IMPROVING THE AUDITOR’S REPORT

INVITATION TO COMMENT
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) or modified opinion 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.

More than ever before, however, users of audited financial statements are calling for 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.

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 risk-based audits. But the auditor’s report should better explain what an auditor does and enable the auditor to shine light on key matters based on the auditor’s work.

As the call for change continues to intensify, we know that now is the time to lay the foundation for the future of auditor reporting with an eye toward a meaningful and workable global solution based on the scope of an audit under the current ISAs.

This Invitation to Comment (ITC) sets out the indicative direction proposed for the future auditor’s report. It reflects the progress the Board has made in its deliberations to date, based on what it has learned from its research, its May 2011 consultation paper, its ongoing dialogue and outreach activities, and related initiatives of others. The IAASB has identified a number of improvements to auditor reporting and is consulting now to better understand whether users of the auditor’s report – especially investors, but also regulators, preparers and others – would value these possible changes to auditor reporting. Hearing from all stakeholders at this stage will inform the Board’s standard-setting proposals in a way that will best serve the public interest.

Featured in this ITC is an illustrative improved auditor’s report, along with a summary of the Board’s rationale and questions to facilitate 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 users’ demands for greater transparency about the financial statements and the audit and provide the value that is sought?

I encourage all stakeholders to provide their views on the matters addressed in this ITC.

Prof. Arnold Schilder, Chairman
The IAASB’s Timetable for Improvements to Auditor Reporting

- **Close of comment period for this Invitation to Comment** – October 8, 2012
- **Exposure draft of revised auditing standards** – June 2013
- **Approval of final revised auditing standards** – June 2014

The IAASB also will continue its outreach program and hold roundtables to solicit additional feedback on this ITC as follows:
- **New York, USA** – September 10, 2012
- **Brussels, Belgium** – September 14, 2012
- **Kuala Lumpur, Malaysia** – October 8, 2012

The IAASB is committed to progressing improvements in auditor reporting as quickly as possible. However, 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.

Comments to this ITC are requested by October 8, 2012. Respondents are asked to submit their comments electronically through the IAASB website, using the “Submit a Comment” link. For more information on how to respond, see page 15. For more information and to follow the progress of this project, visit the Auditor Reporting project history page at www.iaasb.org/auditor-reporting.
The IAASB jointly commissioned international academic research on user perceptions of the standard auditor’s report in 2006. Findings from this research, 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 auditors to provide greater transparency about significant matters in the financial statements, as well as the conduct of the individual audit. 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.

This call for change is common in many quarters of the world. Recent initiatives of the US Public Company Accounting Oversight Board (PCAOB), the European Commission (EC), and others with respect to auditor reporting all indicate that users believe the auditor’s report should be improved. These initiatives also have reflected the need to improve corporate reporting more broadly.

It is notable that the call for change initially came primarily from institutional investors and financial analysts who are looking to auditors 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, and public sector authorities, 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.
The sovereign debt crisis has also demonstrated the critical importance of public sector reporting and highlighted the important interaction between the private and public sectors. This interaction and the effects thereof is likely to be relevant to users of both public and private sector financial statements, and improving auditor reporting in both sectors will strengthen transparency in financial reporting overall.

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

The IAASB aspires to improve auditor reporting on a global basis, in the same way that it has worked to strengthen and harmonize the underlying work effort of audits through its clarified ISAs. This ITC sets out the indicative direction proposed by the IAASB for the future auditor’s report. The IAASB is committed to progressing this change as quickly as possible in the public interest, but needs input from a broad range of stakeholders before it is in a position to revise the relevant ISAs.

The IAASB also recognizes that, to a degree, it will be necessary for auditors’ reports to vary across jurisdictions due to differences in national law or regulation. It is important that reports issued for audits conducted in accordance with ISAs share a degree of commonality that will enable investors around the world to clearly recognize them. Obtaining diverse views in order to achieve the right balance between global consistency and national flexibility is an important objective of this ITC.

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 and information 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 both 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. Therefore, it is important that efforts to improve auditor reporting are synchronized with improvements to corporate governance and financial reporting more broadly.

Accounting standard setters have a critical role to play in ensuring that the financial statements that result from the application of 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, they should seek to present the entity’s information 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, such as governance organizations and securities regulators, 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.

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.
It is vital for the IAASB to have a robust understanding of views 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 principles:

- **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).
- **There is a need to preserve the separate responsibilities of management and TCWG, as providers of original information, and the auditor, respectively.**
- **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.**
The IAASB has reached general agreement on a number of improvements to auditor reporting that it believes in principle should be promulgated internationally.

- Additional information in the auditor’s report to highlight matters that are, in the auditor’s judgment, likely to be most important to users’ understanding of the audited financial statements or the audit, referred to as “Auditor Commentary.” This information would be required for public interest entities (PIEs) – which includes, at a minimum, listed entities – and could be provided at the discretion of the auditor for other 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 in relation to going concern have been identified.

- Auditor statement as to whether any material inconsistencies between the audited financial statements and other information have been identified based on the auditor’s reading of other information, and specific identification of the information read by the auditor.

- Prominent placement of the auditor’s opinion and other entity-specific information in the auditor’s report.

- Further suggestions to provide transparency about the audit performed and clarify the respective responsibilities of the auditor, management, and TCWG in an ISA audit.
WHAT DO WE NEED FROM YOU?

The IAASB needs feedback on its proposed direction at this stage, before endeavoring to revise its auditor reporting standards. As investors and analysts have been leading the call for change, the IAASB is particularly interested in hearing from them as to whether the IAASB’s suggested 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 9–12 will be particularly welcome.

Input from all stakeholders, however, is vital, and will help the IAASB ascertain both the value and potential impediments of its suggested improvements. In particular:

- Auditors and regulators will likely provide insights on the practical aspects, including any challenges, of implementing them.
- Preparers and TCWG are likely to have views on them in light of their financial reporting responsibilities, including how the suggested improvements may affect their interactions with the auditor.
- NSS and supreme audit institutions can provide insight on both value and possible impediments relative to global adoption and in light of national financial reporting regimes and unique public sector considerations.
Pages 13–15 include 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

The illustrative report is intended to show the result of the IAASB’s suggested improvements 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)*. It also acknowledges that other reporting responsibilities specified by national law or regulation could be included in the auditor’s report (for example, reporting on Directors’ remuneration), although these other responsibilities are not specified.

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 is included in Appendix 3.

Any new international auditor reporting standard must be capable of being implemented in diverse national environments. Accordingly, in developing its suggestions to improve the auditor’s report, the IAASB has identified common elements that would be required in all auditors’ reports, while providing the flexibility for jurisdictions to further tailor auditors’ reports, if appropriate. The IAASB is referring to this as a “building blocks” approach and believes it will provide a strong foundation for auditor reporting globally while facilitating comparability and consistency in auditors’ reports across jurisdictions. The approach also allows for certain elements of auditor reporting to be applicable to certain types of entities (for example, required Auditor Commentary for PIEs) or when relevant in the context of the engagement (for example, reporting on other information). 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 Suggested Improvements Be Applied around the World? and Appendix 4.

* Auditor Commentary highlighting the involvement of other auditors and a description of the auditor’s responsibilities in a group audit has been included in the illustrative auditor’s report. In such circumstances, IFRSs would require reference to the consolidated financial statements of the Company and its subsidiaries. This specificity has not been incorporated in the illustrative report, as most of the suggested improvements to auditor reporting would apply to auditor’s reports for all entities.
INDEPENDENT AUDITOR’S REPORT

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

Report on the Financial Statements

Opinion [See paragraph 18]

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). 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 paragraphs 19 and 74–76]

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

Going Concern [See paragraphs 24–34]

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

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 in accordance with IFRSs. 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.

The responsibilities of management with respect to going concern are described in a separate section of our report.

^ Throughout this illustrative auditor’s report, the term management may need to be replaced by another 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.
Without modifying our opinion, we highlight the following matters that are, in our judgment, 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.

Outstanding Litigation

The Company is exposed to various claims and contingencies in the normal course of business. We draw attention to Note 9, which describes the uncertainty related to an environmental claim regarding a business that was sold by the Company in 20X0.

Goodwill

As disclosed in Note 3, in 20X0, the Company acquired a significant operation in [location]. Goodwill attributable to this acquisition is XXX, which is material to the financial statements as a whole. The annual impairment test, as described in the Company’s summary of significant accounting policies, is complex and highly judgmental. Due to the current economic conditions as discussed on page X of Management Commentary, there is significant uncertainty embedded in the future cash flow projections used in the impairment calculation. The Company performed this testing as at [date]. No impairment was recognized because the recoverable amount of the unit to which the goodwill was allocated marginally exceeded its carrying value at that date. The Company has disclosed that a decline of Y% in the fair value of this unit 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.

Valuation of Financial Instruments

The Company’s disclosure with respect to its structured financial instruments is included in Note 5. Due to the significant measurement uncertainty associated with these instruments, we determined that there was a high risk of material misstatement of the financial statements related to the valuation of them. As part of our response to this risk, our firm’s valuation specialists developed an independent range for purposes of evaluating the reasonableness of management’s fair value estimate, which was determined through its use of a model. Management’s recorded amount fell within our range.

Audit Strategy Relating to the Recording of Revenue, Accounts Receivable, and Cash Receipts

During the year, the Company implemented a new system to record revenue, accounts receivable, and cash receipts, which involved the introduction of new accounting software. The new system centralizes processes and related internal control for five of the Company’s seven operating segments. These processes and controls are significant to our audit of the financial statements because they affect a number of material financial statement accounts. We discussed the effect of the new system implementation on our audit strategy with those charged with governance, including our consideration of the work that had been performed on the new system by the Company’s internal audit function. Our audit strategy included supporting our understanding of the design of the new system through discussion with relevant personnel; testing the effectiveness of key controls; and testing the transfer of balances to the new accounting ledgers.

Involvement of Other Auditors [See paragraphs 77–80]

At our request, other auditors performed procedures on the financial information of certain subsidiaries to obtain audit evidence in support of our audit opinion. The work of audit firms with which we are affiliated constituted approximately [percentage of audit measured by, for example, audit hours] of our audit and the work of other non-affiliated audit firms constituted approximately [percentage of audit measured by, for example, audit hours] of our audit. Our responsibilities for the audit are explained in the Auditor’s Responsibility section of our report.
**Other Information** [See paragraphs 65–71]

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 85–86]

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 Company’s financial reporting process.

*Management’s Responsibilities Relating to Going Concern* [See paragraph 32]

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. Under IFRSs, the Company’s financial statements are prepared on a going concern basis, unless management either intends to liquidate the Company or to cease trading, or has no realistic alternative but to do so.

IFRSs also 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 81–84]

The objectives of our audit are to obtain reasonable assurance about whether 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 could reasonably be expected to influence the 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 performing of the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. 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.

- Obtain an understanding of 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.

- Obtain sufficient appropriate audit evidence regarding the financial information of entities and business activities within the group to express an opinion on the group financial statements. 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 80]

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- 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, among other matters, 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 4]

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 integrate reporting on these matters with reporting as required by the ISAs (shown in the Report on the Financial Statements section).

The engagement partner responsible for the audit resulting in this report is [name]. [See paragraphs 72–73]

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

[Address]

[Date]
The IAASB is seeking views on the suggested changes reflected in the improved illustrative auditor’s report on pages 9–12 of this ITC, as well as the matters 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 suggested improvements, the IAASB has used a value and impediments model (see Appendix 1) in considering various options to enhance auditor reporting, and has included the relevant value and impediment considerations in the ITC. The IAASB seeks views on the value of, and impediments (including costs) to, its suggested improvements to better enable it to evaluate the relevant options and inform its standard-setting deliberations thereon.

The IAASB welcomes responses even if they address only some of the listed questions. Respondents also are asked to provide specific reasons for their comments.

**Overall Considerations**

1. Overall, do you believe the IAASB’s suggested improvements sufficiently enhance the relevance and informational value of the auditor’s report, in view of possible impediments (including costs)? Why or why not?

2. Are there other alternatives to improve the auditor’s report, or auditor reporting more broadly, that should be further considered by the IAASB, either alone or in coordination with others? Please explain your answer.
Auditor Commentary

3. Do you believe the concept of Auditor Commentary is an appropriate response to the call for auditors to provide more information to users through the auditor’s report? Why or why not? (See paragraphs 35–64.)

4. Do you agree that the matters to be addressed in Auditor Commentary should be left to the judgment of the auditor, with guidance in the standards to inform the auditor’s judgment? Why or why not? If not, what do you believe should be done to further facilitate the auditor’s decision-making process in selecting the matters to include in Auditor Commentary? (See paragraphs 43–50.)

5. Do the illustrative examples of Auditor Commentary have the informational or decision-making value users seek? Why or why not? If not, what aspects are not valuable, or what is missing? Specifically, what are your views about including a description of audit procedures and related results in Auditor Commentary? (See paragraphs 58–61.)

6. What are the implications for the financial reporting process of including Auditor Commentary in the auditor’s report, including implications for the roles of management and those charged with governance (TCWG), the timing of financial statements, and costs? (See paragraphs 38 and 62–64.)

7. Do you agree that providing Auditor Commentary for certain audits (e.g., audits of public interest entities (PIEs)), and leaving its inclusion to the discretion of the auditor for other audits is appropriate? Why or why not? If not, what other criteria might be used for determining the audits for which Auditor Commentary should be provided? (See paragraphs 51–56.)

Going Concern/Other Information

8. What are your views on the value and impediments of the suggested auditor statements related to going concern, which address the appropriateness of management’s use of the going concern assumption and whether material uncertainties have been identified? Do you believe these statements provide useful information and are appropriate? Why or why not? (See paragraphs 24–34.)

9. What are your views on the value and impediments of including additional information in the auditor’s report about the auditor’s judgments and processes to support the auditor’s statement that no material uncertainties have been identified? (See paragraphs 30–31.)

10. What are your views on the value and impediments of the suggested auditor statement in relation to other information? (See paragraphs 65–71.)

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1 Examples may include: specifying detailed criteria; specifying particular matters to be addressed in Auditor Commentary; specifying a presumptive requirement together with required audit documentation where the presumption is rebutted; or requiring the auditor to make an explicit statement in the auditor’s report that there is nothing to report when this is the case.

2 The illustrative examples of Auditor Commentary are intended to simulate the nature and content expected from the application of the Auditor Commentary concept described in this ITC.
### Clarifications and Transparency

11. Do you believe the enhanced descriptions of the responsibilities of management, TCWG, and the auditor in the illustrative auditor’s report are helpful to users’ understanding of the nature and scope of an audit? Why or why not? Do you have suggestions for other improvements to the description of the auditor’s responsibilities? (See paragraphs 81–86.)

12. What are your views on the value and impediments of disclosing the name of the engagement partner? (See paragraphs 72–73.)

13. What are your views on the value and impediments of the suggested disclosure regarding the involvement of other auditors? Do you believe that such a disclosure should be included in all relevant circumstances, or left to the auditor’s judgment as part of Auditor Commentary? (See paragraphs 77–80.)

14. What are your views on explicitly allowing the standardized material describing the auditor’s responsibilities to be relocated to a website of the appropriate authority, or to an appendix to the auditor’s report? (See paragraphs 83–84.)

### Form and Structure

15. What are your views on whether the IAASB’s suggested 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 users? (See paragraphs 17–20.)

16. 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? (See paragraphs 21–23 and 87–90.)

17. What are your views as to whether the IAASB should mandate the ordering of items in a manner similar to that shown in the illustrative report, unless law or regulation require otherwise? Would this provide sufficient flexibility to accommodate national reporting requirements or practices? (See paragraph 17 and Appendix 4.)

18. In your view, are the IAASB’s suggested improvements appropriate for entities of all sizes and in both the public and private sectors? What considerations specific to audits of small- and medium-sized entities (SMEs) and public sector entities should the IAASB further take into account in approaching its standard-setting proposals? (See paragraphs 91–95.)

### Request for Comments

The suggested improvements in this ITC may be modified in light of comments received. Comments are requested by October 8, 2012.

Respondents are asked to submit their comments electronically through the IAASB website, using the “Submit a Comment” link. Please submit comments in both a PDF and Word file. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website. Although IAASB prefers that comments are submitted via its website, comments can also be sent to James Gunn, IAASB Technical Director at jamesgunn@iaasb.org.

This publication may be downloaded free of charge from the IAASB website: www.iaasb.org. The approved text is published in the English language.
This section provides an overview of the key IAASB deliberations to date in support of the possible actions to improve auditor reporting. 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 the IAASB’s deliberations, including all options considered in arriving at the suggested improvements. Interested parties can find this information in the publicly-available IAASB meeting materials referenced in the Auditor Reporting project history.³

In developing the illustrative report, the IAASB used a value and impediments model (described in Appendix 1) to help evaluate and narrow options to those that it believes should be pursued. The IAASB is suggesting 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. The IAASB’s views on value and impediments relating to possible actions to improve auditor reporting are described below for respondents’ consideration.

**Ordering of Elements within the Illustrative Auditor’s Report**

The illustrative auditor’s report on pages 9–12 reflects the IAASB’s suggested improvements to auditor reporting that it believes could be promulgated on an international basis. 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. To the extent practicable, the IAASB believes there likely is merit in mandating the ordering of the elements within auditors’ reports across entities and jurisdictions, unless otherwise required by law or regulation.

³ The project history can be accessed at www.iaasb.org/auditor-reporting.
Greater Prominence to the Auditor’s Opinion

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 as part of the audit of the financial statements as a whole. It has the further benefit of avoiding confusion with “other information,” which is suggested to be addressed in a new separate section of the auditor’s report (see paragraphs 65–71).

Basis for Opinion

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.4

Entity-Specific Matters vs. Standardized Language

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, TCWG, and the auditor). The IAASB’s suggested improvements to auditor reporting related to these entity-specific matters are discussed in paragraphs 24–80, while enhancements to standardized language are discussed in 81–86.

Balancing the Principles of Consistency Versus Relevance In Auditor Reporting

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 auditors’ 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

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

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 law, regulation 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 law or regulation or national corporate governance regimes).

ISA 700 acknowledges that national law or regulation 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 helps to achieve comparable auditors’ reports while still allowing jurisdictions the ability to 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 Suggested Improvements Be Applied around the World? and Appendix 4 describe how the IAASB’s suggested improvements could be tailored to accommodate national financial reporting regimes.

Going Concern

The recent global financial crisis has highlighted the importance to financial markets of clear and timely financial reporting. It has also 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. 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 PIE. 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.

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) The final report was issued in June 2012 (see 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 policymakers to enhance reporting by both companies and auditors regarding going concern (see pcaobus.org/News/Events/Pages/03282012_IAGMeeting.aspx).

Under Article 22 of the EC’s proposed regulation concerning auditor 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.”
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 570,7 is to require that all auditors’ reports include, having regard to the applicable financial reporting framework:

(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.

The IAASB’s suggested improvements in relation to going concern make explicit in auditors’ reports the auditor’s work effort required by ISA 570. The 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 and 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. Because there is a lack of clarity around the concept of material uncertainty, and a need for considerable judgment by both preparers and auditors in determining whether such uncertainties exist, impediments exist in relation to providing this statement. 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.

Because the going concern assumption and material uncertainties are different concepts, they have been placed under separate subheadings in the Going Concern section of the illustrative report.

Tailoring the Auditor’s Statement about Material Uncertainties when Going Concern Is an Area of Significant Judgment

When the auditor has identified a material uncertainty that has been adequately disclosed in the financial statements, rather than include a statement that no material uncertainty has been identified, the auditor will need to draw users’ attention to where such material uncertainty is disclosed in the financial statements based on the requirement in ISA 570 today (see paragraph 1 in Appendix 2).

7 ISA 570, Going Concern
There are also situations where the auditor may have determined that no material uncertainty exists, but certain events or conditions nevertheless have been identified that may cast significant doubt on the entity’s ability to continue as a going concern. In such circumstances, there may be merit in the auditor describing in the auditor’s report significant judgments the auditor may have made, and audit procedures the auditor may have performed, in reaching a conclusion that no material uncertainty exists. Providing additional information in these circumstances is seen as helpful by some users because it would provide additional transparency about the auditor’s work effort in this area.

However, there are impediments to providing additional information with respect to going concern, because the auditor may find it difficult to avoid disclosing entity-specific information that has not been disclosed by management. The IAASB specifically welcomes views as to whether providing this additional information in such cases would be desirable.

**Expanded Description of Management’s Responsibility with Respect to Going Concern**

Complementing the new Going Concern section, the revised illustrative auditor’s report includes a description of management’s responsibilities with respect to going concern. This description is intended to clarify management’s responsibility under the applicable financial reporting framework and provide users appropriate context to both the auditor’s conclusion on the appropriateness of management’s use of the going concern assumption and statement about the absence of material uncertainties.

**A More Holistic Approach to Going Concern**

The IAASB recognizes that a number of initiatives around the world are already exploring possible solutions to the issues in this area, including how and who is best positioned to provide practical and timely information to users regarding potential going concern issues. 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.

The IAASB intends to explore whether additional guidance could be provided for auditors to supplement what is currently in ISA 570, because the auditor’s work effort with respect to material uncertainties is a complex and judgmental exercise. This is likely to 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 rooted in IFRSs.

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8 See the description of Auditor Commentary in paragraphs 35–64. In such cases, it would likely be necessary for this information to be positioned in the Going Concern section of the auditor’s report rather than as part of Auditor Commentary.

9 As further discussed in Appendix 4, the language used in describing management’s responsibilities for going concern could be tailored for further specificity based on the applicable financial reporting framework.

10 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.”

11 International Accounting Standard (IAS) 1, Presentation of Financial Statements, paragraph 25
Auditor Commentary

Views on the Value of Auditor Commentary

The call for change in auditor reporting, particularly from investors and analysts with respect to listed entities, has been focused on enhancing the informational value of the auditor’s report to assist in investment decision-making. These users believe there would be value in more pertinent information in the auditor’s report about the financial statements and the audit.

However, users have varying reasons for seeking additional information, and appear to have different views about what may have the most value:

✪ For example, some users have indicated that there would be considerable value in the auditor highlighting disclosures about the areas in the financial statements the auditor believes are most important. This would provide a “roadmap” to help users better navigate complex financial reports and focus them on matters likely to be important to their decision-making.

✪ Others believe that the “roadmap” would be more useful if the auditor were to provide additional context to the matters highlighted, such as explaining why the auditor considered the matter to be important from an audit perspective and briefly describing the auditor’s procedures and conclusions in those areas. This information has been cited as being particularly useful for areas involving significant judgments by management, which often are the subject of discussion with TCWG.

✪ Still others would like to understand more about how the audit was conducted, and key judgments made by the auditor in planning the audit, such as materiality, the use of experts, or the involvement of other auditors (see paragraphs 77–80).

Some users have gone further and called for the auditor to provide insights into 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. These users believe that such information would be valuable in helping them to better understand management’s aggressiveness or conservatism in preparing the financial statements, and therefore could help them better assess the quality of the entity’s financial reporting.

Others, however, take 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 and may call into question the auditor’s opinion on the financial statements as a whole. 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 such information would be best provided by TCWG. This view acknowledged the role of TCWG in overseeing both management and the auditor, in particular in relation to significant qualitative aspects of the entity’s accounting practices, and significant difficulties encountered during the audit. (Paragraphs 62–64 provide further discussion of the impediments to the auditor providing additional information about the audited financial statements or the audit).
The Framework for Achieving the Objective of Auditor Commentary

Based on the value cited by users, the IAASB is of the view that the auditor could provide additional information to users tailored to the facts and circumstances of the entity, in a discrete and prominent section of the auditor’s report that would be referred to as Auditor Commentary. 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 financial statements or the audit.

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 specific circumstances for which Emphasis of Matter or Other Matter paragraphs are required. 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 essentially gives the auditor a mechanism by which to do so when considered necessary in the context of the particular engagement.

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 these paragraphs are useful at directing their attention to what is most important within the financial statements or about the audit thereon.

The new concept of Auditor Commentary is consistent with the existing concepts of Emphasis of Matter and Other Matter paragraphs. However, to better meet the information needs of users, Auditor Commentary builds upon these concepts by:

- Lowering of the threshold for auditors to draw attention to certain matters from those that are “fundamental to users’ understanding of the financial statements” to matters “likely to be most important to users’ understanding of the financial statements”;

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12 Circumstances for which such paragraphs are required include when: a material uncertainty exists related to events or conditions that may cast doubt on the entity’s ability to continue as a going concern and is adequately disclosed in the financial statements (see paragraph 29); an inconsistency between the audited financial statements and other information is identified by the auditor for which revision of the other information is necessary, and management refuses to make the revision (see paragraph 68); or the financial reporting framework prescribed by law or regulation is unacceptable but for the fact that it is prescribed by law or regulation. These requirements will be retained, although reporting on going concern and other information would likely be incorporated into those sections within the auditor’s report.

13 ISA 706, *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report*
Because the overarching objective of Auditor Commentary involves providing transparency about matters relating to both the audited financial statements and the audit itself, there may no longer be a need to retain the separate concepts of Emphasis of Matter and Other Matter paragraphs. The IAASB will consider this in its standard-setting proposals, but the IAASB’s preliminary view is that these concepts should be replaced by the more holistic concept of Auditor Commentary. Views from respondents in this regard would be particularly helpful.

**Matters to Be Included in Auditor Commentary in the Auditor’s Report**

At a high level, users have suggested that 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. Including those matters in Auditor Commentary will provide some transparency about the auditor’s communications with TCWG, which users have indicated they would value. However, not all matters discussed with TCWG would be included in Auditor Commentary.

Any matter identified by the auditor as a significant risk generally would be the subject of discussion with TCWG and therefore would be an important consideration as a matter to include in Auditor Commentary. However, the IAASB believes significant risks should not be the primary consideration because there often are other matters that involve significant auditor judgment or for which the auditor has assessed the risk of material misstatement as high. In addition, the concept of significant risk may not be as easy for users to understand as terms such as “judgments” and “uncertainty.”

On a preliminary basis and in light of feedback received on the May 2011 consultation about what users value (see paragraphs 35–37), the IAASB is of the view that auditors should consider the following matters, at a minimum, in determining whether to include Auditor Commentary:

- Areas of significant management judgment (e.g., in relation to the entity’s accounting practices, including accounting policies, accounting estimates, and financial statement disclosures).
- Significant or unusual transactions (e.g., significant related party transactions or restatements).
- Matters of audit significance, including areas of significant auditor judgment in conducting the audit, for example:

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14 ISA 260, Communication with Those Charged with Governance
15 A number of financial reporting frameworks, such as IFRSs, involve the extensive use of significant management judgment. Feedback to date has indicated that there is a natural linkage between management’s significant judgments and the auditor’s assessment of those judgments, illustrating that the individual considerations are interrelated in many cases and that the application of the considerations as a whole is likely to guide the auditor’s judgment about the number of matters to be addressed in Auditor Commentary and how those matters should be described.
— Difficult or contentious matters noted during the audit,\textsuperscript{16} or other audit matters that would typically be discussed with an engagement quality control reviewer or TCWG;\textsuperscript{17} and
— Other issues of significance related to the audit scope or strategy.

Accordingly, the IAASB plans to specify considerations for auditors based on these and perhaps other areas that users may identify as important to them. 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. By requiring auditors to focus on the overarching objective of Auditor Commentary, in particular users’ needs in the context of the individual audit engagement, Auditor Commentary is likely to be more customized and relevant, rather than standardized.

The IAASB acknowledges that guidance will need to be developed for auditors to help them make informed judgments in determining the information (at an appropriate level of detail) to include in their auditors’ reports, and would plan to do so when developing revised auditor reporting standards. At the same time, some may believe that more specific criteria may be helpful in this regard. Therefore, the IAASB is particularly interested in the views of respondents in this area.

The Nature and Extent of Auditor Commentary to Be Provided in the Auditor’s Report

The value to users of the information in Auditor Commentary may depend on the level of detail provided by the auditor, as explained in paragraph 36. In addition, the nature of matters that are likely most important to users will differ from entity to entity. Accordingly, the IAASB believes Auditor Commentary should be tailored to the facts and circumstances of the entity to avoid being labeled as “boilerplate”. 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.

As a result, there will be a need for the IAASB in its future standard-setting proposals to explain the balance to be struck by auditors in providing Auditor Commentary – namely, that it have relevance and be understandable, therefore providing value to users, and does not result in the auditor being the original provider of information about the entity.

It also will be necessary in future standard-setting for the IAASB to clearly state its view that Auditor Commentary should not be used as 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. This is a key premise for the use of Emphasis of Matter paragraphs today, so retaining this premise will be necessary if the IAASB ultimately decides to subsume Emphasis of Matter and Other Matter paragraphs under a broader umbrella of Auditor Commentary as discussed in paragraph 42.

\textsuperscript{16} While some users have suggested that the auditor could describe “close calls,” others believe that there would be difficulty in the auditor providing information about management’s position in the auditor’s report, in particular if the auditor was able to eventually conclude the disclosures in the financial statements achieved fair presentation and a “clean opinion” was appropriate.

\textsuperscript{17} 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.
Required Auditor Commentary for PIEs

In view of the stated objective of Auditor Commentary (i.e., to provide transparency about matters that are, in the auditor’s judgment, likely to be most important to users’ understanding of the audited financial statements or the audit), a decision will need to be made as to whether Auditor Commentary should be provided for audits of all entities, or just certain entities. The IAASB believes feedback from respondents on this matter, in particular users, will be essential.

The IAASB believes it is important to retain the ability for auditors of all entities to include additional information in the auditor’s report when the auditor judges it necessary to do so in the circumstances of the engagement. However, 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 has initially 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.

If Auditor Commentary is required for PIEs, a definition of PIEs will be needed for this purpose. 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. 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.

However, in the context of the IAASB’s auditor reporting project, agreeing a global definition of 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.
- 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 on the challenges that may be presented by requiring Auditor Commentary for audits of PIEs.

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.
Voluntary Auditor Commentary for Entities Other than PIEs

Auditors of entities other than PIEs may wish to provide Auditor Commentary to highlight certain matters in the context of the specific engagement. To date, however, the IAASB is not aware of a demand from users of smaller entities’ financial statements for additional information about the audited financial statements or the audit, in part because these users may have access to this type of information through direct interaction with management or TCWG.

Accordingly, for audits of entities other than PIEs, Auditor Commentary could be included in the auditor’s report at the discretion of the auditor, and the IAASB will give further consideration about whether the auditor should be encouraged to do so. The required considerations and guidance for auditors of PIEs is likely to be relevant for non-PIE auditors in determining the nature and extent of Auditor Commentary that could be provided voluntarily. The IAASB would welcome views of users and preparers of non-PIE financial statements and their auditors to understand the value and impediments in relation to Auditor Commentary for these entities.

Adapting a Possible Requirement to Provide Auditor Commentary to the National Environment

Appendix 4 explains how Auditor Commentary and the discrete section in the auditor’s report would be tailored to the national environment. NSS and other policymakers may also require the use of other mechanisms designed to address the information gap, for example, the use of a “justification of assessments” model (which requires a discussion of the auditor’s procedures) or reporting by TCWG on significant matters relating to the entity and the audit. It is therefore important for the IAASB to understand how these national initiatives could be integrated with the concept of Auditor Commentary. 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 communication in the auditor’s report and would likely need to comment on the completeness and reasonableness of that communication.

Illustrative Examples

Five examples have been provided in the illustrative report to show how the concept of Auditor Commentary could 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. Accordingly, the IAASB has intentionally drafted these examples in a manner that illustrates that Auditor Commentary will vary in terms of the number and selection of topics addressed and the nature in which they may be described, based on the auditor’s judgment about what may be most important to users.

Some of the examples include a description of specific audit procedures performed in a particular area of the audit (e.g., the third and fourth examples), one of which includes the results of the auditor’s procedures (the third example). The IAASB acknowledges that some users believe this type of information would be useful (see paragraph 36) and further notes that, in some jurisdictions, auditors are either required to provide this information, such as in France, or may do so voluntarily. However, the IAASB also notes that some users and other stakeholders have indicated that a description of the auditor’s procedures may be less useful, particularly when there is no mention of the results of these procedures. Auditors also have cited the challenges of summarizing the auditor’s procedures, particularly in complex areas, in a succinct way that reflects the extent of the underlying work effort and the significant auditor judgments involved. Therefore, the IAASB is particularly interested in the views of respondents in this area.
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. This would be tantamount to the auditor concluding that there are no matters that are worthy of highlighting to enhance users’ understanding of the audited financial statements or the audit. 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 in such cases. A documentation requirement in this regard may also be appropriate.

However, the IAASB does not intend to specify a minimum number of matters to be addressed. The IAASB also does not intend to limit the number of matters that could be addressed by the auditor through Auditor Commentary. Given a threshold of providing transparency into “most important” matters about the audited financial statements or the audit, the use of five 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, depending on the nature, size and complexity of the entity. 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

Notwithstanding that some users believe there would be value in the auditor providing additional information in the auditor’s report about the financial statements and the audit, 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. In addition, there may be legal or ethical impediments to doing so. 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. 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.
- Discussion of the form and content of Auditor Commentary prior to issuing the auditor’s report. As a result, preparers would incur additional cost directly in terms 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.\(^\text{19}\)
- 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 providing 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.

\(^{19}\) 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 37). 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.
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.\(^{20}\)

(c) There may be unintended consequences if the Auditor Commentary makes reference to other information in documents containing the audited financial statements.

(d) Some users may inappropriately rely on auditor commentary as a substitute for reading the financial statements.

(e) Auditor commentary could become standardized over time.

(f) Provision of certain information could compete with management’s disclosures, thereby resulting in “dueling information.”

(g) There may be confidentiality or liability implications to auditors as a result of providing Auditor Commentary, for example when Auditor Commentary includes reference to matters not disclosed by management.

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**

“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.

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 in the auditor’s report. 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.

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

\(^{20}\) 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.
procedures currently required by ISA 720, \(^{21}\) 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.

When the auditor has identified a material inconsistency for which revision of the other information is necessary and management refuses to make the revision, the statement that no material inconsistencies have been identified would be replaced by a detailed explanation of this matter (see paragraph 2 in Appendix 2). \(^{22}\)

Because the auditor’s work effort under ISA 720 is limited to reading the other information, including an explicit statement that no material inconsistencies between the other information and the audited financial statements 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.

ISA 720 also addresses material misstatements of fact in the other information. However, the IAASB is not suggesting 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 \(^{23}\) 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 misstatement of fact and the auditor would not be precluded from including Auditor Commentary should the auditor judge it necessary to do so.

The IAASB is currently undertaking a project to revise ISA 720. \(^{24}\) Given that this project may result in enhancements to the auditor’s responsibilities regarding other information, consequential changes to the suggested wording of the statement regarding other information may be necessary when the revision of ISA 720 is finalized.

**Overview of Further Suggestions to Provide Transparency about the Audit**

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

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.25

In deliberating the merits of this disclosure on an international basis, the IAASB is 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.26 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.27

**Statement of Compliance with Relevant Ethical Requirements**

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.

The IAASB considered, but decided against, suggesting the specific identification of the auditor’s ethical code(s) in the auditor’s report. 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**

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 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.

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25 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 4.

26 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. Similar issues may exist in other legal environments.

27 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.
Involvement of Other Auditors

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 other 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\(^{28}\) 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.

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.

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” principle. Nevertheless, the IAASB acknowledges that the involvement of other auditors may be considered a matter of audit significance suitable for inclusion in Auditor Commentary. Alternatively, the IAASB could decide to mandate disclosure of the involvement of other auditors, which may therefore require it to be separately presented.

The IAASB has developed an example of a disclosure of the involvement of other auditors, which is included as an example of Auditor Commentary in the illustrative report (see page 12). This example disclosure includes the amount of audit work performed by other auditors, whether affiliated or not. The IAASB also explored alternatives, such as disclosing the names and locations of other auditors, but questioned whether the value would outweigh the impediments, particularly in view of the potential significant lengthening of the auditor’s report. To further improve transparency for a group audit, the IAASB also has developed a standardized description of the auditor’s responsibilities in a group audit, which is included in the Auditor’s Responsibility section of the illustrative report.

\[^{28}\text{ISA 600, Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)}\]
Overview of Suggestions to Clarify the Respective Responsibilities of the Auditor, Those Charged with Governance, and Management

The Auditor’s Responsibilities

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.

Accordingly, the IAASB is suggesting 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 clarifying 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. 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. In addition, there may be better ways of educating users about the audit. However, others have suggested that such context in the auditor’s report is essential for users to fully understand the auditor’s opinion, in particular in developing and emerging economies where the concept of an audit is not as familiar. The IAASB believes the value of clarifying the auditor’s responsibilities outweighs the impediments of providing the additional material in the auditor’s report. However, 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

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. However, as responsibilities of management and TCWG 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 4).
As noted in paragraphs 15 and 23, 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.

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 Suggestions to Improve Auditor Reporting May Be Tailored by NSS

Appendix 4 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 law, regulation or standard setting, may tailor the content and layout of their respective auditors’ reports for greater specificity.

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 law or regulation in the particular jurisdiction.
Considerations for Small- and Medium-Sized Entities (SMEs) and Audits of Public Sector Entities

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**

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.

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 recognized it may be necessary for the IAASB to develop additional reporting requirements for certain entities.

The IAASB has taken this into account in limiting the suggestion to require Auditor Commentary to PIEs, though the IAASB recognizes that some SMEs may be scoped into the definition of PIEs in certain jurisdictions (see paragraph 54). 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 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 auditors’ reports in the context of audits of SMEs.

**Public Sector Entities**

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 54). The IAASB recognizes, however, that the needs of 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 a 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 suggested improvements and their applicability in the public sector is planned.
The IAASB has considered options for change in terms of the relative value and possible impediments of each, as illustrated by the matrix above:

(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 suggested 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 future 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.
This Appendix illustrates how the certain sections in the illustrative report would appear in the following circumstances relating to going concern and other information, based on current requirements in the ISAs.

1. **A Material Uncertainty Exists that Is Adequately Disclosed in the Financial Statements**
   
   **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. 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 for Which Revision of the Other Information Is Necessary and Management Refuses to Make the Revision**
   
   **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 audited financial statements indicate that total income from continuing operations was XXX. However, 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. We have not audited the information in the MD&A and accordingly do not express an opinion on it.
INDEPENDENT AUDITOR’S REPORT

[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]
APPENDIX 4

APPLYING THE IAASB’S IMPROVEMENTS TO AUDITORS’ REPORTS IN NATIONAL ENVIRONMENTS

This Appendix highlights how the IAASB’s proposals could be tailored to accommodate national financial reporting regimes. It should be read in conjunction with this ITC, in particular, the illustrative auditor’s report on pages 9–12.

Unless otherwise required by law or regulation, the IAASB’s ordering of the following mandatory elements would be specified in the ISAs in a manner consistent with the ordering in the illustrative auditor’s report.

The information in this Appendix is not intended to represent the specific wording of requirements that may be included in a revised ISA 700, nor is it intended to illustrate the full extent to which jurisdictions, in particular NSS, might be able to tailor the section headings and content of revised ISA auditors’ reports. It is intended primarily for NSS and others with an interest in understanding how the IAASB’s “building blocks” approach might operate in practice, and in commenting thereon.
<table>
<thead>
<tr>
<th>MANDATORY ELEMENTS OF AN IMPROVED ISA AUDITOR’S REPORT</th>
<th>OPPORTUNITIES FOR TAILORING AT THE NATIONAL LEVEL</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A title</strong> that clearly indicates that it is the report of an independent auditor</td>
<td>Tailoring for greater specificity</td>
</tr>
<tr>
<td><strong>An addressee</strong>, as required by the circumstances of the engagement</td>
<td>Tailoring for greater specificity</td>
</tr>
<tr>
<td><strong>A heading “Report on the Financial Statements”</strong></td>
<td>Eliminating the title “Report on the Financial Statements” when there are no Other Reporting Responsibilities required by local law or regulation to be presented</td>
</tr>
<tr>
<td><strong>Tailoring the title, if law or regulation require information related to the audit of the financial statements to be integrated with Other Reporting Responsibilities (see also Report on Other Legal and Regulatory Requirements below)</strong></td>
<td></td>
</tr>
<tr>
<td><strong>A section with a heading “Opinion”</strong> that includes the information required by the ISAs (for example, identification of the entity whose financial statements have been audited, identification of the title of each statement that comprises the financial statements and, if applicable, reference to the notes to the financial statements, including a summary of significant accounting policies and other explanatory information)</td>
<td>Tailoring the wording of the auditor’s opinion to align with law or regulation, or applicable financial reporting framework of the particular jurisdiction</td>
</tr>
<tr>
<td><strong>A section with a heading “Basis for Opinion”</strong> that includes the matters presented in the illustrative auditor’s report, for example, a statement that the financial statements have been audited in accordance with ISAs, or other standards that are in conformity with the ISAs; and a statement of compliance with relevant ethical requirements applicable to financial statement audits, including independence requirements</td>
<td>Tailoring for greater specificity with respect to:</td>
</tr>
<tr>
<td></td>
<td>- Whether national auditing standards are in conformity with the ISAs</td>
</tr>
<tr>
<td></td>
<td>- The identification of the particular ethical code(s) with which the auditor is required to comply, including statements about the auditor’s independence</td>
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<td></td>
<td>- Information about non-compliance with relevant ethical requirements</td>
</tr>
<tr>
<td><strong>A section with a heading “Going Concern”</strong> that includes:</td>
<td>Tailoring language to reflect management’s specific responsibilities under the applicable financial reporting framework with respect to:</td>
</tr>
<tr>
<td></td>
<td>- A conclusion on the appropriateness of management’s use of the going concern assumption</td>
</tr>
<tr>
<td></td>
<td>- A Statement about whether material uncertainties related to going concern have been identified, or reference to disclosures when material uncertainties are identified and appropriately disclosed in the financial statements</td>
</tr>
<tr>
<td></td>
<td>- Reference to a description of management’s responsibilities for going concern in accordance with the applicable financial reporting framework, including the use of the going concern assumption and disclosures relating to material uncertainties, included either in the section addressing management’s responsibilities or the Going Concern section</td>
</tr>
<tr>
<td></td>
<td>- The use of the going concern assumption</td>
</tr>
<tr>
<td></td>
<td>- Disclosure of material uncertainties related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern.</td>
</tr>
<tr>
<td></td>
<td>Aligning the terminology and related definitions with respect to going concern to the applicable financial reporting framework. For example, some jurisdictions use terms such as “significant uncertainty” or “substantial doubt” as opposed to “material uncertainty.”</td>
</tr>
</tbody>
</table>

Note: When a modified opinion in relation to Going Concern is appropriate, this section would be adapted as necessary.
**MANDATORY ELEMENTS OF AN IMPROVED ISA AUDITOR’S REPORT**

For audits of public interest entities (PIEs), a section with a heading “Auditor Commentary” that includes:

- Introductory language describing the objective of Auditor Commentary and stating that the auditor’s procedures relating to the matters addressed in Auditor Commentary are not designed for the purpose of expressing an opinion on individual accounts or disclosures and the auditor’s opinion is not modified in respect of these matters.
- A description of those matters that are, in the auditor’s judgment, likely to be most important to users’ understanding of the audited financial statements or the audit, with appropriate headings included for each matter.

For non-PIEs, Auditor Commentary could be included at the discretion of the auditor.

When applicable, a section with a heading “Other Information” that includes:

- Specific identification of the other information read.
- A statement that no material inconsistencies between the audited financial statements and other information have been identified based on the auditor’s reading of other information or a detailed explanation when material inconsistencies were identified for which revision of the other information is necessary and management refuses to make the revision.
- Language describing that the auditor has not audited the other information and does not express an opinion on it.

A section with a heading “Respective Responsibilities of Management, Those Charged with Governance, and the Auditor” that includes:

- A description of the responsibilities of management and TCWG (or other term that is appropriate in the context of the legal framework in the particular jurisdiction) that would address the matters presented in the illustrative auditor’s report on page 11 (for example, the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework).
- A description of the auditor’s responsibilities in accordance with ISAs. Such a description would address the matters presented in the illustrative report on pages 11-12 (for example, descriptions of the purpose of an audit with a reference to the terms reasonable assurance and material misstatements, the auditor’s responsibilities with respect to internal control and fraud, and a statement about the auditor’s communications with TCWG).

**OPPORTUNITIES FOR TAILORING AT THE NATIONAL LEVEL**

- Requiring specific matters or information to be addressed by national requirements that may be integrated with Auditor Commentary (for example, the use of a “justification of assessments” model, or a reference to a report issued by TCWG and a statement about the reasonableness and completeness of that report). In such cases, the title “Auditor Commentary” may also need to be tailored.
- Defining PIEs as appropriate based on the circumstances in their particular jurisdiction.
- Determining whether to require Auditor Commentary for entities other than PIEs.
- Providing guidance in the ordering of or headings for the individual matters within Auditor Commentary.

- Tailoring for greater specificity with respect to the content and placement of additional auditor responsibilities for other information that are required by law or regulation as described in Report on Other Legal and Regulatory Requirements below.

Tailoring for greater specificity the description of the respective responsibilities of management and TCWG, based on national law or regulation or entity type. For example, the responsibilities of TCWG for the appointment, compensation and oversight of the auditor’s work could be described.

Repositioning parts of this section describing the auditor’s responsibilities to a location outside of the auditor’s report (for example, a NSS website) and appropriately incorporating it by reference in the auditor’s report.

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1 Assuming the IAASB ultimately determines that Auditor Commentary should be required for PIEs.
### MANDATORY ELEMENTS OF AN IMPROVED ISA AUDITOR’S REPORT

<table>
<thead>
<tr>
<th><strong>A section with a heading “Report on Other Legal and Regulatory Requirements” that includes a discussion of other reporting requirements that go beyond the requirements of an ISA audit</strong></th>
<th>Tailoring the title, if law, regulation or national standards require Other Reporting Responsibilities that go beyond the requirements of a financial statement audit conducted in accordance with the ISAs. Removing this section if law or regulation require information related to Other Reporting Responsibilities to be integrated with information about the audit of the financial statements in accordance with the ISAs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A statement that includes identification of the engagement partner, in particular the name of the engagement partner responsible for the audit resulting in the auditor’s report</strong></td>
<td>Tailoring for greater specificity with respect to identifying the engagement partner responsible for the audit (for example, requiring auditor licensing information). Tailoring in situations where national requirements require engagement partner signature.</td>
</tr>
<tr>
<td><strong>A signature either in the name of the audit firm, the personal name of the auditor or both, as appropriate for the particular jurisdiction</strong></td>
<td>Tailoring for greater specificity.</td>
</tr>
<tr>
<td><strong>The auditor’s address</strong></td>
<td>Tailoring for greater specificity.</td>
</tr>
<tr>
<td><strong>A date that is no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor’s opinion on the financial statements in accordance with the ISAs</strong></td>
<td>Tailoring for greater specificity with respect to the dating of the auditor’s report as appropriate for the respective jurisdiction.</td>
</tr>
</tbody>
</table>

### OPPORTUNITIES FOR TAILORING AT THE NATIONAL LEVEL

**About the IAASB**

The IAASB develops auditing and assurance standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance.

The objective of the IAASB is to serve the public interest by setting high-quality auditing, assurance, and other related standards and by facilitating the convergence of international and national auditing and assurance standards, thereby enhancing the quality and consistency of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

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The structures and processes that support the operations of the IAASB are facilitated by the International Federation of Accountants (IFAC).


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