

Auditor Reporting—Issues Relating to Proposed Revisions to ISA 700

Introduction and Background

1. In its June 2012 Invitation to Comment: *Improving the Auditor's Report* (ITC), the IAASB suggested that auditor reports include certain mandatory elements. Appendix 4 to the ITC included a list of mandatory elements as well as opportunities for where those requirements may be further tailored at the national level. This paper addresses how those requirements could be drafted in a revised ISA 700.¹ Complementing this paper are: **Agenda Item 2-B**, which summarizes responses received relating to the ITC questions addressing the work of other auditors, and suggested improvements relating to clarifications and transparency and other information; and **Agenda Item 2-D**, which is explained at paragraph 6 below.
2. From an overall perspective, there was broad support from all stakeholder groups who responded to the ITC for enhancing the content and structure of auditors' reports to make them more useful, relevant and consistent. This paper is intended to help guide the discussions and activities of the IAASB as it explores how the requirements and application material of ISA 700 could be revised to achieve that goal and incorporate new reporting requirements to reflect the suggested improvements in the ITC.

Recap and Status of Issues

3. At its September 2012 meeting, the IAASB agreed to retain the current structure of extant ISA 700, as the foundational standard for requirements relating to auditor reporting. The table below summarizes the status of the main issues that will affect the revisions to ISA 700. All matters below will be addressed by DT-700 except as noted. In proposing initial revisions to ISA 700, the ISA 700 Drafting Team (DT-700) has taken the IAASB's preliminary views from its September and December 2012 meetings into account, as well as DT-700's recommendations in relation to the ITC matters that had not yet been discussed by the IAASB (which are included in **Agenda Item 2-B**). However, it is important to note that certain decisions may need to be reconsidered by both DT-700 and the IAASB as discussions involving the new suggested improvements evolve.

Issue ²	Discussed by IAASB to date?	At Which Past or Future Meeting?	Recap of Decisions and Conclusions Reached
Title and Addressee	No	February 2013	See paragraphs 10–11 of this paper.
Format and Structure: Location of Audit Opinion Paragraph	Yes	December 2012	<ul style="list-style-type: none"> • Ordering of auditor reporting elements will not be mandated by the IAASB. • Illustrative report with a format and structure similar to ITC will be included in an Appendix to the revised standard, with application material explaining the

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

² The issues are presented in the order in which the sections appeared in the illustrative report included in the ITC.

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IAASB Main Agenda (February 2013)

Issue ²	Discussed by IAASB to date?	At Which Past or Future Meeting?	Recap of Decisions and Conclusions Reached
			<p>IAASB's rationale for its presentation.</p> <ul style="list-style-type: none"> DT-700 asked to consider the need for multiple illustrative auditor reports, for example for listed and non-listed entities.
Format and Structure: Basis of Opinion, including Compliance with Ethical Requirements	No	February 2013	See paragraph 12 of this paper and paragraph 42 of Agenda Item 2-B .
Going Concern (GC)	Yes	December 2012	<ul style="list-style-type: none"> Continue to explore auditor reporting on GC, including whether an auditor conclusion on the appropriateness of management's use of the going concern assumption and a statement whether material uncertainties, continue to be an appropriate way forward. Further consider whether reporting on GC should be required for all entities and whether the use of Emphasis of Matter (EOM) paragraphs to highlight material uncertainties should be retained (to coordinate with ISA 707 Drafting Team (DT-707)). Further consider how work underway by accounting standard setters, including the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board, may affect the nature and timing of the IAASB's proposals. Further consider whether reporting on GC should be required for all entities, or whether an approach based on the importance of GC considerations to the individual entity would be preferable. <p>See paragraph 12 of this paper.</p>
Auditor Commentary	Yes	December 2012	Addressed by DT-707. See paragraph 12 of this paper and Agenda Item 2-A .
Other Information	No	February 2013	See paragraph 12 of this paper and paragraph 37 of Section III of Agenda Item 2-B .
Description of	No	February	See paragraphs 10 and 12 of this paper, and

Issue ²	Discussed by IAASB to date?	At Which Past or Future Meeting?	Recap of Decisions and Conclusions Reached
Responsibilities, including relocation of description of auditor's responsibilities		2013	paragraphs 48–52 of Section IV and paragraph 59 of Section V of Agenda Item 2-B .
Other Reporting Responsibilities (ORR)	No	February 2013	See paragraph 12 of this paper.
Disclosing the Name of the Engagement Partner	No	February 2013	See paragraph 12 of this paper and paragraphs 68–69 of Section VI of Agenda Item 2-B .
Disclosure of Involvement of Other Auditors	No	February 2013	Addressed by DT-707. See paragraphs 22–24 of Agenda Item 2-A and paragraphs 18–22 of Section II of Agenda Item 2-B .
Auditor's Address	No	February 2013	See paragraph 10 of this paper.
Signature and Date of the Auditor's Report	No	February 2013	See paragraph 11 of this paper.

Considerations in Revising ISA 700 Requirements

4. As a result of the IAASB's agreement to retain the current structure of extant ISA 700, DT-700 will continue to focus primarily on the form, structure, and elements of auditors' reports. This will include, for example, the use of headings and subheadings, ordering, and the implications of law or regulation. References to where more specific requirements are included in other ISAs (e.g. ISA 260,³ ISA 570,⁴ ISA 705,⁵ ISA 706,⁶ new ISA 707,⁷ and ISA 720 (Revised)⁸ will need to be included as well.
5. It is important to note that, at present, DT-700 does not intend to revisit the requirements in ISA 700 relating to forming an opinion on the financial statements⁹ or the form of the opinion (i.e.,

³ ISA 260, *Communication with Those Charged With Governance*

⁴ ISA 570, *Going Concern*

⁵ ISA 705, *Modifications to the Opinion in the Independent Auditor's Report*

⁶ ISA 706, *Emphasis of Matter and Other Matter Paragraphs in the Independent Auditor's Report*

⁷ See discussion related to Auditor Commentary in **Agenda Item 2-A**.

⁸ 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*

⁹ ISA 700, paragraphs 10–15

unmodified/modified).¹⁰ Minor conforming changes may be necessary to material included in the Scope, Objectives and Definitions sections of ISA 700 and will be considered in due course.

6. **Agenda Item 2-D** includes DT-700's suggested revisions to the requirements in paragraphs 20–42 of ISA 700, which address the Auditor's Report, as well as a revised illustrative report based on the application of these revised requirements. These revisions can be characterized in two ways:
- *Revisions to existing ISA 700 requirements* – As a starting point, DT-700 was of the view that many of the requirements of extant ISA 700 could be retained in their existing form. However, some revisions were considered necessary to clarify these requirements, based on (i) the new requirements that were also developed, (ii) feedback from respondents to the ITC, and (iii) discussions of DT-700 and the former Task Force relating to areas where clarification to a requirement or additional application material was considered necessary to align with current practice. The ordering of the requirements was also revised to align with the suggested presentation in the auditor's report. These revisions are further explained in Section I of this paper.
 - *New requirements to operationalize the IAASB's suggested improvements to auditor reporting* – Both drafting teams identified areas where new requirements are considered necessary to enable reporting in the manner contemplated in the illustrative report in the ITC. These new requirements are further explained in Section II of this paper.

Consistency versus Relevance and Recognition of the Effect of Law and Regulation on Auditor Reporting (including Paragraphs 43 and 44 of Extant ISA 700)

7. Extant ISA 700 provides a certain degree of flexibility in auditor reporting by allowing a departure from detailed requirements in certain circumstances when law or regulation prescribe the form and content of the auditor's report (i.e., the so-called exemption in paragraph 43 of ISA 700). Previous discussions with the IAASB and national standard setters (NSS) indicate that pilot testing to illustrate how the suggested improvements in the ITC could be applied using the exemption in extant ISA 700 resulted in a wider degree of variability than was initially anticipated. This indicates a need for the IAASB to consider the appropriate balance between consistency (and therefore comparability between auditors' reports for audits performed under the ISAs) and relevance by providing flexibility for jurisdictions to appropriately tailor the auditors' reports for their national reporting regimes.
8. At its September 2012 meeting, the majority of IAASB members agreed that the current structure of ISA 700 provides the appropriate balance between consistency and flexibility, acknowledging that there are likely to be national or jurisdictional issues that justify differences in the form and content of auditors' reports. Accordingly, the mechanism to provide for allowable jurisdictional differences by paragraph 43 of ISA 700 is likely to be retained. DT-700 has not yet finalized their consideration of paragraph 43 of the auditor's report, including how the minimum elements prescribed by that paragraph may be enhanced or expanded, as it believes it is first necessary to focus on requirements for auditor reporting when law or regulation does not prescribe the form and content of the auditor's report. However, DT-700 is generally of the view that the proposed revised

¹⁰ ISA 700, paragraphs 16–19

requirements in **Agenda Item 2-D** are appropriate to achieve consistency in auditor reporting – in particular, the use of headings for the new sections of the auditor’s report are intended to highlight that the auditor’s report is providing new information than before – while at the same time remaining mostly principles-based.

9. Further consideration will also need to be given to the circumstances addressed in paragraph 44 of ISA 700 relating to compliance with both national auditing standards and the ISAs. Previous IAASB discussions have indicated the IAASB should encourage NSS to refer to ISAs in auditors’ reports when national auditing standards are the same as, or based on, ISAs. DT-700 intends to discuss this matter further at the May 2013 NSS meeting and will consider whether revisions are needed to paragraph 44 of ISA 700 (or whether additional application material may be useful) in due course.

I. Revisions to Existing ISA 700 Requirements

10. As an initial step, DT-700 agreed to reorder the existing requirements to align with the presentation in the ITC. **Agenda Item 2-D** notes the origin of those requirements that were carried over from extant ISA 700. The following are the key changes DT-700 believes were necessary:

- *Addressee* – Minor change to clarify the requirement (see paragraph 22 of **Agenda Item 2-D**). Application material will be refined to address circumstances when law or regulation does not specify the addressee, with linkage to the parties with whom the auditor agrees the terms of the audit engagement in ISA 210.¹¹
- *Auditor’s Opinion* – See paragraphs 23–28 of **Agenda Item 2-D**.
 - Changes made to subsume certain matters previously included in the introductory paragraph in the auditor’s report into the Opinion paragraph, and new text added to explicitly require reference to the notes (rather than simply “a summary of accounting policies and other explanatory information” as in extant ISA 700); and
 - Changes made to clarify the requirement relating to the wording to be used when an unmodified opinion is expressed.

Application material will be developed to explain the need for the auditor to reinstate the use of an introductory paragraph to provide important context to the auditor’s report if the auditor elects not to present the Opinion paragraph first in the auditor’s report. Application material could also be developed to suggest that the auditor may want to explicitly note where the entity’s critical accounting policies are disclosed given the importance of such information.

- *Management’s Responsibility for the Financial Statements* (See paragraphs 34–36 of **Agenda Item 2-D**) – Changes made to streamline previous requirements and recognize that this section is likely to require tailoring based on the jurisdiction in which the audit is performed. Extant application material will be revisited to ensure it explains the possibilities in terms of describing both the responsibilities of management and those charged with governance, incorporating relevant material in ISA 260 as necessary.

¹¹ ISA 210, *Agreeing the Terms of Audit Engagements*

DT-700 was of the view that amending the title to the more generic “Responsibility for the Preparation [and Fair Presentation] of the Financial Statements” and not requiring the overall heading of “Respective Responsibilities of Management, [Appropriate Title for Those Charged with Governance], and the Auditor” was appropriate in light of the need for this section to be tailored.

- *Auditor’s Responsibility* (see paragraphs 37–40 of **Agenda Item 2-D**) – DT-700 discussions indicated a preference for more prescriptive requirements. DT-700 was of the view that, if the IAASB believed the enhanced description of the auditor’s responsibility had value, then it should likely appear consistently across auditors’ reports, albeit that such material could, at the choice of the auditor, be presented in an Appendix to the auditor’s report. New requirements were therefore developed to align with the detailed wording included in the illustrative report in the ITC. The IAASB will need to advise DT-700 whether further time should be spent attempting to streamline this material, in light of the responses received on the ITC (see paragraphs 39–41 of Section IV of **Agenda Item 2-B**).

DT-700 was also of the view that amending the title to the more generic “Responsibility for the Audit of the Financial Statements”, rather than “Auditor’s Responsibility”, was appropriate and mirrors the change to the heading of the section describing management’s responsibilities.

- *Auditor’s Address* – Minor change to require the inclusion of details of both the location and the jurisdiction of the auditor (see paragraph 44 of **Agenda Item 2-D**). New application material will be developed to address the circumstance in practice in which the engagement partner may be located elsewhere but the auditor’s report is to refer to the jurisdiction in which the audit was conducted.
11. Substantive changes are not being proposed to the requirements in extant ISA 700 relating to the auditor’s report being in writing, the title of the auditor’s report, the signature of the auditor’s report, or the date. DT-700 will consider whether changes to extant application material supporting these requirements, or additional application material, may be necessary as it progresses the development of a complete proposed ISA 700 (Revised). For example, additional application material relating to the requirement for the auditor’s report to include a signature may be useful to explain certain practical difficulties and misunderstandings that have been identified in relation to the use of electronic signatures.

II. **New Requirements to Operationalize the IAASB’s Suggested Improvements to Auditor Reporting**

12. Having rearranged the extant ISA 700 requirements to align with the format of the illustrative report in the ITC, DT-700 then considered what new requirements were needed to operationalize the IAASB’s suggested improvements to auditor reporting. Further amendment to these requirements, and additional application material to support them, may be necessary as the IAASB’s discussions continue, however, DT-ISA 700 is of the view that they are initially complete to result in the revised illustrative report included in the Appendix to **Agenda Item 2-D**. The following are the new areas for which additional requirements are necessary.

- *Basis for Opinion* – New requirements to establish a heading to be used in all cases and facilitate the statement indicating compliance with relevant ethical requirements, including independence (see paragraph 42 of **Agenda Item 2-B**). Other changes to require reference to the “Responsibility for the Audit of the Financial Statements” section and relocate material previously included in that section explaining that the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor’s opinion (see paragraph 29 of **Agenda Item 2-D**).

DT-700 is of the view that the construct “We conducted our audit in accordance with ISAs” is preferable to the phrase “We have audited the accompanying financial statements in accordance with ISAs” and has therefore retained the requirement in paragraph 30 of extant ISA 700.

- *Going Concern* – New requirement to report in accordance with proposed ISA 570 (Revised) under the heading “Going Concern” (see paragraph 30 of **Agenda Item 2-D**). For purposes of the revised illustrative report included in the Appendix to **Agenda Item 2-D**, management’s responsibilities for going concern have been presented together with the auditor’s statements about going concern, consistent with feedback received on the ITC.

At its December 2012 meeting, in light of responses to the ITC, the IAASB agreed to continue to explore auditor reporting on going concern. The IAASB asked DT-700 to further consider whether reporting on going concern should be required for all entities, or whether an approach based on the importance of going concern considerations to the individual entity would be preferable. This could include, for example, retaining the concepts of EOM paragraphs for drawing attention to material uncertainties that had been adequately disclosed in the financial statements. However, the IAASB also agreed at that time that more needs to be understood about the International Financial Reporting Interpretations Committee’s (IFRIC) plans to consider amendments to IAS 1¹² before any auditor reporting requirements can be developed. DT-700 had the opportunity to discuss with IFRIC/IASB representatives the proposals IFRIC considered at its January 22–23, 2013 meeting, and was pleased with the direction being proposed, recognizing that changes to ISA 570 may be needed to incorporate changes in IAS 1. An update on IASB and IFRIC’s activities will be given to the IAASB at its February 2013 meeting, with determination of an appropriate way forward to be made by both DT-700 and DT-707, Staff, and IAASB leadership in advance of the April 2013 IAASB Meeting.

- *Auditor Commentary* – New requirement for auditors of listed entities to report in accordance with proposed new ISA 707 under the heading “Key Matters of Audit Significance” (see paragraph 32 of **Agenda Item 2-D** as well as **Agenda Item 2-A**).
- *Other Information* – New requirement to report in accordance with proposed ISA 720 (Revised); Updates to the illustrative report to incorporate wording used in the proposed ISA 720 (Revised) exposure draft (see paragraph 33 of **Agenda Item 2-D** as well as paragraphs 23–26 and 37 of Section III of **Agenda Item 2-B**).

¹² International Accounting Standard (IAS) 1, *Presentation of Financial Statements*

- *Auditor's Responsibility* – New requirement added to explain how the auditor's report is affected when the auditor chooses to relocate material describing the "Responsibility for the Audit of the Financial Statements" in an Appendix to the auditor's report or when law, regulation or national auditing standards permit the auditor to refer to a website of an appropriate authority rather than include such material in the auditor's report. For example, when the auditor does so, the auditor shall include a reference in the auditor's report to clearly indicate where this material is located) (see paragraph 40 of **Agenda Item 2-D** as well as paragraph 59 of Section V of **Agenda Item 2-B**).
- *Other Reporting Responsibilities (ORR)* – New requirement to take into account the view expressed by respondents to the ITC that greater flexibility is need to combine ISA reporting with ORR in particular areas (such as going concern and other information. The requirement specifies that the auditor's report shall clearly distinguish between reporting required by the ISAs and other reporting required by law or regulation (see paragraph 41 of **Agenda Item 2-D**). Extant application material will be refined and new material developed to illustrate how such reporting could be combined.
- *Disclosure of the Name of the Engagement Partner* – New requirement to reflect DT-700's position based on responses to the ITC that, for listed entities, the engagement partner's name should be available to the users of the financial statements and the auditor's report through some public mechanism (see paragraph 42 of **Agenda Item 2-D** and paragraphs 68–69 of Section VI of **Agenda Item 2-B**).

Matters for IAASB Consideration

1. During the IAASB meeting, the DT Chair will walk through the proposed ISA 700 requirements in **Agenda Item 2-D**. IAASB members are asked to share their views on:
 - (a) The appropriateness of the changes in light of DT-700's rationale described above and in **Agenda Item 2-B**.
 - (b) DT-700's suggestions as to areas where application material may be necessary, and any other circumstances that could usefully be addressed by new application material.
 - (c) Further considerations relating to small- and medium-sized entities (SMEs) and public sector organizations that could be addressed in application material, in light of the IAASB's commitment in the ITC to do so.

Other Issues to be Further Considered and Concluded on by DT-700

13. In further revising proposed requirements in ISA 700 and developing new application material, DT-700 intends to take other matters into account, based on responses to the ITC and feedback received at the IAASB's auditor reporting roundtables. IAASB members are welcome to raise any other matters they believe need to be addressed by DT-700 in advance of the June 2013 ED. The matters to be further considered by DT-700 include the following:

Going Concern

- Determine an appropriate way forward for auditor reporting on going concern, including the extent of revisions necessary to ISA 570, bearing in mind developments of accounting standard setters

Other Information

- Determine how best to align work on auditor reporting with the finalization of ISA 720 (Revised); in this regard it is noted that the comment period on proposed ISA 720 (Revised) ends March 14, 2013 and substantive work is expected on finalizing the ISA throughout 2013
- Acknowledge that law or regulation may require, or management may engage the auditor to, provide an assurance conclusion on other information

Description of Responsibilities of Management, Those Charged with Governance and the Auditor

- Explore ways to further clarify language in the illustrative report describing the auditor's responsibilities, with the aim of reducing technical terminology where possible
- Respond to concerns about the appropriateness of the balance between entity-specific material and standardized language in the proposed revised auditor's report, recognizing this may be alleviated by allowing the auditor to relocate standardized information describing the auditor's responsibilities to an appendix or website

Disclosure of Engagement Partner Name

- Further explore how to respond to concerns raised about increased liability exposure

SME and Public Sector Considerations

- Explore ways to ensure that requirements in revised ISA 700 do not impose unnecessary cost burdens for audits of SMEs
- Develop guidance to ensure that it is clear how revised ISA 700 requirements can be applied in audits of public sector entities, in particular when other reporting requirements exist. In this regard, liaison with representatives of the International Organization of Supreme Audit Institutions (INTOSAI) will be useful.

Modifications to the Opinion in the Independent Auditor's Report

- Determine the revisions necessary to ISA 705 to incorporate the suggested improvements to auditor reporting, in particular the need for revised illustrative reports