

**[Draft for Discussion]—IAASB Invitation to Comment: Improving the Auditor's Report****Chairman's Statement**

1. The auditor's report is the auditor's primary means of communication with an entity's stakeholders. What does today's auditor's report on financial statements deliver? It is generally a short, standardized report that describes the financial statements subject to audit, the audit itself, and the respective responsibilities of management and the auditor. A cornerstone of the auditor's report is the auditor's opinion, which is either a "clean" (unmodified) opinion or a modified report with an explanation of the basis for such. This model has many virtues and has been long-standing in many jurisdictions, in some cases for decades.
2. More than ever before, however, users of audited financial statements are calling for additional, and more pertinent, information for their decision making in today's global business environment with increasingly complex financial reporting requirements. The global financial crisis also has spurred users, in particular institutional investors and financial analysts, to want to know more about individual audits and to gain further insights into the audited entity and its financial statements. And while the auditor's opinion is valued, many perceive that the auditor's report could be more informative. Change, therefore, is essential.
3. The International Auditing and Assurance Standards Board (IAASB) embraces this need for change. A quality audit should be accompanied by an informative auditor's report that delivers value to the entity's stakeholders. The IAASB's clarified International Standards on Auditing (ISAs) establish a strong basis for a single global auditing language, both for the private and the public sectors, and promote robust "thinking" audits. But the auditor's report should better explain what an auditor does and have the auditor shine light on key matters based on the auditor's work. As the calls for change continue to intensify, we know that now is the time to lay the foundations for the future of auditor reporting with an eye toward a meaningful and workable global solution.
4. This Invitation to Comment (ITC) sets out the progressive thinking of the IAASB, and the indicative direction proposed for the future auditor's report. It reflects the Board's deliberations to date on what it has learned from its research and consultations, and those of others. The IAASB is consulting now at this preliminary stage to better understand what users of the auditor's report – especially investors, but also regulators, preparers and others – would value most in terms of changes to auditor reporting. Hearing from all stakeholders at this stage will inform the Board's future standard-setting proposals in a way that will best serve the public interest.
5. You will find featured in this ITC an illustrative improved auditor's report for your feedback. There is still much work to be done, and the IAASB will continue its deliberations and outreach with stakeholders in 2012 and 2013. However, we need your input on whether we are moving in the right direction. The essential question for all stakeholders – *will the identified improvements to the auditor's report meet user demands for greater transparency about the financial statements and the audit and provide the value that is sought?*
6. I encourage all stakeholders to provide their views on the matters addressed in this ITC.

## About This Invitation to Comment



### The IAASB's Timetable for Changes to Auditor Reporting

- ❖ Close of comment period for this Invitation to Comment – September 21, 2012
- ❖ Exposure draft of revised auditing standards – June 2013
- ❖ Approval of final revised auditing standards – June 2014

Supplementing its public consultations and deliberations, the IAASB will continue its outreach program and hold roundtables in Asia Pacific, Europe, and North America in September and October 2012.

*The time needed to finalize the auditing standards takes into account the rigorous due process followed by the IAASB, which is critical to ensure that the views of those affected by its standards are thoroughly considered.*

*For more information and to follow the progress of this project, visit the Auditor Reporting project history page at [www.iaasb.org/auditor-reporting](http://www.iaasb.org/auditor-reporting).*

### Why Change Auditors' Reports Now?

7. Findings from IAASB's jointly commissioned international research on user perceptions of the auditor's report, the input obtained from the IAASB's dialogue with various stakeholders around the world, and the international feedback the IAASB has received on its May 2011 Consultation Paper, [Enhancing the Value of Auditor Reporting: Exploring Options for Change](#), have all evidenced a singular point: the status quo is not an option. There is clear demand for greater transparency about what the auditor does in an audit and, in particular, the results of that work. Further, meaningful change now, rather than incremental change over time, is seen as necessary in order to better meet the information needs of users of audited financial statements.
8. This call for change is common in many quarters of the world. Striking similarities exist in the feedback the IAASB, the US Public Company Accounting Oversight Board (PCAOB), and the European Commission (EC) have received on their recent consultations with respect to auditor reporting. Further, other national initiatives have recently focused on strengthening corporate reporting more broadly.

9. It is notable that the call for change initially came primarily from institutional investors and financial analysts who were looking to the auditor to help assist in navigating increasingly complex financial statements and point out the areas on which the auditor's work effort was focused – particularly on the most subjective matters within the financial statements. However, there are other “users” of the auditor's report, including securities regulators, lenders, and other creditors, who will have an interest in developments in this area, as will other stakeholders, including preparers, those charged with governance (TCWG) of an entity, and audit regulators.

In seeking to make judgments in the context of the financial information needs of users of the financial statements, both auditors and preparers assume that users, among other things:

- Have a reasonable knowledge of business and accounting and a willingness to study the financial statements.
- Understand the concept of materiality.
- Recognize the uncertainties inherent in the measurement of certain items in the financial statements.

#### **Finding a Global Solution to Respond to the Call for Change**

10. The call for change raises the question of how to respond to best serve the public interest. There is a wide range of possible actions to enhance auditor reporting, several of them having been set out in the IAASB's May 2011 consultation, which focused on five main options for change in auditor reporting:
- (i) Format and structure of the standard auditors' report;
  - (ii) The auditor's responsibility in relation to other information;
  - (iii) Auditor commentary;
  - (iv) An enhanced corporate governance reporting model; and
  - (v) Assurance or related services on other information or matters not within the scope of the financial statement audit.
11. The IAASB aspires to improve auditor reporting on a global basis, much as how it has worked to strengthen and harmonize the underlying work effort of audits through its clarified ISAs. This ITC sets out the progressive thinking of the IAASB, and the indicative direction proposed for the future auditor's report. The IAASB also is committed to progressing this change as quickly as possible, but needs input from a broad range of stakeholders before it is in a position to revise the relevant ISAs in the public interest.
12. The IAASB also recognizes that, to a degree, it will be necessary for auditors' reports to vary across jurisdictions due to differences in national laws and regulations. It is important that auditors' reports issued for audits conducted in accordance with ISAs share a degree of commonality that will enable investors around the world to clearly recognize these reports. Obtaining views in order to achieve the right balance between global consistency and flexibility to respond to national circumstances is an important objective of this ITC.
13. In pursuing changes to the auditor's report, the IAASB also acknowledges that other, perhaps longer-term, considerations are equally important. As noted in the IAASB's May 2011 consultation,

many believe that the type of change necessary to appropriately respond to the information needs of users and narrow the expectations<sup>1</sup> and information<sup>2</sup> gaps would be more holistic and cannot be achieved by changes to the auditor's report alone. There is a strong view by some that consideration of the information that is included within, and outside of, the financial statements, and the role of TCWG (for example, an entity's Board of Directors or Audit Committee), is paramount to further meaningful change.

14. There is also a role for accounting standard setters to play in ensuring that the financial statements that result from the application a financial reporting framework meet the financial information needs of users. Management and TCWG have a responsibility to prepare the financial statements in a manner that achieves fair presentation but, perhaps even more importantly, should seek to present information in the entity in a manner that gives users of the financial statements a clear and complete picture of the entity and its operations, including its financial results. The collective efforts of the IAASB, and these and other groups, are all with the same goal in mind: to improve users' ability to make more informed decisions on the basis of the financial statements and the audit.

### What Is the IAASB Suggesting to Improve Auditor Reporting?

The IAASB's stated objectives are:

- To appropriately enhance the communicative value and relevance of the auditor's report through proposed revisions to ISA requirements that address its structure and content; and
- To determine whether and how the IAASB's reporting ISAs, in their design, can be modified to accommodate evolving national financial reporting regimes, while at the same time ensuring that common and essential content is being communicated.

15. This ITC serves to help ensure that the IAASB has a robust understanding of views internationally about the value and viability of the IAASB's preferred options for change and how best to effect these changes globally. The IAASB's deliberations have been guided by the following:
- *Change to the auditor's report must have value to users and be capable of being operationalized internationally.*
  - *Users have asked the auditor to enhance their ability to navigate and better understand increasingly complex financial reports.*
  - *More transparency is needed about key matters related to the audited financial statements and the nature of, and work performed in, an ISA audit.*
  - *The current scope of an ISA audit should be maintained (though the IAASB will reconsider this position if responses to the ITC indicate a pervasive need to do so in light of particular options for change in auditor reporting).*

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<sup>1</sup> The term "expectations gap" has been defined and described in a number of ways. In the broadest terms, the expectations gap is the difference between what users expect from the auditor and the financial statement audit, and the reality of what an audit is.

<sup>2</sup> The term "information gap" describes the divide between what users believe is necessary to make informed investment and fiduciary decisions, and what is available to them through the entity's audited financial statements, the auditor's report or other publicly available information.

- *There is a need to preserve the separate responsibilities of management and TCWG, as providers of original information about an entity, and the auditor.*
- *The need for national auditing standard setters (NSS) to tailor or further specify requirements based on the national financial reporting regime should be retained.*
- *A revised auditor reporting standard must be capable of being applied on a proportionate basis to all entities.*

While preliminary at this stage, the IAASB has reached general agreement on a number of improvements to auditor reporting that it believes in principle should be promulgated internationally.

- **Prominent placement of the auditor's opinion and other entity-specific information in the auditor's report in audit reports issued in accordance with ISAs**
- **Auditor commentary on matters that, in the auditor's judgment, are likely to be most important to users' understanding of the audited financial statements or the audit, which would include:**
  - **Expanded Emphasis of Matter (EOM) paragraphs to highlight important matters in the financial statements**
  - **Expanded Other Matters (OM) paragraphs to address matters of audit significance**
  - **Requirements to include EOM and OM paragraphs for audits of PIEs (which includes, at a minimum, listed entities)**
- **Auditor conclusion on the appropriateness of management's use of the going concern assumption in preparing the financial statements and an explicit statement as to whether material uncertainties have been identified**
- **Auditor statement as to whether any material inconsistencies have been identified based on the auditor's reading of other information, and specific identification of the information considered by the auditor**
- **Other proposals to provide transparency about the audit performed and clarify the auditor's responsibilities in an ISA audit**

### **What Do We Need from Respondents to This ITC?**

16. Feedback to the IAASB on its thinking at an early stage, before endeavoring to revise its auditor reporting standards, is essential. As investors and analysts in general have been leading the call for change, the IAASB is particularly interested in hearing from them as to whether the IAASB's proposed improvements to the auditor's report will provide useful additional information and increase the relevance and value of the report. **Understanding the improvements to auditor reporting that are most important from users' perspectives, and whether the direction outlined in this ITC would enhance the value of auditor reporting, will help enable the IAASB to best meet its public interest mandate in this important area. Reactions to the illustrative auditor's report on pages 7–10 will be particularly welcome.**

17. Input from all stakeholders, however, is vital, and will help the IAASB ascertain both the value and potential impediments of its proposals. In particular:
  - Auditors and regulators will likely provide insights on the practical aspects, including any challenges, of implementing these proposed changes.
  - Preparers and TCWG are likely to have views on these proposals in light of their financial reporting responsibilities, including how the proposals may affect their interactions with the auditor.
  - NSS can provide insight on both value and possible impediments relative to global adoption and in light of national financial reporting regimes.
18. Appendix 1 includes specific questions to assist the IAASB in evaluating the appropriateness of the direction it may take to enhance auditor reporting globally. The IAASB welcomes responses, including an articulation of underlying reasoning for respondents' views, even if only some of the listed questions are addressed. All comments will be considered a matter of public record and will ultimately be posted on the IAASB's website.

## Illustration of a Possible Improved Auditor's Report

### How the Illustrative Report Was Developed

19. The illustrative report is intended to show the result of the improvements the IAASB has identified that could be made to the auditor's report. The illustration assumes the common scenario of a "clean" (i.e., unmodified) opinion issued on an audit of financial statements in accordance with International Financial Reporting Standards (IFRSs) (i.e., a fair presentation framework). It also assumes the auditor has other reporting responsibilities specified by national law or regulation although these other responsibilities are not specified.
20. Subject to feedback received from this consultation, the IAASB will determine whether to mandate these improvements for all audits conducted in accordance with ISAs. For reference, an illustration of the current auditor's report under ISA 700<sup>3</sup> is included in Appendix 4.
21. Any new international auditor reporting standard must be capable of being implemented in diverse national environments. Accordingly, the IAASB has also developed what is referred to as a "building blocks" approach. This approach seeks to help ensure users comparing auditors' reports, for example for audits of listed entities, find the same consistent elements in each, while accommodating additional elements specific to the national context when appropriate. The building blocks approach, and the changes to the illustrative report that could arise from its application, is explained further in the section *How Can the IAASB's Improvements Be Applied around the World?*
22. In developing the illustrative report, the IAASB used a value and impediments model (described in Appendix 2) to help evaluate and narrow options to those that it believes should be pursued. The IAASB is proposing options where it believes the perceived value outweighs any identified impediments, rather than simply examining the lowest cost options or those with the lowest impediments. The IAASB also acknowledged that certain impediments, although appearing to be high, may not be insurmountable.

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<sup>3</sup> ISA 700, *Forming an Opinion and Reporting on Financial Statements*

# Illustration of a Possible Improved Auditor's Report

## INDEPENDENT AUDITOR'S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

### Report on the Financial Statements

#### Opinion [See paragraph 24]

In our opinion, the accompanying financial statements present fairly, in all material respects, *(or give a true and fair view of)* the financial position of ABC Company (the 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 (IFRSs).<sup>4</sup> The financial statements comprise the statement of financial position as at December 31, 20X1, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

#### Basis for Opinion [See paragraph 25]

We have audited the accompanying financial statements in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibility* section of our report. In performing our audit, we complied with relevant ethical requirements applicable to financial statement audits, including independence requirements. [See paragraphs 77–79] We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### Going Concern [See paragraphs 30–39]

##### *Use of the Going Concern Assumption*

As part of our audit of the financial statements, we have concluded that management's<sup>5</sup> use of the going concern assumption in the preparation of the financial statements is appropriate.

##### *Material Uncertainties Related to Events or Conditions that May Cast Significant Doubt on the Company's Ability to Continue as a Going Concern*

Based on the work we have performed, we have not identified material uncertainties related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern that we believe would need to be disclosed for the fair presentation of the financial statements. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Company's ability to continue as a going concern.

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<sup>4</sup> For purposes of this illustration, this auditor's report has been prepared assuming IFRSs is the applicable financial reporting framework. All references to IFRSs (or requirements under IFRSs) would be tailored to reflect the application of another financial reporting framework.

<sup>5</sup> Or other term that is appropriate in the context of the legal framework in the particular jurisdiction. For example, those charged with governance, rather than management, may have these responsibilities. This applies throughout this illustrative auditor's report.

The following shaded material represents examples of auditor commentary resulting from expanded Emphasis of Matter and Other Matter paragraphs. Auditors of public interest entities (PIEs) would be required to include Auditor Commentary based on the auditor's judgment about matters that are likely to be most important to users' understanding of the audited financial statements or the audit. The specific topics and content presented herein are purely for illustrative purposes. These sections would be tailored to the facts and circumstances of the individual audit engagement and the entity, and therefore will vary in terms of the number and selection of topics addressed and the nature in which they may be described.

### **Auditor Commentary** [See paragraphs 40–67]

In connection with our audit and without modifying our opinion, we highlight the following matters that, in our judgment, are likely to be most important to users' understanding of the audited financial statements or our audit. Our audit procedures relating to these matters were designed in the context of our audit of the financial statements as a whole, and not to express an opinion on individual accounts or disclosures.

#### *Goodwill*

In recent years, the Company has acquired operations in several countries. Goodwill attributable to these acquisitions is XXX, which is material to the financial statements as a whole and for which the annual impairment test is complex and highly judgmental. As disclosed in Note 3, the Company performed this testing as at [date] and determined goodwill was not impaired. However, due to the current economic conditions particularly in Continental Europe, there is inherent uncertainty embedded in the five-year cash flow projections. The Company has disclosed that a decline of Y% in the fair value of these units would, all other things being equal, give rise to an impairment of the goodwill in the future and such an impairment would have a material negative effect on the Company's statement of financial position and statement of comprehensive income, but would not impact its cash flow from operations.

#### *Outstanding Litigation*

The Company is exposed to various claims and contingencies in the normal course of business. We note the uncertainty related to two significant matters outstanding as of December 31, 20X1. We draw attention to Note 9, which describes the Company's involvement in a patent claim that has been ongoing for several years, and the Company's potential liability for an environmental claim relating to a business that was sold in 20X0.

#### *Valuation of Financial Instruments*

Due to the significant measurement uncertainty underlying the Company's structured financial instruments, we determined that there was a high risk of material misstatement of the financial statements related to the valuation of these financial instruments and planned our audit procedures to respond to this risk. Our audit engagement team included valuation specialists within our firm to evaluate and test management's use of a model. The Company's disclosure with respect to its structured financial instruments is included in Note 5.

#### *Revenue Recognition*

The terms and conditions of the Company's contracts determine the revenue that the Company recognizes in a period, as disclosed in Note 2. The process to measure the amount of revenue to recognize in a period is subject to significant management judgment. As a result, we determined that there was a high risk of material misstatement of the financial statements related to revenue recognition. Our assessment of this risk included an expectation that certain controls over the Company's contracts were operating effectively. During 20X1, the Company implemented a new system for recording these

contracts. The Company's internal audit function tested the design and implementation of the new system, and we reviewed and tested this work. We performed additional tests of controls on the new system, as well as tests of controls on the previous system that had been in place for the first half of the year. Based on exceptions noted during our testing of controls of the new system, we expanded our audit procedures to include confirmation of the terms of the Company's contracts directly with customers on a test basis.

**Other Information** [See paragraphs 68–74]

As part of our audit, we have read [*clearly identify the specific other information read, e.g., the Chairman's Statement, the Business Review, etc.*] contained in [*specify the document containing the other information, e.g., the annual report*], for the purpose of identifying whether there are material inconsistencies with the audited financial statements. Based upon reading it, we have not identified material inconsistencies between this information and the audited financial statements. However, we have not audited this information and accordingly do not express an opinion on it.

**Respective Responsibilities of Management, [Appropriate Title for Those Charged with Governance], and the Auditor**

*Responsibility of Management and [Those Charged with Governance] for the Financial Statements*

[See paragraphs 89–90]

Management is responsible for the preparation and fair presentation of these financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. [Those charged with governance] are responsible for overseeing the strategic direction of the Company and overseeing the financial reporting process.

Going Concern Assumption [See paragraph 36]

Under IFRSs, management is responsible for making an assessment of the Company's ability to continue as a going concern when preparing the financial statements. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period. The Company's financial statements are prepared on a going concern basis, unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Material Uncertainties Related to Going Concern [See paragraph 36]

Also, IFRSs require that, when management is aware of material uncertainties related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern, management disclose those uncertainties in the financial statements.

*Auditor's Responsibility* [See paragraphs 85–88]

The purposes of our audit are to obtain reasonable assurance that the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the

aggregate, they would influence economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism through the planning and performance of an audit and to:

- Identify, assess and respond to the risks of material misstatement in the financial statements, including selecting audit procedures to obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. This responsibility includes designing and performing procedures to identify and assess the risk of material misstatement due to fraud, and obtain audit evidence in response to that risk. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Consider internal control relevant to the audit 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 Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Obtain sufficient appropriate audit evidence regarding the financial information of all entities and business activities within the group to express an opinion on the group financial statements. To this end, we request other auditors to perform work on certain entities or business activities within the group. We are responsible for the direction, supervision and performance of the group audit engagement and remain solely responsible for our audit opinion. [Bullet applicable for group audits only]  
[See paragraph 83]
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Communicate with [those charged with governance] regarding the planned scope and timing of the audit, the significant audit findings, and any significant deficiencies in internal control that we identify during our audit. We also communicate with them regarding all relationships and other matters that we believe may reasonably be thought to bear on our independence. [Last sentence for listed entities only]

### **Report on Other Legal and Regulatory Requirements** [See Appendix 5]

The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities prescribed by local law, regulation, or national auditing standards. Depending on the matters addressed by other law, regulation or national auditing standards, national auditing standard setters may choose to group reporting on these matters with reporting as required by the ISAs (shown in the Report on the Financial Statements section).

[Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate for the particular jurisdiction]

The engagement partner responsible for the audit resulting in this report is [*name*]. [See paragraphs 75–76]

[Address]

[Date]

## IAASB Viewpoints and Explanation of Proposed Direction Included in the Illustrative Auditor's Report

*This section provides an overview of the key IAASB deliberations to date in support of the possible actions to improve auditor reporting as reflected in the illustrative auditor's report included in this ITC. The IAASB's views on value and impediments relating to possible actions to improve auditor reporting are also summarized for respondents' consideration. The illustrative auditor's report represents the proposed direction of the IAASB based on its deliberations to date. Feedback from this consultation will further inform the IAASB decision-making in developing standard-setting proposals, including its approach to new requirements and guidance for auditors related to auditor reporting. The following is not intended to be a comprehensive explanation of all options considered. However, as noted in paragraph 22, in exploring possible improvements to the auditor's report, the IAASB used a value and impediments model to help evaluate and narrow options to those that it believes should be pursued. Interested parties can find this information in the publicly-available IAASB meeting materials referenced in the Auditor Reporting project history.<sup>6</sup>*

### Ordering of Elements within the Illustrative Auditor's Report

23. The illustrative auditor's report on pages 7-10 reflects the IAASB's suggested improvements to auditor reporting. This illustrative auditor's report includes the IAASB's preferred wording and ordering of the matters to be addressed in a revised ISA auditor's report. As part of its improvements, to the extent practicable, the IAASB plans to mandate the ordering of auditor reporting elements within auditors' reports across entities and jurisdictions, unless otherwise required by law or regulation.

### Greater Prominence to the Auditor's Opinion

24. A number of respondents to the IAASB's May 2011 consultation, particularly regulators, supported making the auditor's opinion more prominent within the auditor's report. It was noted that the "pass/fail" nature of the audit opinion has value and is currently the focal point for readers of the auditor's report. Accordingly, the IAASB is suggesting that the opinion be presented first in the illustrative report. The auditor's opinion would be accompanied by the description of the financial statements, and would make explicit reference to the notes, which are an integral part of the financial statements. This explicit reference to the notes to the financial statements is considered preferable to the current generic reference to "other explanatory information," reflecting the importance of the notes and the growing emphasis on the auditor's responsibilities for disclosures. It has the further benefit of avoiding confusion with "other information," which is proposed to be addressed in a new separate section of the auditor's report (see paragraphs 68–74).

### Basis for Opinion

25. The ISAs currently require the auditor to include a Basis for Opinion paragraph only when the opinion is modified (i.e., the auditor expresses a qualified or adverse opinion, or a disclaimer of opinion). For "clean" opinions, the identification of the auditing standards and a statement that the auditor had obtained sufficient appropriate audit evidence as a basis for the auditor's opinion currently appears in the Auditor's Responsibility section. The IAASB believes that this information is relevant to users and placing it in close proximity to the opinion is desirable. This paragraph would be adjusted accordingly when the auditor expresses a modified opinion.<sup>7</sup>

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<sup>6</sup> The project history can be accessed at [www.iaasb.org/auditor-reporting](http://www.iaasb.org/auditor-reporting).

<sup>7</sup> ISA 705, *Modifications to the Opinion in the Independent Auditor's Report*, requires this paragraph to be placed immediately before the opinion paragraph with an appropriate heading. The IAASB will consider further illustrative examples of modified

*Entity-Specific Matters vs. Standardized Language*

26. Some investors and other users have expressed strong support for an auditor's report that includes tailored and entity-specific information based on the auditor's work effort and findings, citing the value and relevance of such information. Based on this, the IAASB sees merit in prominently positioning new sections related to entity-specific matters – Going Concern, Auditor Commentary, and Other Information – before the sections of the auditor's report that include more standardized language (i.e., the description of the respective responsibilities of management and the auditor). The IAASB's suggested improvements to auditor reporting related to these entity-specific matters are discussed in paragraphs 30–84, while enhancements to standardized language are discussed in 85–90.

*Balancing the Principles of Consistency Versus Relevance In Auditor Reporting*

27. The IAASB's current auditor reporting standard, ISA 700, was developed recognizing the desire for consistent and comparable auditors' reports. ISA 700 notes that consistency in auditor's reports, when the audit has been conducted in accordance with ISAs, promotes credibility in the global marketplace by making more readily identifiable those audits that have been conducted in accordance with globally recognized auditing standards. Such consistency facilitates users' understanding of auditors' reports, and their ability to identify unusual circumstances when they occur. In their responses to the IAASB's May 2011 consultation, a number of investors and other users continued to signal that consistency and comparability are important features in auditor reporting, although they also requested the addition of entity-specific information in auditors' reports, which will inevitably affect consistency.
28. Jurisdictions have different perspectives on how the communication of audit results could be best achieved in order to be relevant in the context of their national environments. National laws, regulations and auditing standards often prescribe how to communicate results of the audit, and are affected by socio-economic, cultural and other environmental factors. Thus, it may be difficult to find an appropriate balance between the need for consistency and comparability in auditor reporting globally, and the need to increase the value of auditor reporting by making the information provided more relevant to users, including flexibility to accommodate national circumstances (such as those auditor reporting requirements that may exist under local laws or regulations or national corporate governance regimes).
29. ISA 700 acknowledges that national laws and regulations may affect the form and content of the auditor's report and allows for compliance with ISAs in certain circumstances even when the auditor's report has been prescribed by law. The IAASB is of the view that the building blocks approach help to achieve comparable auditors' reports while still allowing jurisdictions the ability to further tailor auditor reporting requirements in the context of national environments, including their applicable accounting and financial reporting frameworks. The section *How Can the IAASB's Proposed Improvements Be Applied around the World?* and Appendix 5 describe how the IAASB's suggested improvements could be tailored to accommodate national financial reporting regimes.

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opinions, and the ordering of elements in auditors' reports containing modified opinions, as it develops its standard-setting proposals.

## Going Concern

30. The recent global financial crisis has highlighted the importance to financial markets of clear and timely financial reporting, and has resulted in a greater focus on the assessment of going concern and related disclosures. In the wake of the crisis, major policy debates have been initiated regarding the lessons that can be learned and the actions that can be taken with respect to going concern and liquidity risk issues that entities may be facing, including how the auditor might play a greater role in this regard.<sup>8</sup> The fact that going concern remains an especially critical financial reporting and auditing issue is underscored by the recent EC policy proposals regarding the statutory audit, a significant element of which is intended to enhance auditor reporting through the inclusion of an affirmative statement regarding going concern in the auditor's report for a public interest entity (PIE).<sup>9</sup> In addition, some respondents to the IAASB's May 2011 consultation asked for clarification of the respective roles and responsibilities of management and the auditor regarding going concern, and for auditors to report the outcome of their audit work regarding going concern. These developments provide a significant impetus for the IAASB to seek to enhance auditor reporting in this area.
31. The IAASB has therefore considered several options, ranging from a description of the auditor's and management's responsibilities only (low impediments but low value) to a conclusion by the auditor on the entity's future viability (high value but high impediments, including going beyond the current scope of the audit). The option the IAASB found most appropriate, consistent with the audit procedures currently required by ISA 570,<sup>10</sup> is to require that all auditors' reports include:
- (i) A conclusion regarding the appropriateness of management's use of the going concern assumption; and
  - (ii) A statement regarding whether, based on the audit work performed, material uncertainties related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern have been identified.
32. While a conclusion on whether management's use of the going concern assumption is appropriate would present a relatively low level of impediments in terms of implementation on an international basis, on its own it would deliver relatively limited value to users. It would merely convey that the financial statements do not need to be prepared on a liquidation basis. The IAASB believes that additional value would be provided to users if this conclusion were to be supplemented by a statement that material uncertainties have not been identified. Such a statement would make

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<sup>8</sup> For example:

- In March 2011, the UK FRC launched an inquiry to identify lessons for companies and auditors addressing going concern and liquidity risks (the Sharman Inquiry) (see [www.frc.org.uk/about/sharmaninquiry.cfm](http://www.frc.org.uk/about/sharmaninquiry.cfm)).
- In March 2012, the US PCAOB Investor Advisory Group (IAG) held discussions on the topic of going concern and related recommendations for possible actions by policy makers to enhance reporting by both companies and auditors regarding going concern (see [pcaobus.org/News/Events/Pages/03282012\\_IAGMeeting.aspx](http://pcaobus.org/News/Events/Pages/03282012_IAGMeeting.aspx)).

<sup>9</sup> Under Article 22 of the EC's proposed regulation concerning audit reporting for PIEs, auditors would be required to provide "a statement on the situation of the audited entity or, in case of the statutory audit of consolidated financial statements, of the parent undertaking and the group, especially an assessment of the entity's or the parent undertaking's and group's ability to meet its/their obligation in the foreseeable future and therefore continue as a going concern."

<sup>10</sup> ISA 570, *Going Concern*

explicit what is already implicit today under ISA 570 when an Emphasis of Matter paragraph in relation to going concern has not been included in the auditor's report.

33. Impediments exist in relation to a statement about the absence of material uncertainties. There is a lack of clarity around the concept, and considerable judgment is needed by both preparers and auditors in determining whether a material uncertainty exists. Also, including an explicit statement about the absence of material uncertainties may lead to a misinterpretation by users that the auditor is providing a conclusion about the entity's future viability, potentially resulting in a widening, rather than a narrowing, of the expectations gap. To minimize potential misunderstanding, the illustrative report makes clear that, as not all future events or conditions can be predicted, the statement about the absence of material uncertainties is not a guarantee as to the entity's ability to continue as a going concern.
34. Because the ISAs currently provide limited guidance regarding the meaning of a material uncertainty,<sup>11</sup> the IAASB intends to explore whether additional guidance could be provided for auditors in ISA 570. Achieving clarity also may require coordination between the IAASB and the International Accounting Standards Board (IASB) because the phrase "material uncertainty related to events or conditions that may cast significant doubt ..." is used in IFRSs<sup>12</sup> but is not further explained.
35. Apart from the above proposed enhancements, the requirement to include an Emphasis of Matter paragraph in the auditor's report when the auditor has identified a material uncertainty, which has been adequately disclosed in the financial statements, would continue to apply (see paragraph 1 in Appendix 3).
36. To support the proposed enhancements, the IAASB believes it will be necessary to include an expanded description of management's responsibilities and the requirements of the applicable financial reporting framework, in relation to going concern, in the illustrative report to provide users appropriate context. As the auditor's conclusion on the appropriateness of use of the going concern assumption and statement about the absence of material uncertainties relate to different concepts, they have been placed under separate subheadings in the illustrative report to help mitigate potential user confusion or misunderstanding regarding these new auditor reporting elements.
37. None of the proposed wording relating to going concern would be mandated because it is highly dependent on the applicable financial reporting framework and national laws. However, the IAASB hopes the proposed wording in the illustrative report will encourage consistency internationally to the extent possible.
38. Finally, the IAASB considered situations where no material uncertainty exists but events or conditions nevertheless have been identified that may cast significant doubt on the entity's ability to continue as a going concern. Some may see value in the auditor providing Auditor Commentary (see paragraph 46) in the auditor's report regarding significant judgments the auditor may have made, and audit procedures the auditor may have performed, in reaching a conclusion in these

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<sup>11</sup> ISA 570, paragraph 17, currently describes a material uncertainty as follows: "A material uncertainty exists when the magnitude of its potential impact and likelihood of occurrence is such that, in the auditor's judgment, appropriate disclosure of the nature and implications of the uncertainty is necessary for (a) in the case of a fair presentation financial reporting framework, the fair presentation of the financial statements, or (b) in the case of a compliance framework, the financial statements not to be misleading."

<sup>12</sup> International Accounting Standard (IAS) 1, *Presentation of Financial Statements*, paragraph 25

situations. The Auditor Commentary provided in these circumstances might be viewed as providing an *earlier* signal to users about significant potential difficulties the entity may be encountering in discharging its obligations in the normal course of business. Others, however, may highlight the significant practical impediments that exist in doing so. In particular, determining whether or not a material uncertainty exists when there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern is a complex and highly judgmental exercise. In addition, by providing Auditor Commentary in these circumstances, the auditor may find it difficult to avoid disclosing entity-specific information that management is not necessarily required to disclose, but which should be management's responsibility to disclose.

39. The IAASB recognizes that a number of initiatives around the world are already exploring the issues in this particular area, including how best to provide practical and timely disclosures to users regarding potential going concern issues an entity may be facing, the nature of related disclosures, and who should be providing them. The IAASB will continue to monitor these developments to further inform its deliberations regarding an appropriate approach to auditor reporting with respect to going concern.

### **Auditor Commentary**

#### *Views on the Value of Auditor Commentary*

40. The call for change in auditor reporting, particularly from investors and analysts with respect to listed entities, has focused on enhancing the informational value of the auditor's report to assist in investment decision-making. These users want additional, and more pertinent, information in the auditor's report about the financial statements and the audit in order to:
- Better navigate complex financial reports by providing a "roadmap" to the most important areas.
  - Understand more about how the audit was conducted, and the areas on which the auditor focused in light of the auditor's assessment of the risks of material misstatement, as well as the auditor's procedures and conclusions in those areas.
  - Benefit from the auditor's perspectives on entity-specific matters.
41. Respondents to the IAASB's May 2011 consultation also indicated that the auditor should be required to highlight significant auditor judgments and cited the value of the auditor doing so. In particular, many believe:
- It will add value for investors and analysts, and may provide a means of holding the auditor accountable to an entity's stakeholders.
  - It will help to clarify the value of an audit and the importance of the role of the independent auditor in enhancing the credibility of the financial statements.
  - It may enhance auditor behavior and potentially increase audit quality, as transparency into individual audit judgments may allow users to better assess whether the auditor had delivered an objective and independent audit.
42. Some investors and regulators went further and called for the auditor to provide insights into other highly subjective matters. These include the auditor's views about the quality of the entity's accounting practices and policies, and the auditor's perspective on whether management's estimates and judgments are at the low, most likely, or high end of a range of possible outcomes.

They thought that such information would be valuable in helping to better understand management's aggressiveness or conservatism in preparing the financial statements.

43. Other respondents, however, took the view that requiring the auditor to provide highly subjective views about the entity or the quality of its financial reporting based on the work done for the audit could blur the roles of management, TCWG and the auditor. Further, while noting that it is desirable to have further information about the entity and the audit, a number of respondents were of the view that any such information would be best provided by TCWG as part of their oversight of both management and the auditor. (Paragraphs 64–67 provide further discussion of the impediments to the auditor providing additional information about the audited financial statements or the audit).

*Using Emphasis of Matter and Other Matter Paragraphs to Achieve the Objective of Auditor Commentary*

44. Without modifying the auditor's opinion, ISAs currently require, or otherwise allow, the auditor to include additional information in the auditor's report to draw users' attention to, in the auditor's judgment:
- (a) Matters, although appropriately presented or disclosed in the financial statements, that are of such importance that they are *fundamental* to users' understanding of the financial statements (referred to as "Emphasis of Matter" paragraphs); and
  - (b) Any other matters that are relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report (referred to as "Other Matter" paragraphs).

Within the ISAs, there are particular circumstances for which Emphasis of Matter or Other Matter paragraphs are required.<sup>13</sup> Beyond those requirements, however, auditors are not explicitly required to consider whether these paragraphs should be included in the auditor's report. Rather, ISA 706<sup>14</sup> essentially gives the auditor a mechanism by which to do so when considered necessary in the context of the particular engagement.

45. Except where the auditor is required to include such paragraphs, their use in practice is rare – in fact, the ISAs note that a widespread use of Emphasis of Matter paragraphs may diminish the effectiveness of the auditor's communication of such matters. However, users of the auditor's report have expressed a view that Emphasis of Matter paragraphs are useful at directing their attention to what is most important within the financial statements. Other Matter paragraphs allow auditors to provide transparency about the audit work that was performed.
46. Based on the value cited by users, the IAASB is of the view that the auditor could provide additional information about the audited financial statements and the audit, under the umbrella of Auditor Commentary, tailored to the facts and circumstances of the entity, in a discrete and prominent section of the auditor's report. **The overarching objective of such a new Auditor Commentary section in the auditor's report is to provide transparency about matters that are, in the auditor's judgment, likely to be most important to users' understanding of the audited**

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<sup>13</sup> Circumstances for which such paragraphs are required include when: a material uncertainty is adequately disclosed in the financial statements, an inconsistency between the financial statements and other information is identified by the auditor and not revised by management; the financial reporting framework prescribed by law or regulation is unacceptable; the auditor's report is amended due to subsequent events; a predecessor auditor was involved; and the financial statements are prepared in accordance with a special purpose framework.

<sup>14</sup> ISA 706, *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*

**financial statements or the audit.** The new concept of Auditor Commentary strengthens the existing concepts of Emphasis of Matter and Other Matter paragraphs by:

- *Expanding Emphasis of Matter paragraphs* through a lowering of the threshold for including such paragraphs from matters “fundamental” to users’ understanding of the financial statements to matters “most important” to users’ understanding of the financial statements. Doing so allows for a greater use of these paragraphs by auditors of all entities as a navigational tool;
- *Expanding Other Matter paragraphs* to address matters of audit significance, a new term that would be linked to significant auditor judgments; and
- *Expanding the information that can be included in both types of paragraphs* to allow for the auditor to include, in the auditor’s judgment, information that is deemed to be most relevant to users’ understanding of important matters.

47. The nature of matters that are likely most important to users will differ from entity to entity. Further, mandating certain matters to be discussed in all auditors’ reports runs counter, in principle, to the notion that such commentary should be tailored to the facts and circumstances of the entity. Accordingly, the IAASB does not believe that detailed criteria for Auditor Commentary should be specified, or that specific matters should be required to be discussed for all entities. However, the IAASB believes that auditors should be required to consider certain areas in selecting matters for Auditor Commentary. This approach would allow a degree of commonality while emphasizing the application of professional judgment by the auditor in determining the matters to communicate that are likely to be most important to users’ understanding of the audited financial statements or the audit (see paragraphs 50 and 54). The IAASB anticipates developing guidance to help auditors determine which matters to include in Auditor Commentary and the information (at an appropriate level of detail) to provide about those matters in the auditor’s report.
48. Matters to be included in Auditor Commentary are likely those about which the auditor and TCWG had the most robust dialogue as part of the two-way communication required by ISA 260.<sup>15</sup> Including those matters in Auditor Commentary will provide some transparency about the auditor’s communications with TCWG that users have indicated they would value. However, not all matters discussed with TCWG would be included in Auditor Commentary. By definition, matters that are likely to be “most important” to users’ understanding would be limited to only a few key matters (see further discussion in paragraph 63).
49. The extent of value to users of the information in Auditor Commentary may depend, however, on the level of detail provided by the auditor. Some users have indicated that it would be useful for the auditor to provide additional context about the matter, for example, a summary of key points provided in management’s disclosure, a description of the auditor’s procedures, or discussion to assist users’ understanding of possible future consequences relating to particular matters. Others have indicated that there is sufficient value simply from the auditor drawing attention to disclosures in the financial statements. Additional value is also likely to be provided if, within the Emphasis of Matter or Other Matter paragraphs, the auditor explained why a particular matter was being brought to users’ attention (for example, due to the complexity of the accounting policies or the unique industry aspects of the accounting for a particular area of the financial statements).

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<sup>15</sup> ISA 260, *Communication with Those Charged with Governance*

### Emphasis of Matter Paragraphs

50. In determining whether an Emphasis of Matter paragraph should be included in the auditor's report, matters that would be required to be considered by the auditor could include, for example:
- Areas of significant management judgment (e.g., in relation to the entity's accounting practices, including accounting policies, accounting estimates, and financial statement disclosures); and
  - Significant or unusual transactions (e.g., a significant related party transaction, restatements, or unique entity structure).
51. The IAASB believes, as noted above, that an objectives-focused approach, together with specific considerations and relevant guidance, in lieu of detailed criteria, will best achieve the intended aim of expanded Emphasis of Matter paragraphs.
52. The current premise that an Emphasis of Matter paragraph 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; or (b) disclosures in the financial statements that the applicable financial reporting framework requires management to make, would continue to apply.

### Other Matter Paragraphs

53. The IAASB believes that the calls for the auditor to provide more transparency about the conduct of the audit<sup>16</sup> more broadly can be effectively addressed through Other Matter paragraphs. However, to ensure that these paragraphs are used appropriately to highlight matters that are likely to be most important to users' understanding of the audit, the objective of Other Matter paragraphs would be further specified through the use of a new term, "matters of audit significance."
54. Matters of audit significance would include areas of significant auditor judgment in conducting the audit, for example:
- The auditor's identification and assessment of significant risks<sup>17</sup> or areas of high assessed risks of material misstatement;
  - Issues of significance related to the audit scope or strategy;
  - The involvement of internal or external experts or use of the work of internal audit during the audit; and

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<sup>16</sup> Some users have suggested having an understanding of how the audit was designed, including the level of materiality and how the work of others was used in the audit (for example, group audit considerations, the internal audit function, experts, shared service centers and other service organizations), as well as corrected and uncorrected misstatements identified during the audit, would help them to assess audit quality.

<sup>17</sup> The IAASB considered, and rejected, the use of significant risks as the primary criterion for Auditor Commentary, because significant risks may not be all-inclusive of matters on which to provide Auditor Commentary (e.g., areas where the auditor used judgment) or conversely may include risks that are not necessarily significant auditor judgments or areas that have a high assessed risk of material misstatement (e.g., certain fraud risks). In addition, conceptually, significant risk is not as easy for users to understand as terms such as "judgments" and "uncertainty" (both generically and in terms of measurement uncertainty).

- Difficult or contentious matters noted during the audit, or other audit matters that would typically be discussed with an engagement quality control reviewer or TCWG.<sup>18</sup>
55. As noted above, the IAASB does not believe that detailed criteria for Auditor Commentary should be specified, or that specific matters should be required to be discussed for all entities, in Other Matter paragraphs. Rather, the decision about which matters to address in Other Matter paragraphs would be based on the auditor's professional judgment in light of the facts and circumstances of the entity, including the extent that the relevance of such commentary may be enhanced where there are related disclosures in the financial statements or other information that provide further context. There is a natural linkage between management's significant judgments to be considered in determining Emphasis of Matter paragraphs and the auditor's assessment of those judgments.
56. Thus, the auditor may determine that the same topic may be appropriate for including either an Emphasis of Matter paragraph (i.e., because the matter is judged to be most important to users' understanding of the audited financial statements) or an Other Matter paragraph (i.e., because it is a matter of audit significance). To accommodate such a scenario, the nature of Other Matter paragraphs would be revised to enable the auditor to make reference to disclosures in the audited financial statements and provide additional context about the audit in relation to the matters disclosed. This approach would allow the auditor to group discussions together under a descriptive heading on a matter that has been determined to be important to both the audited financial statements and the audit, resulting in a hybrid of an Emphasis of Matter and an Other Matter paragraph.

#### Required Auditor Commentary for PIEs

57. To meet the stated objective of Auditor Commentary (i.e., to provide transparency about matters that, in the auditor's judgment, are likely to be most important to user's understanding of the audited financial statements or the audit), the IAASB believes that it will be necessary to require the auditor to make a more explicit determination than what is currently required by ISA 706 as to whether to include Emphasis of Matter and Other Matter paragraphs (as Auditor Commentary) in the auditor's report.
58. The IAASB recognizes that the demands for Auditor Commentary have come primarily from institutional investors and analysts evaluating financial statements of listed entities. In debating whether the new concept of Auditor Commentary should apply to all, or only some, audits, the IAASB concluded that Auditor Commentary should be required, at a minimum, for audits of listed entities, and believes there is strong merit in extending the requirement to PIEs. This is because of the growing emphasis being placed on this broader group of entities, in light of the global financial crisis and, for example, in the EC's legislative proposals. Accordingly, auditors of PIEs would be required to include Auditor Commentary in the auditor's report in the form of Emphasis of Matter and Other Matter paragraphs as described above.

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<sup>18</sup> As an example, the recent EC legislative proposals suggest the need for the auditor to "assess the entity's ...internal control system, including significant deficiencies identified during the audit ..." Understanding the entity's environment, including its internal control, is a critical area in an ISA audit, and users could likely benefit from greater transparency about an entity's internal control in the context of the current scope of the audit. The illustrative report includes an example of how this could be done.

59. In requiring the application of Auditor Commentary to PIEs, the IAASB would need to consider whether and, if so, how, to define PIEs for the purpose of this requirement. The IESBA Code includes a definition for PIEs which is: all listed entities; and any entity (i) defined by regulation or legislation as a PIE; or (ii) for which the audit is required by regulation or legislation to be conducted in compliance with the same independence requirements that apply to the audit of listed entities.<sup>19</sup> The IESBA Code provides further guidance on treating other entities as PIEs for purposes of maintaining independence as follows, which could be incorporated into a revised ISA 700 to signal that Auditor Commentary for entities other than PIEs may be useful:

Firms and member bodies are encouraged to determine whether to treat additional entities, or certain categories of entities, as public interest entities because they have a large number and wide range of stakeholders. Factors to be considered include: the nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders (examples may include financial institutions, such as banks and insurance companies, and pension funds); size; and number of employees.

60. However, in the context of the IAASB's auditor reporting proposals, defining a PIE gives rise to specific challenges. For example:
- Very small entities would be required to include Auditor Commentary if defined in law or regulation as a PIE. To date, the IAASB is not aware of a demand from users of smaller entities for additional information in the form of Auditor Commentary.
  - Public sector organizations may be inconsistently treated if defined as PIEs in some jurisdictions and not others.
  - Large non-listed entities with a large number of stakeholders, such as pension funds, may not be included in a national definition of PIEs, but users of their financial statements may benefit from Auditor Commentary.

The IAASB therefore is requesting that respondents to this ITC provide input to further assist the IAASB's determination of whether and, if so, how to require Auditor Commentary for PIEs.

#### Adapting a Proposed Requirement to Provide Auditor Commentary to the National Environment

61. Ordering of matters within the Auditor Commentary section would be based on the auditor's professional judgment – likely organized in order of relative importance with appropriate headings to describe the matters. Appendix 5 further explains how Auditor Commentary and the discrete section in the auditor's report would be tailored to the national environment. This takes into account that NSS and other policymakers may require the use of other mechanisms designed to address the information gap, for example, the use of a "justification of assessments" model or reporting by TCWG on significant matters relating to the entity and the audit. The building blocks approach is designed such that these mechanisms can be used as a means of meeting the information needs of users and in such cases could replace Auditor Commentary if seen to be duplicative, provided that the overall objective of Auditor Commentary is achieved. For example, if matters that otherwise would be required to be included by the auditor in Auditor Commentary are communicated to users by other means (for example, reporting by TCWG), the auditor would need to refer to such

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<sup>19</sup> As included in Section 290 of the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code). Such regulation may be promulgated by any relevant regulator, including an audit regulator.

communication in the auditor's report and would likely need to comment on the completeness and reasonableness of that communication.

### *Illustrative Examples*

62. Four examples have been provided in the illustrative report to show how the concept of Auditor Commentary would be applied in practice. These examples are solely for illustration; the matters on which an auditor would report and the related content would vary based on the facts and circumstances of the individual engagement. The IAASB does not intend to specify a minimum number of matters to be addressed through Auditor Commentary. However, the presumption is that it would be rare for the auditor of a PIE to determine there are no matters for which to include Auditor Commentary.<sup>20</sup>
63. The IAASB also does not intend to limit the number of matters that could be addressed by the auditor through Auditor Commentary. However, given a threshold of providing transparency into "most important" matters about the audited financial statements or the audit, the use of four examples in the illustrative auditor's report is indicative of the IAASB's view that a range of two to ten matters in Auditor Commentary would generally be thought to be appropriate for a PIE. In principle, a lengthy list of matters in Auditor Commentary is likely to diminish the effectiveness of the auditor's communication about such matters.

### *Impediments to Providing Auditor Commentary*

64. Notwithstanding the value of Auditor Commentary cited by users, and the fact that Emphasis of Matter and Other Matter paragraphs are already available as a means of providing additional information in the auditor's report, there are impediments to providing auditor commentary that cannot be ignored. Preparers, TCWG and some regulators, as well as auditors and NSS, who responded to the IAASB's May 2011 consultation, were of the view that it is critical that auditors should not be providers of original information about an entity, as this is the role of management and TCWG. These respondents were also concerned about the auditor providing highly subjective views in Auditor Commentary, as this could be seen by some users as diluting the auditor's opinion. For this reason, under the IAASB's approach the auditor would use professional judgment in determining what to include in Auditor Commentary, and provides the ability for the roles of management, TCWG and the auditor to remain distinct by not explicitly requiring the auditor to provide highly subjective views.
65. Respondents to the IAASB's May 2011 consultation also indicated that a further impediment to providing additional auditor commentary relates to the potential cost of doing so, to both auditors and preparers, arising from:
  - Additional quality control processes surrounding the development and review of the Auditor Commentary, with additional time being incurred by the most senior members of the engagement team.
  - Required discussion of the form and content of Auditor Commentary with TCWG prior to issuing the auditor's report. As a result, preparers would incur additional cost directly in terms

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<sup>20</sup> The IAASB will explore whether to require auditors of PIEs to include an explicit statement that the auditor has nothing to report in Auditor Commentary when, in the auditor's judgment, there are no matters that are most important to users' understanding of the audited financial statement or the audit. A documentation requirement in this regard may also be appropriate.

of the dialogue that would ensue between management and TCWG, and with the auditor, which is likely to increase as the subjectivity of, and level of detail in, the auditor's commentary increases.<sup>21</sup>

- A more iterative process to finalize the auditor's report, which may affect the timing of release of the financial statements and the auditor's report.

Understanding the cost and timing implications of the proposal to require Auditor Commentary is highly important to the IAASB. Although the Board acknowledges that the full cost implications may not be known until standard-setting proposals are developed, an early indication of auditors' and preparers' views as to cost and timing would be welcome. The IAASB intends to further inform itself as to these implications through targeted outreach with these groups.

66. While not necessarily impediments, the IAASB has considered a number of risks relating to providing additional commentary in developing its proposed direction:
- (a) Auditor's reports will likely lack comparability, even among entities in the same industry, because no specific matters will be required to be addressed in Auditor Commentary.
  - (b) There is a risk of increasing the expectations gap, to the extent that readers interpret the inclusion of Auditor Commentary as providing assurance on individual accounts or disclosures.<sup>22</sup>
  - (c) Auditor commentary could become standardized over time.
  - (d) Provision of certain information beyond what is included in the financial statements could compete with management's disclosures, thereby resulting in "dueling information."
  - (e) There may be confidentiality or liability implications to auditors as a result of providing Auditor Commentary.
67. Different stakeholders are likely to have differing views about the value and impediments of the auditor providing Auditor Commentary, in particular in relation to the level of detail that may be provided within such commentary. The IAASB welcomes the views of all stakeholders in relation to both value and impediments of Auditor Commentary.

### **Other Information**

68. "Other information" is defined in the ISAs as financial and non-financial information (other than the financial statements and the auditor's report thereon) which is included, either by law, regulation or custom, in a document containing audited financial statements and the auditor's report thereon (i.e., the entity's annual or financial report). Management Discussion and Analysis (MD&A), operating and financial review (OFR) statements, or other narrative sections of an entity's financial report that address both historical and prospective information are considered to be other information.

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<sup>21</sup> The auditor would not be prohibited from providing more subjective views in relation to particular matters (for example, on matters noted by users in paragraph 42). However, it will likely be necessary for the IAASB to develop guidance to highlight the need for the auditor to carefully consider the implications of doing so.

<sup>22</sup> To mitigate this, introductory language to the Auditor Commentary section has been developed for the illustrative auditor's report and would be required for all entities when an Auditor Commentary section is included.

69. The IAASB's May 2011 consultation specifically asked for respondents' views as to whether there would be benefit in including a statement about the auditor's responsibilities regarding other information. An overwhelming majority of respondents expressed support for doing so, either because this would increase transparency about the auditor's work in this area, or because it is already local practice. Many respondents also expressed support for some form of auditor conclusion with respect to the other information for greater clarity.
70. The IAASB has considered several options for how auditor reporting with respect to other information could be enhanced. These ranged from a description of the auditor's responsibilities only (low impediments but low value) to the expression of an opinion by the auditor on the other information (high value but high impediments, including going beyond the current scope of the audit). The option the IAASB found most appropriate, and which would be consistent with the audit procedures currently required by ISA 720<sup>23</sup> would be to require the auditor's report to include a statement regarding whether, based on reading the other information, the auditor has identified material inconsistencies between the other information and the audited financial statements. This would apply for all audits where it would be relevant in the engagement circumstances (i.e., when documents containing audited financial statements and the auditor's report thereon include other information). To provide appropriate context to this statement, the specific other information read by the auditor would be explicitly identified.
71. The inclusion of an Other Matter paragraph in the auditor's report when the auditor has identified a material inconsistency and management refuses to revise the other information would continue to apply, and would replace the statement that no material inconsistencies have been identified (see paragraph 2 in Appendix 3).<sup>24</sup>
72. Because the auditor's work effort under ISA 720 is limited to reading the other information, including an explicit statement that no material inconsistencies have been identified may potentially lead to a misinterpretation by users that the other information has been audited, thus potentially widening, rather than narrowing, the expectations gap. To minimize the potential for misunderstanding, the illustrative report includes a disclaimer that the auditor has not audited the other information as part of the audit of the financial statements.
73. ISA 720 also addresses material misstatements of fact in the other information. However, the IAASB is not proposing that the auditor's report also include a statement regarding such matters. This is because the work effort currently required by ISA 720 in relation to material misstatements of fact<sup>25</sup> would be insufficient to support a statement or conclusion by the auditor with respect to these matters. The IAASB believes that such a statement or conclusion would give rise to false expectations about the scope and nature of the work performed. However, the ISAs establish specific procedures, including notification to TCWG, when the auditor concludes there is a material

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<sup>23</sup> Paragraph 6 of ISA 720, *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements*, requires the auditor to read the other information to identify material inconsistencies, if any, with the audited financial statements.

<sup>24</sup> Presently, in these circumstances, the auditor would be required under ISA 720 to include an Other Matter paragraph in the auditor's report.

<sup>25</sup> Under current ISA 720, the work effort would only be triggered if the auditor becomes aware of an apparent material misstatement of fact when reading the other information for the purpose of identifying material inconsistencies.

misstatement of fact and the auditor would not be precluded from including Auditor Commentary in the form of an Other Matter paragraph should the auditor judge it necessary to do so.

74. The IAASB is currently undertaking a project to revise ISA 720.<sup>26</sup> Given that this project may result in enhancements to the auditor's responsibilities regarding other information, consequential changes to the proposed statement may be necessary when the revision of ISA 720 is finalized.

### **Overview of Further Proposals to Provide Transparency about the Audit**

#### *Disclosure of the Name of the Engagement Partner*

75. In support of the broader objective of making the auditor's report, and the audit process, more transparent, the IAASB believes that disclosure of the engagement partner's name in the auditor's report should be required for all entities. Some users believe this would provide the engagement partner with a greater sense of personal accountability, as this individual is ultimately responsible for the conduct of the audit. In many jurisdictions this is already required (usually by a requirement for a personal signature), but many have indicated to the IAASB such a requirement would be in the public interest.<sup>27</sup>
76. In deliberating the merits of this proposal on an international basis, the IAASB was aware of, and does not underestimate, the potential impediments of such a requirement. In particular, some point to a perceived reduction in the responsibility of the firm and the possibility of increased legal liability for the engagement partner in some jurisdictions.<sup>28</sup> Because of the public interest rationale for this disclosure, the IAASB hopes this ITC will elicit the further information and perspectives needed to ensure that both the value and impediments are fully understood before developing standard-setting proposals in this area.<sup>29</sup>

#### *Statement of Compliance with Relevant Ethical Requirements*

77. ISA 700 requires that the description of an auditor's responsibilities in the auditor's report indicate that the auditor is required to comply with ethical requirements. However, when national law or regulation requires the auditor to use specific wording for the auditor's report, no explicit mention of ethical requirements is required. Because of the importance of compliance with ethical requirements as a basis for the audit, and the increased focus on auditor independence, the IAASB believes that an explicit statement of compliance with relevant ethical requirements should be required in all auditors' reports.

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<sup>26</sup> The IAASB's current work program anticipates approval of an exposure draft of the proposed revised ISA 720 in September 2012.

<sup>27</sup> The IAASB is not proposing that engagement partners' signatures be required. Mandating engagement partners' signature in the auditor's report would be left to the discretion of NSS or may be specified by law or regulation, as further explained in Appendix 5.

<sup>28</sup> For example, in the US, some respondents to the PCAOB's proposals in this area have suggested that naming the engagement partner may potentially increase the personal liability of the engagement partner. This is because US federal securities law imposes certain legal liabilities on parties who are named in documents filed with the US Securities and Exchange Commission. Audits of financial statements filed with the SEC are not subject to ISAs, but similar issues may exist in other legal environments.

<sup>29</sup> For example, there may be exceptional circumstances when identifying the engagement partner publicly may give rise to an imminent and significant threat to an individual's personal security. In such cases, an exception to the required disclosure could be permitted.

78. The IAASB considered, but decided against, proposing to require the specific identification of the auditor's ethical code(s). While this might provide users with details useful in determining the particular restrictions that apply to the auditor under each code, the IAASB recognizes that such a disclosure may be lengthy and complex, as often there are relevant ethical requirements contained in more than one document (such as a professional code of ethics issued by the IESBA or NSS, legislation, and a regulator's or stock exchange's requirements). Therefore, the benefits of naming the ethical code(s) would likely be outweighed by the impediments of doing so.

#### Breaches of Relevant Ethical Requirements

79. Some jurisdictions require the auditor to publicly disclose breaches of relevant ethical requirements. The IESBA currently has a project on its agenda addressing breaches of the IESBA Code. Accordingly, the IAASB believes it would be premature for the IAASB to put forth proposals relating to the disclosure of breaches of relevant ethical requirements until such time as the outcome of the IESBA's work is known and the value and impediments of doing so have been fully considered.

#### *Role of Other Auditors*

80. In audits that cover more than one entity or business activity, the auditor of the group financial statements (known as the "group auditor") may request that one or more other auditors perform work on the financial information of some entities or business activities (components) within the larger group. In such circumstances, ISAs make clear that the group auditor is responsible for the direction, supervision and performance of the group audit engagement. If the group engagement team concludes that the work of other auditors is insufficient, the group engagement team needs to determine what additional procedures are to be performed, and whether the additional procedures are to be performed by the component auditors or by the group engagement team. Therefore, as the group auditor is solely responsible for the audit report on the group financial statements, ISA 600<sup>30</sup> prohibits referencing another auditor in the auditor's report unless required by law or regulation. The same principle holds true in the case of non-group audits when other auditors are used to perform specific procedures for the audit engagement.
81. Unlike ISAs, auditing standards in the US for both listed and non-listed entities provide group auditors with the option to divide responsibility for the group audit with other auditors, and to make reference to this divided responsibility in the auditor's report. The PCAOB has issued a standard-setting proposal that would mandate a disclosure about other auditors involved in the engagement, whether or not the group auditor chooses to divide responsibility. Some maintain that this additional disclosure may improve transparency by providing users with information that enables them to evaluate the other auditors in the same manner that they evaluate the group auditor. For example, users could determine if the other auditors are subject to an audit inspection regime and consider any public inspection reports.
82. In relation to the ISAs, permitting or requiring disclosures regarding the role of other auditors is seen by some to run counter to the "sole responsibility" position. Further, many financial reporting frameworks require disclosure of financial information at a geographical level. Nevertheless, the IAASB recognizes that disclosing the role of other auditors may increase transparency of the audit process and, therefore, wishes to hear the views of its stakeholders.

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<sup>30</sup> ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

83. The IAASB notes that a standardized description of the auditor's responsibilities in a group audit may improve the transparency of the audit process. A proposed disclosure is included in the Auditor's Responsibilities section of the illustrative auditor's report.
84. However, the IAASB also notes that an additional, or alternative, entity-specific disclosure may provide more value to users than a standardized description, particularly with respect to the identification of other auditors involved in the group audit. Accordingly, the IAASB has drafted the following disclosure that could be included in the auditor's report, and invites views on the value such a disclosure would provide to users, and whether it would be perceived as undermining the "sole responsibility" of the group auditor:

We are the auditor of [*name of group entity (which is normally the Company)*], which is the parent entity of a group of entities ("the group"). We are a member firm of XYZ Partners, a global network of affiliated auditing firms. Each member firm in the network is a separate legal entity, and all member firms follow a common audit methodology and consistent quality control policies. At our request, certain network member firms participated in our audit of the group and constituted approximately [*percentage of audit measured by, for example, audit hours*]. Other audit firms, not part of our network, also participated in the audit at our request and constituted approximately [*percentage of audit measured by, for example, audit hours*]. We remain solely responsible for the audit of the group, including the work performed by other auditors at our request.

This disclosure has not been included in the illustrative report, as it may be premature to indicate a preferred option until stakeholders' views are known, particularly concerns about whether any disclosure of other auditors would be inconsistent with the sole responsibility principle of ISA 600.

### **Overview of Proposals to Clarify the Respective Responsibilities of the Auditor, Those Charged with Governance, and Management**

#### *The Auditor's Responsibilities*

85. Users, auditors, regulators and preparers have suggested that (i) including additional information in auditor's reports to further describe the auditor's responsibilities and (ii) clarifying certain technical terms, would contribute to narrowing the expectations gap and improve auditor reporting. Even though such material is largely standardized, benefits cited from providing such additional information include greater transparency of the audit process and an enhanced understanding of the role of the auditor and the nature of audit work.
86. Accordingly, the IAASB is proposing enhancements to the description of the auditor's responsibility in the auditor's report to explain more fully the concept of a risk-based audit, thereby explaining the technical terms in the framework of an ISA audit. This approach facilitates a fuller description of the auditor's responsibilities in relation to specific matters cited as most important to users, including fraud; internal control; accounting policies and estimates; evaluating the overall presentation, structure and content of the financial statements and disclosures; group audits; and communications with TCWG.
87. The enhanced auditor's responsibility section is therefore longer than that currently required under ISA 700. The IAASB acknowledges that some may see the more detailed description of the auditor's responsibility as simply more "boilerplate" and therefore lacking value. However, others have suggested that such context is essential for users of the auditor's report to fully understand the auditor's opinion, in particular in developing and emerging economies where the concept of an audit is not as familiar.

88. The IAASB believes the value of further educating users about auditor's responsibilities outweighs the impediments of providing the additional material. Further, ISA 700 currently does not prohibit moving this material to another location (for example, a NSS website) with a reference in the auditor's report. This option could be more explicitly permitted in a revised auditor reporting standard if making the auditor's report more entity-specific and shorter is valued by stakeholders.

*Responsibilities of Management and Those Charged with Governance*

89. Respondents to the IAASB's May 2011 consultation and the IAASB's ongoing work on audit quality have highlighted the important role that management and TCWG play in the financial reporting process. Also, users' understanding of the auditor's responsibility is framed by their understanding of the responsibilities of management and TCWG. The IAASB notes that the improved description of the auditor's responsibilities gives rise to both the opportunity and the need to evaluate the description of responsibilities of management and TCWG beyond the existing description, and believes a description of the role of TCWG should be included in the auditor's report to complement the description of management's responsibilities.
90. However, as responsibilities of management and those charged with governance vary significantly among jurisdictions, the IAASB notes that attempts to describe these responsibilities in an auditor's report capable of global application is difficult. As such, the IAASB has included in the illustrative auditor's report a description of the role of TCWG (set in terms of how ISAs define TCWG) that is expected to be further tailored to describe the role of TCWG in more detail in the context of a particular jurisdiction (see Appendix 5).

## **How Can the IAASB's Proposed Improvements Be Applied around the World?**

### **Important Role for NSS and Policymakers**

91. As noted in paragraphs 21 and 29, the IAASB has developed a building blocks approach aimed at providing a mechanism whereby jurisdictions are able to build upon an enhanced global foundation for auditor reporting. Such an approach fosters a global solution that improves auditor reporting, while accommodating existing and evolving changes in corporate or auditor reporting in various national environments.
92. The IAASB believes that many NSS will choose to use a revised auditor report based on a revised ISA 700 without modification and apply it in their national environments. However, the IAASB recognizes the need to preserve the important role of NSS and other policymakers to ensure that, based on these improvements, auditor reporting in their respective jurisdictions is relevant in light of the broader corporate and financial reporting regime.

### *Examples of How the IAASB's Proposals to Improve Auditor Reporting May Be Tailored by NSS*

93. Appendix 5 highlights the suggested improvements to the illustrative auditor's report, indicating the minimum requirements that could be mandated by the IAASB based on the improvements described in this ITC. It also describes how jurisdictions, through national laws, regulations or standard setting, may tailor the content and layout of their respective auditors' reports for greater specificity.
94. In allowing for this national tailoring, the IAASB is seeking to balance the need for consistency in auditor reporting (i.e., that a report issued for an ISA audit can be easily recognized by investors and more readily compared to reports of other ISA audits) with the need for auditors' reports that

are relevant in the context of additional laws or regulations in the particular jurisdiction.

### **Considerations for SMEs and Audits of Public Sector Entities**

95. As part of its standard-setting process, the IAASB will consider whether guidance in the form of special considerations for audits of smaller entities and audits of public sector entities would be necessary to support the application of the standards to these entities. The following represents the IAASB's considerations specific to these entities to date.

#### *SMEs*

96. Respondents to the IAASB's May 2011 consultation were of the view that the IAASB should carefully consider the implications that additional auditor reporting requirements may have on audits of SMEs. This was due to the view that users of SME financial statements often already have a relationship with the entity that enables them to obtain any information they need directly from the entity. It was suggested that the impediments to additional reporting requirements, namely cost, would likely exceed the value of the auditor including additional information in the auditor's report. To a lesser extent, concern was expressed that a lengthy auditor's report, particularly if it primarily consisted of standardized language, would be seen as unhelpful by users of SME financial statements.
97. Feedback from the IFAC Small and Medium Practices Committee and others who represent the views of SMEs has indicated that differentiation in auditor reporting by, for example, size or type of entity alone is generally not appropriate, and runs contrary to the notion that "an audit is an audit". However, these stakeholders supported the building blocks approach, believing that this approach would illustrate proportionate application of ISAs to SMEs and recognizing it may be necessary for the IAASB to develop additional reporting requirements for certain entities.
98. The IAASB has taken this into account in limiting the proposal to require Auditor Commentary for PIEs, though the IAASB recognizes that some SMEs may be scoped into the definition of PIEs in certain jurisdictions (see paragraph 60). In suggesting other possible improvements to auditor reporting, the IAASB is of the view that these improvements would likely have value to users of SME financial statements, and that the impediments to these proposals would be no greater for SMEs, as the underlying work effort in the ISAs supporting these possible reporting requirements can be applied proportionally. As such, all other possible improvements would be applicable to SME audits. In this regard, the IAASB welcomes views from respondents, in particular from the users of SME financial statements, about the value and impediments of implementing the potential improvements to auditor's reports in the context of audits of SMEs.

#### *Public Sector Entities*

99. In relation to Auditor Commentary, the ISAs note that, even when not defined as such, public sector entities may need to be considered in the same manner as PIEs and some public sector entities may be scoped into the definition of PIEs in certain jurisdictions (see paragraph 60). The IAASB recognizes, however, that users of public sector financial statements, and their access to the entity preparing the financial statements, will vary. Therefore, through this ITC the IAASB is seeking feedback as to the value and impediments of implementing the potential improvements arising from Auditor Commentary for public sector entities. In particular, the IAASB would like to understand whether as a matter of course public sector entities should be included in the IAASB's definition of PIEs. All other possible improvements to auditor reporting would apply to public sector

entities. Further dialogue with the International Organization of Supreme Audit Institutions (INTOSAI) on all the IAASB's proposals and their applicability in the public sector is planned.

## Questions for Respondents

The IAASB is seeking views on the proposed changes reflected in the improved illustrative auditor's report, as well as all other matters related to auditor reporting discussed in this ITC. In particular, the IAASB encourages stakeholders to respond to the following questions in order to assist its deliberations.

In developing its proposals, the IAASB has used a value and impediments model in considering various options to enhance auditor reporting, and has included relevant value and impediment considerations in the ITC. The IAASB, however, is seeking further respondent views on the value of, and impediments (including costs) to, its proposals to better enable it to evaluate the relevant options and inform its standard-setting deliberations thereon. While specific questions have been prepared for certain stakeholder groups, respondents in these groups are invited to also respond to questions included in the lists of questions for other stakeholders if they wish to provide their perspectives. The IAASB also values responses from other stakeholders not falling into any of these categories, and invites them to respond to those questions they consider most appropriate. When submitting comments, respondents are asked to identify the relevant stakeholder groups to which they see themselves belonging.

The IAASB welcomes responses even if they address only some of the listed questions. The responses should include reasons for the comments.

### Auditor Commentary

*For Investors, Financial Analysts, Lenders and Other Creditors*

1. Do you believe the Auditor Commentary proposals are an appropriate response to the call for more informational value in the auditor's report?
2. Do you support the IAASB's proposal for Auditor Commentary to assist users in better understanding both the audited financial statements and the audit, including by highlighting important matters in the audited financial statements or describing significant aspects of the audit?
3. Do the illustrative examples of Auditor Commentary<sup>31</sup> have the informational value you seek? If not, what aspects are not valuable, or what is missing?

*For Preparers, Those Charged with Governance (TCWG), and Auditors<sup>32</sup>*

4. Do you believe the proposals for, and examples of, Auditor Commentary are compatible with the responsibilities of management, TCWG, and the auditor in your jurisdiction?
5. What are the implications for the financial reporting process, including timing and resources, of having Auditor Commentary in the auditor's report?<sup>33</sup>

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<sup>31</sup> The illustrative examples of Auditor Commentary are intended to simulate the nature and content expected from the Auditor Commentary proposals.

<sup>32</sup> Reference to "Auditors" includes auditors of SMEs and public sector auditors

<sup>33</sup> It is expected that the form and content of the report, in particularly the section on Auditor Commentary, that the auditor intends to issue would be discussed with management and TCWG prior to its issuance.

*For Auditors, Audit Regulators, Audit Oversight Bodies, and National Auditing Standards Setters (NSS)*

6. Do you support the use of both expanded Emphasis of Matter and Other Matter paragraphs as vehicles for Auditor Commentary?
7. Do you believe that the stated objective of Auditor Commentary, together with the IAASB specifying matters that the auditor is required to consider, will result in auditors including Auditor Commentary when it would be appropriate to do so? If not, what measures<sup>34</sup> do you believe would be required?

*For Securities Regulators, NSS, and Other Policymakers*

8. Where initiatives to enhance national corporate reporting, including auditor reporting, are being explored or are already in place, does the proposed objective of Auditor Commentary align with such initiatives? If not, how might the IAASB's proposals need to be adapted to achieve alignment?

*For All Respondents*

9. What benefits or practical difficulties, if any, do you see with the proposal for the ISAs to require Auditor Commentary for all PIEs? Do you believe the ISAs should provide a definition of a PIE for this purpose, perhaps based on or similar to the definition of a PIE in the IESBA Code (see paragraph 58)?
10. Do you believe that a distinction between reporting for PIEs and non-PIEs is useful, or do you believe that there should be other criteria for determining the audits for which auditor commentary should be provided?

**Going Concern/Other Information**

*For Investors, Financial Analysts, Lenders and Other Creditors*

11. Do you believe the Going Concern proposals, as reflected in the section relating to Going Concern in the illustrative report, provide useful and relevant information?
12. Do you believe the proposed auditor conclusion regarding the appropriateness of management's use of the going concern assumption and the auditor statement regarding material uncertainties are understandable, having regard to the related contextual information provided in the auditor's report, including the description of management's related responsibilities?
13. Do you believe the proposed auditor statement in relation to Other Information provides value?

*For All Respondents*

14. In your view, what additional avenues could be explored to further improve corporate and auditor reporting with respect to going concern?

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<sup>34</sup> Examples of measures may include: specifying detailed criteria; specifying particular matters to be addressed in Auditor Commentary; specifying a presumptive requirement together with required audit file documentation where the presumption is rebutted; requiring an explicit statement that there is nothing to report when this is the case.

## Clarifications and Transparency

*For Investors, Financial Analysts, Lenders and Other Creditors*

15. Do you believe the enhanced description of the responsibilities of the auditor in the illustrative auditor's report is helpful in your understanding of the nature and scope of an audit? Do you have any suggestions as to how it could be improved?

*For Investors, Financial Analysts, Lenders and Other Creditors, Audit Regulators, and Audit Oversight Bodies*

16. Do you see value in the inclusion of the name of the engagement partner in the auditor's report? If so, what are the benefits? What impediments or challenges do you see in disclosure of such information?
17. What are the benefits to you, if any, of disclosure of the involvement of other auditors in the engagement? If such disclosure were to be required, at what level of detail would you find it to be valuable for your information purposes? What impediments or challenges do you see in disclosure of such information?

*For All Respondents*

18. In relation to the standardized material on the respective responsibilities of management, TCWG and the auditor, what benefits or disadvantages, if any, do you see if the ISAs were to explicitly allow the auditor's report to replace such material with a reference to the website of the appropriate authority where such material could be found?

## Form and Structure

*For Investors, Financial Analysts, Lenders and Other Creditors, and Securities Regulators*

19. Do you believe the IAASB's preferred structure of the illustrative report, including placement of the auditor's opinion and the Auditor Commentary section towards the beginning of the report, gives appropriate emphasis to matters of most importance to you?
20. How important is it to you for there to be consistency in the form, style or content of auditors' reports across entities? Across jurisdictions?

*For NSS, Other Policymakers, and Auditors*

21. What are your views regarding the need for global consistency in auditors' reports when ISAs, or national auditing standards that incorporate or are otherwise based on ISAs, are used? Do you believe the IAASB should, or should not, mandate the ordering of items in a manner similar to that shown in the illustrative report, unless laws or regulations require otherwise?
22. In your view, are the IAASB's proposals capable of being applied to entities of all sizes and in both the public and private sectors? What considerations specific to audits of SMEs and public sector entities should the IAASB further take into account in approaching its standard-setting proposals?

**Overall Considerations**

*All Respondents*

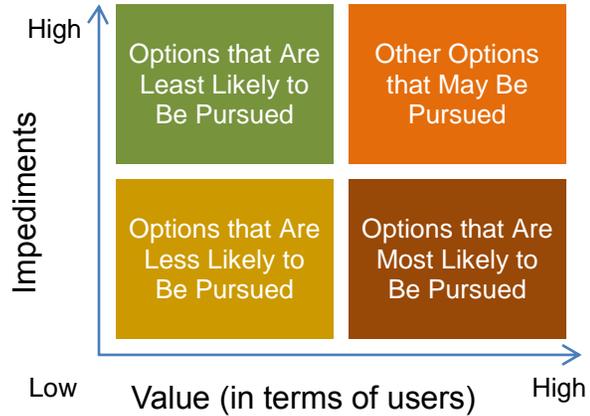
23. Overall, do you believe the changes proposed by the IAASB sufficiently enhance the relevance and informational value of the auditor's report, and are in the public interest?
24. Are there any specific elements of the IAASB's proposals, including the illustrative report, that are either inappropriate or unnecessary for audits of SMEs?
25. Are there any specific elements of the IAASB's proposals, including the illustrative report, that are either inappropriate or unnecessary for audits of public sector entities?
26. Do you believe there are other alternatives to improve the auditor's report, or auditor reporting more broadly, that should be further considered by IAASB, either alone or in coordination with others?

## Consideration of Value and Impediments

The IAASB has considered options for change in terms of the relative value and possible impediments of the various proposals, as illustrated by the matrix below:

(a) What is value?

- Does any proposed additional information to be included in the auditor's report enhance its communicative value (i.e., does it address the information gap)?
- Does it enhance transparency about the audit, by better explaining the nature and purpose of an audit, including explaining what an audit is intended to achieve and how it is executed (i.e., does it narrow the expectations gap)?
- Does the option provide appropriately tailored, rather than additional technical and standardized (i.e., "boilerplate"), language to the extent practicable based on the topic?



(b) What are impediments?

- Does the proposed action go beyond the current scope of the audit? If so, at what cost and to what extent would changes to other ISAs be needed?
- Can the option be operationalized by auditors?
- Does the option raise questions about management's primary responsibility for the financial statements and the auditor's assurance role?

The goal is to focus on areas with high value and a low level of impediments, though it was recognized that user demand may warrant exploration of areas of high value even if impediments are considered to be high.

In considering value and impediments of particular options, the IAASB has been mindful of the links to audit quality. Any proposals should not detract from audit quality or perceptions of audit quality. While it may be more difficult to evaluate how an option may favorably impact audit quality, it is likely that enabling auditors to provide additional commentary on key matters will lead to greater focus on these areas and related disclosures by management and TCWG, thereby strengthening the financial reporting process and audit quality in turn.

## **Examples of How the Illustrative Auditor's Report Would Be Tailored When an Emphasis of Matter or Other Matter Paragraph Is Required in Relation to Going Concern or Other Information**

This Appendix illustrates how the certain sections in the illustrative report would appear in the following circumstances relating to going concern and other information.

### **1. A Material Uncertainty Exists that Is Adequately Disclosed in the Financial Statements (e.g., Emphasis of Matter Paragraph Required)**

#### **Going Concern**

##### *Use of the Going Concern Assumption*

As part of our audit of the financial statements, we have concluded that management's use of the going concern assumption in the preparation of the financial statements is appropriate.

##### *Material Uncertainties Related to Events or Conditions that May Cast Significant Doubt on the Company's Ability to Continue as a Going Concern*

Without qualifying our opinion, we draw attention to Note X in the financial statements which indicates that the Company incurred a net loss of ZZZ during the year ended December 31, 20X1 and, as of that date, the Company's current liabilities exceeded its total assets by YYY. These conditions, along with other matters as set forth in Note X, indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern. However, because not all future events or conditions can be predicted, this statement is not a guarantee that the Company will or will not be able to continue as a going concern.

### **2. A Material Inconsistency Exists between the Audited Financial Statements and Other Information and Management Refuses to Revise the Other Information (i.e., Other Matter Paragraph Necessary)**

#### **Other Information**

As part of our audit, we have read Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) contained in the Company's Annual Report for the year ended December 31, 20X1 for the purpose of identifying whether there are material inconsistencies with the audited financial statements. Based on reading the MD&A, we have noted a material inconsistency in this information compared with the audited financial statements. Specifically, the MD&A indicates that income from continuing operations for the first, second, third and fourth quarters of 20X1 were xxx, xxx, xxx and xxx, respectively, amounting to a total of xxx. However, the audited financial statements indicate that total income from continuing operations was xxx. We have not audited the information in the MD&A and accordingly do not express an opinion on it.

## **INDEPENDENT AUDITOR'S REPORT [In accordance with ISA 700 Today]**

[Appropriate Addressee]

### **Report on the Financial Statements**

We have audited the accompanying financial statements of ABC Company, which comprise the statement of financial position as at December 31, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

#### *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, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

#### *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 about 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 we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

#### *Opinion*

In our opinion, 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.

### **Report on Other Legal and Regulatory Requirements**

[Form and content of this section will vary depending on the nature of the other reporting responsibilities.]

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

**Applying the IAASB's Improvements to Auditors' Reports in National  
Environments**

**See Agenda Item 3-B**