

Meeting: IAASB Consultative Advisory Group
Meeting Location: New York
Meeting Date: September 8-9, 2014

Agenda Item G.1

Auditor Reporting—ISA 700/Other Suggested Improvements to the Auditor's Report – Report Back, Issues and Drafting Team Recommendations

Objectives of Agenda Item

1. To provide a report back on comments of the Representatives on this project as discussed at the March 2014 CAG Meeting.
2. To discuss issues and Drafting Team (DT-700) recommendations relevant to finalizing proposed ISA 700¹ (**Agenda Item G.2**) and ISA 705² (**Agenda Item G.3**).

March 2014 CAG Discussion

3. Below are extracts from the draft minutes of the March 2014 CAG meeting on the discussion of Agenda Item C.3,³ and an indication of how the project Task Force or IAASB has responded to the Representatives' and Observers' comments.

Representatives' Comments	Task Force/IAASB Response
<i>Independence and Ethical Requirements</i>	
<p>Mr. Koktvedgaard supported DT-700's recommendation to retain the statement about independence but echoed the views of the International Ethics Standard Board for Accountants (IESBA) Planning Committee, expressing concern about losing a reference to a framework of independence and ethical requirements. Messrs. Hines, Waldron and White and Ms. Blomme agreed, as did Ms. Sucher, who expressed a personal view.</p> <p>Mr. Koktvedgaard reiterated that having an explicit reference to the source of independence requirements adds transparency to the auditor's report so that users understand under which regime the auditor is</p>	<p>Point accepted.</p> <p>See further discussion in Section I below.</p>

¹ Proposed ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

² Proposed ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*

³ The minutes will be approved at the September 2014 IAASB CAG meeting.

Representatives' Comments	Task Force/IAASB Response
<p>confirming independence, which is in the public interest. Mr. Koktvedgaard noted this was particularly important in the context of multi-jurisdictional audits, as the requirements applicable to the group auditor cannot necessarily be exported to the component auditor.</p>	
<p>Ms. Sucher, supported by Mr. Bluhm, acknowledged that merely listing the sources in a complex group audit does not allow for users to understand the potential implications of the differences between the various ethical frameworks.</p>	<p>Point taken into account. DT-700 considered this point and has refined the application material in proposed ISA 700 (Revised) to better address the complexities that may arise in applying the proposed requirement in group audit circumstances.</p> <p><i>See further discussion in Section I below.</i></p> <p><i>See paragraphs A34–A39 of Agenda Item G.2</i></p>
<p>Mr. Koktvedgaard acknowledged the practical challenges of listing all sources and suggested that, as a possible way forward, DT-700 consider a reference to the IESBA Code as a source in the auditor's report. Mr. Koktvedgaard also noted that jurisdictions in which there are multiple sources of independence requirements would likely make reference to a national set of standards, which would be understood to apply in that country. Mr. White suggested that disclosing the list of sources would clarify to users that the same level of convergence in relation to independence and ethical standards does not exist as is the case with accounting and auditing standards.</p> <p>Mr. Waldron suggested that there is some merit for users in knowing the sources and added that, although listing sources of independence and ethical requirements may result in an even longer auditor's report, such a reference would signal a stronger message about auditor independence.</p>	<p>Point accepted.</p> <p><i>See further discussion in Section I below.</i></p> <p><i>See paragraphs 28(c), and A34–A39 of Agenda Item G.2.</i></p>
<p>Ms. Blomme suggested that DT-700 consider requiring a more generic reference to sources of independence requirements in the auditor's report and that the ISA allow for reference to more detailed disclosure on the applicable sources, for example by way of reference to a website.</p>	<p>Point taken into account.</p> <p>The proposed requirement allows for a more generic reference about sources to be included. It also explains that law or regulation, national auditing standard or the terms of an audit engagement may require the auditor to provide more specific information about the source of the relevant ethical requirements, including those pertaining</p>

Representatives' Comments	Task Force/IAASB Response
	<p>to independence that applied to the audit of the financial statements. However, proposed ISA 700 (Revised) does not address the possibility of referencing to a more detailed disclosure about sources located on a website.</p> <p><i>See further discussion in Section I below.</i></p> <p><i>See paragraphs 28(c) and A36 of Agenda Item G.2.</i></p>
<p>Mr. Dalkin supported DT-700's recommendation, noting that listing sources would be a cumbersome disclosure that would not be very meaningful to readers, in particular given that individual auditors on an engagement may be subject to requirements from a wide variety of sources. Messrs. Bluhm, Fukushima, Hansen and James agreed.</p>	<p>Point taken into account.</p> <p>The Board agreed to retain a requirement to list sources by way of indicating the relevant ethical requirement relating to the audit of the financial statements. The Board also agreed to include new application material to help auditors determine the appropriate amount of information to include in the auditor's report when there are multiple sources relevant ethical requirements relating to the audit of the financial statements.</p> <p><i>See further discussion in Section I below.</i></p> <p><i>See paragraphs 28(c) and A37 of Agenda Item G.2.</i></p>
<p>Mr. Hines acknowledged that actuaries face the same tensions described by Mr. Dalkin in terms of disclosing a lengthy list of applicable sources of standards. However, he was of the view that, when there is a potential for work to be done under different sets of standards, it is critical to identify which set of standards applied to the engagement.</p>	<p>Point accepted.</p> <p><i>See further discussion in Section I below.</i></p> <p><i>See paragraphs 28(c) Agenda Item G.2.</i></p>
<p>Mr. Fukushima added that there was not much incremental value to be derived from having the statement about independence in the auditor's report, because the title of the auditor's report already conveyed the appropriate message about auditor independence.</p>	<p>Point not accepted.</p> <p>The IAASB continues to be of a view that information about independence and other relevant ethical requirements in the auditor's report provides value to users, and emphasizes the important role of independence and ethics in the audit.</p>
<p>Mr. Hansen suggested that comments from investors broadly acknowledged the value of the statement, but some investors did not seem to support disclosure about the sources of independence requirements. He personally was hesitant to list the sources.</p>	<p>Point taken into account.</p> <p>Recognizing the practical challenges that could arise from listing sources, the IAASB tentatively agreed at its June 2014 meeting to move away from the requirement to list sources, and instead require auditors to identify the jurisdiction of origin of relevant ethical requirements in the auditor's report.</p> <p><i>See paragraphs 28(c), and A34–A39 of Agenda Item G.2.</i></p>

Representatives' Comments	Task Force/IAASB Response
<p>Rather than including a list of sources of independence requirements in the auditor's report, Mr. Fukushima noted that IOSCO supported requiring the auditor to communicate breaches of independence requirements in the auditor's report; as such matters could meet the definition of KAM (Key Audit Matters). He suggested the IAASB could clarify how such reporting may be done.</p>	<p>Point partially taken into account.</p> <p>The IAASB continues to be of the view that breaches of independence requirements should not be required, as set out in the Explanatory Memorandum of the ED, in part because it would be extremely difficult to provide this disclosure in a way that would be well understood. Previous discussions with the IESBA indicate a similar view.</p> <p>However, should the auditor determine a breach of independence to be a KAM, nothing in proposed ISA 701 would preclude the auditor from communicating the matter.</p>
<p>Mr. James suggested that DT-700 consider reinstating wording from the ED to explicitly state from whom the auditor is independent, namely, the entity.</p>	<p>Point accepted.</p> <p><i>See paragraph 28(c) and the illustrative auditor's reports in the Appendix to Agenda Item G.2.</i></p>
<p><i>Disclosure of the Engagement Partner's (EP) Name</i></p>	
<p>Ms. de Beer noted that the CAG previously had given a very strong steer towards having a requirement to name the EP in the auditor's report.</p> <p>Mr. Waldron was not supportive of the proposal to identify the EP and was of the view that the requirement should explicitly require the EP to be named in the auditor's report. He challenged DT-700's interpretation of the feedback received and suggested that further consideration be given to those commenters who responded positively to the ITC, but did not respond to the ED.</p> <p>Mr. Waldron was of the view that DT-700's recommendation was not dissimilar to a previously proposed option of only naming the EP in the auditor's report in circumstances when the name of the EP is not otherwise publicly available. Mr. Waldron noted that DT-700's proposal, much like the "otherwise publicly available" approach, would not meet investors' need for transparency because it would not allow for easy access to the EP's name in the auditor's report.</p> <p>Messrs. Hansen (who believed the EP's license number should also be disclosed), Koltvedgaard, Lu, Stewart (who suggested that identification should be</p>	<p>Point accepted.</p> <p>At its March 2014 meeting, the IAASB agreed to revert to the position to require auditors to disclose the name of, rather than "identify", the engagement partner in the auditor's report for audits of financial statements of listed entities, with additional application material to be provided to explain that law, regulation or national auditing standards may require the auditor to include additional information to assist in identifying the engagement partner or the auditor may consider it useful to do so.</p> <p><i>See paragraph 46 of Agenda Item G.2.</i></p>

Representatives' Comments	Task Force/IAASB Response
<p>freely available without charge), Thompson, and Ms. Borgerth agreed. Mmes. Borgerth and Lopez and Messrs. Lu and Thompson added that the requirement to disclose the name of the EP in the auditor's report is already in practice in many jurisdictions, including Brazil, Europe, and many countries in Asia. Mr. Koktvedgaard expressed the view that naming the EP is directly linked to audit quality and the perception of personal accountability.</p> <p>Mr. Waldron further explained that he tested an instance of <i>identifying</i> the EP name, and he had to go through at least seven steps for a US audit engagement in order for the identification to be done.</p>	
<p>Mr. Waldron, supported by Mr. Koktvedgaard, suggested that the requirement for disclosing the name of the EP in the auditor's report be extended to all entities.</p>	<p>Point not accepted.</p> <p>Sensitive to the concerns raised by certain respondents about potential unintended consequences, the IAASB remains of the view that a measured approach whereby the requirement to name the EP only in auditor's reports of listed entities continues to be appropriate. Proposed ISA 700 (Revised) explains that law, regulation or national auditing standards may require that the auditor's report include the name of the EP responsible for audits other than those of financial statements of listed entities.</p> <p><i>See paragraph A60 of Agenda Item G.2.</i></p>
<p>Mr. Dalkin noted that the US Government Accountability Office requires the inclusion of the name of the EP in the auditor's report. However, Mr. Dalkin noted his personal view that there was not much value to including this information in the auditor's report.</p>	<p>Point noted.</p>
<i>Harm's Way Exemption</i>	
<p>Mr. James suggested that the DT-700 consider describing within the ISA what is meant by "significant threat" and the word "rare", in order to establish appropriate thresholds for the invocation of the harm's way exemption.</p>	<p>Point accepted.</p> <p>Mr. Winter indicated that DT-700 would seek to develop application material with respect to the harm's way exemption; this is now included in the proposed ISA.</p> <p><i>See paragraph A61 of Agenda Item G.2.</i></p>
<p>Mr. Hansen agreed and also challenged the need for including the harm's way exemption in the ISA, which</p>	<p>Points taken into account.</p> <p>Mr. Winter added that DT-700 had considered, but opted</p>

Representatives' Comments	Task Force/IAASB Response
<p>he did not support. Mr. Hansen suggested that it may be helpful to indicate by way of example when it would be appropriate for the auditor to invoke such an exemption. Ms. Sucher expressed support for having a harm's way exemption in the ISA and, in response to Mr. Hansen, noted that in some industries the threats to the auditor are very real, and it is pragmatic to allow an exemption for naming the EP in the auditor's report for those rare situations.</p>	<p>against, the idea of including types of entities or industries for which auditors may likely invoke the harm's way exemption as examples, so as not to be seen to promote the use of the harm's way exemption in those cases. Mr. Winter added that the concept of having a harm's way exemption is not new, as it already exists in certain jurisdictions.</p> <p>The IAASB believes the changes to the requirement to explicitly acknowledge the potential use of the harm's way exemption, and the additional guidance that has been provided to contrast circumstances that would not be considered to meet the threshold for a harm's way exemption, are an appropriate response to the concerns about including the possibility of such an exemption in the final standard.</p> <p><i>See paragraph A61 of Agenda Item G.2.</i></p>
<p><i>Enhanced Description of the Auditor's Responsibilities and Its Relocation to an Appendix or Website</i></p>	
<p>Mr. Koktvedgaard expressed support for DT-700's proposal with respect to the enhanced description, but suggested that DT-700 clarify in the ISA what is meant by the term "website of an appropriate authority" (i.e. state whether the website of the company, audit firm or other organization would be appropriate).</p> <p>Mr. Thompson and Ms. Lang supported DT-700's proposal, including the option to relocate the description to an appendix or website, but expressed a preference for jurisdictions to decide who at a national level would be considered an appropriate authority.</p> <p>Mr. Thompson pointed out (by way of reference to a UK auditor's report for Rolls Royce Holdings plc) that the auditor's report also incorporated certain information that forms part of the enhanced description by reference to a website of an audit firm.</p>	<p>Support noted and points taken into account.</p> <p>The requirement in proposed ISA 700 (Revised) relating to the location of the description of the auditor's responsibilities has been clarified. New application material now explains that an appropriate authority could be a national auditing standard setter, regulator or an audit oversight body, and that it would not be appropriate for the auditor to maintain such a website.</p> <p><i>See paragraphs 41 and A55 of Agenda Item G.2.</i></p>
<p>Mr. Koktvedgaard suggested that DT-700 should give consideration to the trend by which financial statements are accessed and read more broadly, referencing the presentation on the topic of integrated reporting (<IR>), and noting that annual reports and</p>	<p>Point taken into account.</p> <p>Proposed ISA 700 (Revised) includes illustrations of how hyperlinks could be used in the auditor's report.</p> <p><i>See paragraph A55 of Agenda Item G.2 and Illustration 3 in the Appendix to Agenda Item G.2.</i></p>

Representatives' Comments	Task Force/IAASB Response
<p>auditor's reports are being read via electronic means (via mobile devices or computers). Mr. Koktvedgaard was of a view that the use of hyperlinks to direct users to the enhanced description within the auditor's report would make it even more accessible than via a multi-page auditor's report.</p>	
<p>Mr. Hansen expressed support for DT-700's proposal with respect to the enhanced description, but did not support allowing the option for auditors to make reference to a website of an appropriate authority. If the IAASB determined it important to mandate an enhanced description, he was of a view that it should be included in all auditors' reports. Ms. Sucher and Messrs. Bluhm and Waldron agreed. Mr. Dalkin questioned whether allowing for such information to be moved to a website may be seen as signaling that the IAASB was adding information in the auditor's report that was not of value.</p>	<p>Point not accepted.</p> <p>The IAASB continues to believe that such flexibility is necessary in light of responses to the ED. However, the IAASB asked that DT-700 clarify within proposed ISA 700 (Revised) that the auditor could only refer to a description of the auditor's responsibilities that is located on a website of an appropriate authority when law, regulation or national auditing standards expressly permit the auditor to do so, as a means of putting appropriate parameters around the option to refer to the website.</p> <p><i>See paragraph 41(c) of Agenda Item G.2.</i></p>
<i>Structure and Format of the Auditor's Report</i>	
<p>Mr. Waldron expressed support for DT-700's proposal, noting that because investors favor the pass/fail model they would likely be very supportive of having the opinion first in all auditor's reports. Mr. James agreed, adding that IOSCO supported making the auditor's opinion prominent in the auditor's report, albeit not necessarily first. Mr. James noted that DT-700's recommendation had achieved the right balance because it allowed jurisdictions the flexibility to move away the required presentation of the auditor's opinion first when law, regulation or national auditing standards require otherwise.</p>	<p>Support noted.</p>
<p>Mr. Koktvedgaard questioned whether placement of any EOM paragraphs would be mandated, suggesting that DT-700 consider mandating them to be placed in close proximity to the auditor's opinion.</p>	<p>Point taken into account.</p> <p>Ms. Healy responded that it would be difficult to mandate placement of an EOM paragraph in all cases, due to DT-570's proposals for a section describing any MU (which are akin to the extant EOM paragraph on GC), as the IAASB would essentially be determining which is relatively more important. Mr. Gunn noted that, much like the KAM section, an EOM paragraph does not modify the</p>

Representatives' Comments	Task Force/IAASB Response
	<p>auditor's opinion but rather provides additional information, so the IAASB would need to be careful not to imply that specificity in placement is seen as affecting the auditor's opinion in some way.</p> <p>Notwithstanding this, the illustrative examples (including in proposed ISA 706 (Revised) continue to suggest placement of an EOM paragraph in close proximity to the auditor's opinion may be appropriate.⁴</p>

Matters for CAG Consideration

4. The Representatives and Observers are asked to note the Report Back above. Specific Matters for CAG Consideration are set out below.

I. Statement of Independence and Other Relevant Ethical Requirements

5. With input from the IESBA, the IAASB agreed at its June 2014 meeting to require the auditor to identify the jurisdiction of origin of the independence and other relevant ethical requirements or refer to the IESBA Code in the auditor's report. Proposed ISA 700 (Revised) also includes application material that explains that the:
 - (a) Identification of the jurisdiction of origin of relevant ethical requirements increases transparency about those requirements relating to the particular engagement.
 - (b) Auditor may choose to name the relevant source(s) (for example, the name of the code, rule or regulation applicable in the jurisdiction), or may use a term that is commonly understood and that appropriately summarizes those sources (for example, independence requirements for audits of private entities in Jurisdiction X).
 - (c) Auditor's report may include a reference to the IESBA Code together with the ethical requirements that are relevant to the audit of the financial statements in the jurisdiction.

Feedback from the IESBA

6. At the IESBA's July 2014 meeting, the DT-700 Chair solicited views from IESBA members on the IAASB's revised proposal (i.e. illustrative wording, requirement and application material as agreed at the IAASB June 2014 meeting) related to having a statement about compliance with independence and other relevant ethical requirements in the auditor's report. The IESBA agenda material that facilitated this discussion is available on the IESBA website.⁵

⁴ Proposed ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Report*

⁵ See July 2014 IESBA Meeting Agenda Item 6, *Auditor Reporting—Independence and other Relevant Ethical Requirements* at <http://www.ifac.org/ethics/meetings/july-7-9-2014-new-york-usa>.

7. The IESBA unanimously supported the IAASB's June 2014 proposal, but suggested that the IAASB consider:
- (a) Providing guidance within proposed ISA 700 (Revised) to address circumstances when a dual reference to both the IESBA Code and national independence and other relevant ethical requirements might be appropriate.
 - (b) Whether the illustrative wording that refers to the IESBA Code could be more prominently presented in the standard, such that it would be indicated as the preferred approach versus having it presented as a secondary option in a footnote.
 - (c) Minor editorial and drafting suggestions aimed at clarifying the illustrative wording and the application material.

Drafting Team Recommendations

Illustrative Auditor's Reports

8. DT-700 considered the input from IESBA and recommends that changes be made to the circumstances that are assumed for the illustrative auditor's reports in proposed ISA 700 (Revised) to reflect when:
- (a) The relevant ethical requirements that apply to the audit comprise the IESBA Code, together with the ethical requirements that are relevant to the audit of the financial statements in the jurisdiction (see Illustration 1 of **Agenda Item G.2**).
 - (b) The IESBA Code comprises the relevant ethical requirements that apply to the audit (see Illustration 2 of **Agenda Item G.2**).
 - (c) The relevant ethical requirements that apply to the audit are those of the jurisdiction (see Illustrations 3–4 of **Agenda Item G.2**).
9. In the illustrative auditor's reports across all the other auditor reporting standards, for simplicity, the statement about independence and ethical requirements refers to:
- (a) The IESBA Code in the case of consolidated financial statements.
 - (b) The relevant ethical requirements that apply to the audit in the jurisdiction in all other circumstances.
10. Notwithstanding the IESBA's suggestion to illustrate reference to the IESBA Code as the preferred approach, DT-700 is of the view that illustrating different circumstances and illustrative wording in the auditor's reports in the standard would provide more guidance to auditors. DT-700 is also of the view that depicting a reference to the IESBA Code within the body of the auditor's report in Illustrations 1 and 2 of **Agenda Item G.2**, rather than how it was previously presented in a footnote, is an appropriate way to provide a steer towards referring to the IESBA Code in ISA auditor's reports.
11. Though not explicitly stated in proposed ISA 700 (Revised), it is envisaged that the auditor will only make a reference to the IESBA Code when it is applicable. Thus, in circumstances when the IESBA Code is not relevant to a jurisdiction, a reference to the IESBA Code in an auditor's report would not be appropriate.

Requirements and Application Material

12. Paragraphs 28(c), A34 and A38–A39 of **Agenda Item G.2** reflect clarifications made to the ISA resulting from input from IESBA members, in particular as it relates to the application material relevant to group audits.

Matters for CAG Consideration

1. Representatives are asked for their views on the revisions to the illustrative wording, requirement and application material in proposed ISA 700 (Revised) relating to the statement of independence and other relevant ethical requirements (paragraphs 28(c) and A34–A39).
2. Representatives are invited to share any further comments on any matters relevant to the finalization of proposed ISA 700 (Revised).

II. Revisions to ISA 705

Elements to Be Included in the Auditor's Report When the Auditor Expresses an Adverse Opinion or Disclaims an Opinion on the Financial Statements

The IAASB's Position in the Exposure Draft (ED)

13. The IAASB's proposals included in proposed ISA 705 (Revised) in the ED prohibited the auditor from including additional information on going concern, key audit matters, and other information when the auditor disclaims an opinion on the financial statements. Proposed ISA 705 (Revised) also prescribed the use of an abbreviated auditor's responsibilities section when the auditor disclaims an opinion on the financial statements. The IAASB's ED did not include such prohibitions in proposed ISA 705 (Revised) when the auditor expressed an adverse opinion.

Going concern

14. At its June 2014 meeting, the Board agreed that there may be merit in allowing for auditor reporting on material uncertainties related to going concern even when the auditor disclaims an opinion on the financial statements, given the importance investors attach to going concern issues and the fact that such disclosure would have been required by extant ISA 570. Accordingly, the requirement in paragraph 29 of proposed ISA 705 (Revised) does not prohibit the auditor from doing so.

Key audit matters (KAM)

15. Paragraphs 20–22 of Section III of **Agenda Item D.2** addresses the changes to proposed ISA 700 (Revised) and proposed ISA 705 (Revised) relating to KAM, reflecting the Board's decision at its June 2014 meeting to require reporting on KAM when the auditor expresses an adverse opinion, but to prohibit the auditor from doing so when the auditor disclaims an opinion on the financial statements as a whole, as well as other clarifications determined to be necessary to align the ISAs.

Other information (OI)

14. As the ISA 720 Task Force (TF) is still considering the implications of auditor reporting on OI more broadly, the DT-700 Chair and ISA 720 TF Chair, together with Staff, are of the view that it is more appropriate for the ISA 720 TF to consider whether auditor reporting on OI should be prohibited when

the auditor expresses an adverse opinion or disclaims an opinion on the financial statements. As such, this circumstance is no longer explicitly addressed in paragraph 29 of **Agenda Item G.3**. Rather, a conforming amendment will be made to ISA 705 (Revised), and if necessary, proposed ISA 700 (Revised), to address those issues once the ISA 720 project is finalized.

Matters for CAG Consideration

3. Representatives are asked for their views on the approach taken in paragraphs 29 and A29 of proposed ISA 705 (Revised) (**Agenda Item G.3**), and to share any further comments on any matters relevant to the finalization of proposed ISA 705 (Revised).

Material Presented – IAASB CAG PAPER

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| Agenda Item G.2 | Proposed ISA 700 (Revised), <i>Forming an Opinion and Reporting on Financial Statements</i> |
| Agenda Item G.3 | Proposed ISA 705 (Revised), <i>Modifications to the Opinion in the Independent Auditor's Report</i> |