

Proposed International Standard on Auditing 706 (Revised) Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report

(Effective for audits of financial statements for periods beginning on or after [date])

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Proposed International Standard on Auditing (ISA) 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*, should be read in conjunction with ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*.

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with additional communication in the auditor's report when the auditor considers it necessary to:
 - (a) Draw users' attention to a matter or matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements; or
 - (b) Draw users' attention to any matter or matters other than those presented or disclosed in the financial statements that are relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.
2. Proposed ISA 701¹ establishes requirements and provides guidance for auditors of financial statements of listed entities to determine key audit matters and communicate them in the auditor's report. Auditors of financial statements of entities other than listed entities may also communicate key audit matters in the auditor's report in accordance with proposed ISA 701. When the auditor includes a Key Audit Matters section in the auditor's report, this ISA addresses the relationship between key audit matters and any additional communication in the auditor's report in accordance with this ISA. (Ref: Para. A1)
- 2.3. Appendices 1 and 2 identify ISAs that contain specific requirements for the auditor to include Emphasis of Matter paragraphs or Other Matter paragraphs in the auditor's report. In those circumstances, the requirements in this ISA regarding the form and placement of such paragraphs apply. (Ref: Para. A2)

Effective Date

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

Objective

- 4.5. The objective of the auditor, having formed an opinion on the financial statements, is to draw users' attention, when in the auditor's judgment it is necessary to do so, by way of clear additional communication in the auditor's report, to:
 - (a) A matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users' understanding of the financial statements; or
 - (b) As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

Definitions

- 5.6. For purposes of the ISAs, the following terms have the meanings attributed below:
 - (a) Emphasis of Matter paragraph – A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

¹ Proposed ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

- (b) Other Matter paragraph – A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

Requirements

Emphasis of Matter Paragraphs in the Auditor's Report

~~6.7.~~ If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided:

- (a) ~~¶~~The auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements; and. ~~Such a paragraph shall refer only to information presented or disclosed in the financial statements.~~
- (b) The matter has not been determined to be a key audit matter in accordance with proposed ISA 701, if applicable. (Ref: Para. A4A3)

~~7.8.~~ When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:

- (a) ~~Include it immediately after the Opinion paragraph in the auditor's report;~~
- (~~a~~) Use the heading "Emphasis of Matter," or other appropriate heading;
- (~~b~~) Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. Such a paragraph shall refer only to information presented or disclosed in the financial statements; and.
- (~~c~~) Indicate that the auditor's opinion is not modified in respect of the matter emphasized; ~~and~~. (Ref: Para. ~~A4A2–A5A4~~, A13)

Other Matter Paragraphs in the Auditor's Report

~~8.9.~~ If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report, the auditor shall include an Other Matter paragraph in the auditor's report, provided:

- (a) ~~and~~ ¶This is not prohibited by law or regulation; and
- (b) The matter has not been determined to be a key audit matter in accordance with proposed ISA 701, if applicable. (Ref: Para. ~~A6A5–A11A44~~)

~~910.~~ When the auditor includes an Other Matter paragraph in the auditor's report, the auditor shall ~~do so in a paragraph in the auditor's report, with~~ use the heading "Other Matter," or other appropriate heading. The auditor shall include this paragraph immediately after the Opinion paragraph and any Emphasis of Matter paragraph, or elsewhere in the auditor's report if the content of the Other Matter paragraph is relevant to the Other Reporting Responsibilities section. (Ref: Para. A12–A13)

Communication with Those Charged with Governance

~~4011.~~ If the auditor expects to include an Emphasis of Matter or an Other Matter paragraph in the auditor's report, the auditor shall communicate with those charged with governance regarding this expectation and the ~~proposed~~ wording of this paragraph. (Ref: Para. ~~A15~~A12)

Application and Other Explanatory Material

The Relationship between Emphasis of Matter Paragraphs and Key Audit Matters in the Auditor's Report (Ref: Para. 2)

A1. Key audit matters are defined in proposed ISA 701 as those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements. They are selected from matters communicated with those charged with governance, which include the significant findings from the audit of the financial statements of the current period.² In many instances, key audit matters will relate to specific areas of the financial statements and therefore will be fundamental to users' understanding of the audited financial statements. Accordingly, when a Key Audit Matters section is included in the auditor's report, Emphasis of Matter paragraphs are expected to be rare, except when otherwise required by other ISAs or by law or regulation.

Circumstances in Which an Emphasis of Matter Paragraph May Be Necessary (Ref: Para. ~~3, 7~~6)

A2. Appendix 1 identifies ISAs that contain specific requirements for the auditor to include Emphasis of Matter paragraphs in the auditor's report in certain circumstances. These circumstances include:

- When a financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation.
- To alert users that the financial statements are prepared in accordance with a special purpose framework.
- When facts become known to the auditor after the date of the auditor's report (i.e., subsequent events).³ In such circumstances, ISA 560 permits the auditor to include an Other Matter paragraph rather than an Emphasis of Matter paragraph if additional information is provided beyond a reference to the applicable disclosure in the notes to the financial statements.

A4A3. Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:

- An uncertainty relating to the future outcome of exceptional litigation or regulatory action.

² Proposed ISA 260 (Revised), *Communication with Those Charged with Governance*, paragraph 16

³ ISA 560, *Subsequent Events*, paragraph 12 and 16

- ~~Early application (where permitted) of a~~ new accounting standard (for example, a new International Financial Reporting Standard) ~~that is not yet effective but is expected to have a material that has a pervasive effect on the financial statements in advance of its effective date.~~
- Significant transactions with related parties.
- ~~A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.~~
- A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.⁴

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

Including an Emphasis of Matter Paragraph in the Auditor's Report (Ref: Para. 87)

~~A3~~A4. The inclusion of an Emphasis of Matter paragraph in the auditor's report does not affect the auditor's opinion. 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 (see proposed ISA 705 (Revised)⁵); or
- (b) Disclosures in the financial statements that the applicable financial reporting framework requires management to make;
- (c) Required statements in the auditor's report relating to going concern in accordance with proposed ISA 570,⁶ or
- (d) A description of key audit matters as required by proposed ISA 701 (see paragraph 7(b)).

~~A4~~A5. The illustrative report in Appendix 3 includes an Emphasis of Matter paragraph in an auditor's report for an entity other than a listed entity that contains a qualified opinion and for which key audit matters have not been communicated.

Other Matter Paragraphs in the Auditor's Report (Ref: Para. 89–10)

Circumstances in Which an Other Matter Paragraph May Be Necessary

Relevant to Users' Understanding of the Audit

A6. Proposed ISA 260 (Revised) requires the auditor to communicate with those charged with governance about the planned scope and timing of the audit, including the significant risks identified and the auditor's

⁴ See paragraph 6 of ISA 560.

⁵ Proposed ISA 705 (Revised), Modifications to the Opinion in the Independent Auditor's Report

⁶ Proposed ISA 570 (Revised), Going Concern

planned response.⁷ Although matters relating to significant risks may be determined to be key audit matters, other planning and scoping matters (e.g., the planned scope of the audit, or the application of materiality in the context of the audit) may not be key audit matters as defined in proposed ISA 701. However, in the auditor’s judgment, such planning and scoping matters may be relevant to users’ understanding of the audit and therefore may be described in an Other Matter paragraph.

A5A7. In the rare circumstance where the auditor is unable to withdraw from an engagement even though the possible effect of an inability to obtain sufficient appropriate audit evidence due to a limitation on the scope of the audit imposed by management is pervasive,⁸ the auditor may consider it necessary to include an Other Matter paragraph in the auditor’s report to explain why it is not possible for the auditor to withdraw from the engagement.

Relevant to Users’ Understanding of the Auditor’s Responsibilities or the Auditor’s Report

A6A8. Law, regulation or generally accepted practice in a jurisdiction may require or permit the auditor to elaborate on matters that provide further explanation of the auditor’s responsibilities in the audit of the financial statements or of the auditor’s report thereon. Where relevant, one or more sub-headings may be used that describe the content of the Other Matter paragraph.

A7A9. An Other Matter paragraph does not deal with circumstances where the auditor has other reporting responsibilities that are in addition to the auditor’s responsibility under the ISAs to report on the financial statements (see “Other Reporting Responsibilities” section in proposed ISA 700 (Revised)⁹), or where the auditor has been asked to perform and report on additional specified procedures, or to express an opinion on specific matters.

Reporting on more than one set of financial statements

A8A10. An entity may prepare one set of financial statements in accordance with a general purpose framework (for example, the national framework) and another set of financial statements in accordance with another general purpose framework (for example, International Financial Reporting Standards), and engage the auditor to report on both sets of financial statements. If the auditor has determined that the frameworks are acceptable in the respective circumstances, the auditor may include an Other Matter paragraph in the auditor’s report, referring to the fact that another set of financial statements has been prepared by the same entity in accordance with another general purpose framework and that the auditor has issued a report on those financial statements.

Restriction on distribution or use of the auditor’s report

A9A11. Financial statements prepared for a specific purpose may be prepared in accordance with a general purpose framework because the intended users have determined that such general purpose financial statements meet their financial information needs. Since the auditor’s report is intended for specific users, the auditor may consider it necessary in the circumstances to include an Other Matter paragraph, stating that the auditor’s report is intended solely for the intended users, and should not be distributed to or used by other parties.

⁷ Proposed ISA 260 (Revised), paragraph 15

⁸ See paragraph 13(b)(ii) of proposed ISA 705 (Revised) for a discussion of this circumstance.

⁹ Proposed ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraphs 4138–39

Including an Other Matter Paragraph in the Auditor's Report

~~A10A12.~~ The content of an Other Matter paragraph reflects clearly that such other matter is not required to be presented and disclosed in the financial statements. An Other Matter paragraph does not include information that the auditor is prohibited from providing by law, regulation or other professional standards, for example, ethical standards relating to confidentiality of information. An Other Matter paragraph also does not include information that is required to be provided by management.

Placement of Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Auditor's Report (Ref: Para. 8, 10)

~~A11A13.~~ The placement of an Emphasis of Matter paragraph or Other Matter paragraph in the auditor's report depends on the nature of the information to be communicated, and the auditor's judgment as to the relative significance of such information to the user compared to other elements required to be reported in accordance with proposed ISA 700 (Revised).¹⁰ For example:

Emphasis of Matter Paragraphs

- When the Emphasis of Matter paragraph relates to the applicable financial reporting framework,¹¹ the auditor may consider it necessary to place the paragraph immediately following the Basis of Opinion section to provide appropriate context to the auditor's opinion.
- When a Key Audit Matters section is presented in the auditor's report, an Emphasis of Matter paragraph matters that were not significant in the audit of the current period financial statements may be presented after the Key Audit Matters section. The auditor may also consider it necessary to add further context to the heading "Emphasis of Matter", such as "Emphasis of Matter – Subsequent Events", to differentiate the Emphasis of Matter paragraph from the individual matters described in the Key Audit Matters section.

Other Matter Paragraphs

- When a Key Audit Matters section is presented in the auditor's report and an Other Matter paragraph is also determined to be necessary, the auditor may consider it necessary to add further context to the heading "Other Matter", such as "Other Matter – Scope of the Audit", to differentiate the Other Matter paragraph from the individual matters described in the Key Audit Matters section. ~~When an Other Matter paragraph is included to draw users' attention to a matter relevant to their understanding of the audit of the financial statements, the paragraph is included immediately after the Opinion paragraph and any Emphasis of Matter paragraph.~~
- When an Other Matter paragraph is included to draw users' attention to a matter relating to Other Reporting Responsibilities addressed in the auditor's report, the paragraph may be included in the section sub-titled "Report on Other Legal and Regulatory Requirements."
- Alternatively, ~~w~~When relevant to all the auditor's responsibilities or users' understanding of the auditor's report, the Other Matter paragraph may be included as a separate section following the Report on the Financial Statements and the Report on Other Legal and Regulatory

¹⁰ Proposed ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

¹¹ For example, as required by ISA 210, *Agreeing the Terms of Audit Engagements*, paragraph 19 and ISA 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*, paragraph 14

Requirements.

Communication with Those Charged with Governance (Ref. Para. 119)

~~A12A14. Such~~ The communication required by paragraph 11 enables those charged with governance to be made aware of the nature of any specific matters that the auditor intends to highlight in the auditor's report, and provides them with an opportunity to obtain further clarification from the auditor where necessary. Where the inclusion of an Other Matter paragraph on a particular matter in the auditor's report recurs on each successive engagement, the auditor may determine that it is unnecessary to repeat the communication on each engagement, unless otherwise required to do so by law or regulation.

Appendix 1

(Ref: Para. 23, A2)

List of ISAs Containing Requirements for Emphasis of Matter Paragraphs

This appendix identifies paragraphs in other ISAs in effect for audits of financial statements for periods beginning on or after ~~[date] December 15, 2009~~ that require the auditor to include an Emphasis of Matter paragraph in the auditor's report in certain circumstances. The list is not a substitute for considering the requirements and related application and other explanatory material in ISAs.

- ISA 210, *Agreeing the Terms of Audit Engagements* – paragraph 19(b)
- ISA 560, *Subsequent Events* – paragraphs 12(b) and 16
- ISA 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks* – paragraph 14

~~ISA 570, *Going Concern* – paragraph 19~~ [Addressed by changes in proposed ISA 570 (Revised), will be included in the separate section on Going Concern and no longer considered to be an Emphasis of Matter paragraph]

Appendix 2

(Ref: Para. 32)

List of ISAs Containing Requirements for Other Matter Paragraphs

This appendix identifies paragraphs in other ISAs in effect for audits of financial statements for periods beginning on or after [date] ~~December 15, 2009~~ that require the auditor to include an Other Matter paragraph in the auditor's report in certain circumstances. The list is not a substitute for considering the requirements and related application and other explanatory material in ISAs.

- ISA 560, *Subsequent Events* – paragraphs 12(b) and 16
- ISA 710, *Comparative Information—Corresponding Figures and Comparative Financial Statements* – paragraphs 13–14, 16–17 and 19

~~ISA 720, *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements* – paragraph 10(a)~~ [Addressed by changes in proposed ISA 720 (Revised),¹² will be included in the separate section on Other Information and no longer considered to be an Other Matter paragraph]

¹² Exposure Draft, Proposed ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information in Documents Containing or Accompanying Audited Financial Statements and the Auditor's Report Thereon*

Appendix 3

(Ref: Para. A5A4)

Illustration of an Auditor’s Report that Includes an Emphasis of Matter Paragraph

Note: Only the required reporting elements that would be affected by have been reproduced in these illustrations. The Appendix in proposed ISA 700 (Revised) contains the illustrative wording for sections whose contents would not be affected by this ISA.

For purposes of this illustrative auditor’s report, the following ~~c~~Circumstances include the following~~are~~ assumed:

- Audit of a complete set of general purpose financial statements prepared by management of ~~an~~the entity other than a listed entity in accordance with International Financial Reporting Standards (IFRSs). The audit is not a group audit conducted in accordance with ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*.
- The terms of the audit engagement reflect the description of management’s responsibility for the financial statements in ISA 210.
- There is uncertainty relating to a pending exceptional litigation matter.
- The auditor is not required, and has otherwise not decided to, communicate key audit matters in accordance with proposed ISA 701.
- A departure from the applicable financial reporting framework resulted in a qualified opinion.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law.

INDEPENDENT AUDITOR’S REPORT

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

Report on the Audit of the Financial Statements¹³

Qualified Opinion

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion ~~section~~~~paragraph~~, 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).

We have audited the ~~accompanying~~ financial statements of ~~ABC~~the Company, which comprise the statement of financial position as at December 31, 20X1, and the statement of comprehensive income,

¹³ The sub-title “Report on the Financial Statements” is unnecessary in circumstances when the second sub-title “Report on Other Legal and Regulatory Requirements” is not applicable.

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 Qualified Opinion

The eCompany's short-term marketable securities are carried in the statement of financial position at xxx. Management has not marked these securities to market but has instead stated them at cost, which constitutes a departure from ~~International Financial Reporting Standards~~ IFRSs. The eCompany's records indicate that had management marked the marketable securities to market, the company would have recognized an unrealized loss of xxx in the statement of comprehensive income for the year. The carrying amount of the securities in the statement of financial position would have been reduced by the same amount at December 31, 20X1, and income tax, net income and shareholders' equity would have been reduced by xxx, xxx and xxx, respectively.

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company within the meaning of *[indicate relevant ethical requirements or applicable law or regulation]* and have fulfilled our other responsibilities under those ethical requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Emphasis of Matter

We draw attention to Note X to the financial statements, which describes the uncertainty related to the outcome of the lawsuit filed against the company by XYZ Company. Our opinion is not qualified in respect of this matter.

Going Concern

[Reporting in accordance with proposed ISA 570 (Revised)]

Other Information

[Reporting in accordance with proposed ISA 720 (Revised)]

Responsibilities of [Management's¹⁴ and Those Charged with Governance or other appropriate terms] Responsibility for the Financial Statements

[Reporting in accordance with proposed ISA 700 (Revised)]

~~Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards,¹⁵ 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.~~

¹⁴ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction

¹⁵ ~~Where management's responsibility is to prepare financial statements that give a true and fair view, this may read: "Management is responsible for the preparation of financial statements that give a true and fair view in accordance with IFRSs International Financial Reporting Standards, and for such"~~

Auditor's Responsibilities for the Audit of the Financial Statements

[Reporting in accordance with proposed ISA 700 (Revised)]

~~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 presentation¹⁶ 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.¹⁷ An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.~~

~~We believe that the audit evidence that we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.~~

Report on Other Legal and Regulatory Requirements

~~[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities~~*Reporting in accordance with proposed ISA 700 (Revised).*~~]~~

~~*[Auditor's sSignature in the name of the audit firm, the personal name of the auditor, or both, as appropriate for the particular jurisdiction]*~~

~~*[Auditor's aAddress]*~~

~~*[Date of the auditor's report]*~~

¹⁶ In the case of footnote 4, this may read: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control."

¹⁷ In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances." In the case of footnote 4, this may read: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances."