consider whether auditor commentary would still be required, in particular when an adverse opinion or a disclaimer of opinion is expressed.

the nature and extent of information required in the report when a disclaimer of opinion is expressed.

15. The TF will also consider whether conforming amendments will be necessary to other ISAs beyond those already mentioned in this paper, in light of any reporting requirements contained therein.

Scope of Revisions to ISA 260 and ISA 570

16. Limited amendments to both ISA 570 and ISA 260 will be necessary, at a minimum, to operationalize the suggested improvements to auditor reporting described in the ITC. However, the time that likely would be needed to appropriately consider any additional amendments to these two ISAs may affect the IAASB's ability to finalize an ED by June 2013.
17. The key question is whether, and to what extent, further revisions to ISA 260 and, in particular, ISA 570 may need to be commenced now (See **Agenda Item 9-C** for a discussion relating to going concern). Paragraphs 8 and 9 of the project proposal in relation to ISAs beyond ISA 700 anticipated the following:

The underlying premise of the project would be to maintain the current scope of the audit. The project does not anticipate changing the fundamental role of the auditor in performing an audit of financial statements in accordance with the ISAs, but rather how the auditor reports on the audit, either in the auditor's report or through other communications. If, during the course of the project, the project TF identifies a need to do so, it will make clear any recommendations as appropriate for consideration by the IAASB. For example, while it is currently contemplated that the project TF will explore how the auditor's report could describe the auditor's responsibilities in relation to going concern, substantive revisions to the requirements and guidance in ISA 570 are not contemplated by this project.

In light of the strong support among respondents for exploring an enhanced corporate governance reporting model, ISA 260 will be considered in the context of exploring enhanced auditor communications to [those charged with governance] TCWG as a step towards an enhanced corporate governance reporting model.

Potential Revisions to ISA 260

18. The primary nature of revisions to ISA 260 would be focused on how the ISA interacts with proposed requirements to provide AC in the auditor's report. The ITC explains that matters to be included in AC are likely those about which the auditor and TCWG had the most robust dialogue as part of the two-way communication required by ISA 260. New requirements in ISA 706 relating to the factors the auditor considers in determining whether to include AC should therefore be in line with matters expected to be communicated to TCWG in a revised ISA 260.¹⁵ This may result in the

¹⁵ Paragraph 45 of the ITC notes the IAASB's view that auditors should consider, at a minimum, the following, in determining whether to include AC:

- Areas of significant management judgment (e.g., in relation to the entity's accounting practices, including accounting policies, accounting estimates, and financial statement disclosures).
- Significant or unusual transactions (e.g., significant related party transactions, or restatements).
- Matters of audit significance, including areas of significant auditor judgment in conducting the audit, for example:
 - Difficult or contentious matters noted during the audit, or other audit matters that would typically be discussed with an engagement quality control reviewer or TCWG; and

TF determining the need to strengthen some of the principles-based requirements in ISA 260 to ensure that matters likely to be included in AC are communicated with TCWG in all cases. Given the other suggested improvements to auditor reporting, there may also be a need for strengthened requirements to discuss other areas with TCWG (for example, going concern, other information, and the involvement of other auditors), and a requirement for the auditor to discuss the form and content of the entire auditor's report may be necessary.¹⁶ The focus of these planned revisions will be on aligning the concepts in ISA 700, ISA 706 and ISA 260, to ensure that ISA 260 is "fit for purpose" in light of the responses to the ITC on AC and the direction the IAASB ultimately agrees in relation to reporting AC.

19. ISA 260 was substantively revised as part of the Clarity project. At the time the IAASB approved the project proposal on auditor reporting, some concern was expressed that a more substantive revision of ISA 260 should not be contemplated until findings from the ISA Implementation Monitoring project were available and the response to those findings was agreed by the IAASB. As part of that process, input is being sought from audit committees, auditors, regulators and others as to whether the revisions to ISA 260 have achieved two goals: promoting effective two-way communications, and a constructive working relationship, between the auditor and TCWG; and recognizing that relevant and timely auditor communications are important in assisting TCWG in fulfilling their oversight responsibility for the entity's financial reporting process, and therefore mandating certain matters to be communicated to TCWG. The ISA Implementation Monitoring project may also identify further matters for consideration in relation to the reporting standards, as well as ISA 570. The formal report of findings from the ISA Implementation Monitoring project is expected to be publicly released in June 2013, though the IAASB is scheduled to discuss the findings earlier in 2013. It will therefore be important for the Auditor Reporting TF to consider the implications of these findings to determine if any matters noted, in particular those relating to auditor reporting, should be addressed in the ED planned for June 2013.
20. There are also a number of relevant developments in relation to ISA 260 that may affect the IAASB's determination of the need for, as well as the nature and extent of, any other revisions to ISA 260. For example:
 - On August 15, 2012, the PCAOB finalized Auditing Standard No. 16, *Communications with Audit Committees* – A PCAOB-prepared analysis issued with the final standard¹⁷ notes that

-
- Other issues of significance related to the audit scope or strategy.

¹⁶ At present, there is no requirement for the auditor to discuss the form and content of the entire auditor's report with TCWG prior to its issuance, although communication is required when the auditor's report is expected to be tailored (vs. standardized language). ISA 210 requires the auditor to agree the engagement letter with management or TCWG and anticipates the engagement letter will include "reference to the expected form and content of any reports to be issued by the auditor." When the auditor expects to modify the opinion in the auditor's report, ISA 705 requires the auditor to communicate with TCWG the circumstances that led to the expected modification and the proposed wording of the modification. If the auditor expects to include an EOM or an OM paragraph in the auditor's report, ISA 706 requires the auditor to communicate with TCWG regarding this expectation and the proposed wording of this paragraph. Because a number of the IAASB's suggested improvements to auditor reporting will result in a more tailored and descriptive auditor's report, it is likely the TF and IAASB will need to consider whether additional communication requirements about its proposed wording would be appropriate.

¹⁷ The final rule, subject to U.S. Securities and Exchange Commission approval, is available at http://pcaobus.org/Rules/Rulemaking/Docket030/Release_2012-004.pdf. Appendix 5 of this document, included on pages 103–121, contains the comparison between AS 16 and ISA 260.

- the PCAOB standard addresses certain areas for which no corresponding requirements exist in ISA 260, namely, significant issues discussed with management in connection with the auditor's appointment or retention; providing the engagement letter to the audit committee; inquiry about whether the audit committee is aware of matters that might be relevant to the audit including, but not limited to, knowledge of violations or possible violations of laws or regulations and complaints or concerns raised regarding financial reporting matters; greater specificity relating to the use of other accounting firms or persons performing audit procedures in the audit; communication about all critical accounting policies and practices, and critical accounting estimates (or alternatively, affirmative confirmation to the audit committee if management has communicated to the audit committee about these matters and the auditor was involved in that discussion); the auditor's evaluation of the quality of the company's financial reporting; and expanded discussions regarding significant and unusual transactions, the auditor's work with respect to going concern, and uncorrected and corrected misstatements.
- Article 23 of the proposed European Commission (EC) regulation for PIEs envisions a "long-form" report from auditors to the audit committee (e.g., TCWG) – Paragraph A10 of ISA 260 explains that law or regulation, among other things, may provide for broader communication with TCWG and paragraph 3 of ISA 260 notes that nothing in ISA 260 precludes the auditor from communicating any other matters (beyond those required by ISA 260) to TCWG. Accordingly, the additional communications that may be required for statutory audits in the EC can be seen as supplementary to the matters required to be communicated by the principles-based ISA 260. However, there may be merit in revisiting ISA 260 to ensure that it is clear how it is envisaged to be applied for PIEs and to promote consistency in practice in light of the proposed regulation.
 - The Audit and Assurance team of the Audit and Assurance Council of the UK Financial Reporting Council (formerly the Auditing Practices Board) is currently analyzing responses to its proposed changes to ISA 260 (UK and Ireland) to implement the proposals on effective company stewardship, including reporting under the UK Corporate Governance Code.¹⁸ – The proposed changes enhance auditor communications by requiring the auditor to communicate to the audit committee:
 - Information that the auditor becomes aware of in the course of the audit and that the auditor believes the audit committee will need in order to understand the rationale and the evidence relied upon when making significant professional judgments in the course of the audit and reaching an opinion on the financial statements. This will include the auditor's judgments made in planning the audit and the auditor's views about the key judgments made by management in preparing the financial statements; and
 - The auditor's insights about the entity's internal control system based on their audit work.

¹⁸ Other jurisdictions already require, or are exploring, "long form reporting". Such jurisdictions may be of the view that the standards governing communications between auditors and TCWG should be more specific to ensure that TCWG are able to meet their oversight and reporting responsibilities.

They also extend auditor reporting by requiring the auditor to report by exception if:

- The board's statement in the annual report setting out the basis on which the board considers that the annual report is fair, balanced and understandable and provides the information necessary for users to assess the entity's performance, business model and strategy, is inconsistent with the knowledge acquired by the auditor in the course of performing the audit; and/or
 - The matters disclosed in the section of the annual report describing the work of the audit committee do not appropriately address matters communicated by the auditor to the audit committee.
21. While the areas highlighted in paragraph 20 should be monitored by Staff and the TF in connection with the IAASB's consideration of the need for future revision to ISA 260, some represent emerging developments whose outcome may not be known in the near term. Further, incorporating these changes into a revised ISA 260 would likely require the IAASB to determine whether to develop new requirements, elevate existing application material to requirements, or develop new application material to acknowledge the need for flexibility in discussions with TCWG due to national law or regulation.
22. The ITC anticipated an ED of revised standards incorporating improvements to auditor reporting by June 2013, with final standards in 2014. To meet this timeline, the TF is of the view that it will be necessary to initially have a relatively narrow focus on revising ISA 260 to operationalize it in relation to the suggested improvements to auditor reporting, rather than change the fundamental scope of ISA 260.
23. However, the TF recognizes that it is difficult to conclude on the scope of revisions to ISA 260 until the direction of AC is known, and the TF has the opportunity to consider the impact of changes to ISA 706 dealing with required considerations for auditor commentary. It therefore anticipates the need to report back to the IAASB on its views regarding the nature and extent of changes to ISA 260 at the December 2012 IAASB meeting, at which time a detailed discussion of the way forward for AC is planned. It is important to note that, if there is seen to be a need for more substantive revisions to ISA 260, it would be very difficult for an ED to be produced by mid-2013, even if other projects on the IAASB's agenda were postponed, and the IAASB will need to determine the implications to the planned timetable for its revisions to the auditor reporting standards.

Matter for IAASB Discussion

4. Does the IAASB support the TF's proposal to focus initially on amendments to ISA 260 necessary to operationalize the suggested improvements to auditor reporting and consider more substantive revisions at a later date based on the results of the ISA Implementation Monitoring project and other relevant emerging developments?

Potential Revisions to ISA 570

24. See **Agenda Item 9-C** for discussion of potential revisions to ISA 570.

Treatment of the “Minimum Elements” of ISA 700 when Law or Regulation Prescribe the Form and Content of the Auditor’s Report

25. Paragraphs 20–42 of ISA 700 establish detailed requirements and provide guidance relating to the form of the auditor’s report, and ISA 700 contains illustrative auditors’ reports resulting from the application of these requirements. The level of prescription within these requirements varies. For example:
- The construct “shall state” is used for certain requirements, which is interpreted to mean that the exact wording must be used in order to comply with ISA 700 (e.g., in relation to the fact that the financial statements have been audited, that the audit was conducted in accordance with ISAs, as well as the responsibility of the auditor to express an opinion on the financial statements based on the audit and the description of the audit).
 - The constructs “shall refer” and “shall use” are intended to ensure the words “the preparation and fair presentation of these financial statements” or “the preparation of financial statements that give a true and fair view” always appear in the auditor’s opinion when the auditor is expressing an unmodified opinion on financial statements prepared in accordance with a fair presentation framework and in the description of management’s and the auditor’s responsibilities.
 - Certain sections with specific headings are prescribed (e.g., the Opinion, “Management’s [or other appropriate term] Responsibility for the Financial Statements, “Auditor’s Responsibilities, and in certain cases “Report on the Financial Statements.”
26. In some cases, a level of flexibility has been introduced, for example:
- The auditor is required to “identify” the title of each statement comprising the financial statements, to allow for necessary differences in financial reporting frameworks;
 - The auditor’s report shall be addressed “as required by the circumstances of the engagement”; and
 - The auditor’s report need not refer specifically to “management” but shall use the term that is appropriate in the context of the legal framework in the particular jurisdiction.
27. ISA 700 then provides further flexibility by allowing for a departure (i.e., an exemption) from these detailed requirements in certain circumstances when law or regulation prescribe the form and content of the auditor’s report. Paragraph 43 of ISA 700 notes that, if the auditor is required by law or regulation of a specific jurisdiction to use a specific layout or wording of the auditor’s report, the auditor’s report shall refer to ISAs only if the auditor’s report includes, at a minimum, each of the following elements:
- A title;
 - An addressee, as required by the circumstances of the engagement;
 - An introductory paragraph that identifies the financial statements audited;
 - A description of the responsibility of management for the preparation of the financial statements;
 - A description of the auditor’s responsibility to express an opinion on the financial statements and the scope of the audit, that includes:

- A reference to International Standards on Auditing and the law or regulation; and
 - A description of an audit in accordance with those standards;
 - An opinion paragraph containing an expression of opinion on the financial statements and a reference to the applicable financial reporting framework used to prepare the financial statements (including identifying the jurisdiction of origin of the financial reporting framework that is not International Financial Reporting Standards or International Public Sector Accounting Standards);
 - The auditor’s signature;
 - The date of the auditor’s report; and
 - The auditor’s address.
28. The ITC highlights the IAASB’s desire to balance the need for consistency in auditor reporting (i.e., that a report issued for an ISA audit can be easily recognized by investors and more readily compared to reports of other ISA audits) with the need for auditors’ reports that are relevant in the context of additional law or regulation in the particular jurisdiction. Preliminary discussions of the TF have indicated that there is likely a need for greater specificity within ISA 700 to ensure that auditors’ reports that refer to ISAs indeed contain what the IAASB believes are the core elements of auditor reporting – and that the “exemption” of certain requirements in ISA 700 because of law or regulation may need to be reconsidered. Responses to the May 2011 consultation on auditor reporting also indicated a strong preference for consistency in auditors’ reports for audits conducted in accordance with ISAs (i.e., the “ISA brand”) and the results of the pilot testing in the April 2012 national standard setters (NSS) meeting indicated that such consistency might be endangered if too much flexibility is provided.
29. Bearing these views in mind, a key question for the IAASB is the extent to which it believes the ISAs should mandate the form and content of the auditor’s report, or said differently, the extent to which flexibility should be provided to NSS. The principal objective in revising ISA 700 will be to strike an appropriate balance such that the level of prescription in the standards neither gets in the way of NSS adopting the ISAs nor makes it too difficult for them to integrate national law and regulation reporting requirements in a way that is meaningful and understandable for users in their respective jurisdictions.
30. The responses to the ITC will inform the IAASB’s decision as to the preferred way forward. However, the preliminary views of the IAASB will be helpful at this stage to give the TF a sense of direction as it begins its deliberations about the detailed requirements of a revised ISA 700. It is anticipated that the TF will report back to the IAASB at its December 2012, following the analysis of responses to the ITC in regard to the balance of consistency versus relevance. Further discussion with NSS likely will be needed to further inform the IAASB’s views on this matter as the IAASB progresses with the revisions to ISA 700.
31. The Appendix to this paper provides additional background information for the IAASB regarding the issue of consistency versus flexibility, including a description of three possible options that likely will be relevant for the TF to discuss. In addition, for illustrative purposes, **Agenda Item 9-B**, a Staff-prepared reference document, compares the mandatory elements included in Appendix 4 of the ITC and, where applicable, the related requirements in ISA 700, including those matters addressed

by paragraph 43.¹⁹ **It is not intended that the IAASB will discuss this agenda item in detail during its September 2012 meeting.**

Matters for IAASB Discussion

5. IAASB members are asked for their preliminary views regarding the level of prescription that should be considered in the requirements of a revised ISA 700 to achieve an appropriate balance between consistency and flexibility, and in particular:
- Whether IAASB members have a preference for a particular option described in the Appendix to this paper, or are explicitly not in favor of one or more options.
 - Whether the pros and cons of each option are appropriately described, and whether there are other matters that should be further considered by the TF as it evaluates the responses to the ITC.

¹⁹ **Agenda Item 9-B** also includes an illustration of the issues included in paragraphs 7–10 and 18 of this paper, as well as areas highlighted by previous discussions where greater specificity in a revised ISA 700 may be considered useful.

Appendix

Addressing the Balance between Consistency and Relevance in Revising ISA 700

1. A number of regulators (including regulators who are also standard setters) utilize the exemption in paragraph 43, although some are working to align national requirements more fully with those in paragraphs 20–42 of ISA 700. The requirement in paragraph 43 was limited to law or regulation, rather than law, regulation *or national auditing standards*, so as not to compromise the authority of the ISAs. This was intended to ensure that flexibility in reporting, while necessary, would not be taken to the extent that an auditor's report issued in accordance with national auditing standards based on the ISAs was unrecognizable when compared to a report issued in accordance with ISA 700.
2. Flexibility accorded to NSS is contemplated in ISA 700 (specifically paragraph 44) only to the extent that the auditor's reports refer to compliance with both national auditing standards and ISAs. In such cases, the same minimum elements apply if reference to ISAs is made. When law or regulation does not prescribe the form and content of the auditor's report in their jurisdiction, NSS adopting ISAs have chosen either to adopt ISA 700 (thereby complying with the requirements in paragraphs 20–42), or develop national auditing standards they deem suitable for their jurisdiction, which may diverge from ISA 700, may not contain the minimum elements, and could result in auditor's reports that are not comparable. Discussions with NSS have highlighted NSS hesitation to directly adopt ISA 700 due to matters beyond the specificity of law or regulation directly prescribing the form and content of the auditor's report. This hesitation may relate to preferences in how to deal with other reporting responsibilities, or for particular wording and presentation or investor feedback.
3. The building blocks approach recognizes that there is likely a need for auditors to be able to tailor auditor reporting requirements in the context of national environments; however, the IAASB will want to ensure that its suggested improvements to auditor reporting can be easily recognized. Appendix 4 of the ITC therefore indicated a longer list of **mandatory elements** of an improved auditor's report (compared with paragraph 43 of ISA 700 today) and highlights opportunities for tailoring at the national level.²⁰
4. The ITC posed direct questions about (i) the need for global consistency in auditors' reports when ISAs, or national auditing standards that incorporate or are otherwise based on ISAs, are used, and (ii) whether the IAASB should mandate the ordering of items in the auditors' report in a manner similar to the illustrative report in the ITC unless law or regulation require otherwise. In seeking to balance the principles of consistency and relevance there will be a need to revisit how ISA 700 addresses these "minimum elements," most importantly how the circumstance when the form and content of the auditor's report is prescribed by law or regulation is addressed in a revised ISA 700. Responses to these questions will inform the IAASB's decision as to how a revised ISA 700 should acknowledge law or regulation. However, it would be helpful to obtain a preliminary view from the IAASB at an early stage, based on the positions taken in the ITC, to guide the TF as it evaluates the responses to the ITC and begins drafting the revised standards.

²⁰ Appendix 4 of the ITC also indicated that, unless otherwise required by law or regulation, the ordering of these mandatory elements would follow that included in the illustrative auditor's report.

5. The following three options are likely to be relevant to the IAASB’s determination of a way forward:

- Option 1 – Enhance paragraph 43 of ISA 700 to align, on a one-to-one basis, with the mandatory elements explained in Appendix 4 of the ITC, but keep these elements at a high level as is the case today, and provide application material to explain why the wording in the illustrative auditor’s report in the ITC would be beneficial or preferred.

<i>Pros</i>	<i>Cons</i>
<ul style="list-style-type: none"> • Maintains the status quo / would not result in a significant change in practice • Helps to ensure that all the suggested improvements are captured in principle in all auditors’ report that refer to ISAs • Will allow a degree of national innovation, e.g., in audit committee reporting or in the use of cross references to material held on the internet 	<ul style="list-style-type: none"> • May result in the suggested improvements not being recognized across jurisdictions • Does not promote adoption by those NSS who have not yet adopted ISA 700, as the exemption would not apply to national auditing standards • Drives further inconsistency by permitting or even encouraging national regulators to make innovations that make their audit reports less consistent with ISAs

- Option 2 - Remove the exemption in paragraph 43 and address in an overarching requirement.²¹ Within this option, the IAASB would need to determine the level of prescription necessary in the detailed requirements (see paragraphs 25–26). Flexibility would be increased in this option if the detailed requirements were less prescriptive, i.e., the phrases “shall state” and “shall refer to” were not used in a revised ISA 700. However, this may result in divergence from the illustrative report included in the ITC. Application material could be developed to support this requirement to explain the effects generally of law or regulation prescribing the form and content of the auditor’s report and highlight what may be different in relation to specific elements.²²

<i>Pros</i>	<i>Cons</i>
Note: <i>The degree of pros and cons depends on the level of prescription of the requirements in a revised ISA 700.</i>	
<ul style="list-style-type: none"> • Goes further to achieve consistency in auditor reporting than current ISA 700, but level of consistency could vary depending on the extent of prescription of the requirements 	<ul style="list-style-type: none"> • May reduce flexibility for NSS, if less principles-based than current ISA 700 (i.e., if requirements are phrased as “shall state” etc.) • May result in an approach whereby

²¹ For example, “Unless otherwise required by law or regulation, the auditor’s report shall only refer to ISAs if the auditor’s report includes all of the elements addressed by the requirements in paragraphs [20–42 of ISA 700].

²² For example, application material for auditor commentary could explain how the French “justification of assessments model” or the UK stewardship proposals are intended to achieve the objective of AC and the resulting impact of these national requirements on the form and content of AC in the auditor’s report.

<ul style="list-style-type: none"> • Strongest option for maintaining the “ISA brand” • Helps to ensure that all the suggested improvements are captured in a similar manner in all auditors’ report that refer to ISAs • Encourages regulators to change current national law to be able to integrate ISA requirements and may help discourage national regulators from introducing future changes to national regulatory requirements 	<p>each detailed requirement may have a different level of consistency (i.e., similar to the requirements currently in paragraphs 20–42 of ISA 700)</p> <ul style="list-style-type: none"> • Depending on the national law, it may not be practical to integrate very detailed ISA 700 requirements with current or future national regulatory requirements
--	--

- Option 3 – Draft new requirements in ISA 700 at a higher level than the current ISA 700 requirements so that no exemption for law or regulation would be necessary (i.e., in a manner similar to current paragraph 43 to replace the more detailed requirements that currently exist in paragraphs 20–42). Application material could be developed to be more specific in relation to the application of that requirement, including suggested wording that may be appropriate, in particular if law, regulation or national auditing standards do not otherwise prescribe the form and content of the auditor’s report, as well as highlight some of the circumstances in which auditor reporting may be tailored at the national level.

<i>Pros</i>	<i>Cons</i>
<ul style="list-style-type: none"> • NSS not currently using ISA 700 may be more inclined to adopt a revised ISA 700 in light of this additional flexibility • Helps to ensure that all the suggested improvements are captured in principle in all auditors’ report that refer to ISAs • Will allow a degree of national innovation, e.g., in audit committee reporting or in the use of cross references to material held on the internet. 	<ul style="list-style-type: none"> • May result in the suggested improvements not being recognized across jurisdictions (as jurisdictions where the auditor’s report is not prescribed by law or regulation would have increased flexibility than currently exists) • Drives further inconsistency by permitting or even encouraging national regulators to make innovations that make their audit reports less consistent with ISAs