Auditor Reporting—Clarifications and Transparency

Discussion of Issues and Illustrative Examples

1. The Clarifications and Transparency Subcommittee of the Auditor Reporting Task Force was tasked with developing and recommending options relative to the issues listed below:

- **Clarification of technical language:** Modifications, if any, to the description of auditor responsibilities including the description of reasonable assurance, a risk-based audit, materiality (including consideration of a generic vs. engagement-specific description) and the auditor’s responsibility for fraud and disclosures.

- **Transparency of elements of the audit process:** Engagement partner signature/name of engagement partner, role of affiliated firms, and others, in the audit and disclosure of engagement team members.

I. Summary of Recommendations and Preferred Options

- Clarification of technical terms used in a standard auditor’s report should be considered to describe what is involved in an audit under International Standards on Auditing (ISAs). The specific terms identified for clarification include “reasonable assurance”, “materiality” and the auditor’s responsibility for fraud and disclosures. The Task Force considered a variety of options, and determined that the preferred option was to focus on more fully describing the nature of a risk-based audit, rather than providing elaboration of individual technical terms in a piecemeal fashion.

- The Task Force is also of the view that the standard auditor’s report should also provide greater transparency into the audit process. Namely, in some cases, the engagement partner’s name should be disclosed and the auditor should provide a statement of compliance with ethical requirements, including independence.

II. User Demand / Calls for Change

*Clarifications of Technical Terms*

2. Nearly all respondents\(^1\) to the May 2011 Consultation Paper (CP),\(^2\) including users, auditors, regulators and preparers, suggested that (i) including additional information in auditor’s reports to further describe the auditor’s responsibilities in certain areas and (ii) clarifying technical terms, together with educating users about the nature and purpose of an audit, would contribute positively to narrow the expectations gap and improve auditor reporting. Some of these respondents suggested that such additional information, even though it would be essentially “boilerplate,” would add greater transparency to the audit process, would allow users to obtain more insights into the

---

\(^1\) All respondents except CNRL and ENMAX

\(^2\) *Enhancing the Value of Auditor Reporting: Exploring Options for Change*
qualitative aspects of an audit, and would be beneficial to investors to fully understand the role of the auditor and the extent of the work the auditor is performing during the financial statement audit.  

3. However, a few respondents were skeptical that adding more words to describe the technical terms used in the auditor’s report would be useful. Those respondents cautioned that including further descriptions of terms would lengthen the auditor’s report and could possibly detract from the auditor’s opinion. There were suggestions made for including definitions and further descriptions of those technical terms in a location other than the auditor’s report (such as a glossary or website), the location of which could be referenced in the auditor’s report as is currently done in UK auditors’ reports.

4. More specifically, respondents supported the following in varying degrees:

- Including standard wording in the auditor’s report that highlights the auditor’s responsibility for planning and performing the audit to obtain reasonable assurance that the financial statements, taken as a whole, are free of material misstatement, “whether due to error or fraud.”

- Including a statement in the auditor’s report that clarifies that the auditor’s opinion on the financial statements as a whole encompasses the accompanying disclosures to the financial statements. Those respondents noted that the context in which disclosures have been audited is not always clear to users of financial statements.

- Including in the auditor’s report includes a statement describing directors’ responsibilities.

5. Less than a month after the IAASB issued its CP, in June 2011, the US Public Company Accounting Oversight Board (PCAOB) issued a Concept Release (CR), which included clarification of language in the standard auditor’s report.

Transparency of the Audit Process

6. The Auditor Reporting Task Force also noted calls for change regarding the transparency of the audit process. In particular, the calls were around:

- Engagement partner signature/name of engagement partner; and

- Role of affiliated firms, and others, in the audit.

It is also noted that a related proposal by the European Commission (EC) would require identification of the members of the engagement team.

---

3 Some respondents to the PCAOB CR, e.g. PCAOB Investor Advisory Group (IAG) and the US Center for Audit Quality (CAQ), were also supportive of similar changes to the auditor’s report that further described and clarified the auditor’s responsibility.

4 ASB, BT, HEOS

5 ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing, paragraph 11


7 See paragraph 31.
7. Proposed amendment to the PCAOB’s auditing standards, released in October 2011, would require, among other things, disclosure in audit reports of the name of the engagement partner, and others whose work the auditor is required to supervise, but were not employed by the audit firm (basically, auditors of components).

8. Recent proposals by the EC included in Article 22, paragraph 5, note: “The audit report shall be signed and dated by the statutory auditor(s) or the audit firm(s). Where an audit firm carries out the statutory audit, the audit report shall be signed by at least the statutory auditor(s) carrying out the statutory audit on behalf of the audit firm.”

Engagement Partner Signature/Name of Engagement Partner

9. ISAs require that auditors’ reports be signed and the application material to ISA 700 indicates that this may be in the name of the audit firm, the personal name of the auditor, or both, as appropriate for the particular jurisdiction. Some jurisdictions have required engagement partners to sign in their own names or disclose the name of the engagement partner. Other jurisdictions have maintained that only the name of the firm is required to be disclosed, meaning that audit reports are signed only in the name of the firm.

10. While the views of academic researchers on the topic are mixed, advocates of revealing the name of the engagement partner point to the enhanced sense of personal accountability, and the effect this may have on the engagement partner’s behavior. They also highlight that this information may be useful to investors, as they can use this information to determine the engagement partner’s experience and track record. Some believe that this may lead to a competition among audit committees for those engagement partners who are seen to provide audits of the highest quality.

11. By contrast, others, such as some firms and professional bodies, believe that engagement partners already feel accountable due to influences such as professionalism, his or her own reputation and that of the firm, and the potential for enforcement against the engagement partner. They point to the heavy involvement of the firm’s quality control systems, which mitigate the emphasis that some wish to place on the person signing the report. Opponents also point to the risk of “league” tables being developed which may lead investors to draw erroneous conclusions about the audit. They also highlight that there may be unintended consequences such as reducing the attractiveness of the profession to students. A further issue is the effect that a signature/disclosure requirement may have on the engagement partner’s liability.

9 ISA 700, paragraph 40
10 ISA 700, Forming an Opinion and Reporting on Financial Statements
11 ISA 700, paragraph A37
13 The comment letters received on the PCAOB proposals are available at www.pcaobus.org/Rules/Rulemaking/Pages/Docket029Comments.aspx
Role of Affiliated Firms, and Others, in the Audit

12. In the context of affiliated firms and others, ISA 600 does not permit the naming of other audit firms in the auditor’s report, unless required by law or regulation. Jurisdictions permitting the inclusion of the name of, and the extent of reliance placed on, the work of that other auditor include the US. The EC proposals include a requirement that the additional report to the audit committee “describe the distribution of tasks among the statutory auditor(s) and/or the audit firm(s).”

13. Supporters of disclosing the name and role of other firms, including some investors, note that the quality of services provided by other audit firms may vary. In some cases, the other firm may be part of the same network and subject to the same quality control framework but, in other cases, the other firm may be completely separate. They have also highlighted that the practice of “off-shoring,” that is, sending audit tasks involving no judgment to a related firm in a low cost jurisdiction, and different legal and regulatory requirements may lead to reduced audit quality. However, opponents of the proposal noted that disclosure of the names of the other audit firms involved may appear to dilute the group auditor’s responsibility, and may be seen as being defensive. There are also concerns about the extension of this principle to disclosure of the involvement of other professionals in the audit, such as valuation experts, actuaries, and geologists whose work the auditor may rely on, as it may be seen as leaving little responsibility for the group auditor.

III. Basis for Recommendations and Preferred Options

14. The Task Force debated the respondents’ comments and the calls for change, and considered various options to address them. In preparing and debating these options, a key consideration was the need to think progressively about how the IAASB could respond and to develop options that reflect a range of responses.

Clarifications of Technical Terms

15. After debating the options, the Task Force determined that the preferred way of addressing respondent’s comments regarding clarifications of technical terms was to enhance the “auditor’s responsibility” section to explain more fully the concept of a risk-based audit, thereby encapsulating the technical terms in the framework of an ISA audit. An alternative, clarifying each of the terms individually, was seen as less helpful to users and harder to read. They also agreed to explore clarifications to address other matters, such as the auditor’s responsibility for disclosures. The results of the Task Force’s deliberations are shown in Appendix 1, an expanded description of a risk-based audit, and Appendix 2, other clarifications of technical terms. These recommendations have not yet been deliberated by the IAASB, and are therefore preliminary in nature. The recommendations made by the Task Force include:

---

14 ISA 600, Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)

15 For example, US Auditing Standards AU Sections 508.11a and 543

16 Article 23, paragraph 2(e)

17 A survey conducted by the Chartered Financial Analysts Institute in March 2010 showed that 91% of respondents supported disclosure of the identities and role of the other audit firms involved in the audit.

18 Such as agreeing the market value of a list of securities to a third-party source
Auditor Reporting—Clarifications and Transparency
IAASB Main Agenda (March 2012)

- Clearer identification that notes to the financial statements are included within the scope of the audit – this provides users with a clearer view of what is covered by the opinion;
- A mandatory,\(^{19}\) explicit statement of compliance with the ethical requirements, including independence requirements – while this will require further discussion with the IAASB and external parties, particularly with the International Ethics Standards Board for Accountants (IESBA), the Task Force believes that this should be highlighted at this stage so that the value and impediments can be further understood, and also noted that this would be responsive to both the EC and PCAOB proposals.\(^{20}\); and
- Further elaboration of the meaning of:
  - Reasonable assurance;
  - Materiality,\(^{21}\)
  - The auditor’s responsibility for fraud; and
  - The auditor’s responsibility to evaluate the overall presentation, structure and content of the financial statements, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

16. The Task Force was of the view that these clarifications should remain within the standard auditor’s report. However, the Task Force (through the work of the Building Blocks subcommittee) and the IAASB will continue to deliberate whether the possibility of providing a link to a website for the “boilerplate” material in the auditor’s report, as is the practice in the UK.

Transparency of the Audit Process

Engagement Partner Signature/Name of Engagement Partner

17. The Task Force deliberations of disclosing the name of the auditor focused on user perceptions that the identity of the engagement partner is valuable information that would aid users’ understanding of and ability to evaluate the audit. Other arguments in support of this proposal include that it is in line with recent regulatory moves to require sign-offs by Chief Executive Officers and Chief Financial Officers in many jurisdictions. The Task Force also noted that accountability of engagement partners may be increased when they are publicly identified with the audit. On the other hand, the Task Force noted some drawbacks associated with the proposal, including:
- That it may lead to decision-making by investors on the basis of the perceived quality of the partner;

\(^{19}\) The illustrative reports in ISA 700 include a statement “We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements ...”, which is required by paragraph 30 of ISA 700. However, this statement could be more explicit about the fact that the auditor does in fact comply, and is not mandatory if law or regulation prescribes a specific layout or wording of the auditor’s report (see ISA 700, paragraph 43).


\(^{21}\) The Clarifications Subcommittee is responsible for considering “boilerplate” clarification of the meaning of materiality. Auditor commentary on entity-specific materiality considerations is within the domain of the Insights Subcommittee.
• Highlighting one partner may make the rest of the firm feel less involved, as it may send a signal to the market that a partner is on his/her own, or may lower quality as partners may not consult sufficiently;
• Concerns about personal safety with the disclosure of names, which may be linked to addresses using other public information;
• Ranking of partners based on perceived audit quality may be misunderstood or misinterpreted; and
• Even in jurisdictions without disclosure of name or signature of engagement partner, the regulatory inspections can identify the engagement partner, so the engagement partner should already feel accountable.

The Task Force did not draw any particular distinction between signing in the partner’s own name and disclosing the name of the partner.

18. The Task Force decided to advance the preliminary proposal that ISAs require the disclosure of the name of the engagement partner to enable stakeholders to express a view on the value and impediments of this proposal. Views will also be sought on whether this should apply to a subset of audit engagements, for example listed entities or public-interest entities (PIEs), and whether this matter should be left to national standard setters (NSS) for resolution at the national level.

Role of Affiliated Firms, and Others, in the Audit

19. In relation to the PCAOB proposal to disclose the role of affiliated firms, and others, in the audit, the Clarifications Subcommittee and the Task Force considered two possible responses:

(a) Disclosure of the names of other firms only; and

(b) Disclosure of the collective, relative responsibilities of the other firms involved in the audit.

20. The Task Force discussion focused on the extant ISA prohibition on referring to other auditors, which was seen as dividing the responsibility for the audit opinion. There were also concerns about the measurement of other firms’ involvement, the cost burden imposed on the auditor and how it will address joint ventures and associates. However, given the support by some stakeholder groups for this proposal, the Task Force agreed to seek views on the value and implications of disclosing the role of affiliated firms, and others, in the audit.

IV. Consideration of Values and Impediments

21. Paragraphs 22–25 explain the Task Force’s preliminary assessment of values and impediments based on responses to the CP and discussions by the Clarifications Subcommittee.

Clarifications of Technical Terms

22. The Task Force noted that this should have few impediments as the descriptions are limited to further explanations of the existing audit process, rather than amending the scope of the audit. However, value was harder to agree upon, although it was noted that investors and other users had
sought the clarifications, so they must perceive value. The comments on the CP showed that there are advantages and disadvantages of enhancing/amplifying technical language are outlined below:

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Further explains terms not commonly understood by non-auditors</td>
<td>The explanation itself may use further technical terms (i.e., if we define reasonable assurance, will people then ask what “assurance” means)</td>
</tr>
<tr>
<td>May decrease expectations gap by providing a better explanation of what an audit is and is not</td>
<td>May increase expectations gap if users perceive a greater role for the audit vis-à-vis fraud, for example</td>
</tr>
<tr>
<td>Opportunity to educate users about the audit</td>
<td>May be seen as a defensive move by the profession to limit its liability</td>
</tr>
<tr>
<td>May provide an opportunity to use more “plain language”</td>
<td>May have unintended domestic implications for liability of auditors</td>
</tr>
<tr>
<td>May increase understandability and readability</td>
<td>May result in a longer audit report, and lead to even less reading of the audit report</td>
</tr>
</tbody>
</table>

23. **Mandatory statement of compliance with ethical requirements** – The Task Force noted that this was already noted in the ISA 700 illustrative reports, and that some value must be perceived given that this was already mandated in certain jurisdictions. The Task Force believes that this should be highlighted at this stage so that the value and impediments can be further understood.

*Transparency of the Audit Process*

Engagement Partner Signature/Name of Engagement Partner

24. The Task Force determined that this would increase transparency of the key participant in the audit, may assist in making the engagement partner feel more accountable for the audit and was responsive to investor and user calls. The Task Force debated the value to users, and, as mentioned in paragraph 18, resolved that the proposal should be advanced to enable stakeholders to express a view on the value and impediments of this proposal.

Role of Affiliated Firms, and Others, in the Audit

25. As noted in paragraph 20, the Task Force agreed to seek views on the value and implications of disclosing the role of affiliated firms, and others, in the audit.

*Other Alternatives and Options Considered*

*Clarifications of Technical Terms*

26. The Task Force found that, in discussing the clarifications of the technical terms in the standard auditor’s report, some of the issues may be better addressed by a brief description of a risk-based
audit as indicated above. However, to provide the IAASB with a full range of options, the Clarifications Subcommittee also considered how the existing technical terms could be clarified individually, and accordingly, prepared an series of options to address the individual clarifications of technical terms, such as “materiality” and “reasonable assurance” (see Appendix 2). A preferred option was identified in relation to each technical term from the range of options presented.

27. In discussing these clarifications, the Clarifications Subcommittee focused on drafting wording options that would provide both the Task Force and the IAASB a wide range of options. This reflects the desire for “progressive” thinking as expressed at the January Task Force meeting. To this end, the Clarifications Subcommittee developed wording options that were potentially viable, albeit some may be more acceptable to some stakeholder groups than others.

**Transparency of the Audit Process**

**Engagement Partner Signature/Name of Engagement Partner**

28. In relation to the preliminary proposal to disclose the name of the engagement partner, the Task Force and the Clarifications Subcommittee also considered whether the engagement partner should sign in their own name (as opposed to disclosure of their personal name, but signing in the name of the firm). Members found it difficult to distinguish the two proposals in any practical way, and agreed to pursue disclosure of the name of the engagement partner as the simpler option.

**Role of Affiliated Firms, and Others, in the Audit**

29. Part of the calls for change included regulatory proposals relative to identifying the role other audit firms play in the audit. The Clarifications Subcommittee discussed several alternatives to disclosing the role of other firms, whether network or non-network firms, including identifying the portion of the audit performed by network firms vs. non-network firms and naming auditors who were subject to regulatory inspections vs. those that were not subject to regulatory inspections. These options may be further considered in the period after the March 2012 IAASB meeting.

**V. Matters for Further Task Force Consideration**

30. Some matters under consideration require further deliberation by the Clarifications Subcommittee or the Task Force before recommendations can be made to the IAASB. In some cases, collaboration and outreach must be undertaken to further understand the public policy objectives behind the proposals. Specifically, the Task Force intends to follow up in relation to:

- The implications of requiring the auditor to provide a statement of compliance with ethical requirements. Of particular interest is how non-compliance should be addressed, and how the requirement will operate in the context of the Code of Ethics for Professional Accountants. Staff and the Clarifications Subcommittee will reach out to the IESBA to further develop options in this area. The EC’s objective was to link the requirement to state that the auditor remained completely independent with a proposal to require disclosure of the names...
of the engagement team members.\textsuperscript{22} The Task Force viewed this as high implications/low value but will seek further understanding of the policy objectives (see paragraph 31 below).

- A proposal regarding disclosure of the auditor’s assessment of internal control,\textsuperscript{23} particularly with regard to how it affects the current scope of the audit.
- Whether there is merit in considering enhancements to the description of management or those charged with governance’s (TCWG) responsibilities, for example, by describing the work of the audit committee, to provide better context for the auditor’s opinion.

31. Regarding the EC proposal to require a statement that the auditor remained completely independent\textsuperscript{24} and, in that context, to require disclosure of the names of the engagement team members,\textsuperscript{25} the Task Force identified some practical difficulties associated with implementation of this proposal. For example:

- Does it apply to the group audit team only, or does it include a “look through” to all engagement team members, including those of component auditors, including auditors of associates and joint ventures?
- How would the disclosure be made? Is a listing of the names practical given the potentially hundreds or thousands of names in some large multinational audits?
- What are the privacy implications of the disclosure of personal names, particularly those of more junior levels of the engagement team?

The Task Force has asked the Clarifications Subcommittee to explore whether there are particular individuals who could be named, such as key partners or staff, which may be responsive to the call for disclosure, while avoiding the practical concerns associated with naming every member of the engagement team.

VI. Matters for IAASB Consideration

1. The IAASB is asked for their views on the following proposed clarifications of technical language, and the values and impediments thereof:

- The proposed description of a risk-based audit (see Appendix 1).
- The “preferred options” regarding descriptions of materiality, fraud and disclosures (see

\textsuperscript{22} The Glossary of Terms defines the engagement team as “All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes external experts engaged by the firm or a network firm.”

\textsuperscript{23} Article 22(2)(m) of the EC proposals stated “The audit report shall be in writing. It shall at least...Assess the entity's or, in case of consolidated financial statements, the parent undertaking's internal control system, including significant internal control deficiencies identified during the statutory audit, as well as the bookkeeping and accounting system.”

\textsuperscript{24} Article 22(2)(q)

\textsuperscript{25} The Glossary of Terms defines the engagement team as “All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes external experts engaged by the firm or a network firm.”
2. The IAASB is asked for their views on requiring the disclosure of the name of the engagement partner, and the values and impediments thereof.

3. The IAASB is asked for their views on requiring disclosure of the role of affiliated firms, and others, in the audit, and the values and impediments thereof.

4. Are there other matters that the IAASB wish to raise relative to clarifications of technical language and the transparency of the audit process?
Description of a Risk-Based Audit

1. The Clarifications Subcommittee found that, in discussing the clarifications of the technical terms in the standard auditor’s report, some of the issues may be better addressed by a brief description of a risk-based audit. The Clarifications Subcommittee thought that this may provide users with a better understanding of the nature and process of an audit, which may add additional context to the opinion.

2. The Task Force’s preferred option for describing a risk-based audit is below (The text marked as deleted is from the extant illustrative report in ISA 700, and is included for reference).

   **Auditor’s Responsibilities**

   …

   *We obtained reasonable assurance that the financial statements as a whole are free from material misstatement. Misstatements can arise from fraud or error and are considered material if they would influence economic decisions of a [wide range of users, or other description of users as appropriate in the circumstances] taken on the basis of these financial statements. We use our knowledge, experience and professional judgment to identify and assess the risks of material misstatement in the financial statements and selecting controls, amounts and disclosures for testing in response to these assessed risks. Reasonable assurance, although representing a high level of assurance, is not a guarantee and, consequently, an audit conducted in accordance with International Standards on Auditing may not always detect a material misstatement when it exists.*

   *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.*

3. The new text includes definitions of reasonable assurance and material misstatements, concludes with an improved description of a risk-based audit and, in the view of the Task Force, is an improvement on the existing language.

4. The Task Force also considered two alternatives for describing a risk-based audit. The first, which was based on existing text from the ISAs, was rejected as being difficult for users to understand and overly technical. The second was a plain language version, which the Task Force found some merit in but noted that it was insufficiently connected to the language in the opinion or in the ISAs themselves. The Task Force viewed the option above as being a reasonable compromise between these two positions. The Task Force also considered:

   - Mentioning the inherent limitations of an audit and the nature of audit evidence (in that it is persuasive rather than conclusive). The TF found that this language may be seen as defensive; and
   - The value of identifying the page numbers of the financial statements, a practice in some jurisdictions and one that assists readers in distinguishing the audited financial statements from the remainder of the document. The Task Force noted that this was of less
contemporary relevance given the increasing accessing of financial statements via the internet, where page numbers may be less relevant.
Clarification of Technical Terms – Preferred Options and Alternatives Considered

1. The tables below cover the options considered by the Clarifications Subcommittee and the Task Force in regard to technical terms. These options are complementary to the preferred option outlined in Appendix 1, and much of the language in the preferred options below mirrors the language in Appendix 1. These options are shown below in isolation to allow appropriate focus on the wording. This allows the IAASB to consider matters of location and geography separately.

<table>
<thead>
<tr>
<th>Options for Describing a Materiality</th>
<th>Discussion</th>
</tr>
</thead>
</table>
| **Preferred Option** | • Describes materiality in a manner that is internationally applicable.  
• Identifies that it is the decisions of “typical” users. This would need to be adjusted for different financial reporting frameworks. |
| “…Misstatements can arise from fraud or error and are considered material if they would influence economic decisions of a [wide range of users] taken on the basis of these financial statements.” | |
| **Alternative Option 1 – Amplification of Existing Technical Terms** | • In line with extant ISAs, also mentions omissions  
• Does not identify the “user”  
• The Task Force noted that this was more verbose than the preferred option, but that the additional words added little of use to the average user. |
| “Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.” | |
| **Alternative Option 2 – Generic/Long Form – Focus on Judgment** | • Identifies users, more discursive, includes reference to judgment, based on existing ISA 320 material  
• The Task Force noted that this was comparatively long, and may outweigh other, more relevant sections of the auditor’s report. |
| “Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. Decisions regarding materiality require professional judgment and are based on a consideration of [Insert user identification]” | |
## Options for Describing a Materiality

<table>
<thead>
<tr>
<th>Discussion</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Here per financial reporting framework “the common financial information needs of users as a group”</strong>(^{26}) OR “an average, prudent user”(^{27}).</td>
</tr>
</tbody>
</table>

### Alternative Option 3 – Specific to the Entity\(^{29}\)

This option is within the scope of the Insights Subcommittee.

---

## Responsibility for Fraud

### Options for Describing the Auditor’s Responsibility for Fraud

<table>
<thead>
<tr>
<th>Discussion</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Preferred Option</strong></td>
</tr>
<tr>
<td>“Our audit included identifying and assessing the risk of material misstatement due to fraud and obtaining evidence in response to those risks.”(^{30})</td>
</tr>
</tbody>
</table>

- Positive language, focused on auditor’s challenges, not management’s
- Identifies the particular issue with senior management fraud.

### Alternative Option 1 – Status Quo

“…material misstatements, whether due to fraud or error.”

- Brief, in line with extant ISAs

### Alternative Option 2 – Explain Limitations

- Follows EC recommendation of clarifying the auditor’s involvement in respect of fraud, emphasizes that the auditor is not giving a fraud-

---

\(^{26}\) ISA 320, Materiality in Planning and Performing an Audit

\(^{27}\) ISA 320, paragraph 2

\(^{28}\) US court case Escott v BarChris Construction Corp

\(^{29}\) See also EC proposal in Article 22, paragraph 2(j) which states “…The audit report…shall at least…lay out the details of the level of materiality applied to perform the statutory audit.” To the extent that this proposal is intended to provide “insights” into the audit, then it may fall within the purview of the Insights subcommittee.

\(^{30}\) ISA 240, paragraph 6
**Options for Describing the Auditor’s Responsibility for Fraud**

<table>
<thead>
<tr>
<th>Options</th>
<th>Discussion</th>
</tr>
</thead>
</table>
| “The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management...” The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting fraud or one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. The auditor’s ability to detect a fraud depends on factors such as the skillfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved and the relative size of individual amounts manipulated. The audit process is better able to detect fraud committed by employees rather than management, as management fraud may involve misrepresentations and the override of internal controls.” | free guarantee  
- May be perceived as defensive or “buckpassing” |

**Responsibility for Disclosures**

<table>
<thead>
<tr>
<th>Options for Describing the Auditor’s Responsibility for Disclosures</th>
<th>Discussion</th>
</tr>
</thead>
</table>
| Preferred Option                                                   | - Identification of the financial statements is brief and clarifies that the scope of the audit includes the notes to the financial statements  
- Highlights the “standback” provision in ISA 700 relating to the overall presentation of the financial statements, albeit that this is not limited |

```
31 ISA 240, paragraph 4
32 ISA 240, paragraph 6
33 ISA 240, paragraph 6
```
### Options for Describing the Auditor’s Responsibility for Disclosures

| Discussion |
|---|---|
| to disclosures |
| • Continued inclusion of “summary of significant accounting policies” may be seen as overemphasizing the role of the accounting policies and the degree to which the auditor focuses on them relative to other critical disclosures. This was not to understate the importance of the accounting policies, but rather that there may be other, equally important disclosures that need to be highlighted in certain engagements, a matter that may be addressed by the auditor commentary proposals. An alternative view is that regulators and users may prefer the emphasis on the summary of significant accounting policies be retained |

### Alternative Option 1 – Short explanation

“*Our audit included the notes to the financial statements shown on pages xx to yy. These notes, as an integral element of the financial statements, are included in audit risk assessments, gathering of audit evidence and in forming our opinion on the financial statements as a whole, including their fair presentation.*”

- Provides more context than the Preferred Option by giving a short explanation of how disclosures are audited
- Does not include an explicit reference to the “standback” provision, seen to add little to the existing wording

---

34 These page numbers encompass both the financial statements and the notes.

35 ISA 700, paragraph 14