

ISA 700—Issues and Drafting Team Recommendations

Summary of the IAASB's Discussions at Its March 2014 Meeting

Statement of Independence and Other Relevant Ethical Requirements, Including Listing of Sources

Board members expressed mixed views about the ISA 700¹ Drafting Team's (DT-700) recommendation set out in Agenda Item 4-A² to retain the proposed requirement in ISA 700 for the auditor to make an explicit statement about independence and other relevant ethical requirements in the auditor's report, but not require the auditor to provide a listing of sources of those requirements.

- The Board generally supported requiring an explicit statement about independence and other relevant ethical requirements in the auditor's report.
- While recognizing the challenges of requiring a listing of sources, the Board encouraged DT-700 to continue to pursue opportunities for further transparency about the sources of independence and other ethical requirements in the auditor's report, consistent with comments from the IAASB Consultative Advisory Group (CAG). Suggestions raised included a reference to the independence requirements of the group auditor, limiting specific identification in the auditor's report to principal requirements that applied to the audit team, listing of the requirements that applied in the country or jurisdiction in which the audit was performed, or listing of the applicable requirements established by the firm. On the latter point, it was noted that the accounting firms in the Forum of Firms develop requirements to comply, at a minimum, with the International Ethics Standards Board for Accountants' (IESBA) *Code of Ethics for Professional Accountants* (IESBA Code).
- DT-700 was also asked to consider whether it would be appropriate to reinstate reference to the auditor being independent "of the entity" in the requirement and illustrative statement.

The Board did not reach a decision on the matter and will continue to deliberate the proposed requirement at its June 2014 meeting.

Disclosure of the Engagement Partner's (EP) Name

Board members expressed mixed views about DT-700's recommendation set out in Agenda Item 4-A to require auditors to identify (rather than disclose the name of) the EP in the auditor's report for audits of financial statements of listed entities.

- While the requirement to explicitly name the EP is in place in many jurisdictions worldwide, developing a requirement that could be implemented in those jurisdictions where this was not currently required, having regard to the potential liability implications and the implementation challenges, needs to be taken into account.
- As the purpose of the disclosure would be to provide additional transparency in response to investor demands, some members, as well as the IAASB CAG, questioned whether identifying rather than naming the EP achieved that aim, in particular if the name was not easily accessible via

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

² Agenda Item 4-A is available at the IAASB's website at www.ifac.org/sites/default/files/meetings/files/20140317-IAASB-Agenda_Item_4A-Auditor_Reporting-Remaining_Suggested_Improvements-final.pdf.

the identification. Views were also expressed that, in some cases, both the name and a further identifier may be necessary in order to clearly identify the EP.

Upon further deliberation and consideration of additional alternatives, the IAASB agreed to:

- Require auditors to disclose the name of the EP in the auditor's report for audits of financial statements of listed entities, with additional application material to be provided to explain that law, regulation or national auditing standards may require the auditor to include additional information to assist in identifying the EP or the auditor may consider it useful to do so; and
- Retain the inclusion of a harm's way exemption, provided that ISA 700 appropriately explained the expectation that the use of such an exemption would be rare.

Other Recommendations Set Out in Agenda Item 4-A

- The Board tentatively agreed with DT-700's recommendations to require an enhanced description of the auditor's responsibilities and to allow for such description to be included in either the auditor's report or an Appendix thereto or, where permitted by law, regulation or national auditing standard setters, to refer to a description on a website of an appropriate authority.
- The Board tentatively agreed with DT-700's recommendation to establish a new requirement to mandate that the Opinion section always be presented first in the auditor's report and to revise the presentation in the illustrative auditor's report.
- The Board tentatively agreed with the recommendation to clarify the requirement addressing the presentation of Other Reporting Responsibilities ("ORR") in the auditor's report.

Objectives of the IAASB Discussion

The objective of the IAASB discussion at its June 2014 meeting is to provide input on DT-700's recommendations and revisions to proposed ISA 700 (Revised) and proposed ISA 705 (Revised). In particular, DT-700 seeks the IAASB's feedback on the following topics:

- The statement of independence and other relevant ethical requirements, including listing of sources;
- Disclosing the name of the EP, including the harm's way exemption;
- The structure and format of ISA auditor's reports, including the new requirement related to mandating the placement of the Opinion and Basis for Opinion sections; and
- Revisions to proposed ISA 705 (Revised), in particular, the applicability of key audit matters (KAM), going concern (GC) and other information (OI) when the auditor expresses an adverse opinion or disclaims an opinion on the financial statements.

I. Statement of Independence and Other Relevant Ethical Requirements, Including Listing of Sources

A. Interaction with, and Feedback from, the IESBA

1. Since the March 2014 IAASB meeting, the DT-700 Chair has obtained input from the IESBA at its April 2014 meeting on a number of possible options with respect to having a statement about independence and other relevant ethical requirements in the auditor's report. IESBA members were asked for their perspectives on four possible options relating to the statement that refers to the listing of sources.³
2. IESBA members were of the view that having some information about the sources of independence and other relevant ethical requirements in the auditor's report would provide value to users, and emphasize the important role of independence and ethics in the audit.
3. Directionally, the majority of IESBA members expressed a preference for having a statement about sources that did not require citation of the applicable standards, but instead identified the source using a more generic statement referencing the geographic origin of the standards, for example, "...ethical requirements that are relevant to the audit of the financial statements in [jurisdiction X]."
4. The IESBA was of a view that:
 - The IAASB should seek to mirror how auditing standards are referenced in the auditor's report in developing the approach for listing sources in the auditor's report about independence and other relevant ethical requirements.
 - It would be most relevant to users if the ISA auditor's report included a reference to the IESBA Code, as this would have the benefit of signaling that the auditor has complied with some minimum benchmark. IESBA members acknowledged that it would not be possible for the IAASB to mandate such a reference in the auditor's report, but suggested that the use of such a reference be encouraged.
5. To be best positioned for receiving timely input on DT-700's work, it was agreed that an IESBA member would be added to DT-700 as a correspondent member. This new DT-700 correspondent member will continue to provide input to DT-700's work in his capacity as an IESBA Member, specifically as it relates to the finalization of the proposed requirement related to independence and other relevant ethical requirements.

B. Drafting Team Recommendations

6. Taking into account feedback received at the March 2014 IAASB meeting, including the suggested options for a way forward, DT-700 is putting forward for IAASB's consideration a revised proposal related to requiring a statement in the auditor's report about independence and other relevant ethical requirements. This revised proposal includes a revised requirement and application material presented in paragraphs 28(c) and A35–A40 of **Agenda Item 2-C** and a revised illustrative statement presented in **Agenda Item 2-D**.

³ Further details about options presented are included in Agenda Item 8 of the IESBA April 2014 meeting materials, which is available at: <http://www.ifac.org/sites/default/files/meetings/files/Agenda%20Item%208-Auditor%20Reporting%20-%20Independence%20and%20Ethical%20Requirements.pdf>.

7. DT-700 believes its revised proposal achieves an appropriate balance between having transparency about the sources of independence and other relevant ethical requirements and addressing the practical challenges of listing all sources of independence and other relevant ethical requirements in the auditor's report.
8. Specifically, the revised wording addresses the practical challenges cited by respondents, while retaining the degree of transparency envisioned in the original ED and is:
 - Grounded in existing ISA concepts, in particular, ISA 200,⁴ ISA 220⁵ and ISA 600;⁶ and
 - Intended to provide a certain degree of flexibility for national auditing standard setters to further tailor the IAASB's requirements to encourage more specific information about sources to be disclosed in the auditor's report where possible, provided that such information does not detract from the informational value of the auditor's report as a whole.

Matter for IAASB Consideration

1. The IAASB is asked to provide input on DT-700's proposed new requirement, application material and illustrative statement relating to the statement about independence and other relevant ethical requirements, in particular whether the revisions to the proposals about listing the sources appropriately mitigate concerns about the practical challenges of such a requirement.

II. Disclosing the Name of the Engagement Partner (EP), Including the Harm's Way Exemption

A. Drafting Team Recommendations

9. At its March 2014 meeting, the IAASB agreed to require auditors to disclose the name of the EP in the auditor's report for audits of financial statements of listed entities, and retain the inclusion of a harm's way exemption, provided that ISA 700 appropriately explained the expectation that the use of such an exemption would be rare.
10. In response to the feedback received to date, DT-700 is recommending a revised requirement and application material in paragraphs 44 and A60–A62 of **Agenda Item 2-C**. Such material:
 - Continues to require disclosure of the name of the EP in auditor's reports for audits of financial statements of listed entities, but specifies such requirement is for complete sets of general purpose financial statements (i.e., that it does not apply to audits of special purpose financial statements). DT-700 was of a view that it was appropriate to parallel the scope of this requirement with that of KAM as required by paragraph 30 of proposed ISA 700 (Revised).
 - Clarifies that invoking of the harm's way exemption (i.e., the auditor's option to not disclose the name of the EP in the auditor's report) is expected to rare, and should be communicated with management and, where appropriate, those charged with governance (TCWG). DT-700 was of a view that a conversation with management and TCWG could help the auditor assess the

⁴ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

⁵ ISA 220, *Quality Control for an Audit of Financial Statements*

⁶ ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

likelihood or severity of a security threat – a condition necessary to for auditors to use the harm’s way exception. Accordingly, this is now reflected in the application material to the ISA.

11. The revised ISA also includes new application material that is intended to:
- Provide contextual information about the importance of having the requirement;
 - Highlight that law, regulation or national auditing standards may require the name of EP in the auditor’s reports of other than complete sets of general purpose financial statements of listed entities (e.g., for all entities or for special purpose financial statements);
 - Explain that the auditor may be required by law, regulation or national auditing standards, or may decide, to include additional information beyond the EP’s name in the auditor’s report to further identify the EP (e.g., a professional license number); and
 - Explain what is meant by “significant security threat”.

Matter for IAASB Consideration

2. The IAASB is asked to provide input on DT-700’s proposed revised requirement and new and revised application material related to naming the EP in the auditor’s report.

III. Other Revisions to ISA 700

A. Responsibilities for the Financial Statements

12. As further discussed in Section II of **Agenda Item 3-A**, a new requirement has been added to proposed ISA 700 (Revised) to require a description of the respective responsibilities of those in the organization responsible for the assessment of the entity’s ability to continue as a GC in the context of the applicable financial reporting framework (see paragraph 33(b) and A48 of **Agenda Item 2-C**).

B. Auditor’s Responsibilities for the Audit of the Financial Statements, Including the Location of Such Description

13. DT-700 continues to believe it is appropriate to allow for parts of the description of the auditor’s responsibilities to be placed outside of the auditor’s report. The requirements in proposed ISA 700 (Revised) have been refined to more clearly articulate that the wording of the description of the auditor’s responsibilities featured in the illustrative auditor’s report must be used when included in the body of the auditor’s report or in an appendix to the auditor’s report (see paragraphs 35–40 of **Agenda Item 2-C**). This includes new requirements related to describing the auditor’s responsibilities with respect to GC (see paragraph 37(b)(iv) of **Agenda Item 2-C**, as explained further in Section II of **Agenda Item 3-A**) and KAM (see paragraphs 38(c) and A52 of **Agenda Item 2-C**, as explained further in Section III.D of **Agenda Item 4-A**).
14. Paragraph 39 of **Agenda Item 2-C** now clarifies that the description of the auditor’s responsibilities for the audit of the financial statements can be located either within the body of the auditor’s report or in an appendix to the auditor’s report; or, where law, regulation or national auditing standards permit, reference can be made to such a description included on a website of an appropriate authority.
15. When law, regulation or national auditing standards permit the auditor to do so, the revised ISA continues to allow flexibility for the auditor to make a reference to a description of the auditor’s

responsibilities on a website of an appropriate authority, provided that the wording on such a website is not inconsistent with what would be required to be included in the auditor's report.

16. Paragraph A56 of **Agenda Item 2-C** features new application material that better explains that the wording of the description of the auditor's responsibilities on the website may be more detailed than what is required by proposed ISA 700 (Revised), or may address other matters such as the process of an audit of financial statements. This is achieved with the inclusion of an explanation of what is meant by the phrase "...not inconsistent with..." as part of the application material to the ISA.

C. Changes Arising from Other IAASB Projects

17. **Agenda Items 2-C** and **2-D** reflects conforming amendments to ISA 700 that have been proposed in the May 2014 ED, *Proposed Changes to the International Standards on Auditing (ISAs)—Addressing Disclosures in the Audit of Financial Statements*, and the April 2014 ED related to the re-exposure of proposed ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*. DT-700 is therefore not seeking feedback on those revisions at the IAASB's June 2014 meeting. However, these amendments have been included for the Board's and other stakeholders' reference on the proposed future direction of those projects. These amendments to ISA 700 arising from the Disclosures and ISA 720 projects will be finalized in due course based on feedback on the respective EDs.

Matter for IAASB Consideration

3. The IAASB is asked to provide feedback on the matters described in this section and the revised draft of proposed ISA 700 (Revised) presented as **Agenda Item 2-C**.

IV. Structure and Format of ISA Auditor's Reports, including a Proposed New Requirement to Mandate the Placement of the Opinion and Basis for Opinion Sections

A. Mandatory Placement of Opinion and Basis for Opinion Sections

Drafting Team Recommendations

18. At its March 2014 meeting, the IAASB tentatively agreed to establish a new requirement to mandate that the Opinion section always be presented first in the auditor's report, and be immediately followed by the Basis for Opinion section. Refinements to these revised requirements that were first presented to the IAASB at its March 2014 meeting are included in paragraphs 23 and 28 of **Agenda Item 2-C**.
19. The IAASB also tentatively agreed at its March 2014 meeting that the ordering of the paragraphs within the Opinion section of the auditor's report for purposes of the illustrative auditor's report only would be reversed so that the paragraph that begins "*We have audited...*" precedes the paragraph beginning "*In our opinion...*". This revision is reflected in the updated illustrative auditor's report in **Agenda Item 2-D**.
20. DT-700 is not proposing that placement of any other elements of the auditor's report be mandated. However, DT-700 is recommending that the ISA include new application material, such as paragraph A19 of **Agenda Item 2-C**, to explain the IAASB's position set out in the ED to further indicate how the use of required headings and titles drive consistency across auditor's reports. It is

envisioned that, together with the illustrative auditor’s reports that will form part of the ISA, this application material will help encourage the IAASB’s preferred presentation of the elements in the auditor’s report (i.e., **Agenda Item 2-D**).

B. Auditor’s Report Prescribed by Law or Regulation and Auditor’s Report for Audits Conducted in Accordance with Both National Auditing Standards and ISAs

21. In the ED, the IAASB also explained that it is necessary for proposed ISA 700 (Revised) to retain the level of flexibility in auditor reporting that exists in extant ISA 700, by allowing a departure from more detailed requirements in the following circumstances:
- When an auditor claims compliance with the ISAs in performing the financial statement audit, and law or regulation prescribes a specific layout or wording of the auditor’s report (see paragraph 46 of proposed ISA 700 (Revised) included in the IAASB’s ED / paragraph 48 of **Agenda Item 2-C**); or
 - When an auditor is required to conduct an audit in accordance with the auditing standards of a specific jurisdiction (the “national auditing standards”) but may have additionally complied with the ISAs in the conduct of the audit and refers to both ISAs and the national auditing standards in the auditor’s report (see paragraphs 46–47 of proposed ISA 700 (Revised) included in the IAASB’s ED / paragraphs 49–50 of **Agenda Item 2-C**).⁷
22. The flexibility allowed by these paragraphs enables the auditor to tailor the wording of the auditor’s report to meet the legal and regulatory requirements of a particular jurisdiction, or its national auditing standards, while still making reference to ISAs in the auditor’s report and complying with proposed ISA 700 (Revised).
23. The IAASB’s ED featured minimum required elements in paragraphs 46–47 of proposed ISA 700 (Revised) that reflect what the IAASB determined to be minimum elements aimed at achieving an appropriate balance between consistency in auditor reporting globally when reference is made to the ISAs in the auditor’s report, and the need for flexibility to accommodate national reporting circumstances.

Drafting Team Recommendations

24. Refinements have been made to these requirements, included in paragraphs 48–49 of **Agenda Item 2-C**, in light of feedback from the ED and other changes DT-700 considers necessary to preserve the alignment between those requirements and others in paragraphs 20–47 of **Agenda Item 2-C**.

Matters for IAASB Consideration

4. The IAASB is asked to share views on revisions made to requirements and application material related to the structure and format of new the ISA auditor’s report.

⁷ The IAASB Policy Position, [Modifications to International Standards of the IAASB: A Guide for National Standard Setters that Adopt the IAASB’s International Standards but Find It Necessary to Make Limited Modifications](#), sets minimum requirements for NSS in developing national auditing standards, with limited flexibility to depart from relevant requirements in individual ISAs. This means that, in developing national auditor reporting standards, NSS must look to incorporate the applicable requirements in proposed ISA 700 (paragraphs 20–47 of **Agenda Item 2-C**) in order to assert compliance with the revised auditor reporting standards and the ISAs more broadly.

5. The IAASB is asked to share views on the illustrative auditor's report at **Agenda Item 2-D**.

V. Revisions to ISA 705

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

The IAASB's Position in the ED

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25. The IAASB's proposals included in proposed ISA 705 (Revised) in the ED prohibited the auditor from including additional information on GC, KAM, and OI when the auditor disclaims an opinion on the financial statements. Proposed ISA 705 (Revised) also prescribed the use of an abbreviated auditor's responsibilities section when the auditor disclaims an opinion on the financial statements.
26. Paragraph 29 of ISA 705 (Revised) included in the ED explained that providing such details about the audit, including addressing the auditor's responsibilities about GC, KAM, or OI, or providing an extensive description of the auditor's responsibilities for the audit of the financial statements, may overshadow the disclaimer of opinion on the financial statements as a whole.
27. The IAASB's ED did not include such prohibitions in proposed ISA 705 (Revised) when the auditor expressed an adverse opinion. Questions have been raised by some respondents to the ED and amongst DT-700 and DT-701 about whether certain sections of the auditor's report, in particular GC, KAM and OI, should be included in the auditor's report when the auditor expresses an adverse opinion.

Drafting Team Recommendations

28. The three DTs considered the question of whether these required elements should be prohibited when the auditor expresses an adverse opinion or disclaims an opinion on the financial statements. These recommendations are set forth below.

Key Audit Matters

29. Section I.B of **Agenda Item 4-A** explains DT-701's considerations in relation to KAM. In summary, DT-701 is recommending that KAM be prohibited for audits when the auditor expresses an adverse opinion or disclaims an opinion on the financial statements. This has been incorporated into the overarching requirement to communicate KAM included in paragraphs 30–30a of **Agenda Item 2-C**.

Other Information

30. Proposed ISA 705 (Revised) prohibited reporting on OI when the auditor disclaimed an opinion on the financial statements, but did not address reporting when the auditor had expressed an adverse opinion. The ISA 720 Task Force has not yet explicitly discussed the implications of reporting on OI when the auditor expresses an adverse opinion. Because it is possible to complete the audit when an adverse opinion is issued (i.e., the auditor has obtained sufficient appropriate audit evidence to provide a basis for the opinion), the auditor is able to read the other information and respond appropriately, and could therefore report on OI.

31. However, on an initial basis the DT Chairs and ISA 720 TF Chair, together with Staff, believe that reporting on OI when the auditor expresses an adverse opinion may imply the financial statements are more credible than is warranted. It is also questionable whether it would be useful to readers of the auditor's report for a statement in relation to OI to be included that essentially indicates that the OI is (or is not) consistent with financial statements that include material and pervasive misstatements relating to a matter(s). In such cases, if the financial statements are misstated, in order to be consistent with the financial statements, the OI would also be misstated – and explaining this in the auditor's report is likely to be confusing to users and could potentially overshadow the adverse opinion. Accordingly, paragraph 31 of **Agenda Item 2-C** prohibits the auditor from reporting on OI when the auditor expresses an adverse opinion. The prohibition from reporting on OI when the auditor disclaims an opinion on the financial statements is proposed to be retained as well.

Going Concern

32. Proposed ISA 705 (Revised) also prohibited reporting on GC when the auditor disclaimed an opinion on the financial statements, but did not address reporting when the auditor had expressed an adverse opinion. **Agenda Item 3-A** explains DT-570's proposal to revert to exception-based reporting in a separate section of the auditor's report, similar to what was required to be included in an Emphasis of Matter (EOM) paragraph. Neither extant ISA 706⁸ nor extant ISA 705 explicitly address whether EOM paragraphs or Other Matter (OM) paragraphs are required or prohibited when the auditor expresses an adverse opinion or disclaims an opinion on the financial statements.
33. There may be merit in allowing for auditor reporting on material uncertainties related to going concern even when the auditor disclaims an opinion on the financial statements, given the importance investors attach to going concern issues. Accordingly, nothing in proposed ISA 700 (Revised) or proposed ISA 705 (Revised) as revised would prohibit the auditor from including such information (see paragraph 32 of **Agenda Item 2-C**).

Treatment in Proposed ISA 705 (Revised)

34. As the requirements relating to the applicability of reporting on KAM and OI are included in proposed ISA 700 (Revised), there is not a need for an additional requirement in proposed ISA 705 (Revised). However, DT-700 is of the view that application material may be useful to explain why such sections are not required in the auditor's report, and acknowledge that law or regulation may require the auditor to include such sections (for example, in the case of audits in the public sector) (see paragraph A26 of **Agenda Item 2-C**). This application material is better placed in proposed ISA 705 (Revised), rather than proposed ISA 700 (Revised). As a result, the requirement in ISA 705 (Revised) has been tailored to reiterate the approach taken in proposed ISA 700 (Revised), reminding auditors of the prohibition of reporting on KAM and OI when the auditor has expressed an adverse opinion or disclaimed an opinion (see paragraph 29 of **Agenda Item 2-C**).

⁸ ISA 706, Emphasis of Matter Paragraphs or Other Matters Paragraph in the Independent Auditor's Report

Matters for IAASB Consideration

6. The IAASB is asked to provide feedback on the matters described in this section and the revised draft of proposed ISA 705 (Revised) presented as **Agenda Item 2-E**.