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 on or after December 15, 2009)

CONTENTS

Introduction
Scope of this ISA ............................................................................................................... 1-24
Effective Date ..................................................................................................................... 3
Objective ............................................................................................................................ 4
Definitions .......................................................................................................................... 5

Requirements
Form and Placement of an Emphasis of Matter Paragraphs in the Auditor’s Report ........ 6-7-8
Other Matter(s) Paragraphs in the Auditor’s Report......................................................... 8-9
Communication with Those Charged with Governance .................................................. 9-10

Application and Other Explanatory Material
Nature of an Emphasis of Matter Paragraph................................................................... A1-A2
Form and Placement of an Emphasis of Matter Paragraphs in the Auditor’s Report ......A13-A45
Other Matter(s) Paragraphs in the Auditor’s Report......................................................... A56-A98
Communication with Those Charged with Governance ................................................. A119

Appendix 1: List of ISAs Containing Requirements for Emphasis of Matter Paragraphs
Appendix 2: Illustration of an Auditor’s Report that Includes an Emphasis of Matter Paragraph
Appendix 3: List of ISAs Containing Requirements and Guidance for Other Matter(s) Paragraphs


See footnote 1.

Prepared by: Kathleen Kerrigan (May 2008)
Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor’s consideration of the inclusion of additional communication in the auditor’s report when the auditor considers it necessary to:

   (a) An Emphasis of Matter paragraph to draw users’ attention to a matter presented or disclosed in the financial statements that is of such importance that it is the auditor judges important fundamental to their users’ understanding of the financial statements as a whole; or

   (b) An Other Matter(s) paragraph to draw users’ attention to any other matters other than those presented or disclosed in the financial statements that may be relevant to their understanding of the financial statements or the audit or the auditor’s responsibilities.

2. The requirements and guidance in Although directed towards communication in an auditor’s report on a complete set of financial statements, prepared and presented in accordance with a fair presentation framework. However, in the context of an engagement to this ISA, adapted as necessary in the circumstances, also applies to communications in the auditor’s report on a single financial statement, an element of a financial statement, or special purpose financial statements or specific elements, accounts or items of a financial statement, or when the applicable financial reporting framework is a compliance framework, these requirements and guidance equally apply, adapted as necessary.

Nature of an Emphasis of Matter Paragraph

3. In rare circumstances, the auditor may consider a matter presented or 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. The auditor may consider it appropriate to use the auditor’s report as a means of communicating information relating to matters, other than those that are presented or disclosed in the financial statements, that may be relevant to users’ understanding of the financial statements or the audit. 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

35. This ISA is effective for audits of financial statements for periods beginning on or after December 15, 2009.[date].¹

Objective

46. The objective of the auditor, having formed an opinion on the financial statements as a whole, is to draw users’ attention, by way of include clear additional communication in the auditor’s report, to when:

- in the auditor’s judgment, such communication is appropriate to draw users’ attention to

  (a) a matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to the users’ understanding of the financial statements, or

  (b) as appropriate, to any other matter(s) that are which may be relevant to their users’ understanding of the financial statements or the audit or auditors responsibilities. [ISSUE G]

Definitions [ISSUE I]

5. For the purposes of the ISAs, the following terms have the meanings attributed below:

(a) Emphasis of Matter paragraph – A paragraph included in the auditor’s report that refers to a matter appropriately presented or disclosed in the financial statements that is of such importance that it is fundamental to the users’ understanding of the financial statements as a whole.

(b) Other Matter(s) paragraph – A paragraph included in the auditor’s report that refers to a matter other than those presented or disclosed in the financial statements that may be relevant to the audit or the auditor’s responsibilities.

Requirements

Form and Placement of an Emphasis of Matter Paragraphs in the Auditor’s Report

67. When the auditor determines it is necessary appropriate to draw users’ attention to a matter presented or disclosed in the financial statements that, in the auditor’s judgment, is of such importance that it is fundamental to the users’ understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor’s report provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements. Such a paragraph shall refer only to information presented or disclosed in the financial statements. (Ref: Para. A1-A23) [ISSUE H]

78. When the auditor includes an Emphasis of Matter paragraph in the auditor’s report, the auditor shall:

¹ This date will not be earlier than December 15, 2008.
(a) Include it immediately after the Opinion paragraph in the auditor’s report;

(b) Use the heading “Emphasis of Matter,” or other appropriate heading;

(c) Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements; and

(d) Indicate that the auditor’s opinion is not modified in respect of the matter emphasized. (Ref: Para. A3-A4-A5)

Other Matter(s) Paragraphs in the Auditor’s Report

89. If the auditor determines it is necessary or appropriate to communicate matter(s) other than those that are presented or disclosed in the financial statements that are relevant to the users’ understanding of the audit or auditors’ responsibilities and this is not prohibited by law or regulation, the auditor shall do so in a separate paragraph in the auditor’s report. Use an Other Matter(s) paragraph for such matters with the heading “Other Matter(s),” or other appropriate heading. The auditor shall include this paragraph immediately after the auditor’s Opinion paragraph and any Emphasis of Matter paragraph, or elsewhere in the auditor’s report if the content of the Other Matter(s) paragraph is relevant to other responsibilities. (Ref: Para. A56-A108) [ISSUE J.1]

Communication with Those Charged with Governance

940. 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)

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Application and Other Explanatory Material

Nature of an Emphasis of Matter Paragraphs in the Auditor’s Report (Ref: Para. 3)

A1. Circumstances where the auditor may consider it appropriate or necessary to emphasize in the auditor’s report a matter presented or disclosed in the financial statements include, for example:

• [Proposed] ISA 560 (Redrafted), “Subsequent Events” deals with circumstances 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. In those circumstances, [proposed] ISA 560 (Redrafted) requires the auditor to include an Emphasis of Matter paragraph in the new auditor’s report 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. [MOVED TO APPENDIX 1]

_Circumstances in which an Emphasis of Matter Paragraph May Be Necessary_ (Ref: Para. 6)

A12. Examples of other circumstances where the auditor may determine that an Emphasis of Matter paragraph is appropriate include:

- When the auditor is required to do so by other ISAs (see Appendix 1). [ISSUE H]
- An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.
- Early Application (where permitted) 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.

A2. A widespread use of Emphasis of Matter paragraphs diminishes the effectiveness of the auditor’s communication of such matters. Additionally, to include more information in an Emphasis of Matter paragraph than is presented or disclosed in the financial statements may imply that the matter has not been appropriately presented or disclosed; accordingly, paragraph 6 limits the use of an Emphasis of Matter paragraph to matters presented or disclosed in the financial statements. [MOVED FROM PARAGRAPHS 3 AND A3]

_Form and Placement of Including an Emphasis of Matter Paragraph in the Auditor’s Report_ (Ref: Para. 7-8)

A3. To include more information in an Emphasis of Matter paragraph than is presented or disclosed in the financial statements may imply that the matter has not been appropriately presented or disclosed. [COMBINED IN NEW PARAGRAPH A2]

A34. 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) 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)^2, “Modifications to the Opinion in the Independent Auditor’s Report”); or

^2 ISA 705 (Revised and Redrafted), “Modifications to the Opinion in the Independent Auditor’s Report.”
(b) Disclosures in the financial statements that the applicable financial reporting framework requires management to make.

A45. The illustrative report in Appendix 2 includes an Emphasis of Matter paragraph in an auditor’s report that contains a qualified opinion.

**Other Matter(s) Paragraphs in the Auditor’s Report (Ref: Para. 89)**

*Circumstances in which an Other Matter(s) Paragraph May Be Necessary*

A56. When law, regulation or generally accepted practice in a jurisdiction may 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 under the Other Matter(s) heading with, where relevant, one or more sub-headings may be used that describe the content of the Other Matter(s) paragraph.

A67. Certain ISAs require the auditor to include an Other Matter(s) paragraph in certain circumstances. See Appendix 3 for a listing of these ISAs. Other matters to which the auditor may wish to refer in an Other Matter(s) paragraph but which are not required to be presented or disclosed in the financial statements by the applicable financial reporting framework include, for example, the following:

(a) Information in a document containing audited financial statements that is materially inconsistent with those financial statements (see [proposed] ISA 720 (Redrafted), “The Auditor’s Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements”).

(b) 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 ISA 710, “Comparatives”).

A7. In the 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 on the scope of the audit imposed by management is pervasive, the auditor may determine that it is necessary to include an Other Matter(s) paragraph in the auditor’s report to explain why it is not possible for the auditor to resign from the engagement.

A8. An Other Matter(s) paragraph does not deal with circumstances where the auditor has additional other reporting responsibilities that are in addition supplementary to the auditor’s responsibility to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework, or where the auditor has been asked to perform and report on additional

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3 See paragraph 15(b)(ii) of ISA 705 (Revised and Redrafted) for a discussion of this circumstance.
specified procedures, or to express an opinion on specific matters (see “Other Reporting Responsibilities” section in [proposed] ISA 700 (Redrafted)).

Including an Other Matter(s) Paragraph in the Auditor’s Report

A9. The content on an Other Matter(s) paragraph reflects clearly that such other matter(s) are not required to be presented and disclosed in the financial statements. An Other Matter(s) paragraph does not include information that the auditor is prohibited from providing by law, regulation or other standards, for example, ethical standards relating to confidentiality of information. An Other Matter(s) paragraph also does not include information that is required to be provided by management.

A10. The placement of an Other Matter(s) paragraph depends on the nature of the information to be communicated. When an Other Matter(s) paragraph is included to draw the users’ attention to matters relevant to their understanding of the audit of the financial statements, the paragraph is included immediately after the Opinion paragraph and any Emphasis of Matter paragraph. When an Other Matter(s) paragraph is included to draw the users’ attention to matters relating to Other Reporting Responsibilities addressed in the auditor’s report, the paragraph may be included in the section sub-titled “Report on Other Legal and Regulatory Requirements.” Alternatively, when relevant to all the auditor’s responsibilities, the Other Matter(s) paragraph may be included as a separate section following the Report on the Financial Statements and the Report on Other Legal and Regulatory Requirements.

Communication with Those Charged with Governance (Ref. Para. 9)

A11. 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.

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[ISSUE H] List of ISAs Containing Requirements for Emphasis of Matter Paragraphs

This appendix identifies paragraphs in other ISAs as at December 31, 2007 that require the auditor to include an Emphasis of Matter paragraph in the auditor’s report in certain circumstances. The list is not a substitute for considering the requirements and related application and other explanatory material in ISAs.

Proposed ISA 210 (Redrafted), “Agreeing the Terms of Audit Engagements” – paragraph [19]

ISA 560 (Redrafted), “Subsequent Events” – paragraphs 12(b) and 16

ISA 570 (Redrafted), “Going Concern” – paragraph 19
Illustration of an Auditor’s Report that Includes an Emphasis of Matter Paragraph

Circumstances include the following:

- There is uncertainty relating to a pending exceptional litigation matter.
- A departure from the applicable financial reporting framework resulted in a qualified opinion.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law.

INDEPENDENT AUDITOR’S REPORT

[Appropriate Addressee]

Report on the Financial Statements

We have audited the accompanying financial statements of ABC Company, which comprise the balance sheet as at December 31, 20X1, 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 information notes.

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: the designing, implementing and maintaining of 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.

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5 The subtitle “Report on the Financial Statements” is unnecessary in circumstances when the second subtitle “Report on Other Legal and Regulatory Requirements” is not applicable.

6 Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

7 Depending on the circumstances, this sentence may read: “Management is responsible for the preparation and presentation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards.”
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 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. 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. Management has not marked these securities 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, 20X1, and income tax, net income and shareholders’ equity would have been reduced by xxx, xxx and xxx, respectively.

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8 Depending on the circumstances, this sentence may read: “In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and presentation of financial statements that give a true and fair view 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.”

9 In circumstances when the auditor also has 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.” In the case of footnote 4, this sentence may read: “In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and presentation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances.”
Qualified Opinion

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements present fairly, in all material respects (or “give a true and fair view of”) the financial position of ABC Company as at December 31, 20X1, 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 uncertainty related to the outcome of the lawsuit filed against the company by XYZ Company. Our opinion is not qualified in respect of this matter.

Report on Other Legal and Regulatory Requirements (see “Other Reporting Responsibilities” section in proposed ISA 700 (Redrafted))

[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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10 In highlighting the uncertainty, the auditor uses the same terminology that is used in the note to the financial statements.
Appendix 3
(Ref.: Para. A6)

List of ISAs Containing Requirements and Guidance for Other Matter(s) Paragraphs

This appendix identifies paragraphs in other ISAs as at December 31, 2007 that require the auditor to include an Other Matter(s) paragraph in the auditor’s report in certain circumstances or provide guidance on when an Other Matter(s) paragraph may be necessary. The list is not a substitute for considering the requirements and related application and other explanatory material in ISAs.

ISA 560 (Redrafted), “Subsequent Events” – paragraphs 12(b) and 16


ISA 720 (Redrafted), “The Auditor’s Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements” – paragraph 10