Hong Kong Institute of
Certified Public Accountants
香港會計師公會

August 2007

To: Members of the Hong Kong Institute of CPAs
All other interested parties

INVITATION TO COMMENT ON IAASB EXPOSURE DRAFTS OF INTERNATIONAL STANDARDS ON AUDITING

Part A

- **Proposed ISA 510 (Redrafted), *The Initial Audit Engagement – Opening Balances***
- **Proposed ISA 530 (Redrafted), *Audit Sampling***

Comments to be received by 15 October 2007

Part B

- **Proposed ISA 700 (Redrafted), *The Independent Auditor's Report on General Purpose Financial Statements***
- **Proposed ISA 705 (Revised and Redrafted), *Modifications to the Opinion in the Independent Auditor's Report***
- **Proposed ISA 706 (Revised and Redrafted), *Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor's Report***
- **Proposed ISA 800 (Revised and Redrafted), *Special Considerations – Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement***
- **Proposed ISA 805 (Revised and Redrafted), *Engagements to Report on Summary Financial Statements***

Comments to be received by 15 November 2007

Part C

- **Proposed ISA 220 (Redrafted), *Quality Control for an Audit of Financial Statements***
- **Proposed ISQC 1 (Redrafted), *Quality Control for Firms that Perform Audits and Reviews of Financial Statement, and Other Assurance and Related Services Engagements***

Comments to be received by 14 December 2007

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The Hong Kong Institute of Certified Public Accountants' (Institute) Auditing and Assurance Standards Committee is seeking comments on the IAASB Exposure Drafts which have been posted on the Institute's website at: www.hkicpa.org.hk/professionaltechnical/assurance/exposuredraft/.

The Explanatory Memorandum to the Exposure Drafts provides background information and explanation of the proposed ISAs and ISQC 1.

In summary, the IAASB's intentions in developing the revisions to the ISAs and ISQC 1 are to contain clearer requirements and easy to understand application guidance.

The IAASB is seeking comments **only** on changes resulting from applying the clarity drafting conventions and their effect on the content of the ISAs and ISQC 1, and certain significant matters explained in the Explanatory Memorandum including:

Part A

ISA 510

- Split Opinion

ISA 530

- Selecting Items for Testing to Obtain Audit Evidence
- Anomalies
- Projecting and Evaluating Sample Results

Part B

ISA 700

- Forming an Opinion on the Financial Statements
- Description of Management's Responsibility for the Financial Statements
- Financial Reporting Frameworks Described by Reference to International Financial Reporting Standards (IFRSs)
- International Auditing Practice Statement 1014 "Reporting by Auditors on Compliance with IFRSs"

ISA 705

- Definition of Pervasive

ISA 706

- New Requirements to Include an Emphasis of Matter Paragraph

ISA 805

- Form of Opinion
- Summary Financial Statements Included in Documents Relating to Securities Offered to the Public

Part C

ISA 220 and ISQC 1

- Authority of the ISQC
- Date of Completion of Engagement Quality Control Review
- Definition of Engagement Team

In accordance with the Institute's ISA Convergence Due Process, comments are invited from any interested party and the Institute would like to hear from both those who do agree and those who do not agree with the proposals contained in the IAASB Exposure Drafts.

Comments should be supported by specific reasoning and should be submitted in written form.

To allow your comments on the IAASB Exposure Drafts to be considered, comments on the exposure drafts are requested by the due dates shown above.

Comments may be sent by mail, fax or e-mail to:

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Executive Director
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213 Queen's Road East
Hong Kong

Fax number (+852) 2865 6776
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Comments will be acknowledged and may be made available for public review unless otherwise requested by the contributor.

August 2007
Exposure Draft

PART A

Response Due Date
15 October 2007

ED of Proposed ISA 510 (Redrafted)

The Initial Audit Engagement – Opening Balances

ED of Proposed ISA 530 (Redrafted)

Audit Sampling

PART B

Response Due Date
15 November 2007

ED of Proposed ISA 700 (Redrafted)

The Independent Auditor's Report on General Purpose Financial Statements

ED of Proposed ISA 705 (Revised and Redrafted)

Modifications to the Opinion in the Independent Auditor's Report

ED of Proposed ISA 706 (Revised and Redrafted)

Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor's Report

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PART B cont'd

Response Due Date
15 November 2007

ED of Proposed ISA 800 (Revised and Redrafted)

Special Considerations – Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement

ED of Proposed ISA 805 (Revised and Redrafted)

Engagements to Report on Summary Financial Statements

PART C

Response Due Date
14 December 2007

ED of Proposed ISQC 1 (Redrafted)

Quality Control for Firms that Perform Audits and Reviews of Financial Statement, and Other Assurance and Related Services Engagements

ED of Proposed ISA 220 (Redrafted)

Quality Control for an Audit of Financial Statements

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CONTENTS

Part A

Part B

Part C

This Exposure Draft may be filed in the “Exposure Drafts, Invitations to Comment” section of Volume III of the Institute Members’ Handbook.

The Exposure Draft can also be found on the Institute’s website at: www.hkicpa.org.hk/professionaltechnical/assurance/exposuredraft/.

International
Auditing
and Assurance
Standards Board

Exposure Draft
July 2007
Comments are requested by October 31, 2007

Proposed Redrafted International Standard on Auditing

ISA 510, Initial Audit Engagements—Opening Balances

International Federation
of Accountants

REQUEST FOR COMMENTS

The International Auditing and Assurance Standards Board (IAASB), an independent standard-setting body within the International Federation of Accountants (IFAC), approved the exposure draft, proposed International Standard on Auditing (ISA) 510 (Redrafted), "Initial Audit Engagements—Opening Balances," for publication in July 2007. The proposed ISA may be modified in light of comments received before being issued in final form.

Please submit your comments, preferably by e-mail, so that they will be received by **October 31, 2007**. All comments will be considered a matter of public record. Comments should be addressed to:

International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, New York 10017 USA

Comments should be emailed to Edcomments@ifac.org. They may also be faxed to +1-212-286-9570 or mailed to the above address.

Copies of the exposure drafts may be downloaded free-of-charge from the IFAC website at http://www.ifac.org.

CONTENTS

EXPLANATORY MEMORANDUM

Introduction

This memorandum provides background to proposed International Standard on Auditing (ISA) 510 (Redrafted), "Initial Audit Engagements―Opening Balances." The proposed ISA has been redrafted in accordance with conventions agreed by the International Auditing and Assurance Standards Board (IAASB) to be applied to all ISAs. The IAASB approved the proposed redrafted ISA for exposure in July 2007.

Background

As part of its project to improve the clarity of its International Standards, the IAASB has undertaken to redraft all of its ISAs in accordance with its new clarity drafting conventions. This approach responds to the desire for all ISAs to be consistently drafted, and subject to a single statement of their authority and effect. The IAASB has agreed, in response to the general call for the Clarity project to be completed within a reasonable time, that while a significant number of the ISAs are under substantive revision as well as redrafting to reflect the new conventions, others will be subject to a limited redrafting to reflect only the conventions and matters of clarity generally. Proposed ISA 510 (Redrafted) is in the latter category.

The conventions used by the IAASB in redrafting extant ISA 510, "Initial Engagements―Opening Balances," and the authority and obligation attaching to those conventions, are established in the amended "Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services"[1] (Preface), approved by the IAASB in September 2006.

Effective Date

The current timetable envisages that all ISAs will have been revised and redrafted, or redrafted only, by late 2008 and the IAASB has provisionally agreed that the complete set of ISAs will be effective for audits of financial statements for periods beginning on or after December 15, 2008. This date will depend on satisfactory progress being made, and will be amended to a later date should that prove necessary. The IAASB believes that it is in the interest of auditors and others who use the ISAs that the ISAs should be released as soon as they are approved so as to facilitate their implementation.

Significant Matter

Split Opinion

Extant ISA 510 restricts the circumstances when the auditor can express an unmodified opinion on the closing financial position of the entity and a qualified opinion or disclaimer of opinion on the results of operations and cash flows ("split opinion") to jurisdictions permitting it. The IAASB believes that this restriction is unnecessary and may create inconsistency in reporting. Accordingly, the IAASB proposes to remove the restriction. This is consistent with the

[1] The Preface can be accessed at http://web.ifac.org/download/IAASB_Preface.pdf.

requirements and guidance of proposed ISA 705 (Revised and Redrafted), "Modifications to the Opinion in the Independent Auditor's Report."

Guide for Respondents

The IAASB is seeking comments **only** on changes resulting from applying the clarity drafting conventions, including the matter discussed above, and their effect on the content of the extant ISA. Respondents are asked to respond in particular to the following questions:

1. Are the objectives to be achieved by the auditor, stated in the proposed redrafted ISA, appropriate?
2. Have the criteria identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and reporting, and the use of professional judgment by auditors?[2]

Recognizing that the final ISA will apply to audits of all sizes and in all sectors of the economy, the IAASB is also interested in comments on matters set out below.

- *Special Considerations in the Audit of Small Entities*—Respondents are asked to comment whether, in their opinion, considerations in the audit of small entities have been dealt with appropriately in the proposed redrafted ISA.
- *Special Considerations in the Audit of Public Sector Entities*—Respondents are asked to comment whether, in their opinion, special considerations in the audit of public sector entities have been dealt with appropriately in the proposed redrafted ISA.
- *Developing Nations*—Recognizing that many developing nations have adopted or are in the process of adopting the ISAs, the IAASB invites respondents from these nations to comment, in particular, on any foreseeable difficulties in applying the proposed redrafted ISA in a developing nation environment.
- *Translations*—Recognizing that many respondents intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues noted in reviewing the proposed redrafted ISA.

Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments and, where appropriate, make specific suggestions for any proposed changes to

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[2] The IAASB has identified the following criteria for determining the requirements of a Standard:

- The requirement is necessary to achieve the objective stated in the Standard;
- The requirement is expected to be applicable in virtually all engagements to which the Standard is relevant; and
- The objective stated in the Standard is unlikely to have been met by the requirements of other Standards.

In determining the requirements of a Standard, the IAASB will consider whether the requirements are proportionate to the importance of the subject matter of the Standard in relation to the overall objective of the engagement.

The criteria, which are intended only to assist the IAASB in appropriately and consistently determining requirements, may be refined as further experience is gained.

wording. When a respondent agrees with proposals in the exposure draft, it will be helpful for the IAASB to be made aware of this view.

Respondents are also invited to comment on any undue costs, set against the benefits of more consistent auditor performance, arising from the fact that the proposed redrafted ISA includes requirements that would previously have been guidance under the old drafting conventions, as in the extant ISA (see below). In commenting on this matter, respondents should bear in mind the criteria that the IAASB has applied in redrafting the proposed ISA (see footnote 2) and the fact that the IAASB is seeking to clarify that there was some guidance in extant ISAs that was more in the nature of requirements and would already have been followed by many auditors.

Supplement to the Exposure Draft

To assist respondents in tracking changes, IAASB staff has prepared an analysis of the decisions that have been made by the IAASB with respect to the treatment of the present tense in the explanatory paragraphs of the extant ISA. This analysis also demonstrates how the material in the extant ISA has been reflected in the proposed redrafted ISA. In particular, the analysis:

- Identifies existing sentences in the present tense and whether they are now treated as a requirement or as application material;
- Maps the material of the extant ISA to the proposed redrafted ISA; and
- Identifies explanatory material that is proposed to be eliminated or repositioned as a result of redrafting.

These staff-prepared mapping documents are available on the IAASB website at http://www.ifac.org/Guidance/EXD-Details.php?EDID=0088. They are for information purposes only and do not form part of the exposure draft.

To be considered, responses should be emailed to Edcomments@ifac.org. They may also be faxed to +1-212-286-9570 or mailed to 545 Fifth Avenue, 14th Floor, New York, NY 10017, USA. They should be received by **October 31, 2007**.

PROPOSED INTERNATIONAL STANDARD ON AUDITING 510 (REDRAFTED)

INITIAL AUDIT ENGAGEMENTS—OPENING BALANCES

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

CONTENTS

International Standard on Auditing (ISA) 510 (Redrafted), "Initial Audit Engagements—Opening Balances" should be read in the context of the "Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services," which sets out the authority of ISAs.

* See footnote 1.

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's responsibilities relating to opening balances when conducting an initial audit engagement. In addition to financial statement amounts, opening balances include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments. ISA 710, "Comparatives" deals with the auditor's responsibilities regarding comparatives and for reporting on them.

Effective Date

2. This ISA is effective for audits of financial statements for periods beginning on or after [date].[1]

Objective

3. The objective of the auditor is, in conducting an initial audit engagement, to obtain sufficient appropriate audit evidence about whether:

   (a) Misstatements that materially affect the current period's financial statements arising from the opening balances exist; and

   (b) Appropriate accounting policies have been consistently applied or changes thereto are accounted for properly.

Definitions

4. For the purposes of the ISAs the following terms have the meanings attributed below:

   (a) Initial audit engagement – An engagement in which either:

      (i) The financial statements for the prior period were not audited; or

      (ii) The financial statements for the prior period were audited by a predecessor auditor.

   (b) Opening balances – Those account balances that exist at the beginning of the period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

   (c) Predecessor auditor – The auditor from a different audit firm, who was previously the auditor of an entity and who has been replaced by an incoming auditor.

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[1] This date will not be earlier than December 15, 2008.

Requirements

Audit Procedures

Opening Balances

5. The auditor shall obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements by:

    (a) Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated;

    (b) Determining that the opening balances reflect the application of appropriate accounting policies; and

    (c) Performing one or more of the following, as is necessary in the circumstances:

        (i) Review of the predecessor auditor's working papers;

        (ii) Evaluation of whether audit procedures performed in the current period provide evidence relevant to the opening balances; or

        (iii) Specific audit procedures to obtain evidence regarding the opening balances. (Ref: Para. A1–A5)

6. If the auditor obtains audit evidence that the opening balances contain misstatements which could materially affect the current period's financial statements, the auditor shall perform such additional audit procedures as are appropriate in the circumstances. If the auditor concludes that such a misstatement exists, the auditor shall communicate the misstatement to the appropriate level of management and those charged with governance in accordance with [proposed] ISA 450 (Revised and Redrafted), "Evaluation of Misstatements Identified during the Audit," and subject to obtaining management's authorization, inform the predecessor auditor, if any.

Consistency of Accounting Policies

7. The auditor shall obtain sufficient appropriate audit evidence whether the accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, and whether changes in the accounting policies have been properly accounted for and adequately presented and disclosed.

Modification to the Opinion in the Predecessor Auditor's Report

8. If the prior period's financial statements were audited by a predecessor auditor and there was a modification to the opinion in the predecessor auditor's report, the auditor shall consider the effect of the matter giving rise to the modification as part of the auditor's risk assessment in the current period. (Ref: Para. A6)

Audit Conclusions and Reporting

Opening Balances

9. If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall consider the effect thereof on the opinion in the auditor's report. (Ref: Para. A7)

10. If the auditor concludes that the opening balances contain misstatements that materially affect the current period's financial statements, and the effect of the misstatement is not properly accounted for or adequately presented and disclosed, the auditor shall express a qualified opinion or an adverse opinion, as appropriate, in accordance with [proposed] ISA 705 (Revised and Redrafted), "Modifications to the Opinion in the Independent Auditor's Report."

Consistency of Accounting Policies

11. If:

    (a) the current period's accounting policies have not been consistently applied in relation to opening balances in accordance with the applicable financial reporting framework; or

    (b) a change in accounting policies has not been properly accounted for or adequately presented and disclosed

    the auditor shall express a qualified opinion or an adverse opinion as appropriate in accordance with [proposed] ISA 705 (Revised and Redrafted).

Modification to the Opinion in the Predecessor Auditor's Report

12. If a modification to the predecessor auditor's opinion regarding the prior period's financial statements remains relevant and material to the current period's financial statements, the auditor shall modify the auditor's report accordingly. (Ref: Para. A8)

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Application and Other Explanatory Material

Audit Procedures

Opening Balances (Ref: Para. 5)

A1. The nature and extent of audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances depends on such matters as:

- The accounting policies followed by the entity.
- The nature of the accounts and the risks of material misstatement in the current period's financial statements.
- The materiality of the opening balances relative to the current period's financial statements.

- Whether the prior period's financial statements were audited, and if so whether the predecessor auditor's report was modified.

A2. If the prior period's financial statements were audited by a predecessor auditor, the auditor may be able to obtain sufficient appropriate audit evidence regarding the opening balances by reviewing the predecessor auditor's working papers. Whether such a review provides sufficient appropriate audit evidence is influenced by the professional competence and independence of the predecessor auditor.

A3. Relevant ethical and professional requirements guide the auditor's communications with the predecessor auditor.

A4. For current assets and liabilities some audit evidence may be obtained as part of the current period's audit procedures. For example, the collection (payment) of opening accounts receivable (accounts payable) during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period. In the case of inventories, however, it is more difficult for the auditor to be satisfied as to inventory on hand at the beginning of the period. Therefore, additional audit procedures may be necessary, such as:

- Observing a current physical inventory taking and reconciling it back to the opening inventory quantities.
- Performing audit procedures on the valuation of the opening inventory items.
- Performing audit procedures on gross profit and cutoff.

A combination of these audit procedures may provide sufficient appropriate audit evidence.

A5. For non current assets and liabilities, such as fixed assets, investments and long-term debt, some audit evidence may be obtained by examining the accounting records and other information underlying the opening balances. In certain cases, the auditor may be able to obtain confirmation of opening balances with third parties, for example, for long-term debt and investments. In other cases, the auditor may need to carry out additional audit procedures.

Modification to the Opinion in the Predecessor Auditor's Report (Ref: Par. 8)

A6. If the predecessor auditor's report was modified, the matter which resulted in the modification is relevant to the auditor's risk assessment in the current period's audit carried out in accordance with ISA 315 (Redrafted), "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment."

Audit Conclusions and Reporting

Opening Balances (Ref: Para. 9)

A7. [Proposed] ISA 705 (Revised and Redrafted) establishes requirements and provides guidance on circumstances that may result in a modification to the auditor's opinion on the financial statements, the type of opinion appropriate in the circumstances, and the content of the auditor's report when the auditor's opinion is modified. The inability of the auditor to obtain sufficient appropriate audit evidence regarding opening balances may result in one of the following modifications to the opinion in the auditor's report:

(a) A qualified opinion; or

(b) A disclaimer of opinion; or

(c) An opinion which is qualified or disclaimed regarding the financial performance and cash flows and unqualified regarding financial position. (Refer to the Appendix.)

Modification to the Opinion in the Predecessor Auditor's Report (Ref: Para. 12)

A8. In some situations a modification to the predecessor auditor's opinion may not be relevant and material to the opinion on the current period's financial statements. This may be the case where, for example, there was a scope limitation in the prior period, but the matter giving rise to the scope limitation has been resolved in the current period.

Appendix

(Ref: Para. A7)

Illustration of Auditor's Report with a Qualified Opinion

Circumstances include the following:

- **Auditor did not observe the counting of the physical inventory at the beginning of the current period and was unable to obtain sufficient other audit evidence regarding the opening balances of inventory.**
- **The inability to obtain sufficient appropriate audit evidence regarding opening balances of inventory, the possible effects of which, in the auditor's judgment, are material but not pervasive to the entity's financial performance and cash flows.**[2]
- **The financial position at the year end is fairly presented.**
- **An opinion which is qualified regarding the financial performance and cash flows and unqualified regarding financial position is considered appropriate in the circumstances.**

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Report on the Financial Statements[3]

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

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation[4] of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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2 If the possible effects, in the auditor's judgment, are considered to be material and pervasive to the entity's financial performance and cash flows, the auditor would disclaim the opinion on the financial performance and cash flows.

3 The subheading "Report on the Financial Statements" is unnecessary in circumstances when the second subheading "Report on Other Legal and Regulatory Requirements" is not applicable.

4 Depending on the circumstances, this sentence may read: "Management is responsible for the preparation and presentation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards."

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 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[5] 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.[6] 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 qualified audit opinion.

Basis for Qualified Opinion on the Financial Performance and Cash Flows

We did not observe the counting of the physical inventory stated at xxx as at December 31, 20X0, since that date was prior to our appointment as auditors. We were unable to satisfy ourselves as to the inventory quantities at that date by other audit procedures. Since opening inventories enter into the determination of the financial performance and cash flows, we were unable to determine whether adjustments to profit for the year and net cash flows from operating activities might be necessary.

Qualified Opinion on the Financial Performance and Cash Flows

In our opinion, except for the effects of adjustments, if any, which we might have determined to be necessary had we been able to audit the opening inventory quantities as described in the Basis for Qualified Opinion paragraph, the income statement and cash flow statement present fairly, in all material respects, (*or "give a true and fair view of"*) the financial performance and cash flows

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

6 In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances." In the case of footnote 5, this sentence may read: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and presentation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances."

of ABC Company for the year ended December 31, 20X1, in accordance with International Financial Reporting Standards.

Opinion on the Financial Position

However, in our opinion, the balance sheet presents fairly, in all material respects, (or "*gives a true and fair view of*") the financial position of ABC Company as at December 31, 20X1, in accordance with International Financial Reporting Standards.

Report on Other Legal and Regulatory Requirements

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

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

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Exposure Draft
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Comments are requested by October 31, 2007

Proposed Redrafted International Standard on Auditing

ISA 530, Audit Sampling

International Federation
of Accountants

REQUEST FOR COMMENTS

The International Auditing and Assurance Standards Board (IAASB), an independent standard-setting body within the International Federation of Accountants (IFAC), approved the exposure draft, proposed International Standard on Auditing (ISA) 530 (Redrafted), "Audit Sampling," for publication in July 2007. The proposed ISA may be modified in light of comments received before being issued in final form.

Please submit your comments, preferably by e-mail, so that they will be received by **October 31, 2007**. All comments will be considered a matter of public record. Comments should be addressed to:

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Copies of the exposure drafts may be downloaded free-of-charge from the IFAC website at http://www.ifac.org.

CONTENTS

EXPLANATORY MEMORANDUM

Introduction

This memorandum provides background to proposed International Standard on Auditing (ISA) 530 (Redrafted), "Audit Sampling." The proposed ISA has been redrafted in accordance with conventions agreed by the International Auditing and Assurance Standards Board (IAASB) to be applied to all ISAs. The IAASB approved the proposed redrafted ISA for exposure in July 2007.

Background

As part of its project to improve the clarity of its International Standards, the IAASB has undertaken to redraft all of its ISAs in accordance with its new clarity drafting conventions. This approach responds to the desire for all ISAs to be consistently drafted, and subject to a single statement of their authority and effect. The IAASB has agreed, in response to the general call for the Clarity project to be completed within a reasonable time, that while a significant number of the ISAs are under substantive revision as well as redrafting to reflect the new conventions, others will be subject to a limited redrafting to reflect only the conventions and matters of clarity generally. Proposed ISA 530 (Redrafted) is in the latter category.

The conventions used by the IAASB in redrafting extant ISA 530, "Audit Sampling and Other Means of Testing," and the authority and obligation attaching to those conventions, are established in the amended "Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services"[1] (Preface), approved by the IAASB in September 2006.

Effective Date

The current timetable envisages that all ISAs will have been revised and redrafted, or redrafted only, by late 2008 and the IAASB has provisionally agreed that the complete set of ISAs will be effective for audits of financial statements for periods beginning on or after December 15, 2008. This date will depend on satisfactory progress being made, and will be amended to a later date should that prove necessary. The IAASB believes that it is in the interests of auditors and others who use the ISAs that the ISAs should be released as soon as they are approved so as to facilitate their implementation.

Significant Matters

Selecting Items for Testing to Obtain Audit Evidence

As well as dealing with audit sampling, extant ISA 530 includes material dealing with the selection of items for testing by means other than sampling (i.e., selecting all items and selecting specific items). The IAASB is of the view that this material is better placed in proposed ISA 500 (Redrafted), "Considering the Relevance and Reliability of Audit Evidence" in order to provide a clear focus on sampling in proposed ISA 530 (Redrafted).

[1] The Preface can be accessed at http://web.ifac.org/download/IAASB_Preface.pdf.

The IAASB has therefore moved the material regarding selecting all items and selecting specific items from extant ISA 530 to proposed ISA 500 (Redrafted). Proposed ISA 500 (Redrafted) has been issued as an exposure draft in April 2007. The comment period for that exposure draft ends on September 15, 2007 so as to enable respondents to consider the effect of this change on both proposed ISA 500 (Redrafted) and proposed ISA 530 (Redrafted).

Anomalies

Extant ISA 530 states that sometimes the auditor may be able to establish that an error arises from an isolated event that has not recurred other than on specifically identifiable occasions and is therefore not representative of similar errors in the population (an anomalous error). The IAASB is concerned that the extant language is not clear about the treatment of anomalies and wishes to caution the auditor against inappropriately concluding that an anomaly exists in a population. Accordingly, the IAASB has specified as requirements in proposed ISA 530 (Redrafted) some of the present tense statements in extant ISA 530 relating to anomalies. In order to conclude that a misstatement or deviation is an anomaly, the auditor is required by proposed ISA 530 (Redrafted) to obtain a high degree of certainty that the misstatement or deviation is not representative of the population. The auditor is required to obtain this high degree of certainty by performing additional audit procedures to obtain sufficient appropriate audit evidence that the misstatement or deviation does not affect the remainder of the population.

In addition, cautionary language has been added to the application and other explanatory material relating to these proposed requirements. This cautionary language states that the smaller the sample relative to the total population, the more difficult it will be for the auditor to obtain the level of certainty necessary to determine that the misstatement or deviation is an anomaly.

Projecting and Evaluating Sample Results

In forming the auditor's opinion whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework, the auditor has to conclude whether reasonable assurance has been obtained about whether the financial statements taken as a whole are free from material misstatement. This includes whether, in light of the risk assessment and further audit procedures, the use of audit sampling has provided an appropriate basis for conclusions about the population. The IAASB is of the view that the auditor's conclusions about whether sufficient audit work had been performed based on the sample results is an important aspect of audit sampling that needed greater clarity. Accordingly, proposed ISA 530 (Redrafted) clarifies the responsibilities of the auditor with respect to the projection and evaluation of sample results. In addition, new guidance has been included (see Appendix 5 of proposed ISA 530 (Redrafted)) that explains how estimated maximum misstatement can be used by the auditor to conclude whether the use of audit sampling has provided an appropriate basis for conclusions about the population.

Guide for Respondents

The IAASB is seeking comments **only** on changes resulting from applying the clarity drafting conventions, including the matters discussed above, and their effect on the content of the extant ISA. Respondents are asked to respond in particular to the following questions:

1. Are the objectives to be achieved by the auditor, stated in the proposed redrafted ISA, appropriate?
2. Have the criteria identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and reporting, and the use of professional judgment by auditors?[2]

Recognizing that the final ISA will apply to audits of all sizes and in all sectors of the economy, the IAASB is also interested in comments on matters set out below.

- *Special Considerations in the Audit of Small Entities*—Respondents are asked to comment whether, in their opinion, considerations in the audit of small entities have been dealt with appropriately in the proposed redrafted ISA.
- *Special Considerations in the Audit of Public Sector Entities*—Respondents are asked to comment whether, in their opinion, special considerations in the audit of public sector entities have been dealt with appropriately in the proposed redrafted ISA.
- *Developing Nations*—Recognizing that many developing nations have adopted or are in the process of adopting the ISAs, the IAASB invites respondents from these nations to comment, in particular, on any foreseeable difficulties in applying the proposed redrafted ISA in a developing nation environment.
- *Translations*—Recognizing that many respondents intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues noted in reviewing the proposed redrafted ISA.

Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in the exposure draft, it will be helpful for the IAASB to be made aware of this view.

Respondents are also invited to comment on any undue costs, set against the benefits of more consistent auditor performance, arising from the fact that the proposed redrafted ISA includes requirements that would previously have been guidance under the old drafting conventions, as in the extant ISA (see below). In commenting on this matter, respondents should bear in mind the criteria that the IAASB has applied in redrafting the proposed ISA (see footnote 2) and the fact

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2 The IAASB has identified the following criteria for determining the requirements of a Standard:

- The requirement is necessary to achieve the objective stated in the Standard;
- The requirement is expected to be applicable in virtually all engagements to which the Standard is relevant; and
- The objective stated in the Standard is unlikely to have been met by the requirements of other Standards.

In determining the requirements of a Standard, the IAASB will consider whether the requirements are proportionate to the importance of the subject matter of the Standard in relation to the overall objective of the engagement.

The criteria, which are intended only to assist the IAASB in appropriately and consistently determining requirements, may be refined as further experience is gained.

that the IAASB is seeking to clarify that there was some guidance in extant ISAs that was more in the nature of requirements and would already have been followed by many auditors.

Supplement to the Exposure Draft

To assist respondents in tracking changes, IAASB staff has prepared an analysis of the decisions that have been made by the IAASB with respect to the treatment of the present tense in the explanatory paragraphs of the extant ISA. This analysis also demonstrates how the material in the extant ISA has been reflected in the proposed redrafted ISA. In particular, the analysis:

- Identifies existing sentences in the present tense and whether they are now treated as a requirement or as application material;
- Maps the material of the extant ISA to the proposed redrafted ISA; and
- Identifies explanatory material that is proposed to be eliminated or repositioned as a result of redrafting.

These staff-prepared mapping documents are available on the IAASB website at http://www.ifac.org/Guidance/EXD-Details.php?EDID=0089. They are for information purposes only and do not form part of the exposure draft.

To be considered, responses should be emailed to Edcomments@ifac.org. They may also be faxed to +1-212-286-9570 or mailed to 545 Fifth Avenue, 14th Floor, New York, NY 10017, USA. They should be received by **October 31, 2007**.

PROPOSED INTERNATIONAL STANDARD ON AUDITING 530

(REDRAFTED)

AUDIT SAMPLING

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

CONTENTS

* See footnote 1.

International Standard on Auditing (ISA) 530 (Redrafted), “Audit Sampling” should be read in the context of the “Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services,” which sets out the authority of ISAs.

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's use of audit sampling when designing and performing tests of controls and tests of details.

2. This ISA complements [proposed] ISA 500 (Redrafted), "Considering the Relevance and Reliability of Audit Evidence," which deals with what constitutes audit evidence in an audit of financial statements, the auditor's responsibility to obtain information that is capable of providing sufficient appropriate audit evidence, and the evaluation of whether sufficient appropriate evidence has been obtained.

Effective Date

3. This ISA is effective for audits of financial statements for periods beginning on or after [date].[1]

Objective

4. The objective of the auditor when using audit sampling is to design and select the audit sample, perform audit procedures on the sample items, and evaluate the results from the sample in a manner that will provide an appropriate basis for the auditor to draw conclusions about the population from which the sample is drawn.

Definitions

5. For purposes of the ISAs, the following terms have the meanings attributed below:

   (a) Audit sampling (sampling) – The application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection.

   (b) Population – The entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions. For example, all of the items in a class of transactions or account balance constitute a population. A population may be divided into strata, or sub-populations, with each stratum being examined separately.

   (c) Sampling risk – The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions:

      (i) In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist when in fact it does. Because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion, the auditor is primarily concerned with this type of erroneous conclusion.

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1 This date will not be earlier than December 15, 2008.

(ii) In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

(d) Non-sampling risk – The risk that the auditor does not recognize misstatements or deviations included in the sample for what they are.

(e) Sampling unit – The individual items constituting a population.

(f) Statistical sampling – An approach to sampling that has the following characteristics:

(i) Random selection of the sample items; and

(ii) The use of probability theory to evaluate sample results, including measurement of sampling risk.

A sampling approach that does not have characteristics (i) and (ii) is considered non-statistical sampling.

(g) Stratification – The process of dividing a population into sub-populations, each of which is a group of sampling units which have similar characteristics (often monetary value).

(h) Tolerable misstatement – A monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that it is not exceeded by the actual misstatement in the population. (Ref: Para A1)

(i) Tolerable rate of deviation – A rate of deviation from prescribed internal control procedures set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that it is not exceeded by the actual rate of deviation in the population.

(j) Estimated maximum misstatement – The upper limit of the range of possible misstatement consistent with the auditor's risk assessment and results of other audit procedures.

(k) Estimated maximum rate of deviation – The upper limit of the range of possible rates of deviation consistent with the auditor's planned reliance on internal controls.

(l) Projected misstatements[2] – The auditor's best estimate of misstatements in populations involving the projection of misstatements identified in audit samples to the entire populations from which the samples were drawn.

(m) Anomaly – A misstatement or deviation that is demonstrably not representative of misstatements or deviations in a population.

[2] The term projected misstatements can be used when referring to a particular sample or when referring to a combination of samples.

Requirements

Sample Design, Size and Selection of Items for Testing

6. When designing an audit sample, the auditor shall consider the objectives of the audit procedure and the characteristics of the population from which the sample will be drawn. (Ref: Para. A2-A8)

7. The auditor shall determine a sample size sufficient to allow the auditor to conclude with an appropriate level of sampling risk that:

   (i) In the case of tests of details, the total misstatement does not exceed tolerable misstatement; or

   (ii) In the case of tests of controls, the total rate of deviation does not exceed the tolerable rate of deviation. (Ref: Para. A9-A10)

8. The auditor shall select items for the sample in such a way that all sampling units in the population have a chance of selection. (Ref: Para. A11-A12)

Performing Audit Procedures

9. The auditor shall perform audit procedures appropriate to the particular audit objective on each item selected.

10. If the audit procedure is not applicable to the selected item, the auditor shall perform the procedure on a replacement item. (Ref: Para. A13)

11. If the auditor is unable to apply the designed audit procedures, or suitable alternative procedures, to a selected item the auditor shall treat that item as a deviation from the prescribed control, in the case of tests of controls, or a misstatement, in the case of tests of details. The auditor shall also consider whether the reasons for the inability to apply the designed audit procedures or suitable alternative procedures have implications for the assessed risk of material misstatement due to fraud, for the assessed level of control risk that the auditor expects to be supported, or for the degree of reliance on management representations. (Ref: Para. A14)

Nature and Cause of Deviations and Misstatements

12. The auditor shall investigate the nature and cause of any deviations or misstatements identified, and their possible effect on the objective of the particular audit procedure and on other areas of the audit. (Ref: Para. A15)

13. In the extremely rare circumstances when the auditor considers a misstatement or deviation discovered in a sample to be an anomaly the auditor shall obtain a high degree of certainty that such misstatement or deviation is not representative of the population. The auditor shall obtain this degree of certainty by performing additional audit procedures to obtain sufficient appropriate audit evidence that the misstatement or deviation does not affect the remainder of the population. (Ref: Para. A16)

Projecting and Evaluating Sample Results

14. The auditor shall conclude whether, in light of the risk assessment and other procedures performed, the use of audit sampling has provided an appropriate basis for conclusions about the population that has been tested. In making these conclusions:

    (a) For tests of controls, the auditor shall determine, for the population, the projected rate of deviation and shall evaluate its effect on the objective of the particular audit procedure and on other areas of the audit.

    (b) For tests of details, the auditor shall determine, for the population, projected misstatement and shall evaluate its effect on the objective of the particular audit procedure and on other areas of the audit. (Ref: Para. A17-A20)

15. If the auditor determines that the use of audit sampling has not provided an appropriate basis for conclusions about the population, the auditor shall obtain additional audit evidence. (Ref: Para. A21)

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Application and Other Explanatory Material

Definitions

Tolerable Misstatement (Ref: Para. 5(h))

A1. When designing a sample, the auditor determines tolerable misstatement in order to address the risk that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated and provide a margin for possible undetected misstatements as described in [proposed] ISA 320 (Revised and Redrafted), "Materiality in Planning and Performing an Audit."

Sample Design, Size and Selection of Items for Testing

Sample Design (Ref: Para. 6)

A2. Audit sampling enables the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population from which the sample is drawn. Audit sampling can be applied using either non-statistical or statistical sampling approaches.

A3. When designing an audit sample, the auditor's consideration includes the specific objectives to be achieved and the combination of audit procedures which is likely to best achieve those objectives. Consideration of the nature of the audit evidence sought and possible deviation or misstatement conditions or other characteristics relating to that audit evidence will assist the auditor in defining what constitutes a deviation or misstatement and what population to use for sampling.

A4. The auditor's consideration of the objectives of the audit procedure, as required by paragraph 9, includes a clear understanding of what constitutes a deviation or misstatement so that all, and only, those conditions that are relevant to the objectives of the audit procedure are included in the projection of deviations or misstatements. For example, in a test of details relating to the existence of accounts receivable, such as confirmation, payments made by the customer before the confirmation date but received shortly after that date by the client, are not considered a misstatement. Also, a misposting between customer accounts does not affect the total accounts receivable balance. Therefore, it is not appropriate to consider this a misstatement in evaluating the sample results of this particular audit procedure, even though it may have an important effect on other areas of the audit, such as the assessment of the risk of fraud or the adequacy of the allowance for doubtful accounts.

A5. For tests of controls, the assessment of the rate of deviation is based on the auditor's understanding of the design of the relevant controls and whether they have been implemented, or on the examination of a small number of items from the population. Similarly, for tests of details, the auditor makes an assessment of the expected misstatement in the population. This assessment is useful for designing an audit sample and for determining sample size. For example, if the expected rate of deviation is unacceptably high, tests of controls will normally not be performed. If the expected misstatement is high, 100% examination or use of a large sample size may be appropriate, when performing tests of details.

Statistical Versus Non-Statistical Sampling Approaches

A6. The decision whether to use a statistical or non-statistical sampling approach is a matter for the auditor's judgment; however, sample size is not a valid criterion to distinguish between statistical and non-statistical approaches.

A7. While the approach adopted may not meet the definition of statistical sampling, elements of a statistical approach may be used, for example the use of random selection using computer generated random numbers. However, statistical measurements of sampling risk are valid only when the approach adopted has the characteristics of statistical sampling.

Information on Which Audit Procedures are Based

A8. In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value weighted selection is appropriate. Appendix 1 provides further discussion on stratification and value weighted selection.

Sample Size (Ref: Para. 7)

A9. The level of sampling risk that the auditor is willing to accept affects the sample size required. The lower the risk the auditor is willing to accept, the greater the sample size will need to be.

A10. The sample size can be determined by the application of a statistically-based formula or through the exercise of professional judgment. Appendices 2 and 3 indicate the influences that various factors typically have on the determination of sample size, and hence the level of sampling risk. When circumstances are similar, the effect on sample size of factors such as those identified in Appendices 2 and 3 will be similar regardless of whether a statistical or non-statistical approach is chosen.

Selection of Items for Testing (Ref: Para. 8)

A11. Statistical sampling requires that sample items are selected at random so that each sampling unit has a known probability of being selected. The sampling units might be physical items (for example, checks listed on deposit slips, credit entries on bank statements, sales invoices or debtors' balances) or monetary units. With non-statistical sampling, an auditor uses professional judgment to select the items for a sample. Because the purpose of sampling is to draw conclusions about the entire population, it is important that the auditor selects a representative sample by choosing sample items, which have characteristics typical of the population, and so that bias is avoided.

A12. The principal methods of selecting samples are the use of random selection, systematic selection and haphazard selection. Each of these methods is discussed in Appendix 4.

Performing Audit Procedures (Ref: Para. 9-11)

A13. An example of when it may be necessary to perform the procedure on a replacement item is when a voided check is selected when testing for evidence of payment authorization. If the auditor is satisfied that the check has been properly voided such that it does not constitute a deviation, an appropriately chosen replacement is examined.

A14. An example of when the auditor is unable to apply the designed audit procedures to a selected item is when documentation relating to that item has been lost.

Nature and Cause of Deviations and Misstatements (Ref: Para. 12-13)

A15. In analyzing the deviations and misstatements identified, the auditor may observe that many have a common feature, for example, type of transaction, location, product line or period of time. In such circumstances, the auditor may decide to identify all items in the population that possess the common feature, and extend audit procedures in that stratum. In addition, such deviations or misstatements may be intentional, and may indicate the possibility of fraud.

A16. The smaller the sample size in which the misstatement or deviation occurs, the more difficult it will be for the auditor to obtain the level of certainty necessary to determine that the misstatement or deviation identified is an anomaly.

Projecting and Evaluating Sample Results (Ref: Para. 14-15)

A17. In the case of tests of controls, an unexpectedly high sample deviation rate may lead to an increase in the assessed risk of material misstatement, unless further audit evidence substantiating the initial assessment is obtained. In the case of tests of details, an unexpectedly high misstatement amount in a sample may cause the auditor to believe that a class of transactions or account balance is materially misstated, in the absence of further audit evidence that no material misstatement exists.

A18. When a misstatement has been established as an anomaly, it may be excluded when projecting misstatements in samples to the population. However, the effect of any such misstatement, if uncorrected, still needs to be considered in addition to the projection of the non-anomalous misstatements.

A19. When the projected rate of deviation exceeds the tolerable rate of deviation or the projected misstatement plus anomalous misstatement exceeds that which the auditor deems tolerable, the sample does not provide an appropriate basis for conclusions about the population that has been tested. If the total amount of projected misstatement plus anomalous misstatement is less than but close to that which the auditor deems tolerable, the auditor may consider the persuasiveness of the sample results in the light of other audit procedures, and may consider it appropriate to obtain additional audit evidence. The total of projected misstatement plus anomalous misstatement is the auditor's best estimate of misstatement in the population. However, sampling results are affected by sampling risk. Thus when the best estimate of misstatement is close to the tolerable misstatement, the auditor recognizes the risk that a different sample would result in a different best estimate that could exceed the tolerable misstatement. Considering the results of other audit procedures helps the auditor to assess this risk, while the risk is reduced if additional audit evidence is obtained.

A20. When using statistical sampling the auditor may use estimated maximum misstatement for purposes of concluding whether the audit sample has provided an appropriate basis for conclusions. See Appendix 5.

A21. If the auditor concludes that audit sampling has not provided an appropriate basis for conclusions about the population that has been tested, the auditor may:

- Request management to first investigate misstatements or deviations that have been identified and the potential for further misstatements or deviations and to make any necessary adjustments; and/or
- Tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance. For example, in the case of tests of controls, the auditor might extend the sample size, test an alternative control or modify related substantive procedures.

Appendix 1

(Ref: Para. A8)

Stratification and Value Weighted Selection

In determining the attributes of the population from which the sample will be drawn, the auditor may determine that stratification or value weighted selection is appropriate. This Appendix provides guidance to the auditor on the use of stratification and value weighted sampling techniques.

Stratification

1. Audit efficiency may be improved if the auditor stratifies a population by dividing it into discrete sub-populations which have an identifying characteristic. The objective of stratification is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.
2. When performing tests of details, the population is often stratified by monetary value. This allows greater audit effort to be directed to the larger value items, as these items may contain the greatest potential misstatement in terms of overstatement. Similarly, a population may be stratified according to a particular characteristic that indicates a higher risk of misstatement, for example, when testing the valuation of accounts receivable, balances may be stratified by age.

Value Weighted Selection

3. When performing tests of details it will often be efficient, particularly when testing for overstatements, to identify the sampling unit as the individual monetary units (for example, dollars) that make up the population. Having selected specific monetary units from within the population, for example, the accounts receivable balance, the auditor may then examine the particular items, for example, individual balances, that contain those monetary units. One benefit of this approach to defining the sampling unit is that audit effort is directed to the larger value items because they have a greater chance of selection, and can result in smaller sample sizes. This approach is ordinarily used in conjunction with the systematic method of sample selection (described in Appendix 4) and is most efficient when selecting items using random selection.

Appendix 2

(Ref: Para. A10)

Examples of Factors Influencing Sample Size for Tests of Controls

The following are factors that the auditor may consider when determining the sample size for tests of controls. These factors, which need to be considered together, assume the auditor does not modify the nature or timing of tests of controls or otherwise modify the approach to substantive procedures in response to assessed risks.

	FACTOR	**EFFECT ON SAMPLE SIZE**
1.	An increase in the extent to which the risk of material misstatement is reduced by the operating effectiveness of controls	Increase
2.	An increase in the rate of deviation from the prescribed control activity that the auditor is willing to accept	Decrease
3.	An increase in the rate of deviation from the prescribed control activity that the auditor expects to find in the population	Increase
4.	A decrease in the risk that the auditor will conclude that the risk of material misstatement is lower than the actual risk of material misstatement in the population	Increase
5.	An increase in the number of sampling units in the population	Depends on the type of sample

1. *The extent to which the risk of material misstatement is reduced by the operating effectiveness of controls.* The more assurance the auditor intends to obtain from the operating effectiveness of controls, the lower the auditor's assessment of the risk of material misstatement will be, and the larger the sample size will need to be. When the auditor's assessment of the risk of material misstatement at the assertion level includes an expectation of the operating effectiveness of controls, the auditor is required to perform tests of controls. Other things being equal, the greater the reliance the auditor places on the operating effectiveness of controls in the risk assessment, the greater is the extent of the auditor's tests of controls (and therefore, the sample size is increased).

2. *The rate of deviation from the prescribed control activity the auditor is willing to accept (tolerable rate of deviation).* The lower the rate of deviation that the auditor is willing to accept, the larger the sample size needs to be.

3. *The rate of deviation from the prescribed control activity the auditor expects to find in the population (expected control deviation).* The higher the rate of deviation that the auditor expects, the larger the sample size needs to be so that the auditor is in a position to make a reasonable estimate of the actual rate of deviation. Factors relevant to the auditor's consideration of the expected rate of deviation include the auditor's understanding of the business (in particular, risk assessment procedures undertaken to obtain an understanding of internal control), changes in personnel or in internal control, the results of audit procedures applied in prior periods and the results of other audit procedures. High expected control deviation rates ordinarily warrant little, if any, reduction of the assessed risk of material misstatement, and therefore in such circumstances tests of controls would ordinarily be omitted.

4. *The auditor's required level of assurance.* The greater the level of assurance that the auditor requires that the results of the sample are in fact indicative of the actual incidence of deviation in the population, the larger the sample size needs to be.

5. *The number of sampling units in the population.* For large populations, the actual size of the population has little, if any, effect on sample size. For small populations however, audit sampling may not be as efficient as alternative means of obtaining sufficient appropriate audit evidence.

Appendix 3

(Ref: Para. A10)

Examples of Factors Influencing Sample Size for Tests of Details

The following are factors that the auditor may consider when determining the sample size for tests of details. These factors, which need to be considered together, assume the auditor does not modify the approach to tests of controls or otherwise modify the nature or timing of substantive procedures in response to the assessed risks.

	FACTOR	EFFECT ON SAMPLE SIZE
1.	An increase in the auditor's assessment of the risk of material misstatement	Increase
2.	An increase in the use of other substantive procedures directed at the same assertion	Decrease
3.	A decrease in the risk that the auditor will conclude that a material misstatement does not exist, when in fact it does exist	Increase
4.	An increase in the total misstatement that the auditor is willing to accept (tolerable misstatement)	Decrease
5.	An increase in the amount of misstatement the auditor expects to find in the population	Increase
6.	Stratification of the population when appropriate	Decrease
7.	The number of sampling units in the population	Negligible Effect

1. *The auditor's assessment of the risk of material misstatement.* The higher the auditor's assessment of the risk of material misstatement, the larger the sample size needs to be. The auditor's assessment of the risk of material misstatement is affected by inherent risk and control risk. For example, if the auditor does not perform tests of controls, the auditor's risk assessment cannot be reduced for the effective operation of internal controls with respect to the particular assertion. Therefore, in order to reduce audit risk to an acceptably low level, the auditor needs a low detection risk and will rely more on substantive procedures. The more audit evidence that is obtained from tests of details (that is, the lower the detection risk), the larger the sample size will need to be.

2. *The use of other substantive procedures directed at the same assertion.* The more the auditor is relying on other substantive procedures (tests of details or substantive analytical procedures) to reduce to an acceptable level the detection risk regarding a particular population, the less assurance the auditor will require from sampling and, therefore, the smaller the sample size can be.

3. *The auditor's required level of assurance.* The greater the level of assurance that the auditor requires that the results of the sample are in fact indicative of the actual amount of misstatement in the population, the larger the sample size needs to be.

4. *The total misstatement the auditor is willing to accept (tolerable misstatement).* The lower the total misstatement that the auditor is willing to accept, the larger the sample size needs to be.

5. *The amount of misstatement the auditor expects to find in the population (expected misstatement).* The greater the amount of misstatement the auditor expects to find in the population, the larger the sample size needs to be in order to make a reasonable estimate of the actual amount of misstatement in the population. Factors relevant to the auditor's consideration of the expected misstatement amount include the extent to which item values are determined subjectively, the results of risk assessment procedures, the results of tests of control, the results of audit procedures applied in prior periods, and the results of other substantive procedures.

6. *Stratification.* When there is a wide range (variability) in the monetary size of items in the population, it may be useful to group items of similar size into separate sub-populations or strata. This is referred to as stratification. When a population can be appropriately stratified, the aggregate of the sample sizes from the strata generally will be less than the sample size that would have been required to attain a given level of sampling risk, had one sample been drawn from the whole population.

7. *The number of sampling units in the population.* For large populations, the actual size of the population has little, if any, effect on sample size. Thus, for small populations, audit sampling is often not as efficient as alternative means of obtaining sufficient appropriate audit evidence. (However, when using monetary unit sampling, an increase in the monetary value of the population increases sample size, unless this is offset by a proportional increase in materiality.)

Appendix 4

(Ref: Para. A12)

Sample Selection Methods

There are many methods of selecting samples. The principal methods are as follows:

(a) Random selection, (such as may be applied through random number generators).

(b) Systematic selection, in which the number of sampling units in the population is divided by the sample size to give a sampling interval, for example 50, and having determined a starting point within the first 50, each 50th sampling unit thereafter is selected. Although the starting point may be determined haphazardly, the sample is more likely to be truly random if it is determined by use of a computerized random number generator or random number tables. When using systematic selection, the auditor would need to determine that sampling units within the population are not structured in such a way that the sampling interval corresponds with a particular pattern in the population. Monetary unit sampling is a form of systematic selection using the monetary unit as the base.

(c) Haphazard selection, in which the auditor selects the sample without following a structured technique. Although no structured technique is used, the auditor would nonetheless avoid any conscious bias or predictability (for example, avoiding difficult to locate items, or always choosing or avoiding the first or last entries on a page) and thus attempt to ensure that all items in the population have a chance of selection. Haphazard selection is not appropriate when using statistical sampling.

Appendix 5

(Ref: Para. A20)

Using Estimated Maximum Misstatement to Evaluate Sample Results

1. Statistical sampling enables the auditor to determine estimated maximum misstatement. When using statistical sampling the auditor may use estimated maximum misstatement for purposes of concluding whether the audit sample has provided an appropriate basis for conclusions.

2. Projected misstatement is the auditor's best estimate of the amount of misstatement in the population. Estimated maximum misstatement, on the other hand, is the upper limit of the range of reasonably possible misstatement; and is always larger than projected misstatement. Even if no misstatements are detected in a sample, so that projected misstatement is zero, there is a probability that at least some misstatement exists despite the lack of sampling evidence. The risk ordinarily declines for increasingly large amounts of potential misstatement, and at some point on the continuum of potential misstatement reaches an acceptably low level. That point is the estimated maximum misstatement. If misstatements are detected in the sample, the projected misstatement is greater than zero and the estimated maximum misstatement is greater than it would have been had no misstatements been detected.

3. When the sample is evaluated, estimated maximum misstatement may be compared with tolerable misstatement to determine whether the auditor has achieved reasonable assurance that actual misstatement is tolerable. If estimated maximum misstatement exceeds tolerable misstatement the auditor cannot conclude with an appropriate level of assurance that actual misstatement does not exceed tolerable misstatement. If this is the case, in order to make the appropriate conclusions required by paragraph 14 of this ISA, it is necessary to obtain additional audit evidence.

4. Considerations analogous to those discussed in paragraphs 2 and 3 in relation to estimated maximum misstatement also apply to the estimated maximum rate of deviation in the context of tests of controls.

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International
Auditing
and Assurance
Standards Board

Exposure Draft
July 2007
Comments are requested by November 30, 2007

Proposed Redrafted International Standard on Auditing

ISA 700, The Independent Auditor's Report on General Purpose Financial Statements

International Federation
of Accountants

REQUEST FOR COMMENTS

The International Auditing and Assurance Standards Board (IAASB), an independent standard-setting body within the International Federation of Accountants (IFAC), approved the exposure draft of proposed International Standard on Auditing (ISA) 700 (Redrafted), "The Independent Auditor's Report on General Purpose Financial Statements" for publication in July 2007. The proposed ISA may be modified in light of comments received before being issued in final form.

Please submit your comments, preferably by e-mail, so that they will be received by **November 30, 2007**. All comments will be considered a matter of public record. Comments should be addressed to:

International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, New York 10017 USA

Comments should be emailed to Edcomments@ifac.org. They may also be faxed to +1-212-286-9570 or mailed to the above address.

Copies of the exposure drafts may be downloaded free-of-charge from the IFAC website at http://www.ifac.org.

CONTENTS

EXPLANATORY MEMORANDUM

Introduction

This memorandum provides background to proposed International Standard on Auditing (ISA) 700 (Redrafted), "The Independent Auditor's Report on General Purpose Financial Statements." The proposed ISA has been redrafted in accordance with conventions agreed by the International Auditing and Assurance Standards Board (IAASB) to be applied to all ISAs. The IAASB approved the proposed redrafted ISA for exposure in July 2007.

Background

The project to revise extant ISA 800, "The Independent Auditor's Report on Special Purpose Audit Engagements" gave rise to conforming amendments to ISA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements."

In October 2006, the IAASB approved a "close off" document of ISA 800 (Revised), "Special Considerations—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement" and related conforming amendments in the "old style" (i.e., following the IAASB's current drafting conventions). ISA 700 (Amended as a result of ISA 800 (Revised)), "The Independent Auditor's Report on General Purpose Financial Statements" forms the basis for proposed ISA 700 (Redrafted).

The close off document of ISA 800 (Revised) and related conforming amendments is available on the IAASB website at: http://www.ifac.org/Guidance/EXD-Details.php?EDID=0093.

The conventions used by the IAASB in redrafting ISA 700 (Amended), and the authority and obligation attaching to those conventions, are established in proposed ISA 200 (Revised and Redrafted), "Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing" approved by the IAASB as an exposure draft in April 2007, and in the amended "Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services"[1] (Preface) approved by the IAASB in September 2006.

Effective Date

The current timetable envisages that all ISAs will have been revised and redrafted, or redrafted only, by late 2008 and the IAASB has provisionally agreed that the complete set of ISAs will be effective for audits of financial statements for periods beginning on or after December 15, 2008. This date will depend on satisfactory progress being made, and will be amended to a later date should that prove necessary. The IAASB believes that it is in the interests of auditors and others who use the ISAs that the ISAs should be released as soon as they are approved so as to facilitate their implementation.

[1] The amended Preface can be accessed at http://web.ifac.org/download/IAASB_Preface.pdf. Proposed ISA 200 (Revised and Redrafted) can be accessed at http://www.ifac.org/Guidance/EXD-Details.php?EDID=0079.

Significant Matters

Forming an Opinion on the Financial Statements

In redrafting ISA 700 (Amended), the IAASB considered how the requirements and guidance in proposed ISA 450 (Revised and Redrafted), "Evaluation of Misstatements Identified during the Audit" that deal with the evaluation whether the financial statements as a whole are free from material misstatement relate to the requirements and guidance in ISA 700 (Amended) that deal with forming an opinion on the financial statements.

The IAASB concluded that, in light of the definition of a "misstatement" in proposed ISA 450 (Revised and Redrafted), there is not a clear differentiation between the consideration of "qualitative aspects of the entity's accounting practices" in proposed ISA 450 (Revised and Redrafted) and the matters that the auditor is asked to evaluate in forming an opinion on the financial statements in ISA 700 (Amended). The IAASB agreed that, in the absence of a separate ISA on forming an opinion on the financial statements, the overlap could be addressed by:

- Transferring the requirements and guidance in proposed ISA 450 (Revised and Redrafted) that deal with the evaluation of whether the financial statements as a whole are free from material misstatement and the consideration of bias to proposed ISA 700 (Redrafted) as indicated below, and amending the objective of proposed ISA 450 (Revised and Redrafted) accordingly;
- Restructuring the Forming an Opinion on the Financial Statements section in proposed ISA 700 (Redrafted) to require the auditor, in forming an opinion on the financial statements, to conclude whether reasonable assurance has been obtained about whether the financial statements taken as a whole are free from material misstatement (see paragraph 8 of proposed ISA 700 (Redrafted)). The auditor's conclusion takes account of the conclusions and evaluations described in or required by paragraphs 9-12 of proposed ISA 700 (Redrafted);
- Clarifying in proposed ISA 700 (Redrafted) that the auditor's evaluation of whether the financial statements are prepared and presented, in all material respects, in accordance with the specific requirements of the applicable financial reporting framework includes consideration of the *qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments* (see paragraph 10 of proposed ISA 700 (Redrafted)); and
- Inserting the application material regarding evaluating whether the financial statements as a whole are free of material misstatement and the consideration of bias from proposed ISA 450 (Revised and Redrafted) in the application material of proposed ISA 700 (Redrafted) (see paragraphs A1-A2 of proposed ISA 700 (Redrafted)).

If respondents accept the IAASB's proposal, proposed ISA 450 (Revised and Redrafted) will deal with the evaluation of the effect of uncorrected misstatements, while proposed ISA 700 (Redrafted) will deal with the evaluation whether the financial statements as a whole are free from material misstatement.

Description of Management's Responsibility for the Financial Statements

Paragraph 24 of ISA 700 (Amended) prescribed the description in the auditor's report of management's responsibility for the financial statements. In redrafting ISA 700 (Amended), several IAASB members and national auditing standard setters requested the IAASB to amend the requirement to allow flexibility with regard to the description. The IAASB was of the view that such an amendment goes beyond the application of the clarity drafting conventions and therefore have not proposed an amendment to the requirement in proposed ISA 700 (Redrafted).

However, the notion of the premises, relating to management's responsibilities, on which an audit in accordance with the ISAs are conducted are currently being considered as part of the project to revise and redraft extant ISA 580, "Management Representations" (see proposed ISA 580 (Revised and Redrafted), "Written Representations"), arising from which a number of conforming amendments are proposed to proposed ISA 200 (Revised and Redrafted), "Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing" and proposed ISA 210 (Redrafted), "Agreeing the Terms of Audit Engagements."[2] The IAASB has received comments in response to the exposure draft of proposed ISA 580 (Revised and Redrafted) on how the ISAs articulate these premises and will be considering how to respond to those comments in due course. Whilst the IAASB concluded that it would not be appropriate to pre-empt the outcome of these considerations in proposed ISA 700 (Redrafted), the finalization of proposed ISA 580 (Revised and Redrafted) may give rise to conforming amendments to proposed ISA 700 (Redrafted) in this regard.

Financial Reporting Frameworks Described by Reference to International Financial Reporting Standards (IFRSs)

A number of jurisdictions are adopting IFRSs. In some cases, the jurisdictions may adopt less than the complete set of current IFRSs. This may be because of the time it takes a jurisdiction to introduce new standards locally, such that the issue is merely one of timing. It may be because a jurisdiction regards a certain IFRS as unsuitable for the jurisdiction. Or it may be because a regulator wishes to impose its own rules in respect of certain aspects of financial reporting. In each case, national standard setters, legislators or regulators may mandate how the financial reporting framework is to be described in financial statements or the auditor's report, or both.

Descriptions of financial reporting frameworks that are required in certain jurisdictions include "IFRSs as adopted for use in [country X]" and "IFRSs as modified by banking regulators for the use of banks in [country X]." Such descriptions may be required to be used in the general purpose financial statements of the relevant entities.

A description of a financial reporting framework in terms such as those set out above is not an explicit and unreserved statement of compliance with IFRSs; the user may not know what the differences between the framework and IFRSs are, or where to find them. The user, however, is entitled to expect that there is close relationship between the framework used and IFRSs.

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2 The exposure draft of proposed ISA 210 (Redrafted) is currently scheduled for approval at the September 2007 IAASB meeting.

In some cases, the differences between adopted or modified IFRSs and the complete set of current IFRSs may be of no significance to some or many entities, such that the effect of using the framework is in fact identical to IFRSs in the vast majority of cases.

In other cases, however, an apparently insignificant difference between adopted or modified IFRSs and the complete set of current IFRSs may have a significant effect on the reported financial position or performance of some or many entities. As a result of such effects, there is the possibility that a user may be misled if he or she were to think that the financial statements comply, or comply in all but immaterial respects, with IFRSs. Accordingly, preparers and auditors should be concerned to avoid such a possibility.

This matter has been of concern to the International Accounting Standards Board (IASB), for the reasons set out above. In December 2006, the IASB agreed to issue an Exposure Draft of a proposed amendment to International Accounting Standard (IAS) 1, "Presentation of Financial Statements" adding disclosure requirements for entities that refer to IFRSs in describing the basis on which their financial statements are prepared, but that are not able to make an explicit and unreserved statement of compliance with IFRSs. Such an entity would be required to make disclosures about how its financial statements would have been different if prepared in full compliance with IFRSs. If, following consideration of comments received on the Exposure Draft, the IASB agrees to proceed with the proposed amendment to IAS 1, it would form part of the annual improvements process of the IASB. The Exposure Draft of the IASB's annual improvements will be published in October 2007. (The proposed amendment to IAS 1 is already posted on the IASB website (http://www.iasb.org) as an Invitation to Comment.)

The IAASB is of the view that, where it is an option, a preferred solution is to avoid references to IFRSs in circumstances when a financial reporting framework is such that compliance with it will not result in an explicit and unreserved statement of compliance with IFRSs, and instead refer to or describe such framework as the following: "the financial reporting framework applicable in [country X]," or "accounting principles applicable to banks in [country X]." The notes to the financial statements would include an appropriate description of the accounting policies.

However, there will be cases where such a solution is not possible because the description of the framework is mandated by law or regulation. In such cases, the auditor's concern is to ensure that the references are not misleading.

The IAASB proposes that ISA 700 (Redrafted) be the place to address this matter as the auditor is required in ISA 700 (Amended) to evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework. To enable respondents to consider how this might be addressed in ISA 700 (Redrafted), proposed guidance has been incorporated in paragraphs A9-A11 (addressing the auditor's evaluation of the description of the financial reporting framework in the financial statements) and paragraphs A33-A34 (addressing the effect that such description may have on the auditor's opinion). These paragraphs are shaded in the exposure draft.

The IAASB recognizes that the proposed guidance is based on the IASB's proposed amendment to IAS 1, which has not yet been finally approved by the IASB for inclusion in the annual improvements Exposure Draft and which is dependent on the IASB's due process. However, should the IASB proceed with its amendment, the IAASB would propose to incorporate the highlighted guidance in ISA 700 (Redrafted), and, therefore, considered it appropriate to use this opportunity to obtain respondents' comment on the proposed guidance. In the event that the IASB does not proceed with its current proposal, or amends the proposal in a material respect, the IAASB would have to decide how, if at all, to deal with the matter in those changed circumstances.

Respondents' comments, and any changes that the IASB may agree based on comments received on its Invitation to Comment and annual improvements Exposure Draft, will be taken into account in finalizing ISA 700 (Redrafted). At that time, the IAASB will evaluate whether it is necessary to re-expose the proposed guidance.

International Auditing Practice Statement (IAPS) 1014

In considering the proposal regarding financial reporting frameworks described by reference to IFRSs, and in response to questions that have arisen about whether the auditor may express more than one opinion when financial statements represent that they comply with the applicable financial reporting framework and IFRSs, the IAASB was of the view that it may be helpful to incorporate the guidance in IAPS 1014, "Reporting by Auditors on Compliance with International Financial Reporting Standards" in proposed ISA 700 (Redrafted).

To enable respondents to consider this proposal, the guidance in IAPS 1014, appropriately amended, has been incorporated in proposed ISA 700 (Redrafted). See paragraphs A4-A8, which deals with the auditor's evaluation of the description of the financial reporting framework in the financial statements, and paragraphs A31-A32, which deals with the effect that such description may have on the auditor's opinion.

The IAASB proposes that the following text of paragraph 7 of IAPS 1014 not be incorporated in proposed ISA 700 (Redrafted): "If the auditor is of the opinion that the failure to comply with one of the financial reporting frameworks causes the financial statements to fail to comply with the other financial reporting framework, the auditor issues a qualified opinion or adverse opinion on compliance with both frameworks." The IAASB is of the view that such circumstances will be rare and that the guidance confuses rather than clarifies.

Should respondents agree with the proposal to incorporate the guidance in IAPS 1014 in proposed ISA 700 (Redrafted), the IAASB proposes that IAPS 1014 be withdrawn.

Guide for Respondents

Request for Specific Comments

The IAASB would welcome views on the following:

1. The proposal to limit the scope of proposed ISA 450 (Revised and Redrafted) to the evaluation of the effect of uncorrected misstatements, while proposed ISA 700 (Redrafted) deals with the evaluation whether the financial statements as a whole are free from material misstatement.

2. The proposed guidance in paragraphs A9-A11 and A33-A34 of proposed ISA 700 (Redrafted), which was developed to address the matter of financial reporting frameworks described by reference to IFRSs.
3. The proposal to incorporate the guidance in IAPS 1014, appropriately amended, in paragraphs A4-A8 and A31-A32 of proposed ISA 700 (Redrafted) and to withdraw IAPS 1014.

Request for Comments on the Application of the Clarity Drafting Conventions

Except for the matters referred to above, the IAASB is seeking comments **only** on changes resulting from applying the clarity drafting conventions and their effect on the content of the ISA. Respondents are asked to respond in particular to the following questions:

1. Are the objectives to be achieved by the auditor, stated in the proposed redrafted ISA, appropriate?
2. Have the criteria identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and reporting, and the use of professional judgment by auditors?[3]

Recognizing that the final ISA will apply to audits of all sizes and in all sectors of the economy, the IAASB is also interested in comments on matters set out below.

- *Special Considerations in the Audit of Small Entities*—Respondents are asked to comment whether, in their opinion, considerations in the audit of small entities have been dealt with appropriately in the proposed redrafted ISA.
- *Special Considerations in the Audit of Public Sector Entities*—Respondents are asked to comment whether, in their opinion, special considerations in the audit of public sector entities have been dealt with appropriately in the proposed redrafted ISA.
- *Developing Nations*—Recognizing that many developing nations have adopted or are in the process of adopting the ISAs, the IAASB invites respondents from these nations to comment, in particular, on any foreseeable difficulties in applying the proposed redrafted ISA in a developing nation environment.

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[3] The IAASB has identified the following criteria for determining the requirements of a Standard:

- The requirement is necessary to achieve the objective stated in the Standard;
- The requirement is expected to be applicable in virtually all engagements to which the Standard is relevant; and
- The objective stated in the Standard is unlikely to have been met by the requirements of other Standards.

In determining the requirements of a Standard, the IAASB will consider whether the requirements are proportionate to the importance of the subject matter of the Standard in relation to the overall objective of the engagement.

The criteria, which are intended only to assist the IAASB in appropriately and consistently determining requirements, may be refined as further experience is gained.

- *Translations*—Recognizing that many respondents intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues noted in reviewing the proposed redrafted ISA.

Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in the exposure draft, it will be helpful for the IAASB to be made aware of this view.

Respondents are also invited to comment on any undue costs, set against the benefits of more consistent auditor performance, arising from the fact that the proposed redrafted ISA includes requirements that would previously have been guidance under the old drafting conventions, as in ISA 700 (Amended) (see below). In commenting on this matter, respondents should bear in mind the criteria that the IAASB has applied in redrafting the proposed ISA (see footnote 3) and the fact that the IAASB is seeking to clarify that there was some guidance in extant ISAs that was more in the nature of requirements and would already have been followed by many auditors.

Supplement to the Exposure Draft

To assist respondents in tracking changes, IAASB staff has prepared an analysis of the decisions that have been made by the IAASB with respect to the treatment of the present tense in the explanatory paragraphs of ISA 700 (Amended). This analysis also demonstrates how the material in ISA 700 (Amended) has been reflected in the proposed redrafted ISA. In particular, the analysis:

- Identifies existing sentences in the present tense and whether they are now treated as a requirement or as application material;
- Maps the material of ISA 700 (Amended) to the proposed redrafted ISA; and
- Identifies explanatory material that is proposed to be eliminated or repositioned as a result of redrafting.

In addition, staff has prepared an analysis that maps the guidance in IAPS 1014 to the guidance in proposed ISA 700 (Redrafted).

These staff-prepared mapping documents are available on the IAASB website at http://www.ifac.org/Guidance/EXD-Details.php?EDID=0090. They are for information purposes only and do not form part of the exposure draft.

To be considered, responses should be emailed to Edcomments@ifac.org. They may also be faxed to +1-212-286-9570 or mailed to 545 Fifth Avenue, 14th Floor, New York, NY 10017, USA. They should be received by **November 30, 2007**.

PROPOSED INTERNATIONAL STANDARD ON AUDITING 700 (REDRAFTED)

THE INDEPENDENT AUDITOR'S REPORT ON GENERAL PURPOSE FINANCIAL STATEMENTS

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

CONTENTS

International Standard on Auditing (ISA) 700 (Redrafted), "The Independent Auditor's Report on General Purpose Financial Statements," should be read in conjunction with [proposed] ISA 200 (Revised and Redrafted), "Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing."

* See footnote 1.

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the independent auditor's report issued as a result of an audit of general purpose financial statements. It also deals with forming an opinion on the financial statements.

2. [Proposed] ISA 705 (Revised and Redrafted), "Modifications to the Opinion in the Independent Auditor's Report" deals with circumstances that may result in a modified opinion, the type of modification required, and how the form and content of the auditor's report is affected in such circumstances. [Proposed] ISA 706 (Revised and Redrafted), "Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor's Report" deals with circumstances when the auditor considers including an Emphasis of Matter paragraph or an Other Matter(s) paragraph in the auditor's report, and the form and placement of such paragraphs.

3. Consistency in the auditor's report, when the audit has been conducted in accordance with International Standards on Auditing, promotes credibility in the global marketplace by making more readily identifiable those audits that have been conducted in accordance with globally recognized standards. It also helps to promote the user's understanding and to identify unusual circumstances when they occur.

Effective Date

4. This ISA is effective for audits of financial statements for periods beginning on or after [date].[1]

Objectives

5. The objectives of the auditor are to:

   (a) Form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and

   (b) Express clearly that opinion through a written report that explains the basis of the opinion.

Definitions

6. For purposes of the ISAs, the following terms have the meanings attributed below:

   (a) General purpose financial statements – Financial statements prepared in accordance with a general purpose framework.

   (b) General purpose framework – A financial reporting framework designed to meet the common financial information needs of a wide range of users.

7. Reference to "financial statements" in this ISA should be read as "general purpose financial statements," and can be to a complete set of financial statements or a single

[1] This date will not be earlier than December 15, 2008.

financial statement.[2]

Requirements

Forming an Opinion on the Financial Statements

8. In forming the auditor's opinion whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework, the auditor shall conclude whether reasonable assurance has been obtained about whether the financial statements taken as a whole are free from material misstatement.

9. The auditor's conclusion shall take into account:

   (a) The auditor's conclusion whether sufficient appropriate audit evidence has been obtained, in accordance with ISA 330 (Redrafted), "The Auditor's Responses to Assessed Risks;"

   (b) The auditor's conclusion whether uncorrected misstatements are material, individually or in aggregate, in accordance with [proposed] ISA 450 (Revised and Redrafted), "Evaluation of Misstatements Identified during the Audit;" and

   (c) The auditor's evaluations required by paragraphs 10-12.

10. The auditor shall evaluate whether the financial statements are prepared and presented, in all material respects, in accordance with the specific requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments. (Ref: Para. A1-A2) In particular, the auditor shall evaluate whether, in view of the specific requirements of the applicable financial reporting framework:

    (a) The financial statements adequately disclose the significant accounting policies selected and applied, and significant interpretations by management of regulatory or legal requirements. In jurisdictions where the applicable financial reporting framework is so codified as to preclude a choice of accounting policies or significant interpretations by management, a reference to the applicable financial reporting framework may suffice;

    (b) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;

    (c) The accounting estimates made by management are reasonable;

    (d) The information presented in the financial statements is relevant, reliable, comparable and understandable;

    (e) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information

2 The requirements of the applicable financial reporting framework determine the form and content of the financial statements and what constitutes a complete set of financial statements.

conveyed in the financial statements, for example, in the case of financial statements prepared and presented in accordance with many general purpose frameworks, the entity's financial position, financial performance and cash flows; and

(f) The terminology used in the financial statements, including their titles, is appropriate.

11. When the financial statements are prepared and presented in accordance with a fair presentation framework, the auditor shall evaluate whether the financial statements achieve fair presentation. The auditor's evaluation shall include consideration of:

(a) The overall presentation, structure and content of the financial statements; and

(b) Whether the financial statements, including the related explanatory notes, faithfully represent the underlying transactions and events in a manner that achieves fair presentation.

12. The auditor shall evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework. (Ref: Para. A3-A11)

Form of Opinion

13. The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework including, in the case of a fair presentation framework, that the financial statements give a true and fair view or are presented fairly, in all material respects, in accordance with the applicable financial reporting framework (see paragraphs 31-32).

14. If the auditor concludes that the financial statements as a whole are materially misstated, or is unable to conclude that the financial statements as a whole are not materially misstated, the auditor shall consider the effect thereof on the opinion in the auditor's report in accordance with [proposed] ISA 705 (Revised and Redrafted). (Ref: Para. A12)

15. When financial statements prepared and presented in accordance with the specific requirements of a fair presentation framework do not achieve fair presentation, the auditor shall discuss the matter with management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved, shall determine whether it is necessary to modify the opinion in the auditor's report in accordance with [proposed] ISA 705 (Revised and Redrafted). (Ref: Para. A13)

16. When the financial statements are prepared and presented in accordance with a compliance framework, the auditor is not required to evaluate whether the financial statements achieve fair presentation. However, in extremely rare circumstances, the auditor may conclude that such financial statements are misleading. In such a case, the auditor shall discuss the matter with management and, depending on how it is resolved, shall determine whether, and how, to deal with it in the auditor's report. (Ref: Para. A14)

Auditor's Report

17. The auditor's report shall be in writing. (Ref: Para. A15-A16)

Auditor's Report for Audits Conducted in Accordance with International Standards on Auditing

Title

18. The auditor's report shall have a title that clearly indicates that it is the report of an independent auditor. (Ref: Para. A17)

Addressee

19. The auditor's report shall be addressed as required by the circumstances of the engagement. (Ref: Para. A18)

Introductory Paragraph

20. The introductory paragraph in the auditor's report shall: (Ref: Para. A19-A20)

    (a) Identify the entity whose financial statements have been audited;

    (b) State that the financial statements have been audited;

    (c) Identify the title of each statement that comprises the financial statements;

    (d) Refer to the summary of significant accounting policies and other explanatory notes; and

    (e) Specify the date or period covered by each financial statement comprising the financial statements.

Management's Responsibility for the Financial Statements

21. The auditor's report shall include a section with the heading "Management's Responsibility for the Financial Statements."

22. In the Management's Responsibility for the Financial Statements section, the auditor's report shall state that management is responsible for the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework and that this responsibility includes: (Ref: Para. A21- A23)

    (a) Designing, implementing and maintaining internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error;

    (b) Selecting and applying appropriate accounting policies; and

    (c) Making accounting estimates that are reasonable in the circumstances.

23. Where the financial statements are prepared in accordance with a fair presentation framework, the statement of management's responsibility for the financial statements shall refer to "the preparation and fair presentation of the financial statements" or "the preparation and presentation of financial statements that give a true and fair view," as

appropriate in the circumstances, instead of "preparation and presentation."

Auditor's Responsibility

24. The auditor's report shall include a section with the heading "Auditor's Responsibility."

25. In the Auditor's Responsibility section, the auditor's report shall state that the responsibility of the auditor is to express an opinion on the financial statements based on the audit. (Ref: Para. A24)

26. The auditor's report shall state that the audit was conducted in accordance with International Standards on Auditing. The auditor's report shall also explain that those standards require that the auditor comply with ethical requirements and that the auditor plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement. (Ref: Para. A25-A26)

27. The auditor's report shall describe an audit by stating that:

    (a) An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements;

    (b) 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 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. In circumstances when the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, the auditor shall omit the phrase that the auditor's consideration of internal control is not for the purpose of expressing an opinion on the effectiveness of internal control; and

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

28. Where the financial statements are prepared in accordance with a fair presentation framework, the description of the audit shall refer to "the entity's preparation and fair presentation of the financial statements" or "the entity's preparation and presentation of financial statements that give a true and fair view," as appropriate in the circumstances, instead of "preparation and presentation."

29. The auditor's report shall state whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

Auditor's Opinion (Ref: Para. A27-A34)

30. The auditor's report shall include a section with the heading "Opinion."

31. When expressing an unmodified opinion on financial statements prepared and presented in accordance with a fair presentation framework, the auditor's opinion shall, unless otherwise required by law or regulation, use one of the following phrases, which are regarded as being equivalent:

    (a) The financial statements give a true and fair view in accordance with the applicable financial reporting framework; or

    (b) The financial statements present fairly, in all material respects, in accordance with the applicable financial reporting framework.

32. When expressing an unmodified opinion on financial statements prepared and presented in accordance with a compliance framework, the auditor's opinion shall be that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

33. When the reference to the applicable financial reporting framework in the auditor's opinion is not to unmodified[3] International Financial Reporting Standards or International Public Sector Accounting Standards, the auditor's opinion shall identify the jurisdiction or country of origin of the framework.

Other Matters

34. Law or regulation may require the auditor, or the auditor may consider it appropriate, to elaborate on matters that provide further explanation of the auditor's responsibilities in the audit of the financial statements or of the auditor's report thereon. Such matters shall be addressed under the heading "Other Matters," which follows the Opinion section. (Ref: Para. A35-A36)

Other Reporting Responsibilities

35. When the auditor addresses other reporting responsibilities in the auditor's report on the financial statements that are in addition to the auditor's responsibility to express the opinion on the financial statements, these other reporting responsibilities shall be addressed in a separate section in the auditor's report following the Opinion section. This separate section shall be sub-titled "Report on Other Legal and Regulatory Requirements," or otherwise as appropriate to the content of the section. (Ref: Para. A37-A38)

36. If the auditor's report contains a separate section on other reporting responsibilities, the headings and statements referred to in paragraphs 20-34 shall be under the sub-title "Report on the Financial Statements." (Ref: Para. A39)

Signature of the Auditor

37. The auditor's report shall be signed. (Ref: Para. A40)

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[3] That is, when it is possible to make an explicit and unreserved statement of compliance with International Financial Reporting Standards (as opposed to the circumstances described in paragraph A9).

Date of the Auditor's Report

38. The auditor's report shall be dated 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. Sufficient appropriate audit evidence shall include evidence that: (Ref: Para. A41-A44)

    (a) All the statements that comprise the financial statements have been prepared; and

    (b) That those with the recognized authority have asserted that they have taken responsibility for them.

Auditor's Address

39. The auditor's report shall name the location in the country or jurisdiction where the auditor practices.

Auditor's Report for Audits Conducted in Accordance with Both International Standards on Auditing and Auditing Standards of a Specific Jurisdiction or Country

40. When the auditor has complied with both International Standards on Auditing and the auditing standards of a specific jurisdiction or country (for purposes of this ISA referred to as "the national auditing standards") in the conduct of the audit, the auditor's report shall refer to International Standards on Auditing in addition to the national auditing standards only if: (Ref: Para. A45-A47)

    (a) There is no conflict between the reporting requirements regarding the auditor's report in International Standards on Auditing and those in the national auditing standards that affects the auditor's opinion or the need to include an Emphasis of Matters paragraph in the particular circumstances; and

    (b) The auditor's report includes, at a minimum, each of the following elements when the auditor uses the layout or wording specified by the national auditing standards:

        (i) A title;

        (ii) An addressee, as required by the circumstances of the engagement;

        (iii) An introductory paragraph that identifies the financial statements audited;

        (iv) A description of management's responsibility for preparing and presenting the financial statements;

        (v) A description of the auditor's responsibility to express an opinion on the financial statements and the scope of the audit, that includes:

        - A reference to International Standards on Auditing and the national auditing standards; and
        - A description of the work an auditor performs in an audit;

        (vi) An opinion paragraph containing an expression of opinion on the financial statements and a reference to the applicable financial reporting framework used to prepare the financial statements (including identifying the country of origin of the financial reporting framework that is not International Financial Reporting Standards or International Public Sector Accounting Standards);

(vii) The auditor's signature;

(viii) The date of the auditor's report; and

(ix) The auditor's address.

41. When the auditor's report refers to both International Standards on Auditing and the national auditing standards, the auditor's report shall identify the jurisdiction or country of origin of the national auditing standards.

Auditor's Report Prescribed by Law or Regulation

42. When the audit is conducted in accordance with International Standards on Auditing and the auditor is required by law or regulation to use a specific layout or wording of the auditor's report, the auditor's report shall refer to International Standards on Auditing only if the conditions in paragraph 40 are met (with references to national standards in paragraph 40 being read as references to the relevant law or regulation, where appropriate), and the auditor's report shall thereby identify such law or regulation. (Ref: Para. A45-A47)

Supplementary Information Presented with the Financial Statements (Ref: Para. A48-A54)

43. Supplementary information that, because of its nature and how it is presented, cannot be clearly differentiated from the audited financial statements, is considered to be an integral part thereof and, accordingly, is covered by the auditor's opinion.

44. The auditor shall evaluate whether supplementary information that is presented together with the audited financial statements (but that is not an integral part thereof) and that is not intended to be covered by the auditor's opinion is clearly differentiated from the audited financial statements. If such supplementary information is not clearly differentiated from the audited financial statements, the auditor shall ask management to change how the unaudited supplementary information is presented. If management refuses to do so, the auditor shall explain in the auditor's report that such information has not been audited.

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Application and Other Explanatory Material

Qualitative Aspects of the Entity's Accounting Practices (Ref: Para. 10)

A1. Management makes a number of judgments about the amounts and disclosures in the financial statements. In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that the cumulative effect of a lack of neutrality, together with the effect of uncorrected misstatements, cause the financial statements as a whole to be materially misstated. Indicators of a lack of neutrality that may affect the auditor's evaluation whether the financial statements as a whole are materially misstated include the following:

- The selective correction of misstatements brought to management's attention during the audit (e.g., correcting misstatements with the effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings).
- Possible management bias in the making of accounting estimates.

A2. [Proposed] ISA 540 (Revised and Redrafted), "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures" addresses possible management bias in making accounting estimates. Indicators of possible management bias do not constitute misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates. They may, however, affect the auditor's evaluation of whether the financial statements as a whole are free from material misstatement.

Description of the Applicable Financial Reporting Framework (Ref: Para. 12)

A3. As explained in [proposed] ISA 200 (Revised and Redrafted), "Overall Objective of the Independent Auditor, and the Conduct of an Audit in accordance with International Standards on Auditing," management is responsible for preparing and presenting the financial statements in accordance with the applicable financial reporting framework and for adequately describing that framework in the financial statements. That description is important because it advises users of the financial statements of the framework on which the financial statements are based.

A4. A description that the financial statements are prepared and presented in accordance with a particular applicable financial reporting framework is appropriate only if the financial statements comply with all the requirements of that framework effective at the date of the financial statements.

A5. A description of the applicable financial reporting framework that contains imprecise qualifying or limiting language (for example, "the financial statements are in substantial compliance with International Financial Reporting Standards") is not an adequate description of that framework as it may mislead users of the financial statements.

Reference to More than One Financial Reporting Framework

A6. In some cases, the financial statements may represent that they are prepared and presented in accordance with two financial reporting frameworks (for example, the national framework and International Financial Reporting Standards). This may be because management is required, or has chosen, to prepare the financial statements in accordance with both frameworks, in which case both are applicable financial reporting frameworks. Such description is appropriate only if the financial statements comply with each of the frameworks individually. To be regarded as being prepared in accordance with both frameworks, the financial statements need to comply with both frameworks simultaneously and without any need for reconciling statements. In practice, simultaneous compliance is unlikely unless the country has adopted the other framework (for example, International Financial Reporting Standards) as its own national financial reporting framework, or has eliminated all barriers to compliance with it.

A7. Financial statements that are prepared and presented in accordance with one financial reporting framework and that contain a note or supplementary statement reconciling the results to those that would be shown under another framework, are not prepared and presented in accordance with that other framework. This is because the financial statements do not include all the information in the manner required by that other framework.

A8. The financial statements may, however, be prepared in accordance with one applicable financial reporting framework and, in addition, describe in the notes to the financial statements the extent to which the financial statements comply with another framework (for example, financial statements prepared and presented in accordance with the national framework that also describe the extent to which they comply with International Financial Reporting Standards). Such description is supplementary financial information and, as discussed in paragraph 43, is considered an integral part of the financial statements and, accordingly, is covered by the auditor's opinion.

Financial Reporting Framework Described by Reference to International Financial Reporting Standards

A9. An authorized or recognized standards setting organization, or relevant law or regulation, may describe the applicable financial reporting framework by reference to International Financial Reporting Standards, even though the framework is such that management cannot make an explicit and unreserved statement of compliance with International Financial Reporting Standards. (Examples of such descriptions include "International Financial Reporting Standards as adopted for use in [country X]" and "International Financial Reporting Standards as modified by banking regulators for the use of banks in [country X]."). In such circumstances, [proposed] International Accounting Standard (IAS) 1, "Presentation of Financial Statements"[4] requires the entity to:

(a) Describe each difference between the basis on which its financial statements are prepared and International Financial Reporting Standards that are applicable to its financial statements; and

(b) Describe how the reported financial position and performance of the entity would have differed if it had complied with International Financial Reporting Standards.

If the framework is described by reference to International Financial Reporting Standards, but the framework does not require the entity to disclose the information in (a) and (b) above and the financial statements do not in fact disclose such information, the description is likely to be misleading if the effect on financial statements of the difference

[4] The proposed amendment to International Accounting Standard (IAS) 1, "Presentation of Financial Statements" will form part of the annual improvements process of the International Accounting Standards Board. The exposure draft of the IASB will be published in October 2007. The proposed amendment to IAS 1 is posted on the IASB website (http://www.iasb.org) as an Invitation to Comment.

between the framework and International Financial Reporting Standards may be significant.

A10. The financial reporting framework may be described without reference to International Financial Reporting Standards if such a description is not required by an authorized or recognized standards setting organization or relevant law or regulation.

A11. Where the applicable financial reporting framework is described by reference to an established financial reporting framework other than International Financial Reporting Standards, considerations similar to those in paragraphs A9-A10 would apply.

Form of Opinion (Ref: Para. 13-16)

A12. In accordance with [proposed] ISA 705 (Revised and Redrafted), the auditor expresses a modified opinion when:

(a) The auditor concludes that, based on the audit evidence obtained, the financial statements are not free from material misstatement; or

(b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements are free from material misstatement.

A13. There may be cases where the financial statements, although prepared and presented in accordance with the specific requirements of a fair presentation framework, do not achieve fair presentation. Where this is the case, management has a responsibility to provide disclosures beyond the specific requirements of the framework or, in extremely rare circumstances, to depart from a specific requirement in the framework to achieve fair presentation of the financial statements, as explained in [proposed] ISA 200 (Revised and Redrafted).

A14. It will be extremely rare for the auditor to consider financial statements that are prepared and presented in accordance with a compliance framework to be misleading if in accordance with ISA 210, "Terms of Audit Engagements," the auditor determined that the framework is acceptable.

Auditor's Report (Ref: Para. 17)

A15. A written report encompasses reports issued in hard copy format and those using an electronic medium.

A16. The Appendix contains illustrations of auditors' reports on general purpose financial statements, incorporating the elements set forth in paragraphs 18-39.

Auditor's Report for Audits Conducted in Accordance with International Standards on Auditing

Title (Ref: Para. 18)

A17. A title indicating the report is the report of an independent auditor, for example, "Independent Auditor's Report," affirms that the auditor has met all of the relevant ethical requirements regarding independence and, therefore, distinguishes the independent auditor's report from reports issued by others.

Addressee (Ref: Para. 19)

A18. Laws or regulations often specify to whom the auditor's report is to be addressed in that particular jurisdiction. The auditor's report is normally addressed to those for whom the report is prepared, often either to the shareholders or to those charged with governance of the entity whose financial statements are being audited.

Introductory Paragraph (Ref: Para. 20)

A19. The introductory paragraph states, for example, that the auditor has audited the accompanying financial statements of the entity, which comprise [state the title of each financial statement comprising the complete set of financial statements required by the applicable financial reporting framework (or, where applicable, the title of the single financial statement), specifying the date or period covered by each financial statement] and referring to the summary of significant accounting policies and other explanatory notes. In addition, when the auditor is aware that the financial statements will be included in a document that contains other information, such as an annual report, the auditor may consider, if the form of presentation allows, identifying the page numbers on which the financial statements are presented. This helps users to identify the financial statements to which the auditor's report relates.

A20. In the case of a complete set of financial statements, the auditor's opinion covers the complete set of financial statements as defined by the applicable financial reporting framework. For example, in the case of financial statements prepared in accordance with many general purpose frameworks, this includes: a balance sheet, an income statement, a statement of changes in equity, a cash flow statement, and a summary of significant accounting policies and other explanatory notes. In some jurisdictions additional information might also be considered to be an integral part of the financial statements.

Management's Responsibility for the Financial Statements (Ref: Para. 22)

A21. [Proposed] ISA 200 (Revised and Redrafted) explains the premises, relating to management's responsibilities, on which an audit is conducted. Management is responsible for preparing and presenting the financial statements in accordance with the applicable financial reporting framework. For example, in the case of many general purpose frameworks, management is responsible for preparing financial statements that fairly present the financial position, financial performance and cash flows of the entity in accordance with those frameworks. To fulfill this responsibility, management designs and implements internal control[5] to prevent or to detect and correct misstatements, whether due to fraud or error, in order to ensure the reliability of the entity's financial reporting. The preparation of the financial statements requires management to exercise judgment in making accounting estimates that are reasonable in the circumstances, as well as to select

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5 In some jurisdictions, law or regulation prescribing management's responsibilities may specifically refer to a responsibility for the adequacy of accounting books and records, or accounting system. As books, records and systems are an integral part of internal control (as defined in ISA 315 (Redrafted), "Identifying and Assessing the Risks of Material Misstatements Through Understanding the Entity and Its Environment"), no specific reference is made to them in paragraph 22 for the description of management's responsibilities.

and apply appropriate accounting policies. These judgments are made in the context of the applicable financial reporting framework.

A22. There may be circumstances when it is appropriate for the auditor to add to the description of management's responsibilities in paragraph 22 to reflect additional responsibilities that are relevant to preparing and presenting the financial statements in the context of the particular jurisdiction or the nature of the entity.

A23. The term management has been used in this ISA to describe those responsible for preparing and presenting the financial statements. Other terms may be appropriate depending on the legal framework in the particular jurisdiction. For example, in some jurisdictions, the appropriate reference may be to those charged with governance (for example, the directors).

Auditor's Responsibility (Ref: Para. 26)

A24. The auditor's report states that the auditor's responsibility is to express an opinion on the financial statements based on the audit in order to contrast it to management's responsibility for preparing and presenting the financial statements.

A25. The reference to the standards used conveys to the users of the auditor's report that the audit has been conducted in accordance with established standards.

A26. In accordance with [proposed] ISA 200 (Revised and Redrafted), the auditor does not represent compliance with International Standards on Auditing unless the auditor has complied with all of the International Standards on Auditing relevant to the audit.

Auditor's Opinion (Ref: Para. 30-33)

"Give a true and fair view" or "present fairly, in all material respects"

A27. Whether the phrase "give a true and fair view" or the phrase "present fairly, in all material respects," is used in any particular jurisdiction is determined by the law or regulation governing the audit of financial statements in that jurisdiction, or by generally accepted practice in that jurisdiction. Where law or regulation requires the use of different wording, the auditor's responsibility to evaluate the fair presentation of financial statements prepared and presented in accordance with a fair presentation framework is the same. ISA 210 deals with circumstances where law or regulation prescribes wording for the auditor's opinion that differs significantly from the wording described in this ISA.

Description of information that the financial statements present

A28. In the case of financial statements prepared and presented in accordance with a fair presentation framework, the auditor's opinion states that the financial statements give a true and fair view of or present fairly, in all material respects, the information that the financial statements are designed to present (which is determined by the financial reporting framework). For example, in the case of a complete set of financial statements, the auditor's opinion states that the financial statements give a true and fair view of or present fairly, in all material respects, the financial position of the entity as at the end of the period and the entity's financial performance and cash flows for the period then ended in accordance with [identify the applicable financial reporting framework, for example, International Financial Reporting Standards].

Description of the applicable financial reporting framework and how it may affect the auditor's opinion

A29. The auditor's opinion identifies the financial reporting framework on which the financial statements are based to advise users of the auditor's report of the context in which the auditor's opinion is expressed. The applicable financial reporting framework is identified in such terms as:

"… in accordance with International Financial Reporting Standards" or

"… in accordance with accounting principles generally accepted in Country X …"

A30. When the applicable financial reporting framework encompasses financial reporting standards and legal or regulatory requirements, the framework is identified in such terms as "… in accordance with International Financial Reporting Standards and the requirements of Country X Corporations Act." ISA 210 deals with circumstances where there are conflicts between the financial reporting standards and the legislative or regulatory requirements.

A31. As indicated in paragraph A6, the financial statements may be prepared and presented in accordance with two financial reporting frameworks, which are therefore both applicable financial reporting frameworks. Accordingly, each framework is considered separately when forming the auditor's opinion on the financial statements, and the auditor's opinion in accordance with paragraphs 31 and 32 refers to both frameworks as follows:

(a) If the financial statements comply with each of the frameworks individually, two opinions are expressed: that is that the financial statements are prepared and presented in accordance with one of the applicable financial reporting frameworks (for example, the national framework) and a separate opinion that the financial statements are prepared and presented in accordance with the other applicable financial reporting framework (for example, International Financial Reporting Standards).

(b) If the financial statements comply with one of the frameworks but fail to comply with the other framework, an unmodified opinion can be given that the financial statements are prepared and presented in accordance with the one framework (for example, the national framework) but a modified opinion given with regard to the other framework (for example, International Financial Reporting Standards) in accordance with [proposed] ISA 705 (Revised and Redrafted).

A32. As indicated in paragraph A8, the financial statements may represent compliance with the applicable financial reporting framework and, in addition, disclose the extent to which they comply with a framework other than the applicable financial reporting framework.

(a) If the financial statements fail to comply with the applicable financial reporting framework because the disclosure as to the compliance with the other framework is misleading, a modified opinion would be expressed in accordance with [proposed]

ISA 705 (Revised and Redrafted).

(b) If the disclosure is not misleading, the auditor may nevertheless decide to add an Emphasis of Matter paragraph in accordance with [proposed] ISA 706 (Revised and Redrafted), drawing attention to the disclosure, if such disclosure is significant.

A33. As indicated in paragraph A9, an authorized or recognized standards setting organization, or law or regulation, may describe the applicable financial reporting framework by reference to International Financial Reporting Standards, even though the framework is such that management cannot make an explicit and unreserved statement that the applicable financial reporting framework complies with International Financial Reporting Standards. In such circumstances:

(a) If the financial statements do not provide sufficient disclosure of the differences and the auditor concludes that they are misleading (see paragraph A9), the auditor's opinion would be modified in accordance with [proposed] ISA 705 (Revised and Redrafted) as appropriate in the circumstances.

(b) If the financial statements do provide sufficient disclosure of the difference and are therefore not misleading (see paragraph A9), the auditor may nevertheless decide to add an Emphasis of Matter paragraph in accordance with [proposed] ISA 706 (Revised and Redrafted) if the auditor judges the differences between the applicable financial reporting framework and International Financial Reporting Standards to be of such importance to users' understanding of the financial statements as a whole that it would be appropriate to draw their attention to it.

(c) In some cases, financial statements prepared and presented in accordance with an applicable financial reporting framework described by reference to International Financial Reporting Standards may also comply with all the requirements of International Financial Reporting Standards applicable in the circumstances. If the financial statements represent, and the auditor concludes, that the financial statements comply with both the applicable financial reporting framework and International Financial Reporting Standards individually, the auditor may express two opinions, that is that the financial statements are prepared and presented in accordance with the applicable financial reporting framework and a separate opinion that the financial statements are prepared and presented in accordance with International Financial Reporting Standards.

A34. Where the applicable financial reporting framework is described by reference to an established financial reporting framework other than International Financial Reporting Standards, considerations similar to those in paragraph A33 would apply.

Other Matters (Ref: Para. 34)

A35. Where relevant, one or more sub-headings may be used that describe the content of the other matters paragraphs.

A36. [Proposed] ISA 706 (Revised and Redrafted) deals with other circumstances in which the inclusion of an Other Matter(s) paragraph in the auditor's report may be appropriate.

Other Reporting Responsibilities (Ref: Para. 35-36)

A37. In some jurisdictions, the auditor may have additional responsibilities to report on other matters that are supplementary to the auditor's responsibility to express an opinion on the financial statements. For example, the auditor may be asked to report certain matters if they come to the auditor's attention during the course of the audit of the financial statements. Alternatively, the auditor may be asked to perform and report on additional specified procedures, or to express an opinion on specific matters, such as the adequacy of accounting books and records. Auditing standards in the specific jurisdiction or country often provide guidance on the auditor's responsibilities with respect to specific additional reporting responsibilities in that jurisdiction or country.

A38. In some cases, the relevant law or regulation may require or permit the auditor to report on these other responsibilities within the auditor's report on the financial statements. In other cases, the auditor may be required or permitted to report on them in a separate report.

A39. These other reporting responsibilities are addressed in a separate section of the auditor's report in order to clearly distinguish them from the auditor's responsibilities for and opinion on the financial statements. Where relevant, this section may contain sub-heading(s) that describe(s) the content of the other reporting responsibility paragraph(s).

Signature of the Auditor (Ref: Para. 37)

A40. The auditor's signature is either in the name of the audit firm, the personal name of the auditor or both, as appropriate for the particular jurisdiction. In addition to the auditor's signature, in certain jurisdictions, the auditor may be required to declare in the auditor's report the auditor's professional accountancy designation or the fact that the auditor or firm, as appropriate, has been recognized by the appropriate licensing authority in that jurisdiction.

Date of the Auditor's Report (Ref: Para. 38)

A41. The date of the auditor's report informs the user of the auditor's report that the auditor has considered the effect of events and transactions of which the auditor became aware and that occurred up to that date. The auditor's responsibility for events and transactions after the date of the auditor's report is addressed in [proposed] ISA 560 (Redrafted), "Subsequent Events."

A42. Since the auditor's opinion is provided on the financial statements and the financial statements are the responsibility of management, the auditor is not in a position to conclude that sufficient appropriate audit evidence has been obtained until evidence is obtained that all the statements that comprise the financial statements have been prepared and management has accepted responsibility for them.

A43. In some jurisdictions, the law or regulation identifies the individuals or bodies (for example, the directors) that are responsible for concluding that all the statements that comprise the financial statements have been prepared, and specifies the necessary approval process. In such cases, evidence is obtained of that approval before dating the report on the financial statements.[6] In other jurisdictions, however, the approval process is not prescribed in law or regulation. In such cases, the procedures the entity follows in preparing and finalizing its financial statements in view of its management and governance structures is considered in order to identify the individuals or body with the authority to conclude that all the statements that comprise the financial statements, including the related notes, have been prepared.

A44. In some jurisdictions, final approval of the financial statements by shareholders is required before the financial statements are issued publicly. In these jurisdictions, final approval by shareholders is not necessary for the auditor to conclude that sufficient appropriate audit evidence has been obtained. The date of approval of the financial statements for purposes of International Standards on Auditing is the earlier date on which those with the recognized authority determine that all the statements that comprise the financial statements have been prepared.

Auditor's Report for Audits Conducted in Accordance with Both International Standards on Auditing and Auditing Standards of a Specific Jurisdiction or Country or Auditor's Report Prescribed by Law or Regulation (Ref: Para. 40-42)

A45. [Proposed] ISA 200 (Revised and Redrafted) explains that the auditor may be required to comply with other professional, legal or regulatory requirements in addition to International Standards on Auditing. Where this is the case, the auditor may be obliged to use a layout or wording in the auditor's report that differs from that described in this ISA. As explained in paragraph 3, consistency in the auditor's report, when the audit has been conducted in accordance with International Standards on Auditing, promotes credibility in the global marketplace by making more readily identifiable those audits that have been conducted in accordance with globally recognized standards. When the differences relate only to the layout and wording of the auditor's report, the auditor's report may refer to International Standards on Auditing only if the auditor's report includes, at a minimum, each of the elements identified in paragraph 40(b). Accordingly, in such circumstances the auditor is considered to have complied with the reporting requirements of International Standards on Auditing, even when the layout and wording used in the auditor's report are specified by the national auditing standards or legal or regulatory reporting requirements. Where specific requirements in a particular jurisdiction do not conflict with International Standards on Auditing, adoption of the layout and wording used in this ISA assists users of the auditor's report more readily to recognize the auditor's report as a report on an audit conducted in accordance with International Standards on Auditing.

A46. The auditor may refer to the audit having been conducted in accordance with both International Standards on Auditing as well as the national auditing standards when the auditor complies with each of the International Standards on Auditing relevant to the audit and performs any additional audit procedures necessary to comply with the relevant national auditing standards.

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6 In rare circumstances, law or regulation also identifies the point in the financial statement reporting process at which the audit is expected to be complete.

A47. A reference to both International Standards on Auditing and the national auditing standards or legal or regulatory reporting requirements is not appropriate if there is a conflict between the reporting requirements regarding the auditor's report in International Standards on Auditing and those in the national auditing standards or legal or regulatory reporting requirements that affects the auditor's opinion or the need to include an Emphasis of Matter paragraph in the particular circumstances. For example, some national auditing standards prohibit the auditor from including an Emphasis of Matter paragraph to highlight a going concern problem, whereas [proposed] ISA 570 (Redrafted), "Going Concern" requires the auditor to add an Emphasis of Matter paragraph in such circumstances. In such a case, the auditor's report refers only to the auditing standards (either International Standards on Auditing or the national auditing standards) in accordance with which the auditor has complied with the reporting requirements.

Supplementary Information Presented with the Financial Statements (Ref: Para. 43-44)

A48. In some circumstances, the entity may be required by law, regulation or standards, or may voluntarily choose, to present together with the financial statements supplementary information that is not required by the applicable financial reporting framework. For example, supplementary information might be presented to enhance a user's understanding of the applicable financial reporting framework or to provide further explanation of specific financial statement items. Such information is normally presented in either supplementary schedules or as additional notes.

A49. The auditor's opinion is considered to cover supplementary information that cannot be clearly differentiated from the financial statements because of its nature and how it is presented. For example, the auditor's opinion covers notes or supplementary schedules that are cross-referenced from the financial statements. This would also be the case when the notes to the financial statements include an explanation of the extent to which the financial statements comply with another financial reporting framework.

A50. Supplementary information that is covered by the auditor's opinion does not need to be specifically referred to in the introductory paragraph of the auditor's report when the reference to the notes in the description of the statements that comprise the financial statements in the introductory paragraph is sufficient.

A51. Law or regulation may not require the supplementary information to be audited and management may not ask the auditor to include the supplementary information within the scope of the audit of the financial statements.

A52. The auditor's evaluation whether unaudited supplementary information is presented in a manner that could be construed as being covered by the auditor's opinion includes, for example, where that information is presented in relation to the financial statements and any audited supplementary information, and whether it is clearly labeled as "unaudited."

A53. Management could change the presentation of unaudited supplementary information that could be construed as being covered by the auditor's opinion, for example, by:

- Removing any cross references from the financial statements to unaudited supplementary schedules or unaudited notes because the demarcation between the audited and unaudited information would not be sufficiently clear.

- Placing the unaudited supplementary information outside of the financial statements or, if that is not possible in the circumstances, at a minimum place the unaudited notes together at the end of the required notes to the financial statements and clearly label them as unaudited. Unaudited notes that are intermingled with the audited notes can be misinterpreted as being audited.

A54. The fact that supplementary information is unaudited does not relieve the auditor of the responsibility to read that information to identify material inconsistencies with the audited financial statements. The auditor's responsibilities with respect to unaudited supplementary information are consistent with those described in [proposed] ISA 720 (Redrafted), "The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements."

Appendix

(Ref: Para. A16)

Illustrations of Auditors' Reports on General Purpose Financial Statements

- Illustration 1: An auditor's report on a complete set of financial statements prepared in accordance with a fair presentation framework designed to meet the common financial information needs of a wide range of users (e.g., International Financial Reporting Standards).
- Illustration 2: An auditor's report on a complete set of financial statements prepared in accordance with a compliance framework designed to meet the common financial information needs of a wide range of users.
- Illustration 3: An auditor's report on a single financial statement prepared in accordance with a fair presentation framework designed to meet the common financial information needs of a wide range of users.

<u>Illustration 1:</u>

Circumstances include the following:

- **Audit of a complete set of financial statements.**
- **The financial statements are prepared for a general purpose by the management of the entity in accordance with International Financial Reporting Standards.**
- **In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law.**

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Report on the Financial Statements[7]

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

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation[8] of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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 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

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

8 Depending on the circumstances, this sentence may read: "Management is responsible for the preparation and presentation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards."

relevant to the entity's preparation and fair presentation[9] 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.[10] 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 of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

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

10 In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances." In the case of footnote 9, this sentence may read: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and presentation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances."

<u>Illustration 2:</u>

Circumstances include the following:

- **Audit of a complete set of financial statements required by law or regulation.**
- **The financial statements are prepared for a general purpose by the management of the entity in accordance with the Financial Reporting Framework (XYZ Law) of Country X (i.e., a financial reporting framework, encompassing law or regulation, designed to meet the common financial information needs of a wide range of users, but which is not a fair presentation framework).**

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

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

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and presentation of these financial statements in accordance with XYZ Law of Country X. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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 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 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.[11] An audit also

[11] In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and

includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the 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 of ABC Company for the year ended December 31, 20X1 are prepared, in all material respects, in accordance with XYZ Law of Country X.

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances."

<u>Illustration 3:</u>

Circumstances include the following:

- **Audit of a balance sheet (i.e., a single financial statement).**
- **The balance sheet has been prepared by the management of the entity in accordance with the requirements of the Financial Reporting Framework in Country X relevant to preparing and presenting a balance sheet (for purposes of this illustration a fair presentation framework designed to meet the common financial information needs of a wide range of users).**

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

We have audited the accompanying balance sheet of ABC Company as at December 31, 20X1 and a summary of significant accounting policies and other explanatory notes (together "the financial statement").

Management's Responsibility for the Financial Statement

Management is responsible for the preparation and fair presentation of this financial statement in accordance with those requirements of the Financial Reporting Framework in Country X relevant to preparing and presenting such a financial statement. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the financial statement that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial statement 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 whether the financial statement is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statement. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statement, 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 statement 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.[12] An audit also includes

[12] In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statement, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair

evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, if any, made by management, as well as evaluating the overall presentation of the financial statement.

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 statement presents fairly, in all material respects, the financial position of ABC Company as at December 31, 20X1 in accordance with those requirements of the Financial Reporting Framework in Country X relevant to preparing and presenting such a financial statement.

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

presentation of the financial statement in order to design audit procedures that are appropriate in the circumstances."

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International
Auditing
and Assurance
Standards Board

Exposure Draft
July 2007
Comments are requested by November 30, 2007

Proposed Redrafted International Standard on Auditing

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

International Federation of Accountants

REQUEST FOR COMMENTS

The International Auditing and Assurance Standards Board (IAASB), an independent standard-setting body within the International Federation of Accountants (IFAC), approved the exposure draft of proposed International Standard on Auditing (ISA) 705 (Revised and Redrafted), "Modifications to the Opinion in the Independent Auditor's Report" for publication in July 2007. The proposed ISA may be modified in light of comments received before being issued in final form.

Please submit your comments, preferably by e-mail, so that they will be received by **November 30, 2007**. All comments will be considered a matter of public record. Comments should be addressed to:

International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, New York 10017 USA

Comments should be emailed to Edcomments@ifac.org. They may also be faxed to +1-212-286-9570 or mailed to the above address.

Copies of the exposure drafts may be downloaded free-of-charge from the IFAC website at http://www.ifac.org.

CONTENTS

EXPLANATORY MEMORANDUM

Introduction

This memorandum provides background to proposed International Standard on Auditing (ISA) 705 (Revised and Redrafted), "Modifications to the Opinion in the Independent Auditor's Report." The proposed ISA has been redrafted in accordance with conventions agreed by the International Auditing and Assurance Standards Board (IAASB) to be applied to all ISAs. The IAASB approved the proposed redrafted ISA for exposure in July 2007.

Background

When the IAASB undertook to revise the original ISA 700, "The Auditor's Report on Financial Statements," it agreed to restrict the revision to engagements where the auditor is able to express an unmodified opinion on the financial statements and no other modifications to the auditor's report are necessary. To facilitate this revision, the standards and guidance on modifications to the auditor's report (including Emphasis of Matter paragraphs (EOMs)) in the original ISA 700 were moved to a new ISA, i.e., ISA 701, "Modifications to the Independent Auditor's Report," which was approved in December 2004. The IAASB then undertook to revise ISA 701 to enhance the standards and guidance on modifications to the auditor's opinion and EOMs, as well as increase consistency in reporting among jurisdictions.

The project to revise ISA 701 led to the issue of an exposure draft in March 2005 of two separate standards, proposed ISA 705 (Revised), "Modifications to the Opinion in the Independent Auditor's Report" and proposed ISA 706 (Revised), "Emphasis of Matter Paragraphs and Other Matters Paragraphs in the Independent Auditor's Report."

In July 2006, the IAASB approved "close off" documents of ISA 705 (Revised) and ISA 706 (Revised) in the "old style" (i.e., following the IAASB's current drafting conventions). The close off documents incorporate the changes based on the comments received on the March 2005 exposure draft, and form the basis for the proposed ISA 705 (Revised and Redrafted) and proposed ISA 706 (Revised and Redrafted).

The Basis for Conclusions: ISA 705 (Revised) and related close off document are available on the IAASB website at http://www.ifac.org/Guidance/EXD-Details.php?EDID=0091. They are referenced here for information purposes only and do not form part of the exposure draft.

The conventions used by the IAASB in redrafting the close off document of ISA 705 (Revised), and the authority and obligation attaching to those conventions, are established in proposed ISA 200 (Revised and Redrafted), "Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing" approved by the IAASB as an exposure draft in April 2007, and in the amended "Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services"[1] (Preface) approved by the IAASB in September 2006.

[1] The amended Preface can be accessed at http://web.ifac.org/download/IAASB_Preface.pdf. Proposed ISA 200 (Revised and Redrafted) can be accessed at http://www.ifac.org/Guidance/EXD-Details.php?EDID=0079.

Effective Date

The current timetable envisages that all ISAs will have been revised and redrafted, or redrafted only, by late 2008 and the IAASB has provisionally agreed that the complete set of ISAs will be effective for audits of financial statements for periods beginning on or after December 15, 2008. This date will depend on satisfactory progress being made, and will be amended to a later date should that prove necessary. The IAASB believes that it is in the interests of auditors and others who use the ISAs that the ISAs should be released as soon as they are approved so as to facilitate their implementation.

Significant Matter

Definition of Pervasive

As the clarity redrafting conventions give more prominence to definitions, the IAASB agreed that greater clarity would be achieved if a definition of the term "pervasive" is included in proposed ISA 705 (Revised and Redrafted). The definition is based on the description of when the matter(s) giving rise to a modification of the auditor's opinion with regard to material misstatements or the inability of the auditor to obtain sufficient appropriate audit evidence is (are) pervasive. This description can be found in the explanatory material in paragraphs 9-12 of the close off document of ISA 705 (Revised), and the application and other explanatory material in paragraphs A11-A13 of proposed ISA 705 (Revised and Redrafted).

Guide for Respondents

The IAASB is seeking comments **only** on changes resulting from applying the clarity drafting conventions, including the matter discussed above, and their effect on the content of the close off document of ISA 705 (Revised). Respondents are asked to respond in particular to the following questions:

1. Is the objective to be achieved by the auditor, stated in the proposed redrafted ISA, appropriate?
2. Have the criteria identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and reporting, and the use of professional judgment by auditors?[2]

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[2] The IAASB has identified the following criteria for determining the requirements of a Standard:

- The requirement is necessary to achieve the objective stated in the Standard;
- The requirement is expected to be applicable in virtually all engagements to which the Standard is relevant; and
- The objective stated in the Standard is unlikely to have been met by the requirements of other Standards.

In determining the requirements of a Standard, the IAASB will consider whether the requirements are proportionate to the importance of the subject matter of the Standard in relation to the overall objective of the engagement.

The criteria, which are intended only to assist the IAASB in appropriately and consistently determining requirements, may be refined as further experience is gained.

Recognizing that the final ISA will apply to audits of all sizes and in all sectors of the economy, the IAASB is also interested in comments on matters set out below.

- *Special Considerations in the Audit of Small Entities*—Respondents are asked to comment whether, in their opinion, considerations in the audit of small entities have been dealt with appropriately in the proposed redrafted ISA.
- *Special Considerations in the Audit of Public Sector Entities*—Respondents are asked to comment whether, in their opinion, special considerations in the audit of public sector entities have been dealt with appropriately in the proposed redrafted ISA.
- *Developing Nations*—Recognizing that many developing nations have adopted or are in the process of adopting the ISAs, the IAASB invites respondents from these nations to comment, in particular, on any foreseeable difficulties in applying the proposed redrafted ISA in a developing nation environment.
- *Translations*—Recognizing that many respondents intend to translate the final ISAs for adoption in their own environments, the IAASB welcomes comment on potential translation issues noted in reviewing the proposed redrafted ISA.

Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in the exposure draft, it will be helpful for the IAASB to be made aware of this view.

Respondents are also invited to comment on any undue costs, set against the benefits of more consistent auditor performance, arising from the fact that the proposed redrafted ISA includes requirements that would previously have been guidance under the old drafting conventions, as in the close off document of ISA 705 (Revised) (see below). In commenting on this matter, respondents should bear in mind the criteria that the IAASB has applied in redrafting the proposed ISA (see footnote 2) and the fact that the IAASB is seeking to clarify that there was some guidance in extant ISAs that was more in the nature of requirements and would already have been followed by many auditors.

Supplement to the Exposure Draft

To assist respondents in tracking changes, IAASB staff has prepared an analysis of the decisions that have been made by the IAASB with respect to the treatment of the present tense in the explanatory paragraphs of the close off document of ISA 705 (Revised). This analysis also demonstrates how the material in the close off document has been reflected in the proposed redrafted ISA. In particular, the analysis:

- Identifies existing sentences in the present tense and whether they are now treated as a requirement or as application material;
- Maps the material of the close off document to the proposed redrafted ISA; and
- Identifies explanatory material that is proposed to be eliminated or repositioned as a result of redrafting.

These staff-prepared mapping documents are available on the IAASB website at http://www.ifac.org/Guidance/EXD-Details.php?EDID=0091. They are for information purposes only and do not form part of the exposure draft.

To be considered, responses should be emailed to Edcomments@ifac.org. They may also be faxed to +1-212-286-9570 or mailed to 545 Fifth Avenue, 14th Floor, New York, NY 10017, USA. They should be received by **November 30, 2007**.

PROPOSED INTERNATIONAL STANDARD ON AUDITING 705

(REVISED AND REDRAFTED)

MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT

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

CONTENTS

* See footnote 1.

International Standard on Auditing (ISA) 705 (Revised and Redrafted), "Modifications to the Opinion in the Independent Auditor's Report," should be read in conjunction with [proposed] ISA 200 (Revised and Redrafted), "Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing."

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's responsibility to issue an appropriate report in circumstances when a modification to the auditor's opinion on the financial statements is required.

2. The requirements and guidance in this ISA are established in the context of engagements to report on general purpose financial statements prepared and presented in accordance with a fair presentation framework. However, in the context of an engagement to report on special purpose financial statements or specific elements, accounts or items of a financial statement, or when the applicable financial reporting framework is a compliance framework, these requirements and guidance equally apply, adapted as necessary.

3. This ISA does not apply to engagements covered by [proposed] ISA 805 (Revised and Redrafted), "Engagements to Report on Summary Financial Statements," which establishes requirements and provides guidance when the auditor modifies the opinion on summary financial statements derived from financial statements audited by the auditor.

Types of Modified Opinions

4. This ISA establishes three types of modified opinions, namely, a qualified opinion, an adverse opinion, and a disclaimer of opinion. The decision regarding which type of modified opinion is appropriate depends upon:

   (a) The nature of the matter giving rise to the modification, i.e., whether the financial statements are materially misstated or whether there is an inability to obtain sufficient appropriate audit evidence; and

   (b) The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.

5. The table below illustrates how the auditor's judgment about the nature of the matter giving rise to the modification, and the pervasiveness of its effects or possible effects on the financial statements, affects the type of opinion to be expressed.

Nature of Matter Giving Rise to the Modification	*Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements*	
	Material but not Pervasive	*Material and Pervasive*
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

Effective Date

6. This ISA is effective for audits of financial statements for periods beginning on or after [date].[1]

Objective

7. The objective of the auditor is to express clearly an appropriate modified opinion on the financial statements that is necessary:

   (a) When the auditor concludes that the financial statements are not free from material misstatement; or

   (b) When the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements are free from material misstatement.

Definition

8. For purposes of the ISAs, the following term has the meaning attributed below:

   Pervasive – in the context of misstatements or an inability to obtain sufficient appropriate audit evidence, the term pervasive is used to describe the effects or possible effects on the financial statements of a matter that, in the auditor's judgment, are not confined to specific elements, accounts or items of the financial statements, or, if confined, represent or could represent a substantial proportion of the financial statements.

Requirements

Circumstances when a Modification to the Auditor's Opinion is Required

9. The auditor shall modify the opinion in the auditor's report when:

   (a) The auditor concludes that, based on the audit evidence obtained, the financial statements are not free from material misstatement; or (Ref: Para. A1-A5)

   (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements are free from material misstatement. (Ref: Para. A6-A10)

Determining the Type of Modification to the Auditor's Opinion

Qualified Opinion

10. The auditor shall express a qualified opinion:

    (a) When the auditor concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or

    (b) When the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the possible effects on the financial statements of that inability are material but not pervasive.

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[1] This date will not be earlier than December 15, 2008.

Adverse Opinion

11. The auditor shall express an adverse opinion when the auditor concludes that misstatements, that are material individually or in the aggregate, are pervasive to the financial statements. (Ref: Para. A11-A12)

Disclaimer of Opinion

12. The auditor shall disclaim an opinion on the financial statements when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the possible effects on the financial statements of that inability are both material and pervasive. (Ref: Para. A13-A14)

Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence due to a Management-imposed Limitation After the Auditor has Accepted the Engagement

13. If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit which the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request the removal of the limitation.

14. If management refuses the auditor's request to remove a limitation that management has imposed on the scope of the audit, the auditor shall communicate the matter with those charged with governance.

15. When a limitation on the scope of the audit imposed by management is not removed, the auditor shall determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence on which to base an unmodified opinion. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:

    (a) If the possible effects of the scope limitation are material but not pervasive to the financial statements, the auditor shall qualify the opinion; or

    (b) If the possible effects of the scope limitation are both material and pervasive to the financial statements so that a qualification of the opinion would be inadequate to communicate the gravity of the situation:

        (i) The auditor shall resign from the audit; or (Ref: Para. A15)

        (ii) If resignation from the audit before issuing the auditor's report is not practicable or possible, the auditor shall disclaim an opinion. (Ref: Para. A16)

16. If the auditor concludes that resignation from the audit is necessary because of a scope limitation imposed by management, before resigning, the auditor shall communicate to those charged with governance any matters of which the auditor has become aware that would have given rise to a modification of the opinion regarding misstatements identified during the audit. (Ref: Para. A17)

Prohibition on Issuing a Piecemeal Opinion

17. If the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements as a whole, the auditor shall not express an unmodified opinion on one or more specific elements, accounts or items of the financial statements in the same report and with respect to the same applicable financial reporting framework (a "piecemeal opinion"). (Ref: Para. A18-A20)

Form and Content of the Auditor's Report when the Opinion is Modified

Basis for Modification Paragraph

18. When the auditor modifies the opinion on the financial statements, the auditor shall, in addition to the specific elements required by [proposed] ISA 700 (Redrafted), "The Independent Auditor's Report on General Purpose Financial Statements," include a paragraph in the auditor's report that provides a description of the matter giving rise to the modification. The auditor shall place this paragraph immediately before the opinion paragraph in the auditor's report and use the heading "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate. (Ref: Para. A21)

19. If there is a material misstatement of the financial statements that relates to specific amounts of the financial statements (including quantitative disclosures), the auditor shall include in the basis for modification paragraph a description and quantification of the financial effects of the misstatement, unless impracticable. If it is not practicable to quantify the financial effects, the auditor shall so state in the basis for modification paragraph. (Ref: Para. A22)

20. If there is a material misstatement of the financial statements that relates to narrative disclosures, the auditor shall include in the basis for modification paragraph an explanation of how the disclosures are misstated.

21. If there is a material misstatement of the financial statements that relates to the non-disclosure of information required to be disclosed, the auditor shall describe in the basis for modification paragraph the nature of the omitted information and, unless prohibited by law or regulation, include the omitted disclosures, provided it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information. (Ref: Para. A23-A24)

22. If the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor shall include in the basis for modification paragraph the reasons for that inability.

23. Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the auditor shall describe in the basis for modification paragraph the reasons for any other matters that would have required a modification to the opinion, and the effects thereof. (Ref: Para. A25)

Opinion Paragraph

24. When the auditor modifies the audit opinion, the auditor shall use the heading "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the opinion paragraph. (Ref: Para. A26, A28-A29)

25. When the auditor expresses a qualified opinion, the auditor shall state in the opinion paragraph that, in the auditor's opinion, except for the effects of the matter(s) described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view (or "present fairly, in all material respects") in accordance with the applicable financial reporting framework. When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase "except for the possible effects of the matter(s) ..." for the modified opinion. (Ref: Para. A27)

26. When the auditor expresses an adverse opinion, the auditor shall state in the opinion paragraph that, in the auditor's opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion paragraph, the financial statements do not give a true and fair view (or "do not present fairly") in accordance with the applicable financial reporting framework.

27. When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall state in the opinion paragraph that, because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion paragraph, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion and, accordingly, the auditor does not express an opinion on the financial statements.

Description of Auditor's Responsibility when the Auditor Expresses a Qualified or Adverse Opinion

28. When the auditor expresses a qualified or adverse opinion, the auditor shall amend the description of the auditor's responsibility to state that the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's modified audit opinion.

Description of Auditor's Responsibility when the Auditor Disclaims an Opinion

29. When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the introductory paragraph of the auditor's report to state that the auditor was engaged to audit the financial statements. The auditor shall also amend the description of the auditor's responsibility and the description of the scope of the audit to state only the following: "Our responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with International Standards on Auditing. Because of the matter(s) described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion."

Communication with Those Charged with Governance

30. When the auditor expects to modify the opinion in the auditor's report, the auditor shall communicate with those charged with governance the circumstances that lead to the expected modification and the proposed wording of the modification. (Ref: Para. A30)

***

Application and Other Explanatory Material

Nature of Material Misstatements (Ref: Para. 9(a))

A1. A material misstatement of the financial statements may arise in relation to:

(a) The appropriateness of the selected accounting policies;

(b) The application of the selected accounting policies; or

(c) The appropriateness or adequacy of disclosures in the financial statements.

Appropriateness of the Selected Accounting Policies

A2. In relation to the appropriateness of the accounting policies management has selected, material misstatements of the financial statements may arise when:

(a) The selected accounting policies are not consistent with the applicable financial reporting framework;

(b) The selected accounting policies are not appropriate in the circumstances and, accordingly, the overall presentation of, and disclosures in, the financial statements are not consistent with the auditor's understanding of the entity and its environment; or

(c) Because of the accounting policies selected by management, the financial statements, including the related explanatory notes, do not faithfully represent the underlying transactions and events in a manner that achieves fair presentation.

A3. Financial reporting frameworks often contain requirements for the accounting for, and disclosure of, changes in accounting policies. Where the entity has changed its selection of significant accounting policies, a material misstatement of the financial statements may arise when the entity has not complied with these requirements.

Application of the Selected Accounting Policies

A4. In relation to the application of the selected accounting policies, material misstatements of the financial statements may arise:

(a) When management has not applied the selected accounting policies consistently with the financial reporting framework, including when management has not applied the selected accounting policies consistently between periods or to similar transactions and events (consistency in application); or

(b) Due to the method of application of the selected accounting policies (such as an unintentional error in application), or when there is a disagreement with management about the underlying facts and circumstances to which the selected accounting policies are applied (for example, a disagreement about estimates for pension liabilities).

Appropriateness or Adequacy of Disclosures in the Financial Statements

A5. In relation to the appropriateness or adequacy of disclosures in the financial statements, material misstatements of the financial statements may arise when:

(a) The financial statements do not include all of the disclosures required by the applicable financial reporting framework;

(b) The disclosures in the financial statements are not presented in accordance with the applicable financial reporting framework; or

(c) The financial statements do not provide the disclosures necessary to achieve fair presentation.

Nature of an Inability to Obtain Sufficient Appropriate Audit Evidence (Ref: Para. 9(b))

A6. The auditor's inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from:

(a) Circumstances beyond the control of the entity;

(b) Circumstances relating to the nature or timing of the auditor's work; or

(c) Limitations imposed by management.

A7. An inability to perform a specific procedure does not constitute a scope limitation if the auditor is able to obtain sufficient appropriate audit evidence by performing alternative procedures. If this is not possible, the requirements of paragraphs 10(b) and 12 apply as appropriate. Limitations imposed by management may have other implications for the audit, for example, for the auditor's assessment of fraud risks and consideration of engagement continuance.

A8. Examples of circumstances beyond the control of the entity include the following:

- When the entity's accounting records have been destroyed.
- When the accounting records of a significant component have been seized indefinitely by governmental authorities.

A9. Examples of circumstances relating to the nature or timing of the auditor's work include the following:

- When the entity is required to use the equity method of accounting for an associated entity, and the auditor is unable to obtain sufficient appropriate audit evidence about the latter's financial information to evaluate whether the equity method has been appropriately applied.

- When the timing of the auditor's appointment is such that the auditor is unable to observe the counting of the physical inventories.
- When the auditor determines that performing substantive procedures alone is not sufficient, but the entity's controls are not effective.

A10. Examples of an inability to obtain sufficient appropriate audit evidence arising from a scope limitation imposed by management include the following:

- When management prevents the auditor from observing the counting of the physical inventory.
- When management prevents the auditor from requesting external confirmation of specific account balances.

Pervasiveness of the Matter or Matters Giving Rise to a Modification

Financial Statements are Materially Misstated (Ref: Para. 11)

A11. The auditor may judge misstatements that are material individually or in the aggregate to be pervasive to the financial statements when such misstatements are not confined to specific elements, accounts or items of the financial statements, or if confined, the misstatements represent or could represent a substantial proportion of the financial statements.

A12. Further, in relation to disclosures, the auditor may judge misstatements that are material individually or in the aggregate to be pervasive to the financial statements when the misstated disclosures are fundamental to users' understanding of the financial statements.

Inability to Obtain Sufficient Appropriate Audit Evidence (Ref: Para. 12)

A13. The auditor may judge an inability to obtain sufficient appropriate audit evidence about one or more matters pertaining to the financial statements to be both material and pervasive when the possible effects of the inability cannot be confined to specific elements, accounts or items of the financial statements or, if confined, those possible effects could represent a substantial proportion of the financial statements.

Disclaimer of Opinion in the Case of Multiple Uncertainties (Ref: Para. 12)

A14. In cases involving multiple uncertainties, the auditor may conclude in extremely rare circumstances that it is not possible to form an opinion on the financial statements as a whole due to the interaction and cumulative possible effects of the uncertainties, even though the auditor has obtained sufficient appropriate audit evidence about management's assertions regarding each of the individual uncertainties. The auditor is not precluded from disclaiming an opinion in such a situation.

Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence due to a Management-imposed Limitation After the Auditor has Accepted the Engagement (Ref: Para. 15-16)

A15. The timing of the auditor's resignation may depend upon the stage of completion of the engagement when management imposes the scope limitation. If the auditor has substantially completed the audit, the auditor may decide to complete the audit to the extent possible, disclaim an opinion and explain the scope limitation in the Basis for Disclaimer of Opinion paragraph prior to resigning.

A16. In certain circumstances, resignation from the audit may not be possible if the auditor is required to continue the audit engagement by law or regulation. This may be the case for an auditor that is appointed to audit the financial statements of public sector entities, or in jurisdictions where the auditor is appointed for a specific period and is prohibited from resigning before the end of that period. In such cases, paragraph 15(b)(ii) requires the auditor to disclaim an opinion on the financial statements.

A17. When the auditor concludes that resignation from the audit is necessary because of a scope limitation, there may be a professional, regulatory or legal requirement for the auditor to communicate matters relating to the resignation from the engagement to regulators or the entity's owners.

Prohibition on Issuing a Piecemeal Opinion (Ref: Para. 17)

A18. For the purpose of this ISA, a piecemeal opinion arises when the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements as a whole and, in the same report, expresses an unmodified opinion on one or more specific elements, accounts or items of the financial statements with respect to the same financial reporting framework.

A19. Specific elements, accounts or items of the financial statements may include, for example, the revenue item in the income statement, or specific disclosures in the financial statements. A combination of an unmodified opinion on one or more of these specific elements, accounts or items, and an adverse opinion or a disclaimer of opinion on the financial statements as a whole, in the same report and with respect to the same financial reporting framework, is contradictory. It is accordingly not permitted.

A20. The description of "piecemeal opinion" in paragraph A18 does not include, for example:

- The expression of an unmodified opinion on financial statements prepared under a given financial reporting framework and, within the same report, the expression of an adverse opinion or the issue of a disclaimer of opinion on the same financial statements under a different financial reporting framework. For example, the auditor may express an adverse opinion on financial statements prepared in accordance with a financial reporting framework designed to achieve fair presentation, and within the same report, express an unmodified opinion with respect to the proper preparation of the financial statements in accordance with specific legal requirements not designed to achieve fair presentation.

- The expression of an unmodified opinion on the closing financial position of the entity but a disclaimer of an opinion on the results of operations and cash flows if the auditor has been unable to obtain sufficient audit evidence concerning the entity's opening balances (see [proposed] ISA 510 (Redrafted), "Initial Audit Engagements―Opening Balances").

Form and Content of the Auditor's Report when the Opinion is Modified

Basis for Modification Paragraph (Ref: Para. 18-23)

A21. Consistency in the auditor's report helps to promote the users' understanding and to identify unusual circumstances when they occur. Accordingly, although uniformity in the wording of a modified opinion and in the description of the basis for the modification may not be possible, consistency in both the form and content of the auditor's report is desirable.

A22. An example of the financial effects of material misstatements that the auditor may describe in the basis for modification paragraph in the auditor's report is the quantification of the effects on income tax, net income and equity if inventory is overstated.

A23. Disclosing the omitted information in the basis for modification paragraph would not be practicable if:

(a) The auditor would be assuming management's responsibility for the preparation of the omitted disclosures; or

(b) In the auditor's judgment, the disclosures would be unduly voluminous in relation to the auditor's report.

A24. The auditor may be assuming management's responsibility for the preparation of the omitted disclosures if the omitted disclosures have not been prepared by management or are otherwise not readily available to the auditor.

A25. An adverse opinion or a disclaimer of opinion does not justify the omission of a description of other identified matters that would require a modification, for example misstatements regarding the recognition, measurement or disclosure of certain assets and liabilities (for example, the existence of inventory).

Opinion Paragraph (Ref: Para. 24-25)

A26. Inclusion of this paragraph heading makes it clear to the user that the auditor's opinion is modified and indicates the type of modification.

A27. When the auditor expresses a qualified opinion, it would not be appropriate to use phrases such as "with the foregoing explanation" or "subject to" in the opinion paragraph as these are not sufficiently clear or forceful.

Illustrative Auditors' Reports

A28. Illustrations 1 and 2 in the Appendix contain auditors' reports with qualified and adverse opinions, respectively, as the financial statements are materially misstated.

A29. Illustration 3 in the Appendix contains an auditor's report with a qualified opinion as the auditor is unable to obtain sufficient appropriate audit evidence. Illustration 4 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about a single element of the financial statements. Illustration 5 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. In each of the latter two cases, the possible effects on the financial statements of the inability are both material and pervasive.

Communication with Those Charged with Governance (Ref: Para. 30)

A30. Communicating with those charged with governance the circumstances that lead to an expected modification to the auditor's opinion and the proposed wording of the modification enables:

(a) The auditor to give notice to those charged with governance of the intended modification(s) and the reasons (or circumstances) for the modification(s);

(b) The auditor to seek the concurrence of those charged with governance regarding the facts of the matter(s) giving rise to the expected modification(s), or to confirm matters of disagreement with management as such; and

(c) Those charged with governance to have an opportunity, where appropriate, to provide the auditor with further information and explanations in respect of the matter(s) giving rise to the expected modification(s).

Appendix

(Ref: Para. A28-29)

Illustrations of Auditors' Reports with Modifications to the Opinion

- Illustration 1: An auditor's report containing a qualified opinion due to a material misstatement of the financial statements.
- Illustration 2: An auditor's report containing an adverse opinion due to a material misstatement of the financial statements.
- Illustration 3: An auditor's report containing a qualified opinion due to the auditor's inability to obtain sufficient appropriate audit evidence.
- Illustration 4: An auditor's report containing a disclaimer of opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about a single element of the financial statements.
- Illustration 5: An auditor's report containing a disclaimer of opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about multiple elements of the financial statements.

<u>Illustration 1:</u>

Circumstances include the following:

- **Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial statements.**
- **In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law.**

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Report on the Financial Statements[2]

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

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation[3] of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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 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[4] of the financial

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

3 Depending on the circumstances, this sentence may read: "Management is responsible for the preparation and presentation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards."

4 Depending on the circumstances, this sentence may read: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and presentation of financial statements that give a

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.[5] 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 qualified audit opinion.

Basis for Qualified Opinion

The company's inventories are carried in the balance sheet at xxx. Management has not stated the inventories at the lower of cost and net realizable value but has stated them solely at cost, which constitutes a departure from International Financial Reporting Standards. The company's records indicate that had management stated the inventories at the lower of cost and net realizable value, an amount of xxx would have been required to write the inventories down to their net realizable value. Accordingly, cost of sales would have been increased by xxx, and income tax, net income and shareholders' equity would have been reduced by xxx, xxx and xxx, respectively.

Qualified Opinion

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, 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 of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

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true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control."

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

Illustration 2:

Circumstances include the following:

- **The financial statements are materially misstated due to the non-consolidation of a subsidiary. The material misstatement is deemed to be pervasive to the financial statements.**
- **In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law.**

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Report on the Financial Statements[6]

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

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation[7] of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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 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

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

7 Depending on the circumstances, this sentence may read: "Management is responsible for the preparation and presentation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards."

internal control relevant to the entity's preparation and fair presentation[8] 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.[9] 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 adverse audit opinion.

Basis for Adverse Opinion

As explained in Note X, the company has not consolidated the financial statements of subsidiary XYZ Company it acquired during 20X1 because it has not yet been able to ascertain the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis. Under International Financial Reporting Standards, the subsidiary should have been consolidated because it is controlled by the company. Had XYZ been consolidated, many elements in the accompanying financial statements would have been materially affected. In the absence of further information about the accounting for the acquisition, however, it is not possible to quantify those effects.

Adverse Opinion

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph, the financial statements do not present fairly *(or "do not 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 of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

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

9 In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances." In the case of footnote 8, this sentence may read: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and presentation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances."

<u>Illustration 3:</u>

Circumstances include the following:

- **The auditor was unable to obtain sufficient appropriate audit evidence regarding an investment in a foreign affiliate. The possible effects of the inability to obtain sufficient appropriate audit evidence are deemed to be material but not pervasive to the financial statement.**
- **In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law.**

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Report on the Financial Statements[10]

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

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation[11] of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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 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

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

11 Depending on the circumstances, this sentence may read: "Management is responsible for the preparation and presentation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards."

internal control relevant to the entity's preparation and fair presentation[12] 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.[13] 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 qualified audit opinion.

Basis for Qualified Opinion

ABC Company's investment in XYZ Company, a foreign associate acquired during the year and accounted for by the equity method, is carried at xxx on the balance sheet as at December 31, 20X1, and ABC's share of XYZ's net income of xxx is included in ABC's income for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC's investment in XYZ as at December 31, 20X1 and ABC's share of XYZ's net income for the year because we were denied access to the financial information, management, and the auditors of XYZ. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

Qualified Opinion

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion paragraph, 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 of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

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

13 In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances." In the case of footnote 12, this sentence may read: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and presentation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances."

<u>Illustration 4:</u>

Circumstances include the following:

- **The auditor was unable to obtain sufficient appropriate audit evidence about a single element of the financial statements. The auditor was also unable to obtain audit evidence about the financial information of a joint venture investment that represents over 90% of the company's net assets. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements.**
- **In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law.**

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Report on the Financial Statements[14]

We were engaged to audit the accompanying financial statements of ABC Company, which comprise the balance sheet as at December 31, 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation[15] of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with International Standards on Auditing. Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

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

15 Depending on the circumstances, this sentence may read: "Management is responsible for the preparation and presentation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards."

Basis for Disclaimer of Opinion

The company's investment in its joint venture XYZ (Country X) Company is carried at xxx on the company's balance sheet, which represents over 90% of the company's net assets as at December 31, 20X1. We were not allowed access to the management and the auditors of XYZ, including XYZ's auditors' audit documentation. As a result, we were unable to determine whether any adjustments were necessary in respect of the company's proportional share of XYZ's assets that it controls jointly, its proportional share of XYZ's liabilities for which it is jointly responsible, its proportional share of XYZ's income and expenses for the year, and the elements making up the statement of changes in equity and cash flow statement.

Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements.

Report on Other Legal and Regulatory Requirements

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

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

<u>Illustration 5:</u>

Circumstances include the following:

- **The auditor was unable to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. That is, the auditor was unable to obtain audit evidence about the entity's inventories and accounts receivable. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements.**
- **In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law.**

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Report on the Financial Statements[16]

We were engaged to audit the accompanying financial statements of ABC Company, which comprise the balance sheet as at December 31, 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation[17] of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with International Standards on Auditing. Because of the matters described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

[16] The sub-title "Report on the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

[17] Depending on the circumstances, this sentence may read: "Management is responsible for the preparation and presentation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards."

Basis for Disclaimer of Opinion

We were not appointed as auditors of the company until after December 31, 20X1 and thus did not observe the counting of physical inventories at the beginning and end of the year. We were unable to satisfy ourselves by alternative means concerning the inventory quantities held at December 31, 20X0 and 20X1 which are stated in the balance sheet at xxx and xxx, respectively. In addition, the introduction of a new computerized accounts receivable system in September 20X1 resulted in numerous errors in accounts receivable. As of the date of our audit report, management was still in the process of rectifying the system deficiencies and correcting the errors. We were unable to confirm or verify by alternative means accounts receivable included in the balance sheet at a total amount of xxx as at December 31, 20X1. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and accounts receivable, and the elements making up the income statement, statement of changes in equity and cash flow statement.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements.

Report on Other Legal and Regulatory Requirements

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

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

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International
Auditing
and Assurance
Standards Board

Exposure Draft
July 2007
Comments are requested by November 30, 2007

Proposed Revised and Redrafted International Standard on Auditing

ISA 706 (Revised), Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor's Report

International Federation
of Accountants

REQUEST FOR COMMENTS

The International Auditing and Assurance Standards Board (IAASB), an independent standard-setting body within the International Federation of Accountants (IFAC), approved the exposure draft of proposed International Standard on Auditing (ISA) 706 (Revised and Redrafted), "Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor's Report" for publication in July 2007. The proposed ISA may be modified in light of comments received before being issued in final form.

Please submit your comments, preferably by e-mail, so that they will be received by **November 30, 2007**. All comments will be considered a matter of public record. Comments should be addressed to:

International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, New York 10017 USA

Comments should be emailed to Edcomments@ifac.org. They may also be faxed to +1-212-286-9570 or mailed to the above address.

Copies of the exposure drafts may be downloaded free-of-charge from the IFAC website at http://www.ifac.org.

CONTENTS

EXPLANATORY MEMORANDUM

Introduction

This memorandum provides background to proposed International Standard on Auditing (ISA) 706 (Revised and Redrafted), "Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor's Report." The proposed ISA has been redrafted in accordance with conventions agreed by the International Auditing and Assurance Standards Board (IAASB) to be applied to all ISAs. The IAASB approved the proposed redrafted ISA for exposure in July 2007.

Background

When the IAASB undertook to revise the original ISA 700, "The Auditor's Report on Financial Statements," it agreed to restrict the revision to engagements where the auditor is able to express an unmodified opinion on the financial statements and no other modifications to the auditor's report are necessary. To facilitate this revision, the standards and guidance on modifications to the auditor's report (including Emphasis of Matter paragraphs (EOMs)) in the original ISA 700 were moved to a new ISA, i.e., ISA 701, "Modifications to the Independent Auditor's Report," which was approved in December 2004. The IAASB then undertook to revise ISA 701 to enhance the standards and guidance on modifications to the auditor's opinion and EOMs, as well as increase consistency in reporting among jurisdictions.

The project to revise ISA 701 led to the issue of an exposure draft in March 2005 of two separate standards, proposed ISA 705 (Revised), "Modifications to the Opinion in the Independent Auditor's Report" and proposed ISA 706 (Revised), "Emphasis of Matter Paragraphs and Other Matters Paragraphs in the Independent Auditor's Report."

In July 2006, the IAASB approved "close off" documents of ISA 705 (Revised) and ISA 706 (Revised) in the "old style" (i.e., following the IAASB's current drafting conventions). The close off documents incorporate the changes based on the comments received on the March 2005 exposure draft, and form the basis for the proposed ISA 705 (Revised and Redrafted) and proposed ISA 706 (Revised and Redrafted).

The Basis for Conclusions: ISA 706 (Revised) and related close off document are available on the IAASB website at http://www.ifac.org/Guidance/EXD-Details.php?EDID=0092. They are referenced here for information purposes only and do not form part of the exposure draft.

The conventions used by the IAASB in redrafting the close off document of ISA 706 (Revised), and the authority and obligation attaching to those conventions, are established in proposed ISA 200 (Revised and Redrafted), "Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing" approved by the IAASB as an exposure draft in April 2007, and in the amended "Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services"[1] (Preface) approved by the IAASB in September 2006.

[1] The amended Preface can be accessed at http://web.ifac.org/download/IAASB_Preface.pdf. Proposed ISA 200 (Revised and Redrafted) can be accessed at http://www.ifac.org/Guidance/EXD-Details.php?EDID=0079.

Effective Date

The current timetable envisages that all ISAs will have been revised and redrafted, or redrafted only, by late 2008 and the IAASB has provisionally agreed that the complete set of ISAs will be effective for audits of financial statements for periods beginning on or after December 15, 2008. This date will depend on satisfactory progress being made, and will be amended to a later date should that prove necessary. The IAASB believes that it is in the interests of auditors and others who use the ISAs that the ISAs should be released as soon as they are approved so as to facilitate their implementation.

Significant Matter

New Requirement to Include an Emphasis of Matter Paragraph

The requirement for an Emphasis of Matter paragraph in the close off document of ISA 706 (Revised) deals with the form and content of such a paragraph, while the equivalent requirement for an Other Matter(s) paragraph also deals with the circumstances in which the auditor would include such a paragraph in the auditor's report.

To align these requirements and clarify the circumstances in which an auditor would include an Emphasis of Matter paragraph in the auditor's report, the IAASB has included a requirement in paragraph 7 of proposed ISA 706 (Revised and Redrafted) that provides for the auditor to use an Emphasis of Matter only if the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements. It also requires that an Emphasis of Matter paragraph only refer to information presented or disclosed in the financial statements. This reinforces the fact that an Emphasis of Matter may not be used as an alternative to a modified opinion, but leaves the question of whether to include one at all to the judgment of the auditor.

Guide for Respondents

The IAASB is seeking comments **only** on changes resulting from applying the clarity drafting conventions, including the matter discussed above, and their effect on the content of the close off document of ISA 706 (Revised). Respondents are asked to respond in particular to the following questions:

1. Is the objective to be achieved by the auditor, stated in the proposed redrafted ISA, appropriate?
2. Have the criteria identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and reporting, and the use of professional judgment by auditors?[2]

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[2] The IAASB has identified the following criteria for determining the requirements of a Standard:

- The requirement is necessary to achieve the objective stated in the Standard;
- The requirement is expected to be applicable in virtually all engagements to which the Standard is relevant; and

Recognizing that the final ISA will apply to audits of all sizes and in all sectors of the economy, the IAASB is also interested in comments on matters set out below.

- *Special Considerations in the Audit of Small Entities*—Respondents are asked to comment whether, in their opinion, considerations in the audit of small entities have been dealt with appropriately in the proposed redrafted ISA.
- *Special Considerations in the Audit of Public Sector Entities*—Respondents are asked to comment whether, in their opinion, special considerations in the audit of public sector entities have been dealt with appropriately in the proposed redrafted ISA.
- *Developing Nations*—Recognizing that many developing nations have adopted or are in the process of adopting the ISAs, the IAASB invites respondents from these nations to comment, in particular, on any foreseeable difficulties in applying the proposed redrafted ISA in a developing nation environment.
- *Translations*—Recognizing that many respondents intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues noted in reviewing the proposed redrafted ISA.

Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in the exposure draft, it will be helpful for the IAASB to be made aware of this view.

Respondents are also invited to comment on any undue costs, set against the benefits of more consistent auditor performance, arising from the fact that the proposed redrafted ISA includes requirements that would previously have been guidance under the old drafting conventions, as in the close off document of ISA 706 (Revised) (see below). In commenting on this matter, respondents should bear in mind the criteria that the IAASB has applied in redrafting the proposed ISA (see footnote 2) and the fact that the IAASB is seeking to clarify that there was some guidance in extant ISAs that was more in the nature of requirements and would already have been followed by many auditors.

Supplement to the Exposure Draft

To assist respondents in tracking changes, IAASB staff has prepared an analysis of the decisions that have been made by the IAASB with respect to the treatment of the present tense in the explanatory paragraphs of the close off document of ISA 706 (Revised). This analysis also demonstrates how the material in the close off document has been reflected in the proposed redrafted ISA. In particular, the analysis:

- The objective stated in the Standard is unlikely to have been met by the requirements of other Standards.

In determining the requirements of a Standard, the IAASB will consider whether the requirements are proportionate to the importance of the subject matter of the Standard in relation to the overall objective of the engagement.

The criteria, which are intended only to assist the IAASB in appropriately and consistently determining requirements, may be refined as further experience is gained.

- Identifies existing sentences in the present tense and whether they are now treated as a requirement or as application material;
- Maps the material of the close off document to the proposed redrafted ISA; and
- Identifies explanatory material that is proposed to be eliminated or repositioned as a result of redrafting.

These staff-prepared mapping documents are available on the IAASB website at http://www.ifac.org/Guidance/EXD-Details.php?EDID=0092. They are for information purposes only and do not form part of the exposure draft.

To be considered, responses should be emailed to Edcomments@ifac.org. They may also be faxed to +1-212-286-9570 or mailed to 545 Fifth Avenue, 14th Floor, New York, NY 10017, USA. They should be received by **November 30, 2007**.

PROPOSED INTERNATIONAL STANDARD ON AUDITING 706

(REVISED AND REDRAFTED)

EMPHASIS OF MATTER PARAGRAPHS AND OTHER MATTER(S) PARAGRAPHS IN THE INDEPENDENT AUDITOR'S REPORT

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

CONTENTS

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

* See footnote 1.

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's consideration of the inclusion in the auditor's report of:

   (a) An Emphasis of Matter paragraph to draw users' attention to a matter presented or disclosed in the financial statements that the auditor judges important to their understanding of the financial statements; or

   (b) An Other Matter(s) paragraph to draw users' attention to any other matter that may be relevant to their understanding of the financial statements or the audit.

2. The requirements and guidance in this ISA are established in the context of engagements to report on general purpose financial statements prepared and presented in accordance with a fair presentation framework. However, in the context of an engagement to report on special purpose financial statements or specific elements, accounts or items of a financial statement, or when the applicable financial reporting framework is a compliance framework, these requirements and guidance equally apply, adapted as necessary.

Nature of an Emphasis of Matter Paragraph

3. In rare circumstances, the auditor may consider a matter presented or disclosed in the financial statements to be of such importance to users' understanding of the financial statements as a whole that it would be appropriate to draw their attention to it. An Emphasis of Matter paragraph in the auditor's report provides the means for the auditor to do so. However, a widespread use of Emphasis of Matter paragraphs diminishes the effectiveness of the auditor's communication of such matters. (Ref: Para. A1-A2)

Nature of an Other Matter(s) Paragraph

4. The auditor may consider it appropriate to use the auditor's report as a means of communicating information relating to matters, other than those that are presented or disclosed in the financial statements, that may be relevant to users' understanding of the financial statements or the audit. Such information is referred to in this ISA as "Other Matter(s)" in order to distinguish it from a matter highlighted in an Emphasis of Matter paragraph.

Effective Date

5. This ISA is effective for audits of financial statements for periods beginning on or after [date].[1]

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[1] This date will not be earlier than December 15, 2008.

Objective

6. The objective of the auditor is to include clear additional communication in the auditor's report when, in the auditor's judgment, such communication is appropriate to draw users' attention to a matter presented or disclosed in the financial statements or to any other matter which may be relevant to their understanding of the financial statements or the audit.

Requirements

Form and Placement of an Emphasis of Matter Paragraph in the Auditor's Report

7. When the auditor considers it appropriate to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to the users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements. Such a paragraph shall refer only to information presented or disclosed in the financial statements. (Ref: Para. A3)

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

   (a) Include it immediately after the Opinion paragraph in the auditor's report;

   (b) Use the heading "Emphasis of Matter;"

   (c) Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements; and

   (d) Indicate that the auditor's opinion is not modified in respect of the matter emphasized. (Ref: Para. A4-A5)

Other Matter(s) in the Auditor's Report

9. When the auditor considers it appropriate to communicate matters other than those that are presented or disclosed in the financial statements, the auditor shall use an Other Matter(s) paragraph for such matters with the heading "Other Matter(s)," placed after the auditor's opinion and any Emphasis of Matter paragraph. (Ref: Para. A6-A8)

Communication with Those Charged with Governance

10. When the auditor expects to include an Emphasis of Matter or an Other Matter(s) paragraph in the auditor's report, the auditor shall communicate with those charged with governance regarding this expectation, and the proposed wording of this paragraph. (Ref: Para. A9)

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Application and Other Explanatory Material

Nature of an Emphasis of Matter Paragraph (Ref: Para. 3)

A1. Circumstances where the auditor may consider it appropriate or necessary to emphasize in the auditor's report a matter presented or disclosed in the financial statements include, for example:

- [Proposed] ISA 560 (Redrafted), "Subsequent Events" deals with circumstances where it is necessary for the auditor to issue a new auditor's report on amended financial statements as a result of the auditor becoming aware of a fact that existed at the date of the auditor's report that, if known at that date, would have caused the financial statements to be amended or the auditor to modify the auditor's opinion. In those circumstances, [proposed] ISA 560 (Redrafted) requires the auditor to include an Emphasis of Matter paragraph in the new auditor's report referring to a note to the financial statements that more extensively discusses the reason for the amendment of the previously issued financial statements and to the earlier report issued by the auditor.
- [Proposed] ISA 570 (Redrafted), "Going Concern" requires the auditor to include an Emphasis of Matter paragraph in the auditor's report on financial statements to highlight the existence of a material uncertainty regarding an entity's ability to continue as a going concern. The Emphasis of Matter paragraph draws attention to the disclosure in the financial statements that discusses the going concern uncertainty.

A2. Examples of other circumstances where the auditor may determine that an Emphasis of Matter paragraph is appropriate include:

- An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.
- Application of a new accounting standard (for example, a new International Financial Reporting Standard) that has a pervasive effect on the financial statements in advance of its effective date (i.e., where early application is permitted).
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

Form and Placement of an Emphasis of Matter Paragraph in the Auditor's Report (Ref: Para. 7-8)

A3. To include more information in an Emphasis of Matter paragraph than is presented or disclosed in the financial statements may imply that the matter has not been appropriately presented or disclosed.

A4. The inclusion of an Emphasis of Matter paragraph in the auditor's report does not affect the auditor's opinion. An emphasis of matter is not a substitute for either:

(a) The auditor expressing a qualified opinion or an adverse opinion, or disclaiming an opinion, when required by the circumstances of a specific audit engagement (see [proposed] ISA 705 (Revised and Redrafted), "Modifications to the Opinion in the Independent Auditor's Report"); or

(b) Disclosures in the financial statements that the applicable financial reporting framework requires management to make.

A5. The illustrative report in the Appendix includes an Emphasis of Matter paragraph in an auditor's report that contains a qualified opinion.

Other Matter(s) in the Auditor's Report (Ref: Para. 9)

A6. When law, regulation or generally accepted practice in a jurisdiction require or permit the auditor to elaborate on matters that provide further explanation of the auditor's responsibilities in the audit of the financial statements or of the auditor's report thereon, [proposed] ISA 700 (Redrafted), "The Independent Auditor's Report on General Purpose Financial Statements," requires the auditor to address such matters under the Other Matter(s) heading with, where relevant, one or more sub-headings that describe the content of the Other Matter(s) paragraph.

A7. Other matters to which the auditor may wish to refer in an Other Matter(s) paragraph but which are not required to be presented or disclosed in the financial statements by the applicable financial reporting framework include, for example, the following:

(a) Information in a document containing audited financial statements that is materially inconsistent with those financial statements (see [proposed] ISA 720 (Redrafted), "The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements").

(b) A predecessor auditor's report on the corresponding figures in the incoming auditor's report for the current period where the incoming auditor is permitted to make such a reference (see ISA 710, "Comparatives").

(c) In rare circumstances, other matters that the auditor considers necessary to communicate to the user, for example, where the auditor judges it necessary to explain why the auditor is unable to resign from the engagement even though the possible effect of an inability to obtain sufficient appropriate audit evidence due to a scope limitation imposed by management is pervasive.

A8. An Other Matter(s) paragraph does not deal with circumstances where the auditor has additional reporting responsibilities that are supplementary to the auditor's responsibility to express an opinion on the financial statements, or where the auditor has been asked to perform and report on additional specified procedures, or to express an opinion on specific matters (see "Other Reporting Responsibilities" section in [proposed] ISA 700 (Redrafted)).

Communication with Those Charged with Governance (Ref. Para. 10)

A9. Such communication enables those charged with governance to be made aware of the nature of any specific matters that the auditor intends to highlight in the auditor's report, and provides them with an opportunity to obtain further clarification from the auditor where necessary. Where the inclusion of an Other Matter(s) paragraph on a particular matter in the auditor's report recurs on each successive engagement, the auditor may determine that it is unnecessary to repeat the communication on each engagement.

Appendix

(Ref.: Para. A5)

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

Circumstances include the following:

- **There is uncertainty relating to a pending exceptional litigation matter.**
- **A departure from the applicable financial reporting framework resulted in a qualified opinion.**
- **In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law.**

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Report on the Financial Statements[2]

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

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation[3] of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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2 The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle "Report on Other Legal and Regulatory Requirements" is not applicable.

3 Depending on the circumstances, this sentence may read: "Management is responsible for the preparation and presentation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards."

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 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[4] 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.[5] An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Basis for Qualified Opinion

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

Qualified Opinion

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

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4 Depending on the circumstances, this sentence may read: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and presentation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but nor for the purpose of expressing an opinion on the effectiveness of the entity's internal control."

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

performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

We draw attention to Note X to the financial statements which describes the uncertainty[6] related to the outcome of the lawsuit filed against the company by XYZ Company. Our opinion is not qualified in respect of this matter.

Report on Other Legal and Regulatory Requirements (see "Other Reporting Responsibilities" section in [proposed] ISA 700 (Redrafted))

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

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

[6] In highlighting the uncertainty, the auditor uses the same terminology that is used in the note to the financial statements.

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International
Auditing
and Assurance
Standards Board

Exposure Draft
July 2007
Comments are requested by November 30, 2007

Proposed Redrafted International Standard on Auditing

ISA 800 (Revised), Special Considerations—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement

International Federation of Accountants

REQUEST FOR COMMENTS

The International Auditing and Assurance Standards Board (IAASB), an independent standard-setting body within the International Federation of Accountants (IFAC), approved the exposure draft of proposed International Standard on Auditing (ISA) 800 (Revised and Redrafted), "Special Considerations—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement" for publication in July 2007. The proposed ISA may be modified in light of comments received before being issued in final form.

Please submit your comments, preferably by e-mail, so that they will be received by **November 30, 2007**. All comments will be considered a matter of public record. Comments should be addressed to:

International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, New York 10017 USA

Comments should be emailed to Edcomments@ifac.org. They may also be faxed to +1-212-286-9570 or mailed to the above address.

Copies of the exposure drafts may be downloaded free-of-charge from the IFAC website at http://www.ifac.org.

CONTENTS

EXPLANATORY MEMORANDUM

Introduction

This memorandum provides background to proposed International Standard on Auditing (ISA) 800 (Revised and Redrafted), "Special Considerations—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement." The proposed ISA has been redrafted in accordance with conventions agreed by the International Auditing and Assurance Standards Board (IAASB) to be applied to all ISAs. The IAASB approved the proposed redrafted ISA for exposure in July 2007.

Background

In June 2005, the IAASB issued an exposure draft of proposed ISA 701, "The Independent Auditor's Report on Other Historical Financial Information." The comment period closed on October 31, 2005. The IAASB gave due consideration to the comments received on the proposed ISA.

The IAASB also agreed to renumber and title the ISA as ISA 800 (Revised), "Special Considerations—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement."

In October 2006, the IAASB approved a "close off" document of ISA 800 (Revised) in the "old style" (i.e., following the IAASB's current drafting conventions). The close off document incorporates the changes based on the comments received on the June 2005 exposure draft, and forms the basis for the proposed redrafted ISA.

The Basis for Conclusions: ISA 800 (Revised) and related close off document are available on the IAASB website at http://www.ifac.org/Guidance/EXD-Details.php?EDID=0093. They are referenced here for information purposes only and do not form part of the exposure draft.

The conventions used by the IAASB in redrafting the close off document of ISA 800 (Revised), and the authority and obligation attaching to those conventions, are established in proposed ISA 200 (Revised and Redrafted), "Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing" approved by the IAASB as an exposure draft in April 2007, and in the amended "Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services"[1] (Preface) approved by the IAASB in September 2006.

Effective Date

The current timetable envisages that all ISAs will have been revised and redrafted, or redrafted only, by late 2008 and the IAASB has provisionally agreed that the complete set of ISAs will be effective for audits of financial statements for periods beginning on or after December 15, 2008.

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1 The amended Preface can be accessed at http://web.ifac.org/download/IAASB_Preface.pdf. Proposed ISA 200 (Revised and Redrafted) can be accessed at http://www.ifac.org/Guidance/EXD-Details.php?EDID=0079.

This date will depend on satisfactory progress being made, and will be amended to a later date should that prove necessary. The IAASB believes that it is in the interests of auditors and others who use the ISAs that the ISAs should be released as soon as they are approved so as to facilitate their implementation.

Guide for Respondents

The IAASB is seeking comments **only** on changes resulting from applying the clarity drafting conventions and their effect on the content of the close off document of ISA 800 (Revised). Respondents are asked to respond in particular to the following questions:

1. Is the objective to be achieved by the auditor, stated in the proposed redrafted ISA, appropriate?
2. Have the criteria identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and reporting, and the use of professional judgment by auditors?[2]

Recognizing that the final ISA will apply to audits of all sizes and in all sectors of the economy, the IAASB is also interested in comments on matters set out below.

- *Special Considerations in the Audit of Small Entities*—Respondents are asked to comment whether, in their opinion, considerations in the audit of small entities have been dealt with appropriately in the proposed redrafted ISA.
- *Special Considerations in the Audit of Public Sector Entities*—Respondents are asked to comment whether, in their opinion, special considerations in the audit of public sector entities have been dealt with appropriately in the proposed redrafted ISA.
- *Developing Nations*—Recognizing that many developing nations have adopted or are in the process of adopting the ISAs, the IAASB invites respondents from these nations to comment, in particular, on any foreseeable difficulties in applying the proposed redrafted ISA in a developing nation environment.
- *Translations*—Recognizing that many respondents intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues noted in reviewing the proposed redrafted ISA.

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[2] The IAASB has identified the following criteria for determining the requirements of a Standard:

- The requirement is necessary to achieve the objective stated in the Standard;
- The requirement is expected to be applicable in virtually all engagements to which the Standard is relevant; and
- The objective stated in the Standard is unlikely to have been met by the requirements of other Standards.

In determining the requirements of a Standard, the IAASB will consider whether the requirements are proportionate to the importance of the subject matter of the Standard in relation to the overall objective of the engagement.

The criteria, which are intended only to assist the IAASB in appropriately and consistently determining requirements, may be refined as further experience is gained.

Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in the exposure draft, it will be helpful for the IAASB to be made aware of this view.

Respondents are also invited to comment on any undue costs, set against the benefits of more consistent auditor performance, arising from the fact that the proposed redrafted ISA includes requirements that would previously have been guidance under the old drafting conventions, as in the close off document of ISA 800 (Revised) (see below). In commenting on this matter, respondents should bear in mind the criteria that the IAASB has applied in redrafting the proposed ISA (see footnote 2) and the fact that the IAASB is seeking to clarify that there was some guidance in extant ISAs that was more in the nature of requirements and would already have been followed by many auditors.

Supplement to the Exposure Draft

To assist respondents in tracking changes, IAASB staff has prepared an analysis of the decisions that have been made by the IAASB with respect to the treatment of the present tense in the explanatory paragraphs of the close off document of ISA 800 (Revised). This analysis also demonstrates how the material in the close off document has been reflected in the proposed redrafted ISA. In particular, the analysis:

- Identifies existing sentences in the present tense and whether they are now treated as a requirement or as application material;
- Maps the material of the close off document to the proposed redrafted ISA; and
- Identifies explanatory material that is proposed to be eliminated or repositioned as a result of redrafting.

These staff-prepared mapping documents are available on the IAASB website at http://www.ifac.org/Guidance/EXD-Details.php?EDID=0093. They are for information purposes only and do not form part of the exposure draft.

To be considered, responses should be emailed to Edcomments@ifac.org. They may also be faxed to +1-212-286-9570 or mailed to 545 Fifth Avenue, 14th Floor, New York, NY 10017, USA. They should be received by **November 30, 2007**.

PROPOSED INTERNATIONAL STANDARD ON AUDITING 800

(REVISED AND REDRAFTED)

SPECIAL CONSIDERATIONS—AUDITS OF SPECIAL PURPOSE FINANCIAL STATEMENTS AND SPECIFIC ELEMENTS, ACCOUNTS OR ITEMS OF A FINANCIAL STATEMENT

(Effective for engagements for periods beginning on or after [date])*

CONTENTS

* See footnote 1.

International Standard on Auditing (ISA) 800 (Revised and Redrafted), "Special Considerations—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement" should be read in conjunction with [proposed] ISA 200 (Revised and Redrafted), "Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing."

Introduction

Scope of this ISA

1. [Proposed] International Standard on Auditing (ISA) 200 (Revised and Redrafted), "Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing" explains that the ISAs are written in the context of an audit of financial statements and are to be adapted as necessary in the circumstances when applied to audits of other historical financial information. This ISA deals with special considerations relevant to an audit of special purpose financial statements. It also deals with special considerations, including the adaptation of ISAs, relevant to an audit of a specific element, account or item of a financial statement. Examples of specific elements, accounts or items of a financial statement are listed in Appendix 1.
2. This ISA does not override the requirements of the other ISAs; nor does it purport to deal with all special considerations that may be relevant in the circumstances of the engagement.
3. This ISA does not apply to the report of a component auditor, issued as a result of work performed on the financial information of a component at the request of a group engagement team for purposes of an audit of group financial statements (see ISA 600 (Revised and Redrafted), "Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)").
4. [Proposed] ISA 705 (Revised and Redrafted), "Modifications to the Opinion in the Independent Auditor's Report" deals with circumstances that may result in a modified opinion, the type of modification required, and how the form and content of the auditor's report is affected in such circumstances. [Proposed] ISA 706 (Revised and Redrafted), "Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor's Report" deals with circumstances when the auditor considers including an Emphasis of Matter paragraph or an Other Matter(s) paragraph in the auditor's report, and the form and placement of such paragraphs.

Effective Date

5. This ISA is effective for engagements for periods beginning on or after [date].[1]

Objective

6. The objective of the auditor is to apply the ISAs by addressing the special considerations that are relevant to:

   (a) The acceptance of an engagement to audit special purpose financial statements or a specific element, account or item of a financial statement; and

   (b) The planning and performing of, and reporting on, that audit.

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[1] This date will not be earlier than December 15, 2008.

Definitions

7. For purposes of the ISAs, the following terms have the meanings attributed below:

   (a) Special purpose financial statements – Financial statements prepared in accordance with a special purpose framework. (Ref: Para. A2)

   (b) Special purpose framework – A financial reporting framework designed to meet the financial information needs of specific users. (Ref: Para. A1-A2)

8. The term "financial statements" in this ISA can refer to a complete set of financial statements or a single financial statement, including related explanatory notes.[2] The term "specific element(s), account(s) or item(s) of a financial statement" should be understood to include related explanatory notes.

Requirements

Audits of Special Purpose Financial Statements

Considerations when Determining the Acceptability of the Applicable Financial Reporting Framework

9. To determine the acceptability of the financial reporting framework, the auditor shall obtain an understanding of the following circumstances of the engagement: (Ref: Para. A3-A7)

   (a) The purpose for which the financial statements are prepared;

   (b) The intended users; and

   (c) The steps taken by management to determine that the financial reporting framework is appropriate in the circumstances.

10. In the case of special purpose financial statements prepared in accordance with the provisions of a contract, the auditor shall also obtain an understanding of any significant interpretations of the contract that management made in preparing the financial information.[3]

Considerations when Planning and Performing the Audit

11. The auditor shall determine whether application of the requirements of the relevant ISAs require special consideration in the circumstances of the engagement. (Ref: Para. A8-A11)

Forming an Opinion and Reporting Considerations

12. When forming an opinion and reporting on special purpose financial statements, the auditor shall apply the requirements in [proposed] ISA 700 (Redrafted), "The

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2 The requirements of the applicable financial reporting framework determine the form and content of the financial statements and what constitutes a complete set of financial statements.

3 An interpretation is significant when adoption of another reasonable interpretation would have produced a material difference in the financial statements.

Independent Auditor's Report on General Purpose Financial Statements." Additional elements of the auditor's report on special purpose financial statements are set out in paragraphs 13-14 of this ISA. (Ref: Para. A12)

Description of the Applicable Financial Reporting Framework

13. The reference to the applicable financial reporting framework in the statement of management's responsibility in the auditor's report on special purpose financial statements shall:

    (a) Make clear the purpose for which the financial statements are prepared and, if necessary, the intended users, or refer to a note in the special purpose financial statements that contains that information; and

    (b) When management has a choice of financial reporting frameworks in preparing and presenting such financial statements, make reference to management's responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances of the engagement.

Restriction on Use and Distribution

14. The auditor's report on the special purpose financial statements shall include a statement that the financial statements are prepared in accordance with a special purpose framework and that, as a result, the financial statements and related auditor's report may not be suitable for another purpose. The statement shall be included in a separate paragraph following the auditor's opinion and under the heading Other Matter – Restriction on Use. (Ref: Para. A13-A14)

Audits of Specific Elements, Accounts or Items of a Financial Statement

Considerations when Accepting the Engagement

15. As required by [proposed] ISA 200 (Revised and Redrafted), the auditor applies all ISAs relevant to the audit of the specific element, account or item of a financial statement (referred to as "element" in paragraphs 16-19), irrespective of whether the auditor is also engaged to audit the entity's financial statements. As the ISAs are written in the context of financial statements, all the ISAs relevant to the audit of the element shall be adapted as necessary in the circumstances of the engagement. (Ref: Para. A15-A17, A19-A22)

16. When the auditor is not also engaged to audit the entity's financial statements, the auditor shall determine whether an audit of the element in accordance with ISAs is practicable. (Ref: Para. A18)

Reporting Considerations

17. When the auditor undertakes an engagement to report on an element in conjunction with an engagement to audit the entity's financial statements, the auditor shall express a separate opinion for each engagement. (Ref: Para. A23)

18. When the entity intends to publish an audited element together with its audited financial

statements, the entity's presentation of the audited element should differentiate it sufficiently from the audited financial statements. The opinion on the element should also be differentiated sufficiently from the opinion on the financial statements. If the auditor concludes that the differentiation is insufficient, the auditor shall ask management to rectify the situation. The auditor shall not issue the auditor's report on the element until satisfied with the differentiation.

19. When the opinion in the auditor's report on an entity's financial statements is modified or that report includes an Emphasis of Matter paragraph or an Other Matter(s) paragraph, the auditor shall determine the effect that this may have on the auditor's report on an element. When deemed appropriate, the auditor shall modify the opinion in the auditor's report on the element, or include an Emphasis of Matter paragraph or an Other Matter(s) paragraph in that report, accordingly. (Ref: Para. A24-A25)

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Application and Other Explanatory Material

Audits of Special Purpose Financial Statements

Special Purpose Frameworks (Ref: Para. 7)

A1. Examples of special purpose frameworks are:

- A tax basis of accounting for a set of financial statements that accompany an entity's tax return;
- The cash receipts and disbursements basis of accounting for cash flow information that an entity may be requested to prepare for creditors;
- The financial reporting provisions established by a regulator to meet that regulator's requirements; or
- The financial reporting provisions of a contract, such as a bond indenture or a loan agreement.

A2. Financial statements prepared and presented in accordance with a special purpose framework may be the only financial statements an entity prepares. In such circumstances, those financial statements are often used by users other than those for whom the financial reporting framework is designed. Despite the broad distribution of the financial statements in those circumstances, the financial statements are still considered to be special purpose financial statements for purposes of the ISAs. The requirements in paragraphs 13-14 are designed to avoid misunderstandings about the purpose for which the financial statements are prepared.

Considerations when Determining the Acceptability of the Applicable Financial Reporting Framework (Ref: Para. 9)

A3. ISA 210, "Terms of Audit Engagements" requires the auditor to agree on and determine the acceptability of the applicable financial reporting framework. In the case of special purpose financial statements, the financial information needs of the intended users are a key factor in obtaining an understanding of the circumstances listed in paragraph 9(a)-(c).

A4. The applicable financial reporting framework may encompass the financial reporting standards established by an organization authorized or recognized to promulgate standards for special purpose financial statements. In that case, those standards will be presumed acceptable for that purpose if the organization follows an established and transparent process involving deliberation and consideration of the views of relevant stakeholders. In some jurisdictions, law or regulation may prescribe the financial reporting framework to be used by management in preparing and presenting special purpose financial statements for a certain type of entity. For example, a regulator may establish financial reporting provisions to meet its requirements. In the absence of indications to the contrary, such a financial reporting framework is presumed acceptable for special purpose financial statements prepared and presented by such entity.

A5. Where the financial reporting standards referred to in paragraph A4 are supplemented by legislative or regulatory requirements, ISA 210 requires the auditor to determine whether any conflicts between the financial reporting standards and the additional requirements exist, and prescribes actions to be taken by the auditor if such conflicts exist.

A6. The applicable financial reporting framework may encompass the financial reporting provisions of a contract, or sources other than those described in paragraphs A4 and A5. In that case, the acceptability of the financial reporting framework in the circumstances of the engagement is determined by considering whether the framework exhibits attributes normally exhibited by acceptable financial reporting frameworks as described in Appendix 2 of ISA 210. In the case of a special purpose framework, the relative importance to a particular engagement of each of the attributes normally exhibited by acceptable financial reporting frameworks is a matter of professional judgment. For example, for purposes of a balance sheet prepared to establish the value of net assets of an entity at the date of its sale, the vendor and the purchaser may have agreed to make very prudent estimates of allowances for uncollectible accounts receivable. This may result in financial information that is not neutral, but nevertheless acceptable in the circumstances of the engagement.

A7. There may be circumstances where a special purpose framework is based on a financial reporting framework established by an authorized or recognized standards setting organization or by law or regulation, but does not comply with all the requirements of that framework. An example is a contract that requires financial statements to be prepared in accordance with most, but not all, of the Financial Reporting Standards of Country X. When this is acceptable in the circumstances of the engagement, it is inappropriate for the description of the applicable financial reporting framework in the special purpose financial statements to imply full compliance with the financial reporting framework established by the authorized or recognized standards setting organization or by law or regulation. In the above example of the contract, the description of the applicable financial reporting framework may refer to the financial reporting provisions of the contract.

Considerations when Planning and Performing the Audit (Ref: Para. 11)

A8. [Proposed] ISA 200 (Revised and Redrafted) requires the auditor to comply with (a) relevant ethical requirements relating to an audit engagement, and (b) all ISAs relevant to the audit. It also requires the auditor to comply with the requirements of each of the relevant ISAs in all cases where the requirements are relevant to the audit unless, in exceptional circumstances, the auditor judges it necessary to depart from a relevant requirement by performing alternative audit procedures to achieve the aim of that requirement.

A9. Application of some of the requirements of the ISAs may require special consideration by the auditor. For example, in [proposed] ISA 320 (Revised and Redrafted), "Materiality in Planning and Performing an Audit" judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. In the case of an audit of special purpose financial statements, however, those judgments are based on a consideration of the financial information needs of the specific users.

A10. In the case of special purpose financial statements prepared for a specific purpose, such as those prepared in accordance with the requirements of a contract, management may agree with the intended users on a threshold below which misstatements identified during the audit will not be corrected or otherwise adjusted. Although such a threshold may satisfy the financial information needs of the intended users for purposes of any adjustments that may arise, it may differ from the amount the auditor determines as a materiality level for purposes of the engagement in accordance with [proposed] ISA 320 (Revised and Redrafted).

A11. Communication with those charged with governance in accordance with the ISAs is based on the relationship between those charged with governance and the financial statements subject to audit, in particular whether those charged with governance are responsible for overseeing the preparation and presentation of those financial statements. In the case of special purpose financial statements prepared for a specific purpose, those charged with governance may not have such a responsibility; for example, when the special purpose financial statements are prepared solely for management's use, or when the party engaging the auditor is not the entity responsible for the special purpose financial statements. In these cases, the requirements of [proposed] ISA 260 (Revised and Redrafted), "Communication with Those Charged with Governance" may not be relevant to the audit of the special purpose financial statements prepared for a specific purpose, except when the auditor is also responsible for the audit of the entity's general purpose financial statements or, for example, has agreed with those charged with governance of the entity to communicate to them relevant matters identified during the audit of the special purpose financial statements prepared for a specific purpose.

Forming an Opinion and Reporting Considerations (Ref: Para. 12)

A12. Appendix 2 of this ISA contains illustrations of auditors' reports on special purpose financial statements (see Illustrations 1-3).

Restriction on Use and Distribution (Ref: Para. 14)

A13. The special purpose financial statements and related auditor's report may be used for purposes other than those for which they were intended. For example, a regulator may require certain entities to place the special purpose financial statements and related auditor's report on public record. To avoid misunderstandings, the auditor alerts users of the auditor's report that the financial statements are prepared in accordance with a special purpose framework and, therefore, may not be suitable for another purpose.

A14. The auditor may also consider including a statement in the auditor's report that it is intended solely for the intended users, and should not be distributed to or used by other parties. Where this is the case, the heading referred to in paragraph 14 would read Other Matter – Restriction on Use and Distribution.

Audits of Specific Elements, Accounts or Items of a Financial Statement

Considerations when Accepting the Engagement (Ref: Para. 15-16)

A15. [Proposed] ISA 200 (Revised and Redrafted) requires the auditor to comply with (a) relevant ethical requirements relating to an audit engagement, and (b) all ISAs relevant to the audit. It also requires the auditor to comply with the requirements of each of the relevant ISAs in all cases where the requirements are relevant to the audit unless, in exceptional circumstances, the auditor judges it necessary to depart from a relevant requirement by performing alternative audit procedures to achieve the aim of that requirement.

A16. The relevance of each of the ISAs requires careful consideration. Even when only an element is the subject of the audit, ISAs such as ISA 240 (Redrafted), "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements," [proposed] ISA 550 (Revised and Redrafted), "Related Parties" and [proposed] ISA 570 (Redrafted), "Going Concern" are in principle relevant. This is because the element could be misstated as a result of fraud, the effect of related party transactions, or the incorrect application of the going concern assumption under the applicable financial reporting framework.

A17. As the ISAs are written in the context of financial statements, all relevant ISAs are to be adapted as necessary in the circumstances when applied to the audit of the element. For example, written representations from management about the financial statements as a whole might be replaced by written representations about the presentation of the element in accordance with the applicable financial reporting framework.

A18. Compliance with relevant requirements may not be practicable when the auditor is not also engaged to audit the entity's financial statements. In such cases, the auditor often does not have the same understanding of the entity and its environment, including its internal control, as an auditor who also audits the entity's financial statements. The auditor also does not have the audit evidence about the general quality of the accounting records or other accounting information that would be acquired in an audit of the entity's financial statements. Accordingly, the auditor may need further evidence to corroborate audit evidence acquired from the accounting records. In some cases, certain ISAs require audit work that may be disproportionate to the element being audited. For example, although the requirements of [proposed] ISA 570 (Redrafted) are likely to be relevant in the circumstances of an audit of a schedule of accounts receivable, complying with those requirements may not be practicable because of the audit effort required. If the auditor concludes that an audit of the element in accordance with ISAs may not be practicable, the auditor may discuss with management whether another type of engagement might be more practicable.

Considerations when Planning and Performing the Audit (Ref: Para. 15)

A19. When auditing the element in conjunction with the audit of the entity's financial statements, the auditor may be able to use audit evidence obtained as part of the audit of the entity's financial statements in the audit of the element. ISAs, however, require the auditor to plan and perform the audit of the element to obtain sufficient appropriate audit evidence on which to base the opinion on the element.

A20. Many financial statement items are interrelated, and are presented with related explanatory notes. Accordingly, when auditing an element, the auditor may not be able to consider the element in isolation. Consequently, the auditor may need to perform procedures in relation to the interrelated items to meet the objective of an audit.

A21. Furthermore, the materiality level determined for the element may be lower than the materiality level or levels determined for the entity's financial statements; this will affect the nature, timing and extent of the audit procedures.

A22. In the case of an element, it is important that management's presentation of the element, in view of the specific requirements of the applicable financial reporting framework, provides adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the element.

Reporting Considerations (Ref: Para. 17, 19)

A23. Unless otherwise required by law or regulation, in accordance with [proposed] ISA 200 (Revised and Redrafted) in conjunction with [proposed] ISA 700 (Redrafted), the opinion paragraph of the auditor's report on an element states that the element gives a true and fair view or presents fairly, in all material respects, in accordance with the applicable financial reporting framework when that framework is a fair presentation framework. In all other cases, the auditor's opinion states that the element is prepared, in all material respects, in accordance with the applicable financial reporting framework. Appendix 2 of this ISA contains an illustration of an auditor's report on a specific account (see Illustration 4).

A24. When either a modified opinion on the entity's financial statements or an Emphasis of Matter paragraph relates to the audited element, the auditor may conclude that it is necessary to modify the auditor's report on the element in a similar manner. Even when a modified opinion on the entity's financial statements or an Emphasis of Matter paragraph does not relate to the audited element, the auditor may still conclude that it is necessary to refer to the modified opinion or Emphasis of Matter in an Other Matter(s) paragraph in the auditor's report on the element because it is important to the users' understanding of the element (see [proposed] ISA 706 (Revised and Redrafted)).

A25. In accordance with [proposed] ISA 705 (Revised and Redrafted), if the auditor has expressed an adverse opinion or disclaimed an opinion on the entity's financial statements as a whole, the auditor is not permitted to express an unmodified opinion on an element of those financial statements in the same auditor's report and with respect to the same applicable financial reporting framework (referred to in [proposed] ISA 705 (Revised and Redrafted) as a "piecemeal opinion"). However, the auditor may be able to express an unmodified opinion on the element where that opinion is expressed in a separate auditor's report. This is only possible if the element to be reported on and the related scope of the audit, including the additional procedures referred to in paragraph A20, were not intended to, and did not, encompass so many elements as to constitute a major portion of those financial statements.

Appendix 1

(Ref: Para. 1)

Examples of Specific Elements, Accounts or Items of a Financial Statement

- Accounts receivable, allowance for doubtful accounts receivable, inventory, the liability for accrued benefits of a private pension plan, the recorded value of identified intangible assets, or the liability for "incurred but not reported" claims in an insurance portfolio, including related explanatory notes.
- A schedule of externally managed assets and income of a private pension plan, including related explanatory notes.
- A schedule of net tangible assets, including related explanatory notes.
- A schedule of disbursements in relation to a lease property, including related explanatory notes.
- A schedule of profit participation or employee bonuses, including related explanatory notes.

Appendix 2

(Ref: Para. A12, A23)

Illustrations of Auditors' Reports on Special Purpose Financial Statements

- Illustration 1: An auditor's report on a complete set of financial statements prepared in accordance with financial reporting provisions of a contract.
- Illustration 2: An auditor's report on a complete set of financial statements prepared in accordance with a special purpose framework, but which is not a fair presentation framework.
- Illustration 3: An auditor's report on a single financial statement prepared in accordance with a special purpose framework, which is a fair presentation framework.
- Illustration 4: An auditor's report on a specific element, account or item of a financial statement prepared in accordance with a special purpose framework, but which is not a fair presentation framework.

<u>Illustration 1:</u>

Circumstances include the following:

- **Audit of a complete set of financial statements.**
- **The financial statements have been prepared by the management of the entity in accordance with the financial reporting provisions of a contract (i.e., a special purpose framework, but which is not a fair presentation framework) to comply with the provisions of that contract (i.e., a specific purpose). Management does not have a choice of financial reporting frameworks.**

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

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

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and presentation of these financial statements in accordance with the financial reporting provisions of section Z of the contract between ABC Company and DEF Company ("the contract"). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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 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 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 of ABC Company for the year ended December 31, 20X1 are prepared, in all material respects, in accordance with the financial reporting provisions of section Z of the contract.

Other Matter – Restriction on Use *[and Distribution]*

As indicated above, the financial statements are prepared in accordance with the financial reporting provisions of section Z of the contract to assist ABC Company to comply with the provisions of the contract. The financial statements and related auditor's report may not be suitable for another purpose. *[Our report is intended solely for ABC Company and DEF Company and should not be distributed to or used by parties other than ABC Company or DEF Company.]*

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

Illustration 2:

Circumstances include the following:

- **Audit of a complete set of financial statements.**
- **The financial statements have been prepared by the management of a partnership in accordance with the tax basis of accounting in Country X (i.e., a special purpose framework, but which is not a fair presentation framework) to assist the partners in preparing their individual income tax returns (i.e., a specific purpose). Management does not have a choice of financial reporting frameworks.**

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

We have audited the accompanying financial statements of ABC Partnership, which comprise the balance sheet as at December 31, 20X1 and the income statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and presentation of these financial statements in accordance with the tax basis of accounting in Country X. They have been prepared to assist the partners of ABC Partnership in preparing their individual income tax returns. Management's responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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 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 partnership's preparation and 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 partnership'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 of ABC Partnership for the year ended December 31, 20X1 are prepared, in all material respects, in accordance with [describe the applicable income tax law] of Country X.

Other Matter – Restriction on Use *[and Distribution]*

As indicated above, the financial statements are prepared in accordance with the tax basis of accounting in Country X to assist the partners of ABC Partnership in preparing their individual income tax returns. The financial statements and related auditor's report may not be suitable for another purpose. *[Our report is intended solely for ABC Partnership and its partners and should not be distributed to or used by parties other than ABC Partnership or its partners.]*

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

<u>Illustration 3:</u>

Circumstances include the following:

- **Audit of a statement of cash receipts and disbursements (i.e., a single financial statement).**
- **The financial statement has been prepared by the management of the entity in accordance with the cash receipts and disbursements basis of accounting (for purposes of this illustration a fair presentation framework designed to meet the financial information needs of specific users) to respond to a request for cash flow information received from a creditor (i.e., a specific purpose). Management has a choice of financial reporting frameworks.**

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

We have audited the accompanying statement of cash receipts and disbursements of ABC Company for the year ended December 31, 20X1 and a summary of significant accounting policies and other explanatory notes (together "the financial statement").

Management's Responsibility for the Financial Statement

Management is responsible for the preparation and fair presentation of this financial statement in accordance with the cash receipts and disbursements basis of accounting described in Note X for the purpose of providing information to XYZ Creditor. This responsibility includes: determining that the cash receipts and disbursements basis of accounting is an acceptable basis for preparing and presenting the financial statement in the circumstances; designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the financial statement that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates, if any, that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial statement 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 whether the financial statement is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statement. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statement, 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 statement 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, if any, made by management, as well as evaluating the overall presentation of the financial statement.

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 statement presents fairly, in all material respects, the cash receipts and disbursements of ABC Company for the year ended December 31, 20X1 in accordance with the cash receipts and disbursements basis of accounting described in Note X.

Other Matter – Restriction on Use *[and Distribution]*

The financial statement is prepared in accordance with the cash receipts and disbursements basis of accounting described in Note X for purposes of providing information to XYZ Creditor. The statement and related auditor's report may not be suitable for another purpose. *[Our report is intended solely for ABC Company and XYZ Creditor and should not be distributed to or used by parties other than ABC Company or XYZ Creditor.]*

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

Illustration 4:

Circumstances include the following:

- **Audit of the liability for "incurred but not reported" claims in an insurance portfolio (i.e., element, account or item of a financial statement).**
- **The financial information has been prepared by the management of the entity in accordance with the financial reporting provisions established by a regulator (i.e., a special purpose framework, but which is not a fair presentation framework) to meet the requirements of that regulator (i.e., a specific purpose). Management does not have a choice of financial reporting frameworks.**

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

We have audited the accompanying schedule of the liability for "incurred but not reported" claims of ABC Insurance Company as of December 31, 20X1 ("the schedule").

Management's Responsibility for the Schedule

Management is responsible for the preparation and presentation of the schedule in accordance with [describe the financial reporting provisions established by the regulator]. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and presentation of the schedule that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on the schedule 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 whether the schedule is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the schedule. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the schedule, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and presentation of the schedule 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 schedule.

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 information in the schedule of the liability for "incurred but not reported" claims of ABC Insurance Company as of December 31, 20X1 is prepared, in all material respects, in accordance with [describe the financial reporting provisions established by the regulator].

Other Matter – Restriction on Use *[and Distribution]*

The schedule is prepared in accordance with [describe the financial reporting provisions established by the regulator] and it and the related auditor's report may not be suitable for another purpose. *[Our report is intended solely for ABC Insurance Company and [insert name of regulator] and should not be distributed to or used by parties other than ABC Insurance Company or [insert name of regulator].]*

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

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International
Auditing
and Assurance
Standards Board

Exposure Draft
July 2007
Comments are requested by November 30, 2007

Proposed Redrafted International Standard on Auditing

ISA 805 (Revised), Engagements to Report on Summary Financial Statements

International Federation of Accountants

REQUEST FOR COMMENTS

The International Auditing and Assurance Standards Board (IAASB), an independent standard-setting body within the International Federation of Accountants (IFAC), approved the exposure draft of proposed International Standard on Auditing (ISA) 805 (Revised and Redrafted), "Engagements to Report on Summary Financial Statements" for publication in July 2007. The proposed ISA may be modified in light of comments received before being issued in final form.

Please submit your comments, preferably by e-mail, so that they will be received by **November 30, 2007**. All comments will be considered a matter of public record. Comments should be addressed to:

International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, New York 10017 USA

Comments should be emailed to Edcomments@ifac.org. They may also be faxed to +1-212-286-9570 or mailed to the above address.

Copies of the exposure drafts may be downloaded free-of-charge from the IFAC website at http://www.ifac.org.

CONTENTS

EXPLANATORY MEMORANDUM

Introduction

This memorandum provides background to proposed International Standard on Auditing (ISA) 805 (Revised and Redrafted), "Engagements to Report on Summary Financial Statements." The proposed ISA has been redrafted in accordance with conventions agreed by the International Auditing and Assurance Standards Board (IAASB) to be applied to all ISAs. The IAASB approved the proposed redrafted ISA for exposure in July 2007.

Background

In June 2005, the IAASB issued an exposure draft of proposed ISA 800, "The Independent Auditor's Report on Summary Audited Financial Statements." The comment period closed on October 31, 2005. The IAASB gave due consideration to the comments received on the proposed ISA.

The IAASB also agreed to renumber and title the ISA as ISA 805 (Revised), "Engagements to Report on Summary Financial Statements."

In October 2006, the IAASB approved a "close off" document of ISA 805 (Revised) in the "old style" (i.e., following the IAASB's current drafting conventions). The close off document incorporates the changes based on the comments received on the June 2005 exposure draft, and forms the basis for the proposed redrafted ISA.

The Basis for Conclusions: ISA 805 (Revised) and related close off document are available on the IAASB website at http://www.ifac.org/Guidance/EXD-Details.php?EDID=0094. They are referenced here for information purposes only and do not form part of the exposure draft.

The conventions used by the IAASB in redrafting ISA 805 (Revised), and the authority and obligation attaching to those conventions, are established in proposed ISA 200 (Revised and Redrafted), "Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing" approved by the IAASB as an exposure draft in April 2007, and in the amended "Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services"[1] (Preface) approved by the IAASB in September 2006.

Effective Date

The current timetable envisages that all ISAs will have been revised and redrafted, or redrafted only, by late 2008 and the IAASB has provisionally agreed that the complete set of ISAs will be effective for audits of financial statements for periods beginning on or after December 15, 2008. This date will depend on satisfactory progress being made, and will be amended to a later date should that prove necessary. The IAASB believes that it is in the interests of auditors and others who use the ISAs that the ISAs should be released as soon as they are approved so as to facilitate their implementation.

[1] The amended Preface can be accessed at http://web.ifac.org/download/IAASB_Preface.pdf. Proposed ISA 200 (Revised and Redrafted) can be accessed at http://www.ifac.org/Guidance/EXD-Details.php?EDID=0079.

Significant Matters

Form of Opinion

When the IAASB approved the close off document of ISA 805 (Revised), it agreed that the following matter would be drawn to the attention of respondents in this explanatory memorandum and views sought thereon.

The exposure draft of proposed ISA 800 required the auditor to express an opinion whether the summary financial statements are an appropriate summary of the audited financial statements from which they are derived, in accordance with the specified established criteria or the basis described. A small majority of respondents did not support the proposed form of opinion. Some preferred the existing form of opinion, i.e., "consistent, in all material respects."

The IAASB debated the comments and agreed that, based on the procedures in paragraph 11 of proposed ISA 805 (Revised and Redrafted), and any other procedures that the auditor may consider necessary in the circumstances, the auditor should form an opinion whether the summary financial statements are a fair summary of the audited financial statements in accordance with the applied criteria. The procedures specified in paragraph 11 include an evaluation whether, in view of the applied criteria, the summary financial statements contain the information necessary so as not to be misleading in the circumstances.

In addition, proposed ISA 805 (Revised and Redrafted) provides for circumstances where national law or regulation governing reporting on summary financial statements prescribes wording for the opinion that is different from that described above. See paragraph 10.

Summary Financial Statements Included in Documents Relating to Securities Offered to the Public

Paragraph 1 of the close off document of ISA 805 (Revised) notes that the requirements and guidance in the ISA do not apply when reporting on summary financial statements that are included in documents relating to securities offered to the public. When the IAASB considered the close off document, a member indicated that the requirements now included in paragraphs 6(c) and 25-26 of proposed ISA 805 (Revised and Redrafted) may be problematic in the context of summary financial statements in documents relating to securities offered to the public. Recognizing that the ISA has not been drafted specifically with such documents in mind, the IAASB agreed that paragraph 1 should be included in the close off document.

The issue relating to the applicability of ISAs to financial information in documents relating to securities offered to the public is addressed in the explanatory memorandum accompanying the exposure draft of proposed ISA 720 (Redrafted), "The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements." Pending analysis of the responses to that exposure draft, the sentence has been deleted from proposed ISA 805 (Revised and Redrafted).

Guide for Respondents

The IAASB is seeking comments **only** on changes resulting from applying the clarity drafting conventions, including the matters discussed above, and their effect on the content of the close off document of ISA 805 (Revised). Respondents are asked to respond in particular to the following questions:

1. Are the objectives to be achieved by the auditor, stated in the proposed redrafted ISA, appropriate?

2. Have the criteria identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and reporting and the use of professional judgment by auditors?[2]

Recognizing that the final ISA will apply to audits of all sizes and in all sectors of the economy, the IAASB is also interested in comments on matters set out below.

- *Special Considerations in the Audit of Small Entities*—Respondents are asked to comment whether, in their opinion, considerations in the audit of small entities have been dealt with appropriately in the proposed redrafted ISA.

- *Special Considerations in the Audit of Public Sector Entities*—Respondents are asked to comment whether, in their opinion, special considerations in the audit of public sector entities have been dealt with appropriately in the proposed redrafted ISA.

- *Developing Nations*—Recognizing that many developing nations have adopted or are in the process of adopting the ISAs, the IAASB invites respondents from these nations to comment, in particular, on any foreseeable difficulties in applying the proposed redrafted ISA in a developing nation environment.

- *Translations*—Recognizing that many respondents intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues noted in reviewing the proposed redrafted ISA.

Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in the exposure draft, it will be helpful for the IAASB to be made aware of this view.

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2 The IAASB has identified the following criteria for determining the requirements of a Standard:

- The requirement is necessary to achieve the objective stated in the Standard;
- The requirement is expected to be applicable in virtually all engagements to which the Standard is relevant; and
- The objective stated in the Standard is unlikely to have been met by the requirements of other Standards.

In determining the requirements of a Standard, the IAASB will consider whether the requirements are proportionate to the importance of the subject matter of the Standard in relation to the overall objective of the engagement.

The criteria, which are intended only to assist the IAASB in appropriately and consistently determining requirements, may be refined as further experience is gained.

Respondents are also invited to comment on any undue costs, set against the benefits of more consistent auditor performance, arising from the fact that the proposed redrafted ISA includes requirements that would previously have been guidance under the old drafting conventions, as in the close off document of ISA 805 (Revised) (see below). In commenting on this matter, respondents should bear in mind the criteria that the IAASB has applied in redrafting the proposed ISA (see footnote 2) and the fact that the IAASB is seeking to clarify that there was some guidance in extant ISAs that was more in the nature of requirements and would already have been followed by many auditors.

Supplement to the Exposure Draft

To assist respondents in tracking changes, IAASB staff has prepared an analysis of the decisions that have been made by the IAASB with respect to the treatment of the present tense in the explanatory paragraphs of the close off document of ISA 805 (Revised). This analysis also demonstrates how the material in the close off document has been reflected in the proposed redrafted ISA. In particular, the analysis:

- Identifies existing sentences in the present tense and whether they are now treated as a requirement or as application material;
- Maps the material of the close off document to the proposed redrafted ISA; and
- Identifies explanatory material that is proposed to be eliminated or repositioned as a result of redrafting.

These staff-prepared mapping documents are available on the IAASB website at http://www.ifac.org/Guidance/EXD-Details.php?EDID=0094. They are for information purposes only and do not form part of the exposure draft.

To be considered, responses should be emailed to Edcomments@ifac.org. They may also be faxed to +1-212-286-9570 or mailed to 545 Fifth Avenue, 14th Floor, New York, NY 10017, USA. They should be received by **November 30, 2007.**

PROPOSED INTERNATIONAL STANDARD ON AUDITING 805 (REVISED AND REDRAFTED)

ENGAGEMENTS TO REPORT ON SUMMARY FINANCIAL STATEMENTS

(Effective for engagements for periods beginning on or after [date])*

CONTENTS

* See footnote 1.

International Standard on Auditing (ISA) 805 (Revised and Redrafted), "Engagements to Report on Summary Financial Statements" should be read in conjunction with [proposed] ISA 200 (Revised and Redrafted), "Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing."

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with engagements to report on summary financial statements derived from financial statements audited in accordance with the ISAs by the same auditor that is engaged to report on the summary financial statements.

Effective Date

2. This ISA is effective for engagements for periods beginning on or after [date].[1]

Definitions

3. For purposes of this ISA, the following terms have the meanings attributed below:

   (a) Applied criteria – The criteria applied by management in preparing and presenting the summary financial statements.

   (b) Audited financial statements – The financial statements, audited by the auditor in accordance with the ISAs, and from which the summary financial statements are derived.

   Although different jurisdictions may use different terminology to describe financial information that is a summary of financial statements, for purposes of this ISA they are referred to as "summary financial statements."

Objective

4. The objective of the auditor is to express an opinion whether the summary financial statements are a fair summary of the audited financial statements in accordance with the applied criteria.

Requirements

Engagement Acceptance

5. The auditor shall accept an engagement to report on summary financial statements in accordance with this ISA only when the summary financial statements are derived from financial statements on which the auditor has issued an auditor's report in accordance with the ISAs. (Ref: Para. A1)

6. Before accepting an engagement to report on summary financial statements, the auditor shall request management to: (Ref: Para. A2)

   (a) Acknowledge its responsibility for preparing and presenting the summary financial statements in accordance with the applied criteria;

[1] This date will not be earlier than December 15, 2008.

(b) Unless the circumstances in paragraph 8 apply, confirm that the audited financial statements will be made available to the intended users of the summary financial statements without undue difficulty; and

(c) Confirm that any document containing the summary financial statements that indicates that the auditor has reported on them will include the auditor's report.

7. If management refuses to provide either the acknowledgement or confirmations in paragraph 6, the auditor shall not accept the engagement, unless law or regulation prohibits the auditor from declining an engagement to report on summary financial statements. When law or regulation prohibits the auditor from declining such an engagement, the auditor shall:

(a) Disclaim an opinion on the summary financial statements in the case of paragraph 6(a); or

(b) Consider seeking legal advice to assist in determining the appropriate course of action if the circumstances in paragraph 6(b) or (c) arise. (See paragraphs 25-26.)

The auditor shall also determine the effect that management's refusal may have on the auditor's acceptance of the engagement to audit the financial statements.

8. In some jurisdictions, law or regulation may provide that the audited financial statements need not be made available to the intended users of the summary financial statements. In such cases, the auditor shall accept an engagement to report on summary financial statements only if the law or regulation establishes the criteria for preparing and presenting the summary financial statements, unless law or regulation prohibits the auditor from declining such an engagement. When law or regulation prohibits the auditor from declining such an engagement, the auditor's report on the summary financial statements shall not indicate that the engagement was conducted in accordance with ISAs.

Criteria

9. The auditor shall accept an engagement to report on summary financial statements only when the auditor concludes that the applied criteria are acceptable in the circumstances, unless law or regulation prohibits the auditor from declining such an engagement. When law or regulation prohibits the auditor from declining such an engagement, the auditor shall modify the auditor's report on the summary financial statements appropriately. (Ref: Para. A3-A7)

Opinion

10. In some cases, law or regulation may prescribe the wording of the opinion on summary financial statements in terms that are significantly different from the requirements of this ISA. In such cases the auditor shall:

(a) Apply the procedures described in paragraph 11 and any further procedures necessary to enable the auditor to express the prescribed opinion; and

(b) Evaluate whether users of the summary financial statements might misunderstand the auditor's opinion on the summary financial statements and, if so, whether additional explanation in the auditor's report on the summary financial statements can mitigate possible misunderstanding. If the auditor concludes that additional explanation in the auditor's report on the summary financial statements cannot mitigate possible misunderstanding, the auditor shall not accept the audit engagement, unless prohibited by law or regulation from doing so. When law or regulation prohibits the auditor from declining such an engagement, the auditor's report on the summary financial statements shall not indicate that the engagement was conducted in accordance with ISAs.

Nature of Procedures and Form of Opinion

11. The auditor shall perform the following procedures as the basis for the auditor's opinion on the summary financial statements:

    (a) Evaluate whether the summary financial statements adequately disclose their summarized nature and identify the audited financial statements.

    (b) When summary financial statements are not accompanied by the audited financial statements, evaluate whether they describe clearly:

        (i) From whom or where the audited financial statements are available; or

        (ii) In the circumstances addressed in paragraph 8, the law or regulation that specifies that the audited financial statements need not be made available to the intended users of the summary financial statements.

    (c) Unless the circumstances in paragraph 8 apply, evaluate whether the audited financial statements are available to the intended users of the summary financial statements without undue difficulty. (Ref: Para. A8)

    (d) Evaluate whether the summary financial statements adequately disclose the applied criteria.

    (e) Compare the summary financial statements with the related information in the audited financial statements to determine whether the summary financial statements agree with or can be recalculated from the related information in the audited financial statements.

    (f) Evaluate whether the summary financial statements are prepared and presented in accordance with the applied criteria.

    (g) In view of the applied criteria, evaluate whether the summary financial statements contain the information necessary so as not to be misleading in the circumstances.

12. Based on the procedures in paragraph 11, and any other procedures that the auditor may consider necessary in the circumstances, the auditor shall form an opinion whether the summary financial statements are a fair summary of the audited financial statements in accordance with the applied criteria.

Timing of Work and Events Subsequent to the Date of the Auditor's Report on the Audited Financial Statements

13. The auditor's report on the summary financial statements may be dated later than the date of the auditor's report on the audited financial statements. In such cases, the auditor's report on the summary financial statements shall state that the summary financial statements and audited financial statements do not reflect the effects of events that occurred subsequent to the date of the auditor's report on the audited financial statements that may require adjustment of, or disclosure in, the audited financial statements. (Ref: Para. A9)

14. The auditor may become aware of facts that existed at the date of the auditor's report on the audited financial statements, but of which the auditor previously was unaware. In such cases, the auditor shall not issue the auditor's report on the summary financial statements until the auditor's consideration of such facts in relation to the audited financial statements in accordance with [proposed] ISA 560 (Redrafted), "Subsequent Events" has been completed. (Ref: Para. A10)

Auditor's Report on Summary Financial Statements

Elements of the Auditor's Report

15. The auditor's report on summary financial statements, derived from audited financial statements on which an unmodified opinion is expressed,2 shall include the following elements: (Ref: Para. A15)
    (a) A title clearly indicating it as the report of an independent auditor. (Ref: Para. A11)
    (b) An addressee. (Ref: Para. A12)
    (c) An introductory paragraph that:
        (i) Identifies the summary financial statements on which the auditor is reporting, including the title of each statement included in the summary financial statements; (Ref: Para. A13)
        (ii) Identifies the audited financial statements;
        (iii) Refers to the auditor's report on the audited financial statements, the date of that report, and the fact that an unmodified opinion is expressed on the audited financial statements;
        (iv) If the date of the auditor's report on the summary financial statements is later than the date of the auditor's report on the audited financial statements, states that the summary financial statements and the audited financial statements do not reflect the effects of events that occurred subsequent to the date of the auditor's report on the audited financial statements; and

[2] Paragraphs 18-19 deal with circumstances where the auditor's report on the audited financial statements has been modified.

(v) A statement, or reference to a note in the summary financial statements, indicating that they do not contain all the disclosures required by the financial reporting framework applied in preparing and presenting the audited financial statements, and that reading the summary financial statements is not a substitute for reading the audited financial statements.

(d) A description of management's responsibility for preparing and presenting the summary financial statements in accordance with the applied criteria.

(e) A statement that the auditor is responsible for expressing an opinion on the summary financial statements based on the procedures required by this ISA.

(f) A paragraph clearly expressing an opinion whether the summary financial statements are a fair summary of the audited financial statements in accordance with the applied criteria or, in the circumstances described in paragraph 10, a paragraph clearly expressing the opinion prescribed by law or regulation.

(g) The auditor's signature.

(h) The date of the auditor's report. (Ref: Para. A14)

(i) The auditor's address.

16. Normally the addressee of the summary financial statements is the same as the addressee of the auditor's report on the audited financial statements. If this is not the case, the auditor shall evaluate the appropriateness of using a different addressee. (Ref: Para. A12)

17. The auditor shall date the auditor's report on the summary financial statements no earlier than (a) the date on which the auditor has obtained sufficient appropriate evidence on which to base the opinion, and (b) the date of the auditor's report on the audited financial statements. Sufficient appropriate evidence shall include evidence that the summary financial statements have been prepared and that management has asserted that it has taken responsibility for them. (Ref: Para. A14)

Modifications to the Opinion, Emphasis of Matter Paragraph or Other Matter(s) Paragraph in the Auditor's Report on the Audited Financial Statements (Ref: Para. A16)

18. When the auditor's report on the audited financial statements contains a qualified opinion, an Emphasis of Matter paragraph, or an Other Matter(s) paragraph, but the auditor is satisfied that the summary financial statements are a fair summary of the audited financial statements in accordance with the applied criteria, the auditor's report on the summary financial statements shall, in addition to the elements in paragraph 15:

(a) State that the auditor's report on the audited financial statements contains a qualified opinion, an Emphasis of Matter paragraph, or an Other Matter(s) paragraph; and

(b) Describe:

(i) The basis for the qualified opinion on the audited financial statements, and that qualified opinion; or the Emphasis of Matter or the Other Matter(s) paragraph in the auditor's report on the audited financial statements; and

(ii) The effect thereof on the summary financial statements, if any.

19. When the auditor's report on the audited financial statements contains an adverse opinion or a disclaimer of opinion, the auditor's report on the summary financial statements shall, in addition to the elements in paragraph 15:

    (a) State that the auditor's report on the audited financial statements contains an adverse opinion or disclaimer of opinion;

    (b) Describe the basis for that adverse opinion or disclaimer of opinion; and

    (c) State that, as a result of the adverse opinion or disclaimer of opinion, it would be inappropriate to express an opinion on the summary financial statements.

Modified Opinion on the Summary Financial Statements

20. If the summary financial statements are not a fair summary of the audited financial statements in accordance with the applied criteria, and management does not agree to make the appropriate changes, the auditor shall express an adverse opinion on the summary financial statements. (Ref: Para. A17)

Restriction on Use or Distribution

21. When the use or distribution of the auditor's report on the audited financial statements is restricted, the auditor shall restrict use or distribution of the auditor's report on the summary financial statements accordingly.

Comparatives (Ref: Para. A18-A19)

22. If the audited financial statements contain comparatives, but the summary financial statements do not, the auditor shall determine whether such omission is reasonable in the circumstances of the engagement. The auditor shall determine the effect of an unreasonable omission on the auditor's report on the summary financial statements.

23. If the summary financial statements contain comparatives that were reported on by another auditor, the auditor's report on the summary financial statements shall also contain the matters included in the auditor's report on the audited financial statements in compliance with ISA 710, "Comparatives."

Unaudited Supplementary Information Presented with Summary Financial Statements

24. The auditor shall evaluate whether any unaudited supplementary information presented with the summary financial statements is clearly differentiated from the summary financial statements. If the auditor concludes that the entity's presentation of the unaudited supplementary information does not differentiate it sufficiently from the summary financial statements, the auditor shall ask management to change how the unaudited supplementary information is presented. If management refuses to do so, the auditor's report on the summary financial statements shall explain that the supplementary information is not covered by the report. (Ref: Para. A20-A21)

Auditor Association

25. The auditor may report on the audited financial statements but not on the summary financial statements. If, in this case, the auditor becomes aware that the entity plans to make a statement in a document that refers to the auditor and the fact that summary financial statements are derived from the audited financial statements, the auditor shall be satisfied that:

    (a) The reference to the auditor is made in the context of the auditor's report on the audited financial statements; and

    (b) The statement does not give the impression that the auditor has reported on the summary financial statements.

    If (a) or (b) are not met, the auditor shall request management to change the statement to meet them, or not to refer to the auditor in the document. Alternatively, the entity may engage the auditor to report on the summary financial statements and include the auditor's report in the document. If management does not change the statement, delete the reference to the auditor, or include an auditor's report on the summary financial statements in the document containing the summary financial statements, the auditor shall advise management that the auditor disagrees with the reference to the auditor, and the auditor shall determine and carry out other appropriate actions designed to prevent management from inappropriately referring to the auditor. (Ref: Para. A22)

26. If the auditor has reported on summary financial statements and becomes aware that the entity plans to state that fact in a document containing the summary financial statements, but does not plan to include the related auditor's report, the auditor shall request management to include the auditor's report in the document. If management does not do so, the auditor shall determine and carry out other appropriate actions designed to prevent management from inappropriately associating the auditor with the summary financial statements in that document. (Ref: Para. A22)

***

Application and Other Explanatory Material

Engagement Acceptance (Ref: Para. 5-6)

A1. The audit of the financial statements from which the summary financial statements are derived provides the auditor with the necessary knowledge to discharge the auditor's responsibilities in relation to the summary financial statements in accordance with this ISA. Application of this ISA will not provide sufficient appropriate evidence on which to base the opinion on the summary financial statements if the auditor has not also audited the financial statements from which the summary financial statements are derived.

A2. Management's acknowledgement and confirmation of the matters described in paragraph 6 may be evidenced by its written acceptance of the terms of the engagement.

Criteria (Ref: Para. 9)

A3. Management is responsible for determining the information that needs to be reflected in the summary financial statements so that they represent a fair summary of the audited financial statements. Because summary financial statements by their nature contain aggregated information and limited disclosure there is an increased risk that they may not contain the information necessary so as not to be misleading in the circumstances. This risk increases when established criteria for preparing and presenting summary financial statements do not exist.

A4. Factors that may affect the auditor's determination of the acceptability of the applied criteria include:

- The nature of the entity;
- The purpose of the summary financial statements;
- The information needs of the intended users of the summary financial statements; and
- Whether the applied criteria will result in summary financial statements that are not misleading in the circumstances.

A5. The criteria for preparing and presenting summary financial statements may be established by an authorized or recognized standards setting organization or by law or regulation. As explained in ISA 210, "Terms of Audit Engagements," in many cases the auditor may presume that such criteria are acceptable.

A6. Where established criteria for preparing and presenting summary financial statements do not exist, criteria may be developed by management, for example, based on practice in a particular industry. Criteria that are acceptable in the circumstances will result in summary financial statements that:

(a) Adequately disclose their summarized nature and identify the audited financial statements;

(b) Clearly describe from whom or where the audited financial statements are available or, in the circumstances addressed in paragraph 8, the law or regulation that specifies that the audited financial statements need not be made available to the intended users of the summary financial statements;

(c) Adequately disclose the applied criteria;

(d) Agree with or can be recalculated from the related information in the audited financial statements; and

(e) In view of the purpose of the summary financial statements, contain the information necessary, and are at a level of aggregation, so as not to be misleading in the circumstances.

A7. Adequate disclosure of the summarized nature of the summary financial statements and the identity of the audited financial statements, as referred to in paragraph A6(a), may, for example, be provided by a title such as "Summary Financial Statements Prepared from the Audited Financial Statements for the Year Ended December 31, 20X1."

Evaluating the Availability of the Audited Financial Statements (Ref: Para. 11(c))

A8. The auditor's evaluation whether the audited financial statements are available to the intended users of the summary financial statements without undue difficulty is affected by factors such as whether:

- The summary financial statements describe clearly from whom or where the audited financial statements are available;
- The audited financial statements are on public record; or
- Management has established a process by which the intended users of the summary financial statements can obtain ready access to the audited financial statements.

Timing of Work and Events Subsequent to the Date of the Auditor's Report on the Audited Financial Statements (Ref: Para. 13-14)

A9. The procedures described in paragraph 11 are often performed during or immediately after the audit of the financial statements. When the auditor is requested to report on the summary financial statements after the completion of the audit of the financial statements, the auditor is not required to obtain additional audit evidence on the audited financial statements, or report on the effects of events that occurred subsequent to the date of the auditor's report on the audited financial statements since the summary financial statements are derived from the audited financial statements and do not update them.

A10. Prior to issuing the report on the summary financial statements, the auditor may become aware of facts that existed at the date of the auditor's report on the audited financial statements but of which the auditor was previously unaware. In such cases, the auditor considers such facts in relation to the audited financial statements in accordance with [proposed] ISA 560 (Redrafted). The auditor does not issue the report on the summary financial statements until such consideration has been completed, since it would be inappropriate to issue summary financial statements if the possibility of adjustment to the audited financial statements was under consideration.

Auditor's Report on Summary Financial Statements

Elements of the Auditor's Report

Title (Ref: Para. 15(a))

A11. A title indicating the report is the report of an independent auditor, for example, "Report of the Independent Auditor," affirms that the auditor has met all of the relevant ethical requirements regarding independence. This distinguishes the report of the independent auditor from reports issued by others.

Addressee (Ref: Para. 15(b), 16)

A12. Factors that may affect the auditor's evaluation of the appropriateness of the addressee of the summary financial statements include the terms of the engagement, the nature of the entity, and the purpose of the summary financial statements.

Introductory Paragraph (Ref: Para. 15(c)(i))

A13. When the auditor is aware that the summary financial statements will be included in a document that contains other information, the auditor may consider, if the form of presentation allows, identifying the page numbers on which the summary financial statements are presented. This helps readers to identify the summary financial statements to which the auditor's report relates.

Date of the Auditor's Report (Ref: Para. 15(h), 17)

A14. The summary financial statements are the responsibility of management. The auditor therefore is not in a position to conclude that sufficient appropriate evidence has been obtained until evidence is obtained that the preparation of the summary financial statements has been completed and management has asserted that it has taken responsibility for them. The person or persons with recognized authority to provide such an assertion depend on the terms of the engagement, the nature of the entity, and the purpose of the summary financial statements.

Illustrations (Ref: Para. 14)

A15. The Appendix to this ISA contains illustrations of auditors' reports that contain unmodified opinions on summary financial statements.

Modifications to the Opinion, Emphasis of Matter Paragraph or Other Matter(s) Paragraph in the Auditor's Report on the Audited Financial Statements (Ref: Para. 18-19)

A16. The Appendix to this ISA contains illustrations of auditors' reports on summary financial statements derived from audited financial statements on which the auditor issued modified opinions.

Modified Opinion on the Summary Financial Statements (Ref: Para. 20)

A17. The Appendix to this ISA contains an illustration of an auditor's report with a modified opinion on the summary financial statements.

Comparatives (Ref: Para. 22-23)

A18. There is a presumption that if the audited financial statements contain comparatives, the summary financial statements also would contain comparatives. Comparatives in the audited financial statements may be regarded as corresponding figures or as comparative financial information. ISA 710 describes how this difference affects the auditor's report, including, in particular, reference to other auditors who audited the financial statements for the prior period.

A19. Circumstances that may affect the auditor's determination whether an omission of comparatives is reasonable include the nature and objective of the summary financial statements, the applied criteria, and the information needs of the intended users of the summary financial statements.

Unaudited Supplementary Information Presented with Summary Financial Statements (Ref: Para. 24)

A20. [Proposed] ISA 700 (Redrafted), "The Independent Auditor's Report on General Purpose Financial Statements" contains requirements and guidance to be applied when unaudited supplementary information is presented with audited financial statements.

A21. The fact that supplementary information is unaudited does not relieve the auditor of the responsibility to read that information to identify material inconsistencies with the summary financial statements in accordance with [proposed] ISA 720 (Redrafted), "The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements."

Auditor Association (Ref: Para. 25-26)

A22. Other appropriate actions the auditor may take when management does not take the requested action (see paragraphs 25-26) may include informing the intended users and other known third party users of the inappropriate reference to the auditor.

Appendix

(Ref: Para. A15- A17)

Illustrations of Reports on Summary Financial Statements

- Illustration 1: An auditor's report on summary financial statements prepared in accordance with established criteria. An unmodified opinion is expressed on the audited financial statements.
- Illustration 2: An auditor's report on summary financial statements prepared in accordance with criteria developed by management and adequately disclosed in the summary financial statements. The auditor has determined that the applied criteria are acceptable in the circumstances. An unmodified opinion is expressed on the audited financial statements.
- Illustration 3: An auditor's report on summary financial statements prepared in accordance with criteria developed by management and adequately disclosed in the summary financial statements. The auditor has determined that the applied criteria are acceptable in the circumstances. A qualified opinion is expressed on the audited financial statements.
- Illustration 4: An auditor's report on summary financial statements prepared in accordance with criteria developed by management and adequately disclosed in the summary financial statements. The auditor has determined that the applied criteria are acceptable in the circumstances. An adverse opinion is expressed on the audited financial statements.
- Illustration 5: An auditor's report on summary financial statements prepared in accordance with established criteria. An unmodified opinion is expressed on the audited financial statements. The auditor concludes that it is not possible to express an unmodified opinion on the summary financial statements.

Illustration 1:

Circumstances include the following:

- **An unmodified opinion is expressed on the audited financial statements.**
- **Established criteria for preparing and presenting summary financial statements exist.**

REPORT OF THE INDEPENDENT AUDITOR ON THE SUMMARY FINANCIAL STATEMENTS

[Appropriate Addressee]

The accompanying summary financial statements, which comprise the summary balance sheet as at December 31, 20X1, the summary income statement, summary statement of changes in equity and summary cash flow statement for the year then ended, and related notes, are derived from the audited financial statements of ABC Company for the year ended December 31, 20X1. We expressed an unmodified audit opinion on those financial statements in our report dated February 15, 20X2.[3]

The summary financial statements do not contain all the disclosures required by [describe financial reporting framework applied in preparing and presenting the audited financial statements of ABC Company]. Reading the summary financial statements, therefore, is not a substitute for reading the audited financial statements of ABC Company.

Management's Responsibility for the Summary Financial Statements

Management is responsible for preparing and presenting a summary of the audited financial statements in accordance with [describe established criteria].

Auditor's Responsibility

Our responsibility is to express an opinion on the summary financial statements based on our procedures which were conducted in accordance with International Standard on Auditing (ISA) 805 (Revised and Redrafted), "Engagements to Report on Summary Financial Statements."

Opinion

In our opinion, the summary financial statements derived from the audited financial statements of ABC Company for the year ended December 31, 20X1 are a fair summary of those financial statements in accordance with [describe established criteria].

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

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3 When the auditor's report on the summary financial statements is dated later than the date of the auditor's report on the audited financial statements from which it is derived, the following sentence is added to this paragraph: "Those financial statements, and the summary financial statements, do not reflect the effects of events that occurred subsequent to the date of the auditor's report on those financial statements."

Illustration 2:

Circumstances include the following:

- **An unmodified opinion is expressed on the audited financial statements.**
- **Criteria are developed by management and adequately disclosed in Note X. The auditor has determined that the criteria are acceptable in the circumstances.**

REPORT OF THE INDEPENDENT AUDITOR ON THE SUMMARY FINANCIAL STATEMENTS

[Appropriate Addressee]

The accompanying summary financial statements, which comprise the summary balance sheet as at December 31, 20X1, the summary income statement, summary statement of changes in equity and summary cash flow statement for the year then ended, and related notes, are derived from the audited financial statements of ABC Company for the year ended December 31, 20X1. We expressed an unmodified audit opinion on those financial statements in our report dated February 15, 20X2.[4]

The summary financial statements do not contain all the disclosures required by [describe financial reporting framework applied in preparing and presenting the audited financial statements of ABC Company]. Reading the summary financial statements, therefore, is not a substitute for reading the audited financial statements of ABC Company.

Management's Responsibility for the Summary Financial Statements

Management is responsible for preparing and presenting a summary of the audited financial statements on the basis described in Note X.

Auditor's Responsibility

Our responsibility is to express an opinion on the summary financial statements based on our procedures which were conducted in accordance with International Standard on Auditing (ISA) 805 (Revised and Redrafted), "Engagements to Report on Summary Financial Statements."

Opinion

In our opinion, the summary financial statements derived from the audited financial statements of ABC Company for the year ended December 31, 20X1 are a fair summary of those financial statements on the basis described in Note X.

[Auditor's signature]

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[4] When the auditor's report on the summary financial statements is dated later than the date of the auditor's report on the audited financial statements from which it is derived, the following sentence is added to this paragraph: "Those financial statements, and the summary financial statements, do not reflect the effects of events that occurred subsequent to the date of the auditor's report on those financial statements."

[Date of the auditor's report]

[Auditor's address]

Illustration 3:

Circumstances include the following:

- **A qualified opinion is expressed on the audited financial statements.**
- **Criteria are developed by management and adequately disclosed in Note X. The auditor has determined that the criteria are acceptable in the circumstances.**

REPORT OF THE INDEPENDENT AUDITOR ON THE SUMMARY FINANCIAL STATEMENTS

[Appropriate Addressee]

The accompanying summary financial statements, which comprise the summary balance sheet as at December 31, 20X1, the summary income statement, summary statement of changes in equity and summary cash flow statement for the year then ended, and related notes, are derived from the audited financial statements of ABC Company for the year ended December 31, 20X1.[5] We expressed a qualified audit opinion on those financial statements in our report dated February 15, 20X2 (see below).

The summary financial statements do not contain all the disclosures required by [describe financial reporting framework applied in preparing and presenting the audited financial statements of ABC Company]. Reading the summary financial statements, therefore, is not a substitute for reading the audited financial statements of ABC Company.

Management's Responsibility for the Summary Financial Statements

Management is responsible for preparing and presenting a summary of the audited financial statements on the basis described in Note X.

Auditor's Responsibility

Our responsibility is to express an opinion on the summary financial statements based on our procedures which were conducted in accordance with International Standard on Auditing (ISA) 805 (Revised and Redrafted), "Engagements to Report on Summary Financial Statements."

Opinion

In our opinion, the summary financial statements derived from the audited financial statements of ABC Company for the year ended December 31, 20X1 are a fair summary of those financial statements on the basis described in Note X. However, the summary financial statements are misstated to the equivalent extent as the audited financial statements of ABC Company for the year ended December 31, 20X1.

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5 When the auditor's report on the summary financial statements is dated later than the date of the auditor's report on the audited financial statements from which it is derived, the following sentence is added to this paragraph: "Those financial statements, and the summary financial statements, do not reflect the effects of events that occurred subsequent to the date of the auditor's report on those financial statements."

The misstatement of the audited financial statements is described in our qualified audit opinion in our report dated February 15, 20X2. Our qualified audit opinion is based on the fact that the company's inventories are carried in the balance sheet in those financial statements at xxx. Management has not stated the inventories at the lower of cost and net realizable value but has stated them solely at cost, which constitutes a departure from International Financial Reporting Standards. The company's records indicate that had management stated the inventories at the lower of cost and net realizable value, an amount of xxx would have been required to write the inventories down to their net realizable value. Accordingly, cost of sales would have been increased by xxx, and income tax, net income and shareholders' equity would have been reduced by xxx, xxx and xxx, respectively. Our qualified audit opinion states that, except for the effects of the described matter, those financial statements present fairly, in all material respects, *(or "give a true and fair view of")* the financial position of ABC Company as of December 31, 20X1, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

<u>Illustration 4:</u>

Circumstances include the following:

- **An adverse opinion is expressed on the audited financial statements.**
- **Criteria are developed by management and adequately disclosed in Note X. The auditor has determined that the criteria are acceptable in the circumstances.**

REPORT OF THE INDEPENDENT AUDITOR ON THE SUMMARY FINANCIAL STATEMENTS

[Appropriate Addressee]

The accompanying summary financial statements, which comprise the summary balance sheet as at December 31, 20X1, the summary income statement, summary statement of changes in equity and summary cash flow statement for the year then ended, and related notes, are derived from the audited financial statements of ABC Company for the year ended December 31, 20X1.[6]

The summary financial statements do not contain all the disclosures required by [describe financial reporting framework applied in preparing and presenting the audited financial statements of ABC Company]. Reading the summary financial statements, therefore, is not a substitute for reading the audited financial statements of ABC Company.

Management's Responsibility for the Summary Financial Statements

Management is responsible for preparing and presenting a summary of the audited financial statements on the basis described in Note X.

Auditor's Responsibility

Our responsibility is to express an opinion on the summary financial statements based on our procedures which were conducted in accordance with International Standard on Auditing (ISA) 805 (Revised and Redrafted), "Engagements to Report on Summary Financial Statements."

Denial of Opinion

In our report dated February 15, 20X2, we expressed an adverse audit opinion on the financial statements of ABC Company for the year ended December 31, 20X1. The basis for our adverse audit opinion was [describe basis for adverse audit opinion]. Our adverse audit opinion stated that [describe adverse audit opinion].

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[6] When the auditor's report on the summary financial statements is dated later than the date of the auditor's report on the audited financial statements from which it is derived, the following sentence is added to this paragraph: "Those financial statements, and the summary financial statements, do not reflect the effects of events that occurred subsequent to the date of the auditor's report on those financial statements."

Because of the significance of the matter discussed above, it would be inappropriate to express an opinion on the summary financial statements of ABC Company for the year ended December 31, 20X1.

[Auditor’s signature]

[Date of the auditor’s report]

[Auditor’s address]

<u>Illustration 5:</u>

Circumstances include the following:

- **An unmodified opinion is expressed on the audited financial statements.**
- **Established criteria for preparing and presenting summary financial statements exist.**
- **The auditor concludes that it is not possible to express an unmodified opinion on the summary financial statements.**

REPORT OF THE INDEPENDENT AUDITOR ON THE SUMMARY FINANCIAL STATEMENTS

[Appropriate Addressee]

The accompanying summary financial statements, which comprise the summary balance sheet as at December 31, 20X1, the summary income statement, summary statement of changes in equity and summary cash flow statement for the year then ended, and related notes, are derived from the audited financial statements of ABC Company for the year ended December 31, 20X1. We expressed an unmodified audit opinion on those financial statements in our report dated February 15, 20X5.[7]

The summary financial statements do not contain all the disclosures required by [describe financial reporting framework applied in preparing and presenting the audited financial statements of ABC Company]. Reading the summary financial statements, therefore, is not a substitute for reading the audited financial statements of ABC Company.

Management's Responsibility for the Summary Audited Financial Statements

Management is responsible for preparing and presenting a summary of the audited financial statements in accordance with [describe established criteria].

Auditor's Responsibility

Our responsibility is to express an opinion on the summary financial statements based on our procedures which were conducted in accordance with International Standard on Auditing (ISA) 805 (Revised and Redrafted), "Engagements to Report on Summary Financial Statements."

Basis for Adverse Opinion

[Describe matter that caused the summary financial statements not to be a fair summary of the audited financial statements in accordance with the applied criteria.]

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[7] When the auditor's report on the summary financial statements is dated later than the date of the auditor's report on the audited financial statements from which it is derived, the following sentence is added to this paragraph: "Those financial statements, and the summary financial statements, do not reflect the effects of events that occurred subsequent to the date of the auditor's report on those financial statements."

Adverse Opinion

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph, the summary financial statements are not a fair summary of the audited financial statements of ABC Company for the year ended December 31, 20X1 in accordance with [describe established criteria].

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

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International
Auditing
and Assurance
Standards Board

Exposure Drafts
July 2007
Comments are requested by December 31, 2007

Proposed Redrafted International Standard on Auditing

ISA 220, Quality Control for an Audit of Financial Statements

Proposed Redrafted International Standard on Quality Control

ISQC 1, Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements

International Federation
of Accountants

REQUEST FOR COMMENTS

The International Auditing and Assurance Standards Board (IAASB), an independent standard-setting body within the International Federation of Accountants (IFAC), approved the exposure drafts of proposed International Standard on Auditing (ISA) 220 (Redrafted), "Quality Control for an Audit of Financial Statements" and proposed International Standard on Quality Control (ISQC) 1 (Redrafted), "Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements" for publication in July 2007. The proposed ISA and ISQC may be modified in light of comments received before being issued in final form.

Please submit your comments, preferably by email, so that they will be received by **December 31, 2007**. All comments will be considered a matter of public record. Comments should be addressed to:

International Auditing and Assurance Standards Board
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, New York 10017 USA

Comments should be emailed to Edcomments@ifac.org. They may also be faxed to +1-212-286-9570 or mailed to the above address.

Copies of the exposure drafts may be downloaded free-of-charge from the IFAC website at http://www.ifac.org.

CONTENTS

EXPLANATORY MEMORANDUM

Introduction

This memorandum provides background to proposed International Standard on Auditing (ISA) 220 (Redrafted), "Quality Control for an Audit of Financial Statements" and proposed International Standard on Quality Control (ISQC) 1 (Redrafted), "Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements." The proposed ISA has been redrafted in accordance with conventions agreed by the International Auditing and Assurance Standards Board (IAASB) to be applied to all ISAs. Those conventions, adapted as necessary, have also been applied in redrafting the proposed ISQC. The IAASB approved the proposed redrafted ISA and ISQC for exposure in July 2007.

Background

As part of its project to improve the clarity of its International Standards, the IAASB has undertaken to redraft all of its ISAs in accordance with its new clarity drafting conventions. This approach responds to the desire for all ISAs to be consistently drafted, and subject to a single statement of their authority and effect. The IAASB has agreed, in response to the general call for the Clarity project to be completed within a reasonable time, that while a significant number of the ISAs are under substantive revision as well as redrafting to reflect the new conventions, others will be subject to a limited redrafting to reflect only the conventions and matters of clarity generally. Proposed ISA 220 (Redrafted) and proposed ISQC 1 (Redrafted) are in the latter category.

The conventions used by the IAASB in redrafting extant ISA 220, "Quality Control for Audits of Historical Financial Information," and the authority and obligation attaching to those conventions, are established in proposed ISA 200 (Revised and Redrafted), "Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing" approved by the IAASB as an exposure draft in April 2007, and in the amended "Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services" (Preface) approved by the IAASB in September 2006.[1]

The IAASB decided to clarify extant ISQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements" at the same time as extant ISA 220, as together they deal with important quality control considerations at both the firm level and the engagement level. Further, in complying with extant ISA 220, the engagement team is entitled to rely on the firm's policies and procedures established under extant ISQC 1. The standards are therefore closely linked, and the IAASB believes that their clarification at the same time makes sense to ensure consistency between them and in their application.

The conventions used by the IAASB in redrafting ISAs have been used in redrafting extant ISQC 1. However, they have been adapted as necessary in light of the scope of extant ISQC 1.

1 The amended Preface can be accessed at http://web.ifac.org/download/IAASB_Preface.pdf. Proposed ISA 200 (Revised and Redrafted) can be accessed at http://www.ifac.org/Guidance/EXD-Details.php?EDID=0079.

Effective Date

The current timetable envisages that all ISAs will have been revised and redrafted, or redrafted only, by late 2008 and the IAASB has provisionally agreed that the complete set of ISAs will be effective for audits of financial statements for periods beginning on or after December 15, 2008. Similarly, the IAASB has provisionally agreed that proposed ISQC 1 (Redrafted) will be effective for firms' systems of quality control as of December 15, 2008. This date will depend on satisfactory progress being made, and will be amended to a later date should that prove necessary. The IAASB believes that it is in the interests of auditors and others who use the ISAs and ISQC 1 that the standards should be released as soon as they are approved so as to facilitate their implementation.

Significant Matters

Authority of the ISQC

The IAASB proposes to establish within proposed ISQC 1 (Redrafted) the authority attaching to the ISQC, the conventions used in its drafting, and the obligations of the firms that follow the standard. This is consistent with the amended Preface, which states that the authority of ISQCs will be set out within the ISQCs themselves.

The authority and obligations attaching to the content of proposed ISQC 1 (Redrafted) are substantially the same as those proposed by the IAASB with respect to ISAs. However, because of the scope of the ISQC, the IAASB has adapted them, in particular in relation to the objective stated in the ISQC. In addition, no provision is made for departure from a requirement when this is deemed necessary by the firm. This is consistent with the current Preface, which makes no provision for this in respect of the ISQCs. The IAASB reconfirmed this position in approving the adaptations, since the generally principled nature of the requirements are not expected to give rise to circumstances in which departure would be appropriate.

The IAASB proposes that the authority be described within the Introduction section of proposed ISQC 1 (Redrafted). This provides necessary context when reading and understanding the objective and requirements of the firm in establishing a system of quality control in accordance with the ISQC. The obligations attaching to objectives, requirements and other material have been established within the Requirements section of proposed ISQC 1 (Redrafted). This is consistent with how the IAASB has incorporated the provisions of the amended Preface in proposed ISA 200 (Revised and Redrafted).

Date of Completion of Engagement Quality Control Review

Subsequent to the issue of extant ISA 220 and ISQC 1 in 2004, the IAASB issued ISA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements." ISA 700 defines and refers to the date of the auditor's report, but not to the issuance of the auditor's report. However, extant ISA 220 and ISQC 1 contain certain requirements that refer specifically to the issuance of the auditor's report. The IAASB has decided to amend ISA 220 and ISQC 1 to conform to ISA 700 by referring to the date of the auditor's report, and to remove references to the issuance of the auditor's report as it is a term that is undefined in the *Handbook of International Auditing, Assurance, and Ethics Pronouncements*.

Definition of Engagement Team

In December 2006, the International Ethics Standards Board for Accountants (IESBA) of IFAC issued exposure drafts of Section 290, "Independence—Audit and Review Engagements" and Section 291, "Independence—Other Assurance Engagements" of the *Code of Ethics for Professional Accountants*. These exposure drafts include a proposed definition of "engagement team" which differs from the definition included in proposed ISA 220 (Redrafted) and proposed ISQC 1 (Redrafted). The IESBA is currently in the process of considering comments received on its exposure drafts, and the IAASB has consulted the IESBA on the direction that it may take in finalizing the definition. The definition of "engagement team" in proposed ISA 220 (Redrafted) and proposed ISQC 1 (Redrafted) reflects that which the IAASB believes is currently being considered by the IESBA. The IAASB considers this definition to be broadly appropriate, but it acknowledges that it may be subject to further refinement as the IESBA continues its deliberations. The IAASB will continue to work with the IESBA, with the intention that the final definition of "engagement team" will be the same in the respective Boards' standards.

The definition currently under consideration by the IESBA excludes "an auditor's external expert" from the engagement team. "An auditor's external expert" will be defined in proposed ISA 620 (Revised and Redrafted), "Using the Work of an Auditor's Expert;" the definition is currently expected to be "an auditor's expert who is engaged, not employed, by the auditor." As a consequence, references in proposed ISA 220 (Redrafted) to the need to ensure that the members of the engagement team have the appropriate competence to perform the audit have been extended to refer to the auditor's external experts.

Further implications of the change in definition will be highlighted in the explanatory memorandum to accompany the exposure draft of proposed ISA 620 (Revised and Redrafted), which is currently scheduled for approval at the September 2007 IAASB meeting.

Guide for Respondents

The IAASB is seeking comments **only** on changes resulting from applying the clarity drafting conventions, including the matters discussed above, and their effect on the content of the extant ISA and ISQC. Respondents are asked to respond in particular to the following questions:

1. Are the objectives stated in the proposed redrafted ISA and ISQC appropriate?
2. Have the criteria identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and reporting, and the use of professional judgment by auditors?[2]

[2] The IAASB has identified the following criteria for determining the requirements of a Standard:

- The requirement is necessary to achieve the objective stated in the Standard;
- The requirement is expected to be applicable in virtually all engagements to which the Standard is relevant; and
- The objective stated in the Standard is unlikely to have been met by the requirements of other Standards.

Recognizing that the final ISA and ISQC will apply to firms and audits of all sizes and to audits in all sectors of the economy, the IAASB is also interested in comments on matters set out below.

- *Special Considerations in the Audit of Small Entities and Considerations Specific to Smaller Practices*—Respondents are asked to comment whether, in their opinion, considerations in the audit of small entities have been dealt with appropriately in the proposed redrafted ISA. Respondents are also asked to comment on the appropriateness of the considerations specific to smaller practices in the proposed redrafted ISQC.
- *Special Considerations in the Audit of Public Sector Entities and Considerations Specific to Public Sector Audit Organizations*—Respondents are asked to comment whether, in their opinion, special considerations in the audit of public sector entities have been dealt with appropriately in the proposed redrafted ISA. Respondents are also asked to comment on the appropriateness of the considerations specific to public sector audit organizations in the proposed redrafted ISQC.
- *Developing Nations*—Recognizing that many developing nations have adopted or are in the process of adopting the ISAs and ISQC 1, the IAASB invites respondents from these nations to comment, in particular, on any foreseeable difficulties in applying the proposed redrafted ISA and ISQC in a developing nation environment.
- *Translations*—Recognizing that many respondents intend to translate the final ISA and ISQC for adoption in their own environments, the IAASB welcomes comment on potential translation issues noted in reviewing the proposed redrafted ISA and ISQC.

Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in the exposure drafts, it will be helpful for the IAASB to be made aware of this view.

Respondents are also invited to comment on any undue costs, set against the benefits of more consistent auditor performance, arising from the fact that the proposed redrafted ISA and ISQC include requirements that would previously have been guidance under the old drafting conventions, as in the extant ISA and ISQC (see below). In commenting on this matter, respondents should bear in mind the criteria that the IAASB has applied in redrafting the proposed ISA and ISQC (see footnote 2) and the fact that the IAASB is seeking to clarify that there was some guidance in extant ISAs and ISQC 1 that was more in the nature of requirements and would already have been followed by many auditors.

Supplements to the Exposure Drafts

To assist respondents in tracking changes, IAASB staff has prepared analyses of the decisions that have been made by the IAASB with respect to the treatment of the present tense in the

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In determining the requirements of a Standard, the IAASB will consider whether the requirements are proportionate to the importance of the subject matter of the Standard in relation to the overall objective of the engagement.

The criteria, which are intended only to assist the IAASB in appropriately and consistently determining requirements, may be refined as further experience is gained.

explanatory paragraphs of the extant ISA and ISQC. These analyses also demonstrate how the material in the extant ISA and ISQC has been reflected in the proposed redrafted ISA and ISQC. In particular, the analyses:

- Identify existing sentences in the present tense and whether they are now treated as requirements or as application material;
- Map the material of the extant ISA and ISQC to the proposed redrafted ISA and ISQC, respectively; and
- Identify explanatory material that is proposed to be eliminated or repositioned as a result of redrafting.

These staff-prepared mapping documents are available on the IAASB website at http://www.ifac.org/Guidance/EXD-Details.php?EDID=0086. They are for information purposes only and do not form part of the exposure drafts.

To be considered, responses should be emailed to Edcomments@ifac.org. They may also be faxed to +1-212-286-9570 or mailed to 545 Fifth Avenue, 14th Floor, New York, NY 10017, USA. They should be received by **December 31, 2007**.

PROPOSED INTERNATIONAL STANDARD ON AUDITING 220 (REDRAFTED)

QUALITY CONTROL FOR AN AUDIT OF FINANCIAL STATEMENTS

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

CONTENTS

* See footnote 1.

International Standard on Auditing (ISA) 220 (Redrafted), "Quality Control for an Audit of Financial Statements" should be read in conjunction with [proposed] ISA 200 (Revised and Redrafted), "Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing."

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the specific responsibilities of firm personnel regarding quality control procedures for an audit of financial statements. This ISA is to be read in conjunction with relevant ethical requirements. It is to be adapted as necessary in the circumstances when applied to audits of other historical financial information.

2. Under [proposed] International Standard on Quality Control 1 (Redrafted), "Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements," a firm has an obligation to establish a system of quality control designed to provide it with reasonable assurance that:

   (a) The firm and its personnel comply with professional standards and regulatory and legal requirements; and

   (b) The auditors' reports issued by the firm or engagement partners are appropriate in the circumstances.

3. Engagement teams:

   (a) Implement quality control procedures that are applicable to the audit engagement;

   (b) Provide the firm with relevant information to enable the functioning of that part of the firm's system of quality control relating to independence; and

   (c) Are entitled to rely on the firm's systems (for example, in relation to capabilities and competence of personnel through their recruitment and formal training; independence through the accumulation and communication of relevant independence information; maintenance of client relationships through acceptance and continuance systems; and adherence to regulatory and legal requirements through the monitoring process), unless information provided by the firm or other parties suggests otherwise.

Effective Date

4. This ISA is effective for audits of financial statements for periods beginning on or after [date].[1]

Objective

5. The objective of the auditor is to obtain reasonable assurance that the audit complies with professional standards and regulatory and legal requirements, through the implementation of appropriate quality control procedures at the engagement level.

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1 This date will not be earlier than December 15, 2008.

Definitions

6. For purposes of the ISAs, the following terms have the meanings attributed below:

   (a) Engagement partner[2] – The partner or other person in the firm who is responsible for the audit engagement and its performance, and for the auditor's report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

   (b) Engagement quality control review – A process designed to provide an objective evaluation, before the date of the auditor's report, of the significant judgments the engagement team made and the conclusions they reached in formulating the auditor's report.

   (c) Engagement quality control reviewer – A partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the significant judgments the engagement team made and the conclusions they reached in formulating the auditor's report.

   (d) Engagement team – [Partners and staff performing the engagement and any individuals engaged by the firm who perform audit procedures. This does not include auditor's external experts.][3]

   (e) Firm – A sole practitioner, partnership, corporation or other entity of professional accountants.

   (f) Inspection – In relation to completed audit engagements, procedures designed to provide evidence of compliance by engagement teams with the firm's quality control policies and procedures.

   (g) Listed entity – An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.

   (h) Monitoring – A process comprising an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements, designed to enable the firm to obtain reasonable assurance that its system of quality control is operating effectively.

   (i) Network firm – A firm or entity that belongs to a network.

   (j) Network – A larger structure:

      (i) That is aimed at cooperation, and

2 "Engagement partner," "partner," and "firm" should be read as referring to their public sector equivalents where relevant.

3 This definition is subject to further consideration by the IAASB and the International Ethics Standards Board for Accountants.

(ii) That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.

(k) Partner – Any individual with authority to bind the firm with respect to the performance of a professional services engagement.

(l) Personnel – Partners and staff.

(m) Professional standards – International Standards on Auditing (ISAs) and relevant ethical requirements.

(n) Relevant ethical requirements – Ethical requirements to which the engagement team and engagement quality control reviewer are subject, which ordinarily comprise Parts A and B of the International Federation of Accountants' *Code of Ethics for Professional Accountants* (IFAC Code) related to an audit of financial statements together with national requirements that are more restrictive.

(o) Staff – Professionals, other than partners, including any experts the firm employs.

(p) Suitably qualified external person – An individual outside the firm with the capabilities and competence to act as an engagement partner, for example a partner of another firm, or an employee (with appropriate experience) of either a professional accountancy body whose members may perform audits of historical financial information or of an organization that provides relevant quality control services.

Requirements

Leadership Responsibilities for Quality on Audits

7. The engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is so assigned. (Ref: Para. A1)

Relevant Ethical Requirements

8. The engagement partner shall evaluate whether members of the engagement team have complied with relevant ethical requirements:

(a) Through inquiry and observation regarding ethical matters among the engagement team as necessary throughout the audit engagement; and

(b) By remaining alert for evidence of non-compliance with those requirements. (Ref: Para. A2)

9. If matters come to the engagement partner's attention through the firm's systems or otherwise that indicate that members of the engagement team have not complied with relevant ethical requirements, the partner, in consultation with others in the firm, shall determine the appropriate action.

Independence

10. The engagement partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the engagement partner shall:

    (a) Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;

    (b) Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and

    (c) Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards. The engagement partner shall promptly report to the firm any failure to resolve the matter for appropriate action. (Ref: Para. A3-A4)

Acceptance and Continuance of Client Relationships and Audit Engagements

11. The engagement partner shall be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and audit engagements have been followed, and shall determine that conclusions reached in this regard are appropriate. (Ref: Para. A5-A6)

12. When the engagement partner obtains information that would have caused the firm to decline the audit engagement if that information had been available earlier, the engagement partner shall communicate that information promptly to the firm, so that the firm and the engagement partner can take the necessary action.

Assignment of Engagement Teams

13. The engagement partner shall be satisfied that the engagement team, and any auditor's external experts, collectively have the appropriate capabilities, competence and time to perform the audit engagement in accordance with professional standards and regulatory and legal requirements, and to enable an auditor's report that is appropriate in the circumstances to be issued. (Ref: Para. A7-A8)

Engagement Performance

Direction, Supervision and Performance

14. The engagement partner shall take responsibility for:

    (a) The direction, supervision and performance of the audit engagement in compliance with professional standards and regulatory and legal requirements; and (Ref: Para. A9-A11)

    (b) Whether the auditor's report that is issued is appropriate in the circumstances.

Review

15. Review responsibilities shall be determined on the basis that the work of a less experienced team member is reviewed on a timely basis by a more experienced team member. (Ref: Para. A12)

16. Before the date of the auditor's report, the engagement partner shall, through a timely review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued. (Ref: Para. A13)

17. An engagement partner taking over responsibility for the audit during the course of an audit engagement shall review the work performed to the date of the change in order to determine that the audit work has been planned and performed in accordance with professional standards and regulatory and legal requirements.

Consultation

18. The engagement partner shall:

    (a) Take responsibility for the engagement team undertaking appropriate consultation on difficult or contentious matters;

    (b) Be satisfied that members of the engagement team have undertaken appropriate consultation during the course of the engagement, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm;

    (c) Be satisfied that the nature and scope of, and conclusions resulting from, such consultations are agreed with the party consulted; and

    (d) Determine that conclusions resulting from such consultations have been implemented. (Ref: Para. A14-A15)

Engagement Quality Control Review

19. For audits of financial statements of listed entities, and those other audit engagements for which an engagement quality control review is performed, the engagement partner shall:

    (a) Determine that an engagement quality control reviewer has been appointed;

    (b) Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer; and

    (c) Not date the auditor's report until the completion of the engagement quality control review.

20. An engagement quality control review shall include an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached in formulating the auditor's report.

21. The engagement quality control review shall involve discussion with the engagement partner, a review of the financial statements and the auditor's report, and consideration of whether the auditor's report is appropriate. It shall also involve a review of selected working papers relating to the significant judgments the engagement team made and the conclusions they reached. (Ref: Para. A16-A21)

22. The engagement quality control review for audits of financial statements of listed entities shall include consideration of the following:

    (a) The engagement team's evaluation of the firm's independence in relation to the audit engagement;

    (b) Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations; and

    (c) Whether audit documentation selected for review reflects the work performed in relation to the significant judgments and supports the conclusions reached.

23. The engagement partner shall remain responsible for the audit engagement and its performance, notwithstanding involvement of the engagement quality control reviewer.

Differences of Opinion

24. Where differences of opinion arise within the engagement team, with those consulted or, where applicable, between the engagement partner and the engagement quality control reviewer, the engagement team shall follow the firm's procedures for dealing with and resolving differences of opinion.

Monitoring

25. [Proposed] ISQC 1 (Redrafted) requires the firm to establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. The engagement partner shall consider the results of the monitoring process as evidenced in the latest information circulated by the firm and, if applicable, other network firms and shall determine whether:

    (a) Deficiencies noted in that information may affect the audit engagement; and

    (b) Any additional procedures are required. (Ref: Para. A22)

Documentation

26. The engagement partner and, where appropriate, other members of the engagement team, shall document:

    (a) Issues identified with respect to compliance with relevant ethical requirements and how they were resolved.

(b) Conclusions on compliance with independence requirements that apply to the audit engagement, and any relevant discussions with the firm that support these conclusions.

(c) Conclusions reached regarding the acceptance and continuance of client relationships and audit engagements.

(d) The nature and scope of, and conclusions resulting from consultations undertaken during the course of the audit engagement. (Ref: Para. A23)

27. The engagement quality control reviewer shall document, for the audit engagement reviewed, that:

(a) The procedures required by the firm's policies on engagement quality control review have been performed;

(b) The engagement quality control review has been completed before the date of the auditor's report; and

(c) The reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate.

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Application and Other Explanatory Material

Leadership Responsibilities for Quality on Audits (Ref: Para. 7)

A1. The actions of the engagement partner and appropriate messages to the other members of the engagement team emphasize:

(a) The importance to audit quality of:

(i) Performing work that complies with professional standards and regulatory and legal requirements;

(ii) Complying with the firm's quality control policies and procedures as applicable;

(iii) Issuing auditor's reports that are appropriate in the circumstances; and

(iv) The engagement team's ability to raise concerns without fear of reprisals; and

(b) The fact that quality is essential in performing audit engagements.

Relevant Ethical Requirements (Ref: Para. 8-9)

A2. The IFAC Code establishes the fundamental principles of professional ethics, which include:

(a) Integrity;

(b) Objectivity;

(c) Professional competence and due care;

(d) Confidentiality; and

(e) Professional behavior.

Independence (Ref: Para. 10)

A3. The engagement partner may identify a threat to independence regarding the audit engagement that safeguards may not be able to eliminate or reduce to an acceptable level. In that case, as required by paragraph 10(c), the engagement partner reports to the firm to determine appropriate action, which may include eliminating the activity or interest that creates the threat, or withdrawing from the audit engagement.

Considerations Specific to Public Sector Entities

A4. The independence of public sector auditors may be protected by statutory measures. However, public sector auditors or audit firms carrying out public sector audits on behalf of the statutory auditor may, depending on the terms of the mandate in a particular jurisdiction, need to adapt their approach in order to promote compliance with the spirit of paragraph 10. This may include, where the public sector auditor's mandate does not permit withdrawal from the engagement, disclosure through a public report, of circumstances that have arisen that would, if they were in the private sector, lead the auditor to withdraw.

Acceptance and Continuance of Client Relationships and Audit Engagements (Ref: Para. 11-12)

A5. [Proposed] ISQC 1 (Redrafted) requires the firm to obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Information such as the following assists the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate:

- The integrity of the principal owners, key management and those charged with governance of the entity;
- Whether the engagement team is competent to perform the audit engagement and has the necessary time and resources;
- Whether the firm and the engagement team can comply with relevant ethical requirements; and
- Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

Considerations Specific to Public Sector Entities

A6. In the public sector, auditors may be appointed in accordance with statutory procedures. Accordingly, certain of the requirements and considerations regarding the acceptance and continuance of client relationships and audit engagements as set out in paragraphs 11, 12 and A5 may not be relevant. Nonetheless, information gathered as a result of the process described may be valuable to public sector auditors in performing risk assessments and in carrying out reporting responsibilities.

Assignment of Engagement Teams (Ref: Para. 13)

A7. When reviewing the appropriate capabilities and competence expected of the engagement team as a whole, the engagement partner may take into consideration such matters as the team's:

- Understanding of, and practical experience with, audit engagements of a similar nature and complexity through appropriate training and participation.
- Understanding of professional standards and regulatory and legal requirements.
- Technical knowledge and expertise, including knowledge of relevant information technology.
- Knowledge of relevant industries in which the client operates.
- Ability to apply professional judgment.
- Understanding of the firm's quality control policies and procedures.

Considerations Specific to Public Sector Entities

A8. In the public sector, additional appropriate capabilities and competence may include skills that are necessary to discharge the terms of the audit mandate in a particular jurisdiction. Such capabilities and competence may include an understanding of the applicable reporting arrangements, including reporting to the legislature or other governing body or in the public interest. The wider scope of a public sector audit may include, for example, some aspects of performance auditing or a comprehensive assessment of compliance with legislative authorities and preventing and detecting fraud and corruption.

Engagement Performance

Direction, Supervision and Performance (Ref: Para. 14)

A9. Direction of the engagement team involves informing the members of the engagement team of matters such as:

- Their responsibilities, including the need to comply with relevant ethical requirements, and to plan and perform an audit with an attitude of professional skepticism as required by [proposed] ISA 200 (Revised and Redrafted), "Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing."
- Responsibilities of respective partners where more than one partner is involved in the conduct of an audit engagement.
- The objectives of the work to be performed.
- The nature of the entity's business.

- Risk-related issues.
- Problems that may arise.
- The detailed approach to the performance of the engagement.

Discussion among members of the engagement team allows less experienced team members to raise questions with more experienced team members so that appropriate communication can occur within the engagement team.

A10. Appropriate teamwork and training assist less experienced members of the engagement team to clearly understand the objectives of the assigned work.

A11. Supervision includes matters such as:

- Tracking the progress of the audit engagement.
- Considering the capabilities and competence of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions, and whether the work is being carried out in accordance with the planned approach to the audit engagement.
- Addressing significant matters arising during the audit engagement, considering their significance and modifying the planned approach appropriately.
- Identifying matters for consultation or consideration by more experienced engagement team members during the audit engagement.

Review (Ref: Para. 15-16)

A12. A review consists of consideration whether, for example:

- The work has been performed in accordance with professional standards and regulatory and legal requirements;
- Significant matters have been raised for further consideration;
- Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- There is a need to revise the nature, timing and extent of work performed;
- The work performed supports the conclusions reached and is appropriately documented;
- The evidence obtained is sufficient and appropriate to support the auditor's report; and
- The objectives of the engagement procedures have been achieved.

A13. Timely reviews of the following by the engagement partner at appropriate stages during the engagement allow significant matters to be resolved on a timely basis to the engagement partner's satisfaction before the date of the auditor's report:

- Critical areas of judgment, especially those relating to difficult or contentious matters identified during the course of the engagement;

- Significant risks; and
- Other areas the engagement partner considers important.

The engagement partner need not review all audit documentation, but may do so. However, as required by [proposed] ISA 230 (Redrafted), “Audit Documentation,” the partner documents the extent and timing of the reviews.

Consultation (Ref: Para. 18)

A14. Effective consultation on significant technical, ethical, and other matters within the firm or, where applicable, outside the firm can be achieved when those consulted:

- Are given all the relevant facts that will enable them to provide informed advice; and
- Have appropriate knowledge, seniority and experience.

A15. It may be appropriate for the engagement team to consult outside the firm, for example, where the firm lacks appropriate internal resources. They may take advantage of advisory services provided by other firms, professional and regulatory bodies, or commercial organizations that provide relevant quality control services.

Engagement Quality Control Review (Ref: Para. 19-23)

A16. Matters of significant judgment include, for example:

- Significant risks identified during the engagement (in accordance with ISA 315 (Redrafted), “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment”), and the responses to those risks (in accordance with ISA 330 (Redrafted), “The Auditor’s Responses to Assessed Risks”), including the engagement team’s assessment of, and response to, the risk of fraud.
- Judgments made, particularly with respect to materiality and significant risks.
- The significance and disposition of corrected and uncorrected misstatements identified during the audit.
- The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.

A17. Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant matters to be promptly resolved to the reviewer’s satisfaction before the date of the auditor’s report.

A18. The extent of the engagement quality control review may depend, among other things, on the complexity of the audit engagement, whether the entity is a listed entity, and the risk that the auditor’s report might not be appropriate in the circumstances.

A19. Remaining alert for changes in circumstances allows the engagement partner to identify situations in which an engagement quality control review is necessary, even though at the start of the engagement, such a review was not required.

Considerations Specific to Public Sector Entities

A20. Listed entities are not common in the public sector. However, there may be other public sector entities that are significant due to size, complexity or public interest aspects, and which consequently have a wide range of stakeholders. Examples include state owned corporations and public utilities. Ongoing transformations within the public sector may also give rise to new types of significant entities. There are no fixed objective criteria on which the determination of significance is based. Nonetheless, public sector auditors evaluate which entities may be of sufficient significance to warrant performance of an engagement quality control review.

A21. In the public sector, a statutorily appointed auditor (for example, an Auditor General, or other suitably qualified person appointed on behalf of the Auditor General), may act in a role equivalent to that of engagement partner with overall responsibility for public sector audits. In such circumstances, where applicable, the selection of engagement quality control reviewer includes consideration of the need for independence from the audited entity and the ability of the engagement quality control reviewer to provide an objective evaluation.

Monitoring (Ref: Para. 25)

A22. A deficiency in the firm's system of quality control does not necessarily indicate that a particular audit engagement was not performed in accordance with professional standards and regulatory and legal requirements, or that the auditor's report was not appropriate.

Documentation (Ref: Para. 26-27)

A23. Documentation of consultations with other professionals that involve difficult or contentious matters that is sufficiently complete and detailed contributes to an understanding of:

- The issue on which consultation was sought; and
- The results of the consultation, including any decisions taken, the basis for those decisions and how they were implemented.

PROPOSED INTERNATIONAL STANDARD ON QUALITY CONTROL 1

(REDRAFTED)

QUALITY CONTROL FOR FIRMS THAT PERFORM AUDITS AND REVIEWS OF FINANCIAL STATEMENTS, AND OTHER ASSURANCE AND RELATED SERVICES ENGAGEMENTS

(Effective as of [date])*

CONTENTS

* See footnote 1.

Introduction

Scope of this ISQC

1. This International Standard on Quality Control (ISQC) deals with a firm's responsibilities for its system of quality control for audits and reviews of financial statements, and other assurance and related services engagements. This ISQC is to be read in conjunction with relevant ethical requirements.

2. Other pronouncements of the International Auditing and Assurance Standards Board (IAASB) set out additional standards and guidance on the responsibilities of firm personnel regarding quality control procedures for specific types of engagements. [Proposed] International Standard on Auditing (ISA) 220 (Redrafted), "Quality Control for an Audit of Financial Statements," for example, deals with quality control procedures for audits of financial statements.

3. A system of quality control consists of policies designed to achieve the objective set out in paragraph 11 and the procedures necessary to implement and monitor compliance with those policies.

Authority of this ISQC

4. This ISQC applies to all firms of professional accountants in respect of audits and reviews of financial statements, and other assurance and related services engagements. The nature of the policies and procedures developed by individual firms to comply with this ISQC will depend on various factors such as the size and operating characteristics of the firm, and whether it is part of a network.

5. This ISQC contains the objective for the firm in following the ISQC, and requirements designed to enable the firm to meet the stated objective. In addition, it contains related guidance in the form of application and other explanatory material and introductory material that provides context essential to a proper understanding of the ISQC, and definitions.

6. The objective provides the context in which the requirements of this ISQC are set, and is intended to assist the firm in:

   - Understanding what needs to be accomplished; and
   - Deciding what more, if anything, needs to be done to achieve the objective.

7. The requirements of this ISQC are expressed using the word "shall." The requirements are designed to enable the firm to meet the objective of this ISQC.

8. The application and other explanatory material is an integral part of this ISQC, as it provides further explanation of, and guidance for carrying out, the requirements, along with background information on the matters addressed in this ISQC. It includes examples of policies and procedures, some of which the firm may judge to be appropriate in the circumstances. Such guidance is, however, not intended to impose a requirement. Where appropriate, additional considerations specific to public sector audit organizations or smaller practices are included within the application and other explanatory material.

9. This ISQC includes, under the heading "Definitions," a description of the meanings attributed to certain terms for purposes of this ISQC. These are provided to assist in the consistent application and interpretation of this ISQC, and are not intended to override definitions that may be established for other purposes, whether in law, regulation or otherwise. The Glossary of Terms relating to International Standards issued by the IAASB in the *Handbook of International Auditing, Assurance, and Ethics Pronouncements* published by IFAC contains a complete listing of terms defined in this ISQC. It also includes descriptions of other terms found in this ISQC to assist in common and consistent interpretation and translation.

Effective Date

10. Systems of quality control in compliance with this ISQC are required to be established by [date].[1]

Objective

11. The objective of the firm in establishing a system of quality control is to provide it with reasonable assurance that:

    (a) The firm and its personnel comply with professional standards and regulatory and legal requirements; and

    (b) Reports issued by the firm or engagement partners are appropriate in the circumstances.

Definitions

12. In this ISQC, the following terms have the meanings attributed below:

    (a) Engagement documentation – The record of work performed, results obtained, and conclusions the practitioner reached (terms such as "working papers" or "workpapers" are sometimes used).

    (b) Engagement partner[2] – The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

    (c) Engagement quality control review – A process designed to provide an objective evaluation, before the date of the report, of the significant judgments the engagement team made and the conclusions they reached in formulating the report.

    (d) Engagement quality control reviewer – A partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and

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1 This date will not be earlier than December 15, 2008.

2 "Engagement partner," "partner," and "firm" should be read as referring to their public sector equivalents where relevant.

authority to objectively evaluate the significant judgments the engagement team made and the conclusions they reached in formulating the report.

(e) Engagement team – [Partners and staff performing the engagement and any individuals engaged by the firm who perform procedures on that engagement. This does not include auditor's external experts.][3]

(f) Firm – A sole practitioner, partnership, corporation or other entity of professional accountants.

(g) Inspection – In relation to completed engagements, procedures designed to provide evidence of compliance by engagement teams with the firm's quality control policies and procedures.

(h) Listed entity – An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.

(i) Monitoring – A process comprising an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements, designed to enable the firm to obtain reasonable assurance that its system of quality control is operating effectively.

(j) Network firm – A firm or entity that belongs to a network.

(k) Network – A larger structure:

  (i) That is aimed at cooperation, and

  (ii) That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.

(l) Partner – Any individual with authority to bind the firm with respect to the performance of a professional services engagement.

(m) Personnel – Partners and staff.

(n) Professional standards – IAASB Engagement Standards, as defined in the IAASB's "Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services," and relevant ethical requirements.

(o) Reasonable assurance – In the context of this ISQC, a high, but not absolute, level of assurance.

(p) Relevant ethical requirements – Ethical requirements to which the engagement team and engagement quality control reviewer are subject, which ordinarily comprise Parts A and B of the International Federation of Accountants' *Code of Ethics for*

[3] This definition is subject to further consideration by the IAASB and the International Ethics Standards Board for Accountants.

Professional Accountants (IFAC Code) related to an audit of financial statements together with national requirements that are more restrictive.

(q) Staff – Professionals, other than partners, including any experts the firm employs.

(r) Suitably qualified external person – An individual outside the firm with the capabilities and competence to act as an engagement partner, for example a partner of another firm, or an employee (with appropriate experience) of either a professional accountancy body whose members may perform audits and reviews of historical financial information, or other assurance or related services engagements, or of an organization that provides relevant quality control services.

Requirements

Applying, and Complying with, Relevant Requirements

13. The firm shall consider the entire text of this ISQC to understand its requirements.

14. The firm shall comply with the requirements of this ISQC where, in the circumstances of the firm, such requirements are relevant in providing services in respect of audits and reviews of financial statements, and other assurance and related services engagements. Proper application of requirements will ordinarily provide a sufficient basis for achievement of the objective of this ISQC. However, this ISQC cannot anticipate all circumstances that may arise.

15. The firm shall apply the requirements in the context of the other material included in this ISQC.

Elements of a System of Quality Control

16. The firm shall establish a system of quality control that includes policies and procedures that address each of the following elements:

    (a) Leadership responsibilities for quality within the firm.

    (b) Relevant ethical requirements.

    (c) Acceptance and continuance of client relationships and specific engagements.

    (d) Human resources.

    (e) Engagement performance.

    (f) Monitoring.

17. The firm's quality control policies and procedures shall be:

    (a) Documented; and

    (b) Communicated to the firm's personnel.

    Such communication shall describe the quality control policies and procedures and the objectives they are designed to achieve, and include the message that each individual has a personal responsibility for quality and is expected to comply with these policies and procedures.

18. In recognition of the importance of obtaining feedback on its quality control system from its personnel, the firm shall encourage its personnel to communicate their views or concerns on quality control matters.

Leadership Responsibilities for Quality within the Firm

19. The firm shall establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements. Such policies and procedures shall require the firm's chief executive officer (or equivalent) or, if appropriate, the firm's managing board of partners (or equivalent), to assume ultimate responsibility for the firm's system of quality control. (Ref: Para. A1)

20. Such policies and procedures shall also address performance evaluation, compensation, and promotion (including incentive systems) with regard to its personnel, in order to demonstrate the firm's overriding commitment to quality.

21. The firm shall assign management responsibilities so that commercial considerations do not override the quality of work performed. (Ref: Para. A2)

22. The firm shall devote sufficient resources for the development, documentation and support of its quality control policies and procedures.

23. Any person or persons assigned operational responsibility for the firm's quality control system by the firm's chief executive officer or managing board of partners shall have sufficient and appropriate experience and ability, and the necessary authority, to assume that responsibility. (Ref: Para. A3)

Relevant Ethical Requirements

24. The firm shall establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements. (Ref: Para. A4-A6)

Independence

25. The firm shall establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements (including network firm personnel), maintain independence where required by relevant ethical requirements. Such policies and procedures shall enable the firm to:

    (a) Communicate its independence requirements to its personnel and, where applicable, others subject to them; and

    (b) Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement.

26. Such policies and procedures shall require:

(a) Engagement partners to provide the firm with relevant information about client engagements, including the scope of services, to enable the firm to evaluate the overall impact, if any, on independence requirements;

(b) Personnel to promptly notify the firm of circumstances and relationships that create a threat to independence so that appropriate action can be taken; and

(c) The accumulation and communication of relevant information to appropriate personnel so that:

(i) The firm and its personnel can readily determine whether they satisfy independence requirements;

(ii) The firm can maintain and update its records relating to independence; and

(iii) The firm can take appropriate action regarding identified threats to independence.

27. The firm shall establish policies and procedures designed to provide it with reasonable assurance that it is notified of breaches of independence requirements, and to enable it to take appropriate actions to resolve such situations. The policies and procedures shall include requirements for:

(a) Personnel to promptly notify the firm of independence breaches of which they become aware;

(b) The firm to promptly communicate identified breaches of these policies and procedures to:

(i) The engagement partner who, with the firm, has the responsibility to address the breach; and

(ii) Other relevant personnel in the firm and, where appropriate, the network, and those subject to the independence requirements who need to take appropriate action; and

(c) Prompt communication to the firm, if necessary, by the engagement partner and the other individuals referred to in subparagraph (b)(ii) of the actions taken to resolve the matter, so that the firm can determine whether it should take further action.

28. At least annually, the firm shall obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent by relevant ethical requirements. (Ref: Para. A7)

29. The firm shall establish policies and procedures:

(a) Setting out criteria for determining the need for safeguards to reduce the familiarity threat to an acceptable level when using the same senior personnel on an assurance engagement over a long period of time; and

(b) For all audits of financial statements of listed entities, requiring the rotation of the engagement partner after a specified period in compliance with relevant ethical requirements. (Ref: Para. A8-A13)

Acceptance and Continuance of Client Relationships and Specific Engagements

30. The firm shall establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide the firm with reasonable assurance that it will only undertake or continue relationships and engagements where the firm:

    (a) Has considered the integrity of the client, including the identity and business reputation of the client's principal owners, key management, and those charged with its governance, and does not have information that would lead it to conclude that the client lacks integrity; (Ref: Para. A14)

    (b) Is competent to perform the engagement and has the capabilities, time and resources to do so; and (Ref: Para. A15)

    (c) Can comply with relevant ethical requirements.

31. The firm shall obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. (Ref: Para. A16-A17)

32. Where a potential conflict of interest is identified in accepting an engagement from a new or an existing client, the firm shall determine whether it is appropriate to accept the engagement.

33. Where issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement, it shall document how the issues were resolved.

34. Where the firm obtains information that would have caused it to decline an engagement if that information had been available earlier, policies and procedures on the continuance of the engagement and the client relationship shall include consideration of:

    (a) The professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the firm to report to the person or persons who made the appointment or, in some cases, to regulatory authorities; and

    (b) The possibility of withdrawing from the engagement or from both the engagement and the client relationship. (Ref: Para. A18-A19)

Human Resources

35. The firm shall establish policies and procedures regarding assessment of its staff's capabilities and competence designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to:

    (a) Perform engagements in accordance with professional standards and regulatory and legal requirements; and

    (b) Enable the firm or engagement partners to issue reports that are appropriate in the circumstances. (Ref: Para. A20-A25)

Assignment of Engagement Teams

36. The firm shall assign responsibility for each engagement to an engagement partner and shall establish policies and procedures requiring that:

    (a) The identity and role of the engagement partner are communicated to key members of client management and those charged with governance;

    (b) The engagement partner has the appropriate capabilities, competence, authority and time to perform the role; and

    (c) The responsibilities of the engagement partner are clearly defined and communicated to that partner. (Ref: Para. A26)

37. The firm shall also establish policies and procedures to assign appropriate staff with the necessary capabilities, competence and time to:

    (a) Perform engagements in accordance with professional standards and regulatory and legal requirements; and

    (b) Enable the firm or engagement partners to issue reports that are appropriate in the circumstances. (Ref: Para. A27)

Engagement Performance

38. The firm shall establish policies and procedures designed to provide it with reasonable assurance that engagements are consistently performed in accordance with professional standards and regulatory and legal requirements, and that the firm or the engagement partner issue reports that are appropriate in the circumstances. Required policies and procedures shall address:

    (a) Engagement performance; (Ref: Para. A28-A29)

    (b) Supervision responsibilities; and (Ref: Para. A30)

    (c) Review responsibilities. (Ref: Para. A31)

39. Review responsibility policies and procedures shall be determined on the basis that the work of a less experienced team member is reviewed on a timely basis by a more experienced engagement team member.

Consultation

40. The firm shall establish policies and procedures designed to provide it with reasonable assurance that:

    (a) Appropriate consultation takes place on difficult or contentious matters;

    (b) Sufficient resources are available to enable appropriate consultation to take place;

    (c) The nature and scope of such consultations are documented and are agreed by both the individual seeking consultation and the individual consulted; and

    (d) Conclusions resulting from consultations are documented and implemented. (Ref: Para. A32-A36)

Engagement Quality Control Review

41. The firm shall establish policies and procedures requiring, for appropriate engagements, an engagement quality control review and setting out the nature, timing and extent of the review. Such policies and procedures shall:

    (a) Require an engagement quality control review for all audits of financial statements of listed entities;

    (b) Set out criteria against which all other audits and reviews of financial statements and other assurance and related services engagements shall be evaluated to determine whether an engagement quality control review should be performed; (Ref: Para. A37)

    (c) Require an engagement quality control review for all engagements meeting the criteria established in compliance with subparagraph (b); and

    (d) Require that the report not be dated until the completion of the engagement quality control review.

42. The firm's policies and procedures shall require the engagement partner to remain responsible for the engagement and its performance, notwithstanding involvement of the engagement quality control reviewer.

43. An engagement quality control review shall include an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached in formulating the report.

44. The engagement quality control review shall involve discussion with the engagement partner, a review of the financial statements or other subject matter information and the report, and consideration of whether the report is appropriate. It shall also involve a review of selected working papers relating to the significant judgments the engagement team made and the conclusions they reached. (Ref: Para. A38-A41)

45. The engagement quality control review for audits of financial statements of listed entities shall include consideration of the following:

    (a) The engagement team's evaluation of the firm's independence in relation to the specific engagement;

    (b) Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations; and

    (c) Whether working papers selected for review reflect the work performed in relation to the significant judgments and support the conclusions reached.

Criteria for the Eligibility of Engagement Quality Control Reviewers

46. The firm shall establish policies and procedures to address the appointment of engagement quality control reviewers and establish their eligibility through:

(a) The technical qualifications required to perform the role, including the necessary experience and authority; and (Ref: Para. A42)

(b) The degree to which an engagement quality control reviewer can be consulted on the engagement without compromising the reviewer's objectivity. (Ref: Para. A43)

47. The firm shall establish policies and procedures designed to maintain the objectivity of the engagement quality control reviewer. (Ref: Para. A44-A47)

48. The firm's policies and procedures shall provide for the replacement of the engagement quality control reviewer where the reviewer's ability to perform an objective review may be impaired.

Documentation of the Engagement Quality Control Review

49. The firm shall establish policies and procedures on documentation of the engagement quality control review which require documentation that:

(a) The procedures required by the firm's policies on engagement quality control review have been performed;

(b) The engagement quality control review has been completed before the date of the report; and

(c) The reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate.

Differences of Opinion

50. The firm shall establish policies and procedures for dealing with and resolving differences of opinion within the engagement team, with those consulted and, where applicable, between the engagement partner and the engagement quality control reviewer. (Ref: Para. A48-A49)

51. Such policies and procedures shall require that:

(a) Conclusions reached be documented and implemented; and

(b) The report not be dated until the matter is resolved.

Engagement Documentation

Completion of the Assembly of Final Engagement Files

52. The firm shall establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been finalized. (Ref: Para. A50-A51)

Confidentiality, Safe Custody, Integrity, Accessibility and Retrievability of Engagement Documentation

53. The firm shall establish policies and procedures designed to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation. (Ref: Para. A52-A55)

Retention of Engagement Documentation

54. The firm shall establish policies and procedures for the retention of engagement documentation for a period sufficient to meet the needs of the firm or as required by law or regulation. (Ref: Para. A56-A58)

Monitoring

Monitoring the Firm's Quality Control Policies and Procedures

55. The firm shall establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures shall:

    (a) Include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements;

    (b) Require responsibility for the monitoring process to be assigned to a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume that responsibility; and

    (c) Require that those performing the engagement or the engagement quality control review are not involved in inspecting the engagements. (Ref: Para. A60-A61)

56. The firm's policies and procedures shall require inspection of a selection of completed engagements on a cyclical basis. (Ref: Para. A62-A64)

Communicating Deficiencies

57. The firm shall evaluate the effect of deficiencies noted as a result of the monitoring process and determine whether they are either:

    (a) Instances that do not necessarily indicate that the firm's system of quality control is insufficient to provide it with reasonable assurance that it complies with professional standards and regulatory and legal requirements, and that the reports issued by the firm or engagement partners are appropriate in the circumstances; or

    (b) Systemic, repetitive or other significant deficiencies that require prompt corrective action.

58. The firm shall communicate to relevant engagement partners and other appropriate personnel deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action. (Ref: Para. A65)

59. The firm's evaluation of each type of deficiency shall result in recommendations for one or more of the following:

    (a) Taking appropriate remedial action in relation to an individual engagement or member of personnel;

    (b) The communication of the findings to those responsible for training and professional development;

(c) Changes to the quality control policies and procedures; and

(d) Disciplinary action against those who fail to comply with the policies and procedures of the firm, especially those who do so repeatedly.

60. Where the results of the monitoring procedures indicate that a report may be inappropriate or that procedures were omitted during the performance of the engagement, the firm shall determine what further action is appropriate to comply with relevant professional standards and regulatory and legal requirements. It shall also consider obtaining legal advice.

61. At least annually, the firm shall communicate the results of the monitoring of its quality control system to engagement partners and other appropriate individuals within the firm, including the firm's chief executive officer or, if appropriate, its managing board of partners. Such communication shall be sufficient to enable the firm and these individuals to take prompt and appropriate action where necessary in accordance with their defined roles and responsibilities. Information communicated shall include the following:

(a) A description of the monitoring procedures performed.

(b) The conclusions drawn from the monitoring procedures.

(c) Where relevant, a description of systemic, repetitive or other significant deficiencies and of the actions taken to resolve or amend those deficiencies.

62. Some firms operate as part of a network and, for consistency, may implement some or all of their monitoring procedures on a network basis. Where firms within a network operate under common monitoring policies and procedures designed to comply with this ISQC, and these firms place reliance on such a monitoring system, the firm's policies and procedures shall require that:

(a) At least annually, the network communicate the overall scope, extent and results of the monitoring process to appropriate individuals within the network firms; and

(b) The network communicate promptly any identified deficiencies in the quality control system to appropriate individuals within the relevant network firm or firms so that the necessary action can be taken,

in order that engagement partners in the network firms can rely on the results of the monitoring process implemented within the network, unless the firms or the network advise otherwise.

Complaints and Allegations

63. The firm shall establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with:

(a) Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements;

(b) Allegations of non-compliance with the firm's system of quality control; and

(c) Deficiencies in the design or operation of the firm's quality control policies and procedures, or non-compliance with the firm's system of quality control by an individual or individuals, as identified during the investigations into complaints and allegations.

As part of this process, the firm shall establish clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals. (Ref: Para. A66-A67)

64. The firm shall require that investigations of complaints and allegations in accordance with established policies and procedures be supervised by a partner with sufficient and appropriate experience and authority within the firm but who is not otherwise involved in the engagement.

65. The firm shall establish policies and procedures requiring documentation of complaints and allegations and the responses to them.

Documentation of the System of Quality Control

66. The firm shall establish policies and procedures requiring appropriate documentation to provide evidence of the operation of each element of its system of quality control. (Ref: Para. A68-A69)

67. The firm shall establish policies and procedures that require retention of documentation for a period of time sufficient to permit those performing monitoring procedures to evaluate the firm's compliance with its system of quality control, or for a longer period if required by law or regulation.

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Application and Other Explanatory Material

Leadership Responsibilities for Quality within the Firm (Ref: Para. 19-23)

A1. The firm's leadership and the examples it sets significantly influence the internal culture of the firm. The promotion of a quality-oriented internal culture depends on clear, consistent and frequent actions and messages from all levels of the firm's management that emphasize the firm's quality control policies and procedures, and the requirement to:

(a) Perform work that complies with professional standards and regulatory and legal requirements; and

(b) Issue reports that are appropriate in the circumstances.

Such actions and messages encourage a culture that recognizes and rewards high quality work. These actions and messages may be communicated by training seminars, meetings, formal or informal dialogue, mission statements, newsletters, or briefing memoranda. They may be incorporated in the firm's internal documentation and training materials, and in partner and staff appraisal procedures such that they will support and reinforce the firm's view on the importance of quality and how, practically, it is to be achieved.

A2. Of particular importance in promoting an internal culture based on quality is the need for the firm's leadership to recognize that the firm's business strategy is subject to the overriding requirement for the firm to achieve quality in all the engagements that the firm performs.

A3. Sufficient and appropriate experience and ability enables the person or persons responsible for the firm's quality control system to identify and understand quality control issues and to develop appropriate policies and procedures. Necessary authority enables the person or persons to implement those policies and procedures.

Relevant Ethical Requirements (Ref: Para. 24)

A4. The IFAC Code establishes the fundamental principles of professional ethics, which include:

(a) Integrity;

(b) Objectivity;

(c) Professional competence and due care;

(d) Confidentiality; and

(e) Professional behavior.

A5. Part B of the IFAC Code includes a conceptual approach to independence for assurance engagements that takes into account threats to independence, accepted safeguards and the public interest.

A6. The fundamental principles are reinforced in particular by:

- The leadership of the firm;
- Education and training;
- Monitoring; and
- A process for dealing with non-compliance.

Independence for assurance engagements is so significant that it is addressed separately in this ISQC, paragraphs 25 to 29.

Independence

Written Confirmation (Ref: Para. 28)

A7. The purpose of obtaining confirmation in paper or electronic form and taking appropriate action on information indicating non-compliance is to demonstrate the importance that the firm attaches to independence and to make the issue current for, and visible to, its personnel.

Familiarity Threat (Ref: Para. 29)

A8. The IFAC Code discusses the familiarity threat that may be created by using the same senior personnel on an assurance engagement over a long period of time and the safeguards that might be appropriate to address such a threat.

A9. In determining appropriate criteria to address a familiarity threat, the firm may consider such matters as:

- The nature of the engagement, including the extent to which it involves a matter of public interest; and
- The length of service of the senior personnel on the engagement.

Examples of safeguards include rotating the senior personnel or requiring an engagement quality control review.

A10. The IFAC Code recognizes that the familiarity threat is particularly relevant in the context of financial statement audits of listed entities. For these audits, the IFAC Code requires the rotation of the engagement partner after a pre-defined period, normally no more than seven years, and provides related standards and guidance. National requirements may establish shorter rotation periods.

Considerations Specific to Public Sector Audit Organizations

A11. The independence of public sector auditors may be protected by statutory measures, with the consequence that certain of the threats to independence of the nature envisaged by the material in paragraphs 25-29 and A8-A10 are unlikely to occur. However, threats such as self-review, familiarity and intimidation may still exist regardless of any statutory measures designed to protect independence. Public sector audit organizations consider how to appropriately address any such identified threats.

A12. Listed entities as referred to in paragraphs 29 and A10 are not common in the public sector. However, there may be other public sector entities that are significant due to size, complexity or public interest aspects, and which consequently have a wide range of stakeholders.

A13. In the public sector, legislation may establish the appointments and terms of office of the auditor with engagement partner responsibility. As a result, it may not be possible to comply strictly with the engagement partner rotation requirements envisaged for listed entities. Nonetheless, for public sector entities considered comparable to listed entities, it may be in the public interest for public sector audit organizations to establish policies and procedures to promote compliance with the spirit of rotation of engagement partner responsibility.

Acceptance and Continuance of Client Relationships and Specific Engagements (Ref: Para. 30-34)

A14. With regard to the integrity of a client, matters to consider include, for example:

- The nature of the client's operations, including its business practices.
- Information concerning the attitude of the client's principal owners, key management

and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.

- Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
- Indications of an inappropriate limitation in the scope of work.
- Indications that the client might be involved in money laundering or other criminal activities.
- The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.
- The identity and business reputation of related parties.

The extent of knowledge a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.

A15. Reviewing partner and staff profiles in light of the specific requirements of the engagement aids the firm in considering whether it has the capabilities, competence, time, and resources to undertake a new engagement from a new or an existing client. Matters the firm considers in accepting or continuing the client engagement include, for example, whether:

- Firm personnel have knowledge of relevant industries or subject matters;
- Firm personnel have experience with relevant regulatory or reporting requirements, or the ability to gain the necessary skills and knowledge effectively;
- The firm has sufficient personnel with the necessary capabilities and competence;
- Experts are available, if needed;
- Individuals meeting the criteria and eligibility requirements to perform engagement quality control review are available, where applicable; and
- The firm is able to complete the engagement within the reporting deadline.

A16. Sources of information on such matters obtained by the firm may include the following:

- Communications with existing or previous providers of professional accountancy services to the client in accordance with relevant ethical requirements, and discussions with other third parties.
- Inquiry of other firm personnel or third parties such as bankers, legal counsel and industry peers.
- Background searches of relevant databases.

A17. Deciding whether to continue a client relationship includes consideration of significant matters that have arisen during the current or previous engagements, and their implications for continuing the relationship. For example, a client may have started to expand its business operations into an area where the firm does not possess the necessary knowledge or expertise.

A18. Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship address issues that include the following:

- Discussing with the appropriate level of the client's management and those charged with its governance the appropriate action that the firm might take based on the relevant facts and circumstances.
- If the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement or from both the engagement and the client relationship, and the reasons for the withdrawal.
- Considering whether there is a professional, regulatory or legal requirement for the firm to remain in place, or for the firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.
- Documenting significant matters, consultations, conclusions and the basis for the conclusions.

Considerations Specific to Public Sector Audit Organizations

A19. In the public sector, auditors may be appointed in accordance with statutory procedures. Accordingly, certain of the requirements and considerations regarding the acceptance and continuance of client relationships and specific engagements as set out paragraphs 30-34 and A14-A18 may not be relevant. Nonetheless, establishing policies and procedures as described may provide valuable information to public sector auditors in performing risk assessments and in carrying out reporting responsibilities.

Human Resources (Ref: Para. 35)

A20. Policies and procedures related to human resources may address the following personnel issues:

- Recruitment.
- Performance evaluation.
- Capabilities.
- Competence.
- Career development.
- Promotion.
- Compensation.
- The estimation of personnel needs.

Effective recruitment processes and procedures help the firm select individuals of integrity who have the capacity to develop the capabilities and competence necessary to perform the firm's work and possess the appropriate characteristics to enable them to perform competently.

A21. Capabilities and competence are developed through a variety of methods, including the following:

- Professional education.
- Continuing professional development, including training.
- Work experience.
- Coaching by more experienced staff, for example, other members of the engagement team.
- Independence education for personnel who are required to be independent.

A22. The continuing competence of the firm's personnel depends to a significant extent on an appropriate level of continuing professional development so that personnel maintain their knowledge and capabilities. Effective policies and procedures emphasize the need for continuing training for all levels of firm personnel, and provide the necessary training resources and assistance to enable personnel to develop and maintain the required capabilities and competence.

A23. Performance evaluation, compensation and promotion procedures give due recognition and reward to the development and maintenance of competence and commitment to ethical principles. Steps a firm may take in developing and maintaining competence and commitment to ethical principles include:

- Making personnel aware of the firm's expectations regarding performance and ethical principles;
- Providing personnel with evaluation of, and counseling on, performance, progress and career development; and
- Helping personnel understand that advancement to positions of greater responsibility depends, among other things, upon performance quality and adherence to ethical principles, and that failure to comply with the firm's policies and procedures may result in disciplinary action.

A24. The size and circumstances of the firm will influence the structure of the firm's performance evaluation process. Smaller firms, in particular, may employ less formal methods of evaluating the performance of their personnel.

Considerations Specific to Smaller Practices

A25. The firm may use a suitably qualified external person when internal technical and training resources are unavailable, or for any other reason.

Assignment of Engagement Teams (Ref: Para. 36-37)

A26. Policies and procedures may include systems to monitor the workload and availability of engagement partners so as to enable these individuals to have sufficient time to adequately discharge their responsibilities.

A27. When assigning engagement teams, and in determining the level of supervision required, the firm considers, for example, the engagement team's:

- Understanding of, and practical experience with, engagements of a similar nature and complexity through appropriate training and participation;
- Understanding of professional standards and regulatory and legal requirements;
- Technical knowledge and expertise, including knowledge of relevant information technology;
- Knowledge of relevant industries in which the clients operate;
- Ability to apply professional judgment; and
- Understanding of the firm's quality control policies and procedures.

Engagement Performance

Consistency in the Quality of Engagement Performance (Ref: Para. 38(a))

A28. The firm promotes consistency in the quality of engagement performance through its policies and procedures. This is often accomplished through written or electronic manuals, software tools or other forms of standardized documentation, and industry or subject matter-specific guidance materials. Matters addressed may include the following:

- How engagement teams are briefed on the engagement to obtain an understanding of the objectives of their work.
- Processes for complying with applicable engagement standards.
- Processes of engagement supervision, staff training and coaching.
- Methods of reviewing the work performed, the significant judgments made and the form of report being issued.
- Appropriate documentation of the work performed and of the timing and extent of the review.
- Processes to keep all policies and procedures current.

A29. Appropriate teamwork and training assist less experienced members of the engagement team to clearly understand the objectives of the assigned work.

Supervision (Ref: Para. 38(b))

A30. Engagement supervision policies cover matters such as:

- Tracking the progress of the engagement;

- Considering the capabilities and competence of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions and whether the work is being carried out in accordance with the planned approach to the engagement;
- Addressing significant matters arising during the engagement, considering their significance and modifying the planned approach appropriately; and
- Identifying matters for consultation or consideration by more experienced engagement team members during the engagement.

Review (Ref: Para. 38(c))

A31. A review consists of consideration whether, for example:

- The work has been performed in accordance with professional standards and regulatory and legal requirements;
- Significant matters have been raised for further consideration;
- Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- There is a need to revise the nature, timing and extent of work performed;
- The work performed supports the conclusions reached and is appropriately documented;
- The evidence obtained is sufficient and appropriate to support the report; and
- The objectives of the engagement procedures have been achieved.

Consultation (Ref: Para. 40)

A32. Consultation includes discussion, at the appropriate professional level, with individuals within or outside the firm who have specialized expertise, to resolve a difficult or contentious matter.

A33. Consultation uses appropriate research resources as well as the collective experience and technical expertise of the firm. Consultation helps to promote quality and improves the application of professional judgment. Appropriate recognition of consultation in the firm's policies and procedures helps to promote a culture in which consultation is recognized as a strength and encourages personnel to consult on difficult or contentious matters.

A34. Effective consultation on significant technical, ethical and other matters within the firm, or where applicable, outside the firm can be achieved when those consulted:

- Are given all the relevant facts that will enable them to provide informed advice; and
- Have appropriate knowledge, seniority and experience,

and when conclusions resulting from consultations are appropriately documented and implemented.

A35. Documentation of consultations with other professionals that involve difficult or contentious matters that is sufficiently complete and detailed contributes to an understanding of:

- The issue on which consultation was sought; and
- The results of the consultation, including any decisions taken, the basis for those decisions and how they were implemented.

Considerations Specific to Smaller Practices

A36. A firm needing to consult externally, for example, a firm without appropriate internal resources, may take advantage of advisory services provided by:

- Other firms;
- Professional and regulatory bodies; or
- Commercial organizations that provide relevant quality control services.

Before contracting for such services, consideration of the qualifications of the external provider helps the firm to determine whether the external provider is suitably qualified for that purpose.

Engagement Quality Control Review (Ref: Para. 41(b))

A37. Criteria to consider when determining which engagements other than audits of financial statements of listed entities are to be subject to an engagement quality control review include, for example:

- The nature of the engagement, including the extent to which it involves a matter of public interest.
- The identification of unusual circumstances or risks in an engagement or class of engagements.
- Whether laws or regulations require an engagement quality control review.

Nature, Timing and Extent of the Engagement Quality Control Review (Ref: Para. 43-45)

A38. Matters of significant judgment include, for example:

- Significant risks identified during the engagement and the responses to those risks.
- Judgments made, particularly with respect to materiality and significant risks.
- The significance and disposition of corrected and uncorrected misstatements identified during the engagement.
- The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.

A39. Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant matters to be promptly resolved to the reviewer's satisfaction before the date of the report.

A40. The extent of the engagement quality control review may depend, among other things, on the complexity of the engagement, whether the entity is a listed entity, and the risk that the report might not be appropriate in the circumstances.

Considerations specific to public sector audit organizations

A41. Although not referred to as listed entities, as described in paragraph A12, certain public sector entities may be of sufficient significance to warrant performance of an engagement quality control review.

Criteria for the Eligibility of Engagement Quality Control Reviewers (Ref: Para. 46-48)

A42. What constitutes sufficient and appropriate technical expertise, experience and authority depends on the circumstances of the engagement. For example, the engagement quality control reviewer for an audit of the financial statements of a listed entity would be an individual with sufficient and appropriate experience and authority to act as an audit engagement partner on audits of financial statements of listed entities.

A43. The engagement partner may consult the engagement quality control reviewer during the engagement, for example, to establish that a judgment made by the engagement partner will be acceptable to the engagement quality control reviewer. Such consultation avoids identification of differences of opinion at a late stage of the engagement and need not compromise the engagement quality control reviewer's eligibility to perform the role. However, when the consultation is a necessary part of the engagement partner's process of forming an opinion on a matter, consultation with the engagement quality control reviewer for this purpose would not be appropriate. Similarly, when the nature and extent of the consultations become significant the reviewer's objectivity may be compromised unless care is taken by both the engagement team and the reviewer to maintain the reviewer's objectivity. Where this is not possible, another individual within the firm or a suitably qualified external person may be appointed to take on the role of either the engagement quality control reviewer or the person to be consulted on the engagement.

A44. Policies and procedures designed to maintain the objectivity of the engagement quality control reviewer may include for example, where practicable, a requirement that the engagement quality control reviewer:

- Is not selected by the engagement partner;
- Does not otherwise participate in the engagement during the period of review;
- Does not make decisions for the engagement team; and
- Is not subject to other considerations that would threaten the reviewer's objectivity.

Considerations specific to smaller practices

A45. The examples in paragraph A44 are relevant only when practicable. For example, it may not be practicable, in the case of firms with few partners, for the engagement partner not to be involved in selecting the engagement quality control reviewer.

A46. Suitably qualified external persons may be contracted where sole practitioners or small firms identify engagements requiring engagement quality control reviews. Alternatively, some sole practitioners or small firms may wish to use other firms to facilitate engagement quality control reviews. Where the firm contracts suitably qualified external persons, the requirements in paragraphs 46-48 and guidance in paragraphs A42-A43 apply.

Considerations specific to public sector audit organizations

A47. In the public sector, a statutorily appointed auditor (for example, an Auditor General, or other suitably qualified person appointed on behalf of the Auditor General) may act in a role equivalent to that of engagement partner with overall responsibility for public sector audits. In such circumstances, where applicable, the selection of the engagement quality control reviewer includes consideration of the need for independence from the audited entity and the ability of the engagement quality control reviewer to provide an objective evaluation.

Differences of Opinion (Ref: Para. 50-51)

A48. Effective procedures encourage identification of differences of opinion at an early stage, provide clear guidelines as to the successive steps to be taken thereafter, and require documentation regarding the resolution of the differences and the implementation of the conclusions reached.

A49. Procedures to resolve such differences may include consulting with another practitioner or firm, or a professional or regulatory body.

Engagement Documentation

Completion of the Assembly of Final Engagement Files (Ref: Para. 52)

A50. Law or regulation may prescribe the time limits by which the assembly of final engagement files for specific types of engagement is to be completed. Where no such time limits are prescribed in law or regulation, paragraph 52 requires the firm to establish policies and procedures related to time limits that reflect the need to complete the assembly of final engagement files on a timely basis. In the case of an audit, for example, such a time limit would ordinarily not be more than 60 days after the date of the auditor's report.

A51. Where two or more different reports are issued in respect of the same subject matter information of an entity, the firm's policies and procedures relating to time limits for the assembly of final engagement files address each report as if it were for a separate engagement. This may, for example, be the case when the firm issues an auditor's report on a component's financial information for group consolidation purposes and, at a subsequent date, an auditor's report on the same financial information for statutory purposes.

Confidentiality, Safe Custody, Integrity, Accessibility and Retrievability of Engagement Documentation (Ref: Para. 53)

A52. Relevant ethical requirements establish an obligation for the firm's personnel to observe at all times the confidentiality of information contained in engagement documentation, unless specific client authority has been given to disclose information, or there is a legal or professional duty to do so. Specific laws or regulations may impose additional obligations on the firm's personnel to maintain client confidentiality, particularly where data of a personal nature are concerned.

A53. Whether engagement documentation is in paper, electronic or other media, the integrity, accessibility or retrievability of the underlying data may be compromised if the documentation could be altered, added to or deleted without the firm's knowledge, or if it could be permanently lost or damaged. Accordingly, controls that the firm designs and implements to avoid unauthorized alteration or loss of engagement documentation may include those that:

- Enable the determination of when and by whom engagement documentation was created, changed or reviewed;
- Protect the integrity of the information at all stages of the engagement, especially when the information is shared within the engagement team or transmitted to other parties via the Internet;
- Prevent unauthorized changes to the engagement documentation; and
- Allow access to the engagement documentation by the engagement team and other authorized parties as necessary to properly discharge their responsibilities.

A54. Controls that the firm designs and implements to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation may include the following:

- The use of a password among engagement team members to restrict access to electronic engagement documentation to authorized users.
- Appropriate back-up routines for electronic engagement documentation at appropriate stages during the engagement.
- Procedures for properly distributing engagement documentation to the team members at the start of the engagement, processing it during engagement, and collating it at the end of engagement.
- Procedures for restricting access to, and enabling proper distribution and confidential storage of, hardcopy engagement documentation.

A55. For practical reasons, original paper documentation may be electronically scanned for inclusion in engagement files. In such cases, the firm's procedures designed to maintain the integrity, accessibility, and retrievability of the documentation would include requiring the engagement teams to:

- Generate scanned copies that reflect the entire content of the original paper documentation, including manual signatures, cross-references and annotations;

- Integrate the scanned copies into the engagement files, including indexing and signing off on the scanned copies as necessary; and
- Enable the scanned copies to be retrieved and printed as necessary.

There may be legal, regulatory or other reasons for a firm to retain original paper documentation that has been scanned.

Retention of Engagement Documentation (Ref: Para. 54)

A56. The needs of the firm for retention of engagement documentation, and the period of such retention, will vary with the nature of the engagement and the firm's circumstances, for example, whether the engagement documentation is needed to provide a record of matters of continuing significance to future engagements. The retention period may also depend on other factors, such as whether local law or regulation prescribes specific retention periods for certain types of engagements, or whether there are generally accepted retention periods in the jurisdiction in the absence of specific legal or regulatory requirements.

A57. In the specific case of audit engagements, the retention period would ordinarily be no shorter than five years from the date of the auditor's report, or, if later, the date of the group auditor's report.

A58. Procedures that the firm adopts for retention of engagement documentation include those that enable the requirements of paragraph 54 to be met during the retention period, for example to:

- Enable the retrieval of, and access to, the engagement documentation during the retention period, particularly in the case of electronic documentation since the underlying technology may be upgraded or changed over time;
- Provide, where necessary, a record of changes made to engagement documentation after the engagement files have been completed; and
- Enable authorized external parties to access and review specific engagement documentation for quality control or other purposes.

Ownership of Engagement Documentation

A59. Unless otherwise specified by law or regulation, engagement documentation is the property of the firm. The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the firm or its personnel.

Monitoring

Monitoring the Firm's Quality Control Policies and Procedures (Ref: Para. 55-56)

A60. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of:

- Adherence to professional standards and regulatory and legal requirements;
- Whether the quality control system has been appropriately designed and effectively implemented; and
- Whether the firm's quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances.

A61. Ongoing consideration and evaluation of the system of quality control may include matters such as the following:

- Analysis of:
  - New developments in professional standards and regulatory and legal requirements, and how they are reflected in the firm's policies and procedures where appropriate;
  - Written confirmation of compliance with policies and procedures on independence;
  - Continuing professional development, including training; and
  - Decisions related to acceptance and continuance of client relationships and specific engagements.
- Determination of corrective actions to be taken and improvements to be made in the system, including the provision of feedback into the firm's policies and procedures relating to education and training.
- Communication to appropriate firm personnel of weaknesses identified in the system, in the level of understanding of the system, or compliance with it.
- Follow-up by appropriate firm personnel so that necessary modifications are promptly made to the quality control policies and procedures.

A62. Inspection cycle policies and procedures may include, for example, selecting at least one engagement for each engagement partner over an inspection cycle that spans three years. The manner in which the inspection cycle is organized, including the timing of selection of individual engagements, depends on many factors, such as the following:

- The size of the firm.
- The number and geographical location of offices.
- The results of previous monitoring procedures.
- The degree of authority both personnel and offices have (for example, whether individual offices are authorized to conduct their own inspections or whether only the head office may conduct them).
- The nature and complexity of the firm's practice and organization.

- The risks associated with the firm's clients and specific engagements.

A63. The inspection process includes the selection of individual engagements, some of which may be selected without prior notification to the engagement team. In determining the scope of the inspections, the firm may take into account the scope or conclusions of an independent external inspection program. However, an independent external inspection program does not act as a substitute for the firm's own internal monitoring program.

Considerations Specific to Smaller Practices

A64. In the case of small firms, monitoring procedures may need to be performed by individuals who are responsible for design and implementation of the firm's quality control policies and procedures, or who may be involved in performing the engagement quality control review. A firm with a limited number of persons may choose to use a suitably qualified external person or another firm to carry out engagement inspections and other monitoring procedures. Alternatively, the firm may establish arrangements to share resources with other appropriate organizations to facilitate monitoring activities.

Communicating Deficiencies (Ref: Para. 58)

A65. The reporting of identified deficiencies to individuals other than the relevant engagement partners need not include an identification of the specific engagements concerned, although there may be cases where such identification may be necessary for the proper discharge of the responsibilities of the individuals other than the engagement partners.

Complaints and Allegations (Ref: Para. 63)

A66. Complaints and allegations (which do not include those that are clearly frivolous) may originate from within or outside the firm. They may be made by firm personnel, clients or other third parties. They may be received by engagement team members or other firm personnel. The firm's policies and procedures may require involving legal counsel in the investigation.

Considerations Specific to Smaller Practices

A67. Small firms and sole practitioners may use the services of a suitably qualified external person or another firm to carry out the investigation into complaints and allegations.

Documentation of the System of Quality Control (Ref: Para. 66-67)

A68. The form and content of documentation evidencing the operation of each of the elements of the system of quality control is a matter of judgment and depends on a number of factors, including the following:

- The size of the firm and the number of offices.
- The nature and complexity of the firm's practice and organization.

For example, large firms may use electronic databases to document matters such as independence confirmations, performance evaluations and the results of monitoring inspections. Smaller firms may use more informal methods such as manual notes, checklists and forms.

A69. Appropriate documentation relating to monitoring includes, for example:

- Monitoring procedures, including the procedure for selecting completed engagements to be inspected.
- A record of the evaluation of:
  - Adherence to professional standards and regulatory and legal requirements;
  - Whether the quality control system has been appropriately designed and effectively implemented; and
  - Whether the firm's quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances.
- Identification of the deficiencies noted, an evaluation of their effect, and the basis for determining whether and what further action is necessary.

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translated menu

- About IFAC
- Media Center
- Exposure Drafts
- Compliance Program
- Standard-Setting Boards
- Committees
- Forum of Firms
- Articles and Speeches Library
- Bookstore
- Translation and Permissions Policies
- Jobs at IFAC

- Home
- Site Feedback
- Contact IFAC
- Leadership

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IAASB Clarifies its Quality Control and Auditor Reporting Standards; Makes Further Progress on Clarifying Other Auditing Standards

(New York/August 3, 2007) - To enhance the quality and consistency of audits, the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting board under the auspices of the International Federation of Accountants (IFAC), is continuing to advance its project to clarify its international standards. At its July 2007 meeting in Warsaw, Poland, the IAASB approved exposure drafts of nine proposed standards, including each of its international quality control and auditor reporting standards. These have all been redrafted in accordance with

Media Resources

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Key Publications

- IFAC Annual Report
- IAASB Annual Report
- IFAC Newsletter
- Rebuilding Public Confidence in Financial Reporting: An International Perspective (Credibility Report)
- Challenges and Successes In Implementing International Standards: Achieving Convergence To IFRSs and ISAs
- Enterprise Governance - Getting the Balance Right

the IAASB's new drafting conventions designed to improve the clarity of its pronouncements.

Further information about each exposure draft and the changes proposed therein is provided in the explanatory memorandum at the beginning of the exposure drafts. The exposure drafts may be viewed by going to http://www.ifac.org/EDs.

Quality Control Exposure Drafts

The IAASB has issued proposed International Standard on Quality Control (ISQC) 1 (Redrafted), *Quality Control for Firms that Perform Audits and Reviews of Financial Statement, and Other Assurance and Related Services Engagements*, along with proposed International Standard on Auditing (ISA) 220 (Redrafted), *Quality Control for an Audit of Financial Statements*.

"Together, these standards deal with important quality control considerations at both the firm and engagement levels. The standards are closely linked, and therefore, implementing clarity revisions at the same time makes sense to ensure consistency between them," explains John Kellas, IAASB Chairman.

Auditor Reporting Exposure

Drafts

The IAASB has also addressed the clarification of its auditor reporting standards. The proposed clarified auditor reporting standards comprise:

- ISA 700 (Redrafted), *The Independent Auditor's Report on General Purpose Financial Statements*;
- ISA 705 (Revised and Redrafted), *Modifications to the Opinion in the Independent Auditor's Report*;
- ISA 706 (Revised and Redrafted), *Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor's Report*;
- ISA 800 (Revised and Redrafted), *Special Considerations - Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*; and
- ISA 805 (Revised and Redrafted), *Engagements to Report on Summary Financial Statements*.

Proposed ISA 700 (Redrafted) redrafts a standard that was revised in 2004. The other reporting standards have been fully revised to update them and make them consistent with

ISA 700. Those revisions were completed and approved by the IAASB in 2006, and the standards are now being issued for comment only on their redrafting into the new clarity conventions.

Other Proposed Standards
In addition, the IAASB has issued exposure drafts of proposed ISA 510 (Redrafted), *Initial Audit Engagements - Opening Balances*, and proposed ISA 530 (Redrafted), *Audit Sampling*.

Progress of the Clarity Project
All of the proposed standards have been drafted in accordance with the IAASB's new drafting conventions. These conventions include the specification of an objective within each standard and separate sections for requirements and application and other material.

The IAASB has now approved five final ISAs drafted in accordance with the new conventions and, including the eight just released, 23 exposure drafts of ISAs. The IAASB expects to issue a further seven exposure drafts this year, and to complete all 35 ISAs as final standards by the end of 2008.

Further information on the Clarity project may be obtained from http://www.ifac.org/IAASB/downloads/IAASB_Clarity_Status_Report.pdf.

How to Comment
Recognizing the number of exposure drafts being issued, the IAASB has staggered the deadlines for comments:

- Comments on the exposure drafts of proposed ISA 510 (Redrafted) and ISA 530 (Redrafted) are requested by **October 31, 2007**.
- Comments on the exposure drafts of proposed ISA 700 (Redrafted), ISA 705 (Revised and Redrafted), ISA 706 (Revised and Redrafted), ISA 800 (Revised and Redrafted) and ISA 805 (Revised and Redrafted) are requested by **November 30, 2007**.
- Comments on the exposure drafts of proposed ISQC 1 (Redrafted) and ISA 220 (Redrafted) are requested by **December 31, 2007**.

Comments should be submitted by email to EDComments@ifac.org. They may also be faxed to IAASB ED Comments, at +1-212-286-9570 or mailed to IAASB ED Comments at 545 Fifth Avenue, 14th Floor, New

York, NY 10017, USA. All comments will be considered a matter of public record and will ultimately be posted on the IFAC website.

About the IAASB and IFAC

The objective of the IAASB is to serve the public interest by setting high quality auditing and assurance standards and by facilitating the convergence of international and national standards, thereby enhancing the quality and uniformity of practice throughout the world and strengthening public confidence in the global auditing and assurance profession. The Public Interest Oversight Board oversees the activities of the IAASB and, as one element of that oversight, establishes its due process and working procedures.

Founded in 1977, IFAC is the global organization for the accountancy profession dedicated to serving the public interest by strengthening the profession and contributing to the development of strong international economies. IFAC is comprised of 155 members and associates in 118 countries, representing more than 2.5 million accountants in public practice, education, government service, industry and commerce. In addition to setting international auditing and assurance standards through the IAASB, IFAC, through its independent standard-setting boards, sets international ethics, education, and public sector accounting standards. It also issues guidance to encourage high quality performance by professional accountants in business.

Further information about IAASB may be obtained from its website: http://www.iaasb.org. The PIOB website address is http://www.ipiob.org.