

Basis for Conclusions:
ISA 706 (Revised and
Redrafted), “Emphasis of Matter
Paragraphs and Other Matter
Paragraphs in the Independent
Auditor’s Report”

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Assurance Standards Board*



**International Federation
of Accountants**

BASIS FOR CONCLUSIONS:

ISA 706 (REVISED AND REDRAFTED), EMPHASIS OF MATTER PARAGRAPHS AND OTHER MATTER PARAGRAPHS IN THE INDEPENDENT AUDITOR'S REPORT

This Basis for Conclusions has been prepared by staff of the International Auditing and Assurance Standards Board (IAASB). It relates to, but does not form part of, ISA 706 (Revised and Redrafted), "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report," which was approved by the IAASB in June 2008.¹

Background

1. In March 2005, the IAASB issued an exposure draft of proposed ISA 706 (Revised). The comment period for the proposed ISA closed on July 31, 2005. The IAASB gave due consideration to the comments received and approved the "close off" document of ISA 706 (Revised) in the "old style" (i.e., following the extant ISA's drafting conventions for ISAs) in July 2006.² The IAASB's Clarity conventions were applied to those documents. An exposure draft of proposed ISA 706 (Revised and Redrafted) (ED-ISA 706) was published in July 2007.
2. The Clarity conventions used by the IAASB in redrafting its ISAs, and the authority and obligation attaching to those conventions, are established in ISA 200 (Revised and Redrafted), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing."³
3. The comment date for the exposure draft was November 30, 2007. The IAASB received forty-six comment letters from a variety of respondents, including IFAC member bodies, national standard setters, firms, regulators, government organizations, and others. Comments were also discussed with the IAASB Consultative Advisory Group (CAG). The IAASB revised the proposed ISA as a result of these comments. The following summarizes the more significant issues raised by respondents, and how the IAASB addressed them.

Objective

4. ED-ISA 706 contained the following objective:

The objective of the auditor is to include clear additional communication in the auditor's report when, in the auditor's judgment, such communication is appropriate to draw users' attention to a matter presented or disclosed in the

¹ See minutes of the June 16-20, 2008 IAASB meeting at <http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=4272>.

² The Basis for Conclusions: ISA 705 (Revised) and ISA 706 (Revised) and related close off documents are available on the IAASB website at <http://www.ifac.org/Guidance/EXD-Details.php?EDID=0062>.

³ ISA 200 (Revised and Redrafted), which was approved by the IAASB in June 2008 for submission to the Public Interest Oversight Board for its confirmation of due process, contains the final statement of the authority and obligation attaching to the Clarity conventions.

financial statements or to any other matter which may be relevant to their understanding of the financial statements or the audit.

5. Half of the respondents who expressly commented on the objective supported the objective as drafted in ED-ISA 706. Two respondents, while supporting the objective, believed it was important to include reference to the fact that the inclusion of an Emphasis of Matter (EOM) paragraph or an Other Matter paragraph does not affect the auditor's opinion.
6. Many who did not support the objective believed that it was encouraging too many additional communications since it framed such communications in terms of those that the auditor considered "appropriate." These respondents recommended that the word "appropriate" be replaced with "necessary." Others believed the concept of communicating other matters that are "fundamental to users' understanding" should be incorporated into the objective. A few felt the objective should include the notion that, in some circumstances, the auditor is required to include an EOM paragraph. A few recommended "information" be used rather than "communication," as the auditor's report as a whole constitutes a means of communication.
7. In light of respondents' comments, the IAASB agreed to revise the objective to bring in the following concepts:
 - The auditor has formed an opinion on the financial statements, before considering whether additional communication is necessary.
 - The additional communication is included *when in the auditor's judgment it is necessary to do so*.
 - An EOM paragraph is only to be included when the information is *fundamental to the users' understanding of the financial statements*.
 - An Other Matter paragraph includes the communication as appropriate of matters other than those presented or disclosed in the financial statements that are relevant to the user's understanding of the audit, the auditor's responsibilities, or the auditor's report. (See discussion on relevance to the auditor's report in paragraph 21 below).
8. The objective was also separated into bullets to address concerns over the length and complexity of the objective in ED-ISA 706.

Responses to Requests for Specific Comments—New Requirement to Include an Emphasis of Matter Paragraph

9. The explanatory memorandum that accompanied ED-ISA 706⁴ requested respondents to comment on the inclusion of a new requirement in paragraph 7 of ED-ISA 706 that provides for the auditor to use an EOM paragraph only if the auditor has obtained

⁴ The explanatory memorandum formed part of the exposure draft of proposed ISA 706 (Revised and Redrafted), which can be found at <http://www.ifac.org/Guidance/EXD-Details.php?EDID=0092>.

sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements. It also requires that an EOM paragraph only refer to information presented or disclosed in the financial statements.

10. While respondents generally supported the proposal, similar to concerns expressed with respect to the objective, one respondent believed that this requirement did not set precise boundaries around the use of EOM paragraphs and may impose an additional reporting responsibility on the auditor that exceeds the objective of expressing an opinion on the financial statements. Some also believed that the requirement should acknowledge that in certain specified circumstances (i.e., by virtue of requirements in other ISAs) the auditor is *required* to include an EOM (this is also the case for Other Matter paragraphs).
11. Based on the respondents' support, the IAASB agreed that the new requirement should be retained. The requirement was, however, strengthened to require the auditor to include an EOM paragraph when the auditor determines it is necessary. Further, a new paragraph (paragraph 2) was added in the final ISA to highlight that other ISAs require the auditor to include an EOM paragraph or Other Matter paragraph and, in those cases, the requirements in ISA 706 (Revised and Redrafted) regarding the form and placement of those paragraphs apply.
12. The other ISAs which require the auditor to include an EOM paragraph have been listed in Appendix 1 of the final ISA.

Definitions

13. A few respondents were concerned with the level of detail in the Scope section of this ISA. These respondents suggested the IAASB include definitions of EOM paragraphs and Other Matter paragraphs in the ISA, using the material in paragraphs 3-4 of ED-ISA 706. The IAASB agreed with this suggestion and has included definitions in the revised ISA.

Requirements

14. The majority of respondents were of the view that the criteria identified by the IAASB for determining whether a requirement should be specified have been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and reporting, and the use of professional judgment by auditors.
15. Although some respondents commented on the appropriateness of some of the requirements or suggested refinement, no single requirement received a significant number of comments. Comments that resulted in changes to ED-ISA 706 and matters for the IAASB's possible future consideration are discussed below.

Other Matter in the Auditor's Report

16. Some respondents believed that the requirement for the auditor to include an Other Matter Paragraph should mirror the two requirements included in the ISA relating to Emphasis of Matter paragraphs. Due to the differences between an Emphasis of Matter paragraph and an Other Matter paragraph, the IAASB disagreed. However, as noted in

paragraph 11 above, the Scope section of this ISA was modified to highlight that the auditor is required to include an Other Matter paragraph in certain specified circumstances. The other ISAs which require the auditor to include an Other Matter paragraph have been listed in Appendix 2 of the final ISA.

17. Paragraph 34 of ED-ISA 700⁵ explained that law or regulation may require the auditor, or the auditor may consider it appropriate, 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. It required the auditor to address such matters under the heading Other Matters in the auditor's report.
18. Respondents to ED-ISA 700 held diverse views on this paragraph, and a number of respondents to ED-ISA 706 also believed that the distinction between the requirement in ED-ISA 700 and the material included in ED-ISA 706 needed to be clarified. To avoid confusion, it was suggested that Other Matters be dealt with only in one ISA. Accordingly, it was recommended that such matters be addressed only in ISA 706 (Revised and Redrafted) and that the reference to other matters in ED-ISA 700 be deleted.
19. The IAASB agreed that the requirement to include an Other Matter paragraph in the auditor's report in prescribed circumstances, including its presentation and position, should be dealt with solely in ISA 706 (Revised and Redrafted). The material in paragraph 34 of ED-ISA 700 has been subsumed into the requirement in paragraph 8 of ISA 706 (Revised and Redrafted) and was not carried forward to proposed ISA 700 (Redrafted).⁶
20. In response to comments received on ED-ISA 700, the IAASB developed two new paragraphs, providing guidance on additional circumstances in which an Other Matter paragraph may be necessary. They are presented as paragraphs A8 and A9 of ISA 706 (Revised and Redrafted). These paragraphs are:
 - (a) *Restriction on Distribution or Use of the Auditor's Report.* New paragraph A9 of ISA 706 (Revised and Redrafted) explains that financial statements prepared for a specific purpose may be prepared in accordance with a general purpose framework because the intended users have determined that such general purpose financial statements meet their financial information needs. Since the auditor's report is intended for specific users, the auditor may determine it necessary in the circumstances to include an Other Matter paragraph, stating that the auditor's report is intended solely for the intended users, and should not be distributed to or used by other parties.
 - (b) *Reporting on More than One Set of Financial Statements.* New paragraph A8 of ISA 706 (Revised and Redrafted) explains that an entity may prepare one set of financial statements in accordance with a general purpose framework (e.g., the

⁵ Exposure Draft of ISA 700 (Redrafted), "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements," issued in

⁶ Proposed ISA 700 (Redrafted), "Forming an Opinion and Reporting on Financial Statements."

national framework) and another set of financial statements in accordance with another general purpose framework (e.g., International Financial Reporting Standards), and engage the auditor to report on both sets of financial statements. If the auditor has determined that the frameworks are acceptable in the respective circumstances, the auditor may include an Other Matter paragraph in the auditor's report, referring to the fact that another set of financial statements has been prepared by the same entity in accordance with another general purpose framework and that the auditor has issued a report on those financial statements.

21. The IAASB recognized that the matters addressed in these two new paragraphs are intended to enhance users' understanding of the auditor's report as opposed to the audit. Accordingly, the IAASB determined it was necessary to expand the definition of an Other Matter paragraph to "a paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities, *or the auditor's report.*" Changes to include this phrase were also made throughout the requirements.