

***International Standard  
on Auditing  
(UK and Ireland)***

**700 (Revised)**

**2008**

**September**

**THE AUDITOR'S REPORT ON FINANCIAL STATEMENTS**

EXPOSURE DRAFT

**The Auditing Practices  
Board**

## **THE AUDITING PRACTICES BOARD**

The Auditing Practices Board (APB), which is part of the Financial Reporting Council (FRC), prepares for use within the United Kingdom and the Republic of Ireland:

- Standards and guidance for auditing;
- Standards and guidance for reviews of interim financial information performed by the auditor of the entity;
- Standards and guidance for the work of reporting accountants in connection with investment circulars; and
- Standards and guidance for auditor's and reporting accountant's integrity and objectivity and independence

with the objective of enhancing public confidence in the audit process and the quality and relevance of audit services in the public interest.

The APB comprises individuals who are not eligible for appointment as company auditors, as well as those who are so eligible. Those who are eligible for appointment as company auditors may not exceed 40% of the APB by number.

Neither the APB nor the FRC accepts any liability to any party for any loss, damage or costs howsoever arising, whether directly or indirectly, whether in contract, tort or otherwise from any action or decision taken (or not taken) as a result of any person relying on or otherwise using this Consultation Paper or arising from any omission from it.

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## INVITATION TO COMMENT

The APB is issuing for public comment this proposed International Standard on Auditing (UK and Ireland) 700 (Revised). The primary purpose of revising ISA (UK and Ireland) 700 is to facilitate a more concise auditor's report.

### BACKGROUND

In December 2007 the APB issued a Discussion Paper entitled "The Auditor's Report: A time for change?" The Discussion Paper sought views on what steps were needed to be taken to reflect the coming into force of the Companies Act 2006 (CA 2006) and whether other, more wide ranging, changes should be made to the form and content of the auditor's report.

The Discussion Paper was prepared in the light of responses to an earlier paper issued by the FRC on the subject of "Promoting Audit Quality" which had revealed that a number of stakeholder groups considered auditor's reports to be overly legalistic and to contain caveats and provisos that limit their usefulness.

The APB received 31 comment letters<sup>1</sup> from a number of stakeholder groups and also held an open meeting to obtain the views of stakeholders. There was quite a high degree of consistency in the responses within the different stakeholder groups, yet quite marked differences of view between certain of the stakeholder groups. The views of commentators are summarized in the Feedback Paper on pages 43 to 56.

### APB'S RESPONSE TO COMMENTS RECEIVED

As discussed in the Feedback Paper, the APB has decided to take action to accommodate the views of institutional investors, organisations representing preparers, public sector bodies and some auditing firms and individuals. To accomplish this, the APB proposes, among other things, to revise ISA (UK and Ireland) 700 to permit a more concise auditor's report. The APB also proposes to initiate research to better understand what can realistically be done to make auditor's reports more informative.

Taking action at this time will help influence international thinking on auditor's reports. The European Commission (the EC) has yet to decide on the form and content of auditor's reports within the European Union (the EU) and the International Auditing and Assurance Standards Board (the IAASB) has agreed to consider recent research and developments with regard to the auditor's report and, in the light of this, determine what action should be taken in relation to ISA 700.

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<sup>1</sup> A full list of respondents is set out in Appendix 1.

The APB has concluded that there is a “window of opportunity” during which it can influence international decisions on the auditor’s report by implementing a concise auditor’s report, and commencing research to better understand what can realistically be done to make auditor’s reports more informative. As discussed more fully in the feedback paper the APB believes that the proposed ISA (UK and Ireland) 700 (Revised) would have a “shelf life” of at least 3 years.

The APB is aware that a number of the accountancy bodies and auditing firms, motivated by their desire to see global convergence through compliance with ISAs, recommended that minimal changes to the auditor’s report be made at this time. Pursuing this option would have meant that no changes to ISA (UK and Ireland) 700 would have been required. In framing its proposals to revise ISA (UK and Ireland) 700, the APB has sought to ensure that compliance with it would not preclude auditors from asserting, in their auditor’s reports, that the ISAs have been complied with.

## **CONCISE AUDITOR’S REPORT**

Illustrative examples of the more concise auditor’s report for both UK and Irish publicly traded companies are set out on pages 11 to 14: The principal features of the more concise reports, compared to auditor’s reports being issued at the present time, are that they:

- Emphasise the primacy of the true and fair requirement, as the overarching concept in reporting on financial statements, by using bullet points to distinguish the three distinct elements of the auditor’s opinion on the financial statements.
- Do not include much of the standard language relating to the responsibilities of the auditor and of those charged with governance, and of the basis of the auditor’s opinion. They do, however, include a cross reference to a description of the responsibilities of the auditor and of the scope of an audit, which will be maintained on the APB’s web site.
- State the auditor’s responsibility to comply with APB’s Ethical Standards.
- Separate the auditor’s opinion on the financial statements from other opinions required by law and regulation (the so called two-part opinion required by ISA 700<sup>2</sup>).
- Include a statement that the auditor has nothing to report in respect of those responsibilities where the auditor is required to report by exception.

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<sup>2</sup> The IAASB issued ISA 700 (Revised) in 2005. It is currently being redrafted by the IAASB as part of its Clarity Project. The Clarity version of ISA 700 will take effect internationally for accounting periods commencing on or after 15 December 2009. The APB will be consulting, as a separate exercise, to obtain views on whether it should update ISAs (UK and Ireland) to reflect the new Clarity ISAs and, if so, the timing of this.

## **APB'S PROPOSED COURSE OF ACTION**

In overview the APB proposes the following course of action:

### **Summer 2008:**

- Issue for exposure a revision to ISA (UK and Ireland) 700 "The auditor's report on financial statements" that would facilitate, but not mandate, a more concise auditor's report. It is proposed that ISA (UK and Ireland) 700 (Revised) will take effect for accounting periods ending on or after 5 April 2009. The Exposure Draft is included in this document (see pages 15 to 31).
- Issue for exposure an example "Statement of the scope of an audit and the auditor's reporting responsibilities" which (along with the other examples listed on pages 41 and 42) would be posted to the APB's web site to allow such material to be cross referred to from future auditor's reports. The Exposure Draft is also included in this document (see pages 33 to 39).
- Issue a Bulletin (2008/8) providing illustrative auditor's reports for those (short) accounting periods that commence on or after 6 April 2008 but end before 5 April 2009. This updates the example auditor's reports in APB Bulletin 2006/6 to reflect the requirements of the Companies Act 2006 that are effective for accounting periods beginning on or after 6 April 2008.

### **Spring 2009**

- Issue ISA (UK and Ireland) 700 (Revised) so that it applies for years ending on or after 5 April 2009.
- Issue a revision to Bulletin 2006/6 (for the UK) and 2006/1 (for the Republic of Ireland) updating the example APB auditor's reports to reflect compliance with ISA (UK and Ireland) 700 (Revised).
- Post to the APB web site a number of "Statements of the scope of an audit and the auditor's responsibilities" that can be cross referred to from the auditor's report. The range of examples that the APB proposes to prepare is set out on pages 41 and 42.

### **Longer term**

- Undertake research to better understand what can realistically be done to make auditor's reports more informative.
- Influence international decisions that will affect auditor's reports:
  - Contribute to the IAASB's plans to consider revisions to ISA 700.

- Contribute to the thinking within the EU on the form and content of the auditor's report.
- Together with the FRC progress the development of guidance on "adequate accounting records".

## OVERVIEW OF PROPOSED CHANGES TO ISA (UK AND IRELAND) 700

The principal changes proposed to ISA (UK and Ireland) 700 are those that are necessary to facilitate auditor's issuing the more concise auditor's report described above. In addition the proposed revised ISA (UK and Ireland) 700:

- Includes guidance on the "true and fair" concept derived from the recent Counsel's Opinion obtained by the FRC on this subject. In particular with respect to the auditor's opinion on the financial statement the following statement has been included in paragraph 18: **"It is not sufficient for the auditor to reach its conclusion concerning the true and fair view solely on the basis that the financial statements were prepared in accordance with applicable law and accounting standards"**.
- Contains guidance on the financial reporting frameworks that are permitted by Company Law (see paragraph 21).
- Expands the scope of the ISA (UK and Ireland) to address circumstances where the auditor is requested to express a separate second opinion on an additional financial reporting framework (For example IFRSs as issued by the IASB) where the first opinion is in respect of "IFRSs as adopted by the EU". (This material is included in paragraphs 22 and 23 of the Exposure Draft of ISA (UK and Ireland) 700 (Revised) and has previously been included in Bulletins 2006/1 and 2006/6).
- Adds certain new requirements (paragraphs 5 and 6 of the Exposure Draft of ISA (UK and Ireland) 700 (Revised)) regarding the matters that the auditor is required to take into account when evaluating the conclusions drawn from the audit. These requirements have been derived from ISA 700.

## GUIDE FOR COMMENTATORS

### General invitation to comment

*Question 1 – The APB invites comments on:*

- (a) the proposed ISA (UK and Ireland) 700 (Revised) on pages 15 to 31;*
- (b) the proposed "Statement of the scope of an audit and the auditor's responsibilities in respect of a publicly traded company incorporated in the*

***United Kingdom”, on pages 33 to 39, which it is intended would be posted to the APB’s web site; and***

***(c) the example auditor’s reports on pages 11 to 14.***

### **Specific issues on which APB invites responses**

The APB welcomes views on the following matters:

#### **Permitting cross referencing to information held on the APB’s web site**

Paragraph 16 of the Exposure Draft of the proposed ISA (UK and Ireland) 700 (Revised) requires that the auditor’s report should either:

- (a) cross refer to the relevant statement of the scope of an audit and the auditor’s reporting responsibilities, that is maintained on the APB’s web site; or
- (b) include a description of the auditor’s responsibilities and the work an auditor typically performs.

This requirement is drafted in this way to enable the auditor’s report to be more concise by cross-referring to standard language, concerning the auditor’s responsibilities and the scope of an audit, maintained on the APB’s web-site, rather than including this information in the auditor’s report itself. This approach is consistent with the requirement in paragraph 40(b) of the IAASB’s clarified ISA 700 (see Appendix 2) and thus would enable an auditor to assert compliance with the ISAs.

***Question 2 – Do commentators support APB’s proposal of describing the auditor’s responsibilities and the work an auditor typically performs by either:***

- (a) ***cross referring to standard paragraphs maintained by the APB on its web site;***  
***or***
- (b) ***including a description in the auditor’s report itself?***

The APB’s proposed approach gives rise to the practical difficulty that the APB will need to develop and maintain a number of example statements of the auditor’s reporting responsibilities that address the auditor’s differing responsibilities with respect to different types of entities (such as companies, charities, credit unions and public sector bodies).

***Question 3 – On pages 41 and 42 the APB sets out a schedule of the range of example statements that it presently intends to post to its web site. Are there any other examples that you believe it is imperative the APB should post to its web-site?***

***Question 4 – In addition to the need for the APB to develop and maintain current examples relating to a number of different types of entity what other practical difficulties do you think might arise from the APB’s proposed approach?***

## References to the true and fair view

Paragraphs 19, 20 and 53 of the Exposure Draft of the proposed ISA (UK and Ireland) 700 (Revised) refer to the Counsel’s Opinion that the FRC commissioned, entitled “The true and fair view requirement revisited”. Amongst other things the Opinion confirms the overarching nature of the true and fair requirement to the preparation of financial statements in the United Kingdom, whether they are prepared in accordance with international or national accounting standards. Both the requirements and guidance in the Exposure Draft have been structured so as to emphasise the overarching nature of the true and fair requirement.

The Exposure Draft of the proposed ISA (UK and Ireland) 700 (Revised) has been developed to address both the UK and the Republic of Ireland and, with respect to each of those countries, entities subject to different legislative requirements, such as companies, charities and pension funds. The law relating to the content and the form of the auditor’s opinion varies.

***Question 5 – Is the wording of paragraph 18 in the Exposure Draft of the proposed ISA (UK and Ireland) 700 (revised) sufficiently generic to apply to all entities that are required to be audited? (In this regard more detail concerning the legal framework applicable to a particular type of entity will be provided in the applicable example “Statement of the scope of an audit and the auditor’s responsibilities”). If not please describe any concerns?***

## Ordering of the elements of the opinion on the financial statements

The illustrative auditor’s opinions on the financial statements (see pages 11 and 13) present the opinion in the following three discrete elements:

“In our opinion the financial statements:

- have been properly prepared in accordance with the applicable financial reporting framework;
- have been prepared in accordance with applicable law; and
- give a true and fair view . . .”

These bullet points reflect the three distinct elements of the opinion on the financial statements required by section 495(3) of CA 2006 but in a different sequence to that used in CA 2006. The APB believes that placing the reference to the true and fair view as the final bullet point results in the most logical sequence as it emphasises the importance of the auditor making this final judgment.

***Question 6 – Do you agree that it is logical for the reference to the “true and fair view” to be the final element in the auditor’s opinion on the financial statements? If you disagree what would be your preference for ordering the elements?”***

## APB's Proposed Course of Action

**Question 7 – Please provide any comments that you may have on the steps set out concerning the APB's proposed course of action and the proposed timing of those steps (see pages 5 and 6)? Are there any other actions that you believe the APB should be taking?**

The APB would prefer to receive letters of comment in electronic form (preferably in word format): these may be sent by e-mail to [s.leonard@frc-apb.org.uk](mailto:s.leonard@frc-apb.org.uk) If this is not possible, please send letters of comment to:

**Steven Leonard**  
**Project Director**  
**The Auditing Practices Board**  
**5<sup>th</sup> Floor**  
**Aldwych House**  
**71-91 Aldwych**  
**LONDON WC2B 4HN**

To enable the APB to issue ISA (UK and Ireland) 700 (Revised) in final form before 31 March 2009, the APB requests that letters of comment on this exposure draft be sent so as to be received no later than **28 November 2008**.

All comments will be regarded as being on the public record, and will be made available on the APB's web-site, unless otherwise requested.



## EXAMPLE AUDITOR'S REPORT FOR A UNITED KINGDOM PUBLICLY TRADED COMPANY

- *Financial statements prepared in accordance with IFRSs as adopted by the European Union*

### INDEPENDENT AUDITOR'S REPORT TO THE [SHAREHOLDERS] [MEMBERS] OF XYZ PLC

#### Report on the financial statements

We have audited the financial statements of (name of entity) for the year ended ... which comprise [specify the financial statements, such as the Group and Parent Income Statements, the Group and Parent Balance Sheets, the Group and Parent Cash Flow Statements, the Group and Parent Statements of Changes in Equity], and the related notes. The financial statements have been prepared in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

#### Respective responsibilities of directors and auditors

In relation to these financial statements, the directors are responsible for their preparation and presentation and for being satisfied that they give a true and fair view.

Our responsibility is to audit the financial statements in accordance with the requirements of the Companies Act 2006 and International Standards on Auditing (UK and Ireland) and to express an opinion on the financial statements. In forming our opinion we are also required to comply with the Auditing Practices Board's Ethical Standards. A statement describing the scope of an audit and the auditor's reporting responsibilities in respect of a United Kingdom publicly traded company is available on the APB's web site [*insert reference to web page*].

#### Opinion

In our opinion the financial statements:

- have been properly prepared in accordance with IFRSs as adopted by the European Union;
- have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation; and
- give a true and fair view of the state of the group's and the parent company's affairs as at ... and of the group's and the parent company's profit for the year then ended.

## Report on other legal and regulatory requirements

### Opinion

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' Report is consistent with the financial statements.

We also have responsibilities:

- under the Companies Act 2006 to report to you if, in our opinion:
  - Adequate accounting records have not been kept, or that returns adequate for our audit have not been received from branches not visited by us.
  - The parent company financial statements are not in agreement with the accounting records and returns.
  - The part of the Directors' Remuneration Report to be audited is not in agreement with the accounting records and returns.
  - We have not received all the information and explanations we require for our audit.
- under the Listing Rules of the Financial Services Authority, to review:
  - The statement made by the directors that the business is a going concern, together with supporting assumptions or qualifications as necessary.
  - The parts of the Corporate Governance Statement relating to the company's compliance with the nine provisions of the [2006]/[June 2008]<sup>3</sup> Combined Code specified for our review.

We have nothing to report to you in respect of these responsibilities.

*[Signature]*

*John Smith (Senior statutory auditor)*

*for and on behalf of ABC LLP, Statutory Auditor*

*Address*

*Date*

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<sup>3</sup> At present two versions of the Combined Code are in effect. The 2006 edition applies to accounting periods beginning on or after 1 November 2006 and the June 2008 edition applies to accounting periods beginning on or after 29 June 2008.

## EXAMPLE AUDITORS REPORT FOR AN IRISH PUBLICLY TRADED COMPANY

- *Financial statements prepared in accordance with IFRSs as adopted by the European Union*

### INDEPENDENT AUDITOR'S REPORT TO THE [SHAREHOLDERS] [MEMBERS] OF LMN PLC

#### Report on the financial statements

We have audited the financial statements of (name of entity) for the year ended ... which comprise [specify the financial statements, such as the Group and Parent Income Statements, the Group and Parent Balance Sheets, the Group and Parent Cash Flow Statements, the Group and Parent Statements of Changes in Equity], and the related notes. The financial statements have been prepared in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

#### Respective responsibilities of directors and auditors

In relation to these financial statements, the directors are responsible for their preparation and presentation and for being satisfied that they give a true and fair view.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland) and to express an opinion on the financial statements. In forming our opinion we are also required to comply with the Auditing Practices Board's Ethical Standards. A statement describing the scope of an audit and the auditor's reporting responsibilities in respect of an Irish publicly traded company is available on the APB's web site [insert reference to web page].

#### Opinion

In our opinion the financial statements:

- have been properly prepared in accordance with IFRSs as adopted by the European Union;
- have been prepared in accordance with the requirements of the Companies Acts 1963 to 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation; and
- give a true and fair view of the state of the group's and the parent company's affairs as at ... and of the group's and parent company's profit for the year then ended.

## Report on other legal and regulatory requirements

### Opinion

In our opinion:

- proper books of account have been kept by the company;
- the information given in the directors' report is consistent with the financial statements;
- the financial statements are in agreement with the books of account;
- we have obtained all the information and explanations which we consider necessary for the purposes of our audit; and
- the net assets of the company, as stated in the company balance sheet are more than half of the amount of its called-up share capital and, in our opinion, on that basis there did not exist at ... a financial situation which under Section 40(1) of the Companies (Amendment) Act, 1983 would require the convening of an extraordinary general meeting of the company.

We have nothing to report to you in respect of our responsibilities under the Listing Rules of the Irish Stock Exchange, to review:

- The statement made by the directors that the business is a going concern, together with supporting assumptions or qualifications as necessary.
- The parts of the Corporate Governance Statement relating to the company's compliance with the nine provisions of the [2006]/[June 2008]<sup>4</sup> Combined Code specified for our review.

We also have nothing to report to you, in our opinion, in relation to any information specified by law regarding directors' remuneration and directors' transactions which have not already been disclosed.

*Registered Auditors*

*Address*

*Date*

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<sup>4</sup> At present two versions of the Combined Code are in effect. The 2006 edition applies to accounting periods beginning on or after 1 November 2006 and the June 2008 edition applies to accounting periods beginning on or after 29 June 2008.

# EXPOSURE DRAFT OF INTERNATIONAL STANDARD ON AUDITING (UK AND IRELAND) 700 (REVISED) THE AUDITOR'S REPORT ON FINANCIAL STATEMENTS

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International Standard on Auditing (UK and Ireland) 700 "The Auditor's Report on Financial Statements" (Revised) should be read in the context of the Auditing Practices Board's Statement "The Auditing Practices Board – Scope and Authority of Pronouncements (Revised)" which sets out the application and authority of ISAs (UK and Ireland).

## Introduction

1. The purpose of this International Standard on Auditing (UK and Ireland) (ISA (UK and Ireland)) is to establish standards and provide guidance on the form and content of the auditor's report issued as a result of an audit performed by an independent auditor of the financial statements of an entity.
2. This ISA (UK and Ireland) has been drafted in terms of auditor's reports prepared in connection with audits where the auditor is required to report on whether the financial statements give a true and fair view. It may be adapted, as necessary in the circumstances, to compliance audits where the auditor is not required to report on whether the financial statements give a true and fair view.
3. This ISA (UK and Ireland) uses the term "those charged with governance". The term "governance" describes the role of persons entrusted with the supervision, control and direction of an entity. Ordinarily, those charged with governance are accountable for ensuring that the entity achieves its objectives, and for the quality of its financial reporting and reporting to interested parties.
4. Those charged with governance include the directors (executive and non-executive) of a company or other body, the members of an audit committee where one exists, the partners, proprietors, committee of management or trustees of other forms of entity, or equivalent persons responsible for directing the entity's affairs and preparing its financial statements.
5. **The auditor's report on financial statements should contain a clear written expression of opinion on the financial statements taken as a whole, based on the auditor evaluating the conclusions drawn from the audit evidence obtained, including evaluating whether.**
  - (a) **sufficient appropriate audit evidence has been obtained;**
  - (b) **uncorrected misstatements are material, individually or in aggregate;**
  - (c) **the financial statements;**
    - (i) **have been properly prepared and presented in all material respects in accordance with the relevant financial reporting framework, including the requirements of applicable law; and**
    - (ii) **give a true and fair view.**
6. **In particular, the auditor should evaluate whether:**

- (a) **the financial statements adequately refer to or describe the relevant financial reporting framework;**
- (b) **the financial statements adequately disclose the significant accounting policies selected and applied;**
- (c) **the accounting policies selected and applied are consistent with the applicable financial reporting framework, and are appropriate in the circumstances;**
- (d) **the accounting estimates made by management are reasonable;**
- (e) **the information presented in the financial statements is relevant, reliable, comparable and understandable;**
- (f) **the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements;**
- (g) **the terminology used in the financial statements, including the title of each financial statement, is appropriate; and**
- (h) **the financial statements, including the related notes, faithfully represent the underlying transactions and events in a manner that achieves a true and fair view.**

## **Basic Elements of the Auditor's Report**

7. The auditor's report includes the following basic elements, ordinarily in the following order:
- (a) title;
  - (b) addressee;
  - (c) opening or introductory paragraph identifying the financial statements audited;
  - (d) respective responsibilities paragraph:
    - (i) *a statement of the responsibility of those charged with governance and the responsibility of the auditor;*
    - (ii) *a reference to the audit being performed in accordance with ISAs (UK and Ireland);*

- (iii) either a description of the scope of an audit and the auditor's reporting responsibilities, or a cross reference to a suitable description; and*
    - (iv) a reference to the need for the auditor to comply with the Auditing Practices Board's (APB's) Ethical Standards;*
  - (e) opinion paragraph on the financial statements containing:
    - (i) a reference to the financial reporting framework used to prepare and present the financial statements; and*
    - (ii) an expression of opinion on the financial statements;*
  - (f) where requested by those charged with governance, a separate opinion on compliance with an additional financial reporting framework (for example, International Financial Reporting Standards as issued by the IASB);
  - (g) opinion paragraph on other legal and regulatory requirements;
  - (h) auditor's signature;
  - (i) date of the report; and
  - (j) auditor's address.

## **Title**

- 8. **The auditor's report should have an appropriate title.**
- 9. The term "Independent Auditor" is usually used in the title in order to distinguish the auditor's report from reports that might be issued by others, such as by officers of the entity, those charged with governance, or from the reports of other auditors who may not have to comply with APB's Ethical Standards.

## **Addressee**

- 10. **The auditor's report should be appropriately addressed as required by the circumstances of the engagement.**
- 11. The Companies Acts require the auditor to report to the company's members because the audit is undertaken on their behalf. Such auditor's reports are, therefore, typically addressed to either the members or the shareholders of the company. The auditor's report on financial statements of other types of reporting entity is addressed to the appropriate person or persons, as defined by statute or by the terms of the individual engagement.

## Opening or Introductory Paragraph

12. **The auditor’s report should identify the financial statements of the entity that have been audited, including the date of, and period covered by, the financial statements.**

## Respective responsibilities of those charged with governance and auditors

13. **The auditor’s report should include a statement that those charged with governance are responsible for the preparation and presentation of the financial statements and a statement that the responsibility of the auditor is to audit and express an opinion on the financial statements in accordance with applicable legal requirements, International Standards on Auditing (UK and Ireland) and APB’s Ethical Standards.**
14. An appreciation of the interrelationship between the responsibilities of those who prepare financial statements and those who audit them facilitates an understanding of the nature and context of the opinion expressed by the auditor.
15. The preparation of financial statements requires those charged with governance to make significant accounting estimates and judgments, as well as to determine the appropriate accounting principles and methods used in preparation of the financial statements. This determination will be made in the context of the financial reporting framework that those charged with governance choose, or are required, to use. In contrast, the auditor’s responsibility is to audit the financial statements in order to express an opinion on them.
16. **The auditor’s report should either:**
  - (a) **cross refer to the relevant “Statement of the Scope of an Audit and the Auditor’s Reporting Responsibilities” that is maintained on the APB’s web site; or**
  - (b) **include a description of the auditor’s responsibilities and the work an auditor typically performs.**
17. The APB maintains on its web site<sup>5</sup> various statements describing the scope of an audit and the auditor’s reporting responsibilities applicable to a number of industries and types of entity.

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<sup>5</sup> [Insert reference to pages on APB’s web-site.]

## Opinion on the financial statements

18. **The opinion paragraph of the auditor’s report should clearly state the auditor’s opinion as to whether the financial statements have been properly prepared in accordance with the relevant financial reporting framework used to prepare the financial statements, including applicable law, and give a true and fair view. It is not sufficient for the auditor to reach its conclusion concerning the true and fair view solely on the basis that the financial statements were prepared in accordance with applicable law and accounting standards.**
19. Although the “true and fair” concept has been central to accounting and auditing practice in the UK and Ireland for many years it is not defined in legislation. In 2008, the Financial Reporting Council published a legal opinion, that it had commissioned, entitled “The true and fair requirement revisited” (The Opinion)<sup>6</sup>. The Opinion confirms the overarching nature of the true and fair requirement to the preparation of financial statements in the United Kingdom, whether they are prepared in accordance with international or national accounting standards. Those charged with governance are required to consider whether, taken in the round, the financial statements that they approve are appropriate. Similarly auditors are required to exercise professional judgment before expressing their audit opinion.
20. The Opinion states that “The preparation of financial statements is not a mechanical process where compliance with relevant accounting standards will automatically ensure that those financial statements show a true and fair view, or a fair presentation. Such compliance may be highly likely to produce such an outcome; but it does not guarantee it”.
21. To advise the reader of the context in which the auditor’s opinion is expressed, the auditor’s opinion indicates the financial reporting framework upon which the financial statements are based. Subject to certain restrictions UK and Irish company law permit the statutory financial statements of companies to be prepared in accordance with either:
- (a) “International Financial Reporting Standards (IFRSs) as adopted by the European Union”, and the national and European company law that is applicable when using IFRSs<sup>7</sup>; or
  - (b) “UK Generally Accepted Accounting Practice”, which comprises applicable UK company law and UK Accounting Standards as issued by the Accounting Standards Board (ASB); or

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<sup>6</sup> The opinion can be downloaded from the FRC website at <http://www.frc.org.uk/about/trueandfair.cfm>

<sup>7</sup> With respect to the consolidated accounts of publicly traded companies applicable law includes, in addition to UK or Irish Company Law, Article 4 of the IAS Regulation (Regulation 1606/2002/EC).

- (c) “Generally Accepted Accounting Practice in Ireland”, which comprises applicable Irish company law and the accounting standards issued by the ASB and promulgated by the Institute of Chartered Accountants in Ireland.

### **Separate opinion on compliance with an additional financial reporting framework**

22. **Where a separate opinion is required to be expressed on the compliance of the financial statements with an additional financial reporting framework the second opinion should be clearly separated from the opinion on the financial statements required by company law, by use of an appropriate heading.**
23. In order to comply with the regulatory requirements of another jurisdiction, the auditor may be asked to express an opinion as to whether the financial statements also comply with another financial reporting framework, such as “IFRSs as issued by the IASB”. Once the auditor is satisfied that there are no differences between the two financial reporting frameworks that affect the financial statements being reported on, the auditor states a second separate opinion with regard to the other financial reporting framework.

### **Other reporting responsibilities**

24. The auditor often has 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 required 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 required by law to perform and report on additional specified procedures, or to express an opinion on specific matters, such as the adequacy of accounting records.
25. **When the auditor addresses other reporting responsibilities within the auditor’s report on the financial statements, the opinion arising from such other reporting responsibilities should be set out in a separate section of the auditor’s report following the opinion[s] on the financial statements.**
26. The auditor sets out its opinion on these other reporting responsibilities in a separate section of the report in order to clearly distinguish it from the auditor’s opinion on the financial statements.
27. Other reporting responsibilities may be determined by specific statutory requirements applicable to the reporting entity, or, in some circumstances, by the terms of the auditor’s engagement<sup>8</sup>. Such matters may be required to be dealt with by either:

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<sup>8</sup> An example of a reporting responsibility determined by the terms of the auditor’s engagement is where the directors of a listed company are required by the rules of a Listing Authority to ensure that the auditor reviews certain statements made by the directors before the annual report is published.

- (a) a positive statement in the auditor's report; or
- (b) by exception.

For example, in the Republic of Ireland the auditor is required to state whether, in the auditor's opinion, proper books of account have been kept<sup>9</sup>, whereas company legislation in the United Kingdom requires the auditor to report only when a company has not maintained adequate accounting records<sup>10</sup>.

28. Where further opinions are required by statute or other regulation, matters which result in qualification of such an opinion may also result in a qualification of the auditor's opinion on the financial statements: for example, if adequate accounting records have not been maintained and as a result it proves impracticable for the auditor to obtain sufficient appropriate evidence concerning material matters in the financial statements, the auditor's report indicates that the scope of the examination was limited and includes a qualified opinion or disclaimer of opinion on the financial statements arising from that limitation.

### **Date of Report**

29. **The date of an auditor's report on a reporting entity's financial statements should be the date on which the auditor signed the report expressing an opinion on those statements.**
30. This informs the reader that the auditor has considered the effect on the financial statements and on the auditor's report of events and transactions of which the auditor became aware and that occurred up to that date.
31. **The auditor should not date the report earlier than the date on which all other information contained in a report of which the audited financial statements form a part have been approved by those charged with governance and the auditor has considered all necessary available evidence.**
32. The auditor is not in a position to form the opinion until the financial statements (and any other information contained in a report of which the audited financial statements form a part) have been approved by those charged with governance and the auditor has completed the assessment of all the evidence the auditor considers necessary for the opinion or opinions to be given in the auditor's report. This assessment includes events occurring up to the date the opinion is expressed. The auditor therefore plans the conduct of audits to take account of the need to ensure, before expressing an opinion on financial statements, that those charged with governance have approved the

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<sup>9</sup> Section 193(4)(B)(b) of the Companies Act 1990.

<sup>10</sup> Section 498(2)(a) of the Companies Act 2006.

financial statements and any accompanying other information and that the auditor has completed a sufficient review of post balance sheet events.

33. The date of the auditor's report is, therefore, the date on which, following:
- (a) receipt of the financial statements and accompanying documents in the form approved by those charged with governance for release;
  - (b) review of all documents which the auditor is required to consider in addition to the financial statements (for example the directors' report, chairman's statement or other review of an entity's affairs which will accompany the financial statements); and
  - (c) completion of all procedures necessary to form an opinion on the financial statements (and any other opinions required by law or regulation) including a review of post balance sheet events

the auditor signs the auditor's report expressing an opinion on the financial statements for distribution with those financial statements.

34. The form of the financial statements and other information approved by those charged with governance, and considered by the auditor when signing a report expressing the auditor's opinion, may be in the form of final drafts from which printed documents will be prepared. Subsequent production of printed copies of the financial statements and the auditor's report does not constitute the creation of a new document. Copies of the report produced for circulation to shareholders or others may therefore reproduce a printed version of the auditor's signature showing the date of actual signature.
35. If the date on which the auditor signs the report is later than that on which those charged with governance approved the financial statements, the auditor takes such steps as are appropriate:
- (a) to obtain assurance that those charged with governance would have approved the financial statements on that later date (for example, by obtaining confirmation from specified individual members of the board to whom authority has been delegated for this purpose); and
  - (b) to ensure that their procedures for reviewing subsequent events cover the period up to that date.

### **Auditor's Address**

36. **The report should name the location in the jurisdiction where the auditor practices.**

## Auditor's Signature

37. **The auditor's report should state the name of the auditor and be signed and dated.**
38. The report is signed in the name of the audit firm, the personal name of the auditor or both, as appropriate. In the case of a UK company, where the auditor is an individual the report is required to be signed by the individual. Where the auditor of a UK company is a firm the report is required to be signed by the senior statutory auditor in his or her own name, for and on behalf of the auditor.

## The Auditor's Report

39. **An unqualified opinion should be expressed when the auditor concludes that the financial statements have been properly prepared in accordance with the identified financial reporting framework, including the requirements of applicable law, and give a true and fair view.**
40. Illustrative examples of auditor's reports tailored for use with audits conducted in accordance with ISAs (UK and Ireland) are given in the most recent versions of the APB Bulletins, "Auditor's Reports on Financial Statements"<sup>11</sup>.

## Modified Reports

41. An auditor's report is considered to be modified in the following situations:

### *Matters That Do Not Affect the Auditor's Opinion*

- (a) Emphasis of matter

### *Matters That Do Affect the Auditor's Opinion*

- (b) Qualified opinion,  
(c) Disclaimer of opinion, or  
(d) Adverse opinion.

The APB Bulletins "Auditor's Reports on Financial Statements" include examples of modified auditor's reports for each of these situations.

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<sup>11</sup> Separate Bulletins are issued for the UK and for Ireland.

## **Matters That Do Not Affect the Auditor's Opinion**

42. An auditor's report may be modified by adding an emphasis of matter paragraph to highlight a matter affecting the financial statements which is included in a note to the financial statements that more extensively discusses the matter. The addition of such an emphasis of matter paragraph does not affect the auditor's opinion. The emphasis of matter paragraph usually follows the opinion paragraph on the financial statements and refers to the fact that the auditor's opinion is not qualified in this respect. Communication with the reader is enhanced by the use of an appropriate sub-heading.
43. **The auditor should consider modifying the auditor's report by adding a paragraph if there is a significant uncertainty, the resolution of which is dependent upon future events and which may affect the financial statements. However, the auditor should always modify the auditor's report by adding a paragraph to highlight a material matter regarding a going concern problem.**
44. An uncertainty is a matter whose outcome depends on future actions or events not under the direct control of the entity but that may affect the financial statements.
45. The emphasis of matter paragraph describes the matter giving rise to the significant uncertainty and its possible effects on the financial statements, including (where practicable) quantification. Where it is not possible to quantify the potential effects of the resolution of the uncertainty, the auditor includes a statement to that effect. Reference may be made to notes in the financial statements but such a reference is not a substitute for sufficient description of the significant uncertainty so that a reader can appreciate the principal points at issue and their implications.
46. In determining whether an uncertainty is significant, the auditor considers:
- (a) the risk that the estimate included in financial statements may be subject to change;
  - (b) the range of possible outcomes; and
  - (c) the consequences of those outcomes on the view shown in the financial statements.
47. Uncertainties are regarded as significant when they involve a significant level of concern about the validity of the going concern basis or other matters whose potential effect on the financial statements is unusually great. An example of a significant uncertainty may be the outcome of major litigation.
48. An unqualified opinion indicates that the auditor considers that appropriate estimates and disclosures relating to significant uncertainties are made in the financial statements.

It remains unqualified notwithstanding the inclusion of an emphasis of matter paragraph describing a significant uncertainty.

49. When the auditor concludes that the estimate of the outcome of a significant uncertainty is materially misstated or that the disclosure relating to it is inadequate, the auditor issues a qualified opinion.
50. The addition of a paragraph emphasising a going concern problem or significant uncertainty is ordinarily adequate to meet the auditor's reporting responsibilities regarding such matters. However, in extreme cases, such as situations involving multiple uncertainties that are significant to the financial statements, the auditor may consider it appropriate to express a disclaimer of opinion instead of adding an emphasis of matter paragraph.
51. In addition to the use of an emphasis of matter paragraph for matters that affect the financial statements, the auditor may also modify the auditor's report by using an emphasis of matter paragraph to report on matters other than those affecting the financial statements. For example, if an amendment to other information in a document containing audited financial statements is necessary to correct a material inconsistency and the entity refuses to make the amendment, the auditor would consider including in the auditor's report an emphasis of matter paragraph describing the material inconsistency.

### **Matters That Do Affect the Auditor's Opinion**

52. An auditor may not be able to express an unqualified opinion when either of the following circumstances exist and, in the auditor's judgment, the effect of the matter is or may be material to the financial statements:
  - (a) there is a disagreement with those charged with governance regarding the acceptability of the accounting policies selected, the method of their application or the adequacy of financial statement disclosures; or
  - (b) there is a limitation on the scope of the auditor's work.

The circumstances described in (a) could lead to a qualified opinion or an adverse opinion. The circumstances described in (b) could lead to a qualified opinion or a disclaimer of opinion. These circumstances are discussed more fully in paragraphs 61–71.

53. The three financial reporting frameworks described in paragraph 21 recognise that a departure from an accounting standard may be necessary where compliance with that standard would produce a result so misleading that it would conflict with the objective of financial statements. IAS 1 states that the circumstances in which there should be such a conflict are "extremely rare", FRS 18 uses the word "exceptional". As discussed in

the Opinion, both of these terms contemplate departures from a relevant standard in circumstances that compliance therewith would be inconsistent with the basic objective of fair presentation or the true and fair view. Against this background, therefore, the circumstances in which departure from an accounting standard is appropriate are very limited.

54. In almost all cases, therefore, a departure from accounting standards will result in the issuance of a qualified or adverse opinion on the view given by the financial statements. When the auditor concludes that the financial statements of a company do not comply with accounting standards, the auditor assesses whether:
  - (a) the departure is necessary, for example to show a true and fair view; and
  - (b) adequate disclosure has been made concerning the departure from accounting standards.
55. Where an explanation is not given for a departure from accounting standards, its absence may of itself impair the ability of the financial statements to give a true and fair view of the company's state of affairs and profit or loss. When the auditor concludes that this is so, a qualified or adverse opinion on the view given by the financial statements is appropriate, in addition to a reference (where appropriate) to the departure from accounting standards and the reasons for the departure.
56. **A qualified opinion should be expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with management, or limitation on scope is not so material and pervasive as to require an adverse opinion or a disclaimer of opinion. A qualified opinion should be expressed as being "except for" the effects of the matter to which the qualification relates.**
57. **A disclaimer of opinion should be expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and accordingly is unable to express an opinion on the financial statements.**
58. **An adverse opinion should be expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements.**
59. **Whenever the auditor expresses an opinion that is other than unqualified, a clear description of all the substantive reasons should be included in the report and, unless impracticable, a quantification of the possible effect(s) on the financial statements. Ordinarily, this information would be set out in a separate paragraph**

preceding the opinion or disclaimer of opinion and may include a reference to a more extensive discussion, if any, in a note to the financial statements.

60. Whilst reference may be made to relevant notes in the financial statements, such reference is not a substitute for sufficient description of the circumstances in the auditor's report so that a reader can appreciate the principal points at issue and their implications for an understanding of the financial statements.

### **Disagreement with Those Charged with Governance**

61. The auditor may disagree with those charged with governance about matters such as the acceptability of accounting policies selected, the method of their application, or the adequacy of disclosures in the financial statements. **If such disagreements are material to the financial statements, the auditor should express a qualified or an adverse opinion.**

### **Limitation of Scope**

62. A limitation on the scope of the auditor's work may sometimes be imposed by the entity (for example, when the terms of the engagement specify that the auditor will not carry out an audit procedure that the auditor believes is necessary). However, when the limitation in the terms of a proposed engagement is such that the auditor believes the need to express a disclaimer of opinion exists; the auditor would ordinarily not accept such a limited engagement as an audit engagement, unless required to by statute. Also, a statutory auditor would not accept such an audit engagement when the limitation infringes on the auditor's statutory duties.

#### *Limitation of scope imposed by the entity before accepting an audit engagement*

63. **If the auditor is aware, before accepting an audit engagement, that those charged with governance of the entity, or those who appoint its auditor, will impose a limitation on the scope of the audit work which the auditor considers likely to result in the need to issue a disclaimer of opinion on the financial statements, the auditor should not accept that engagement, unless required to do so by statute<sup>12</sup>.**
64. Agreeing to such a restriction on the scope of the audit work would seriously threaten the auditor's independence and make it impossible for the auditor to meet with integrity and rigour the requirements of ISAs (UK and Ireland). The acceptance of such a limited

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<sup>12</sup> There are certain circumstances in which (regardless of any limitation imposed on the scope of the audit work) the auditor is required by statute to accept an audit engagement, for example the majority of appointments of the national audit agencies to audit the accounts of certain public sector bodies. However, in general, there is no such requirement in the private sector; there may be a statutory requirement for the entity to appoint auditors, but this does not create an obligation for any auditors to accept appointment.

engagement as an audit engagement would be incompatible with the auditor's obligations to conduct any audit of financial statements in accordance with:

- (a) applicable legislation; and
- (b) Auditing Standards contained in the ISAs (UK and Ireland).

Furthermore, the auditor, by accepting the engagement on such restricted terms, might be regarded as complicit in an arrangement to enable the entity to observe the form of any legal or regulatory audit requirements but to evade complying with the substance of those obligations.

*Limitation on scope imposed by the entity after accepting an audit engagement*

65. **If the auditor becomes aware, after accepting an audit engagement, that those charged with governance of the entity, or those who appointed them as its auditor, have imposed a limitation on the scope of the audit work which they consider likely to result in the need to issue a disclaimer of opinion on the financial statements, the auditor should request the removal of the limitation. If the limitation is not removed, the auditor should consider resigning from the audit engagement.**
66. If the limitation is not removed, the auditor considers the factors discussed in paragraph 64 above and may often decide that resignation from the audit engagement is appropriate. If, after careful consideration of all the circumstances (for example, where third party interests are involved), the auditor concludes that it is appropriate to continue with the engagement, the auditor includes in the audit report a full description of the events which led to the disclaimer. On completion of the audit for that year, however, the auditor will follow the requirements of paragraph 63 when deciding whether to undertake the audit for the following period<sup>13</sup>.
67. In cases where the auditor resigns immediately, or continues with the audit for that year but does not seek reappointment, the auditor needs to comply with any statutory, regulatory or professional requirements for a statement of the circumstances of ceasing to hold office.<sup>14</sup> The fact that such a limitation has been imposed on the scope of the auditor's work may be a matter to which the auditor refers in both cases.

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<sup>13</sup> Auditors in the Republic of Ireland are required by the Companies Act 1963 (section 160, para 2(c)) to give the company notice in writing of their unwillingness to be re-appointed, where this is the case.

<sup>14</sup> For example, in the case of a quoted company incorporated in the United Kingdom, on ceasing to hold office for any reason, the auditor is required under section 519(3) Companies Act 2006 to make '... a statement of the circumstances connected with his ceasing to hold office.' Similar requirements exist in the Republic of Ireland (section 185 Companies Act, 1990).

68. Where a significant limitation of scope has arisen during the course of the audit work the auditor considers whether an obligation arises under statute, as discussed in ISA (UK and Ireland) 250, Part B, to make a report to the appropriate regulators.

*Limitation on scope imposed by circumstances*

69. A scope limitation may be imposed by circumstances (for example, when the timing of the auditor's appointment is such that the auditor is unable to observe the counting of physical inventories). It may also arise when, in the opinion of the auditor, the entity's accounting records are inadequate or when the auditor is unable to carry out an audit procedure believed to be desirable. In these circumstances, the auditor would attempt to carry out reasonable alternative procedures to obtain sufficient appropriate audit evidence to support an unqualified opinion.
70. **When there is a limitation on the scope of the auditor's work that requires expression of a qualified opinion or a disclaimer of opinion, the auditor's report should describe the limitation and indicate the possible adjustments to the financial statements that might have been determined to be necessary had the limitation not existed.**
71. In the UK and Ireland, in considering whether a limitation of scope results in a lack of evidence necessary to form an opinion, the auditor assesses:
- (a) the quantity and type of evidence which may reasonably be expected to be available to support the particular figure or disclosure in the financial statements; and
  - (b) the possible effect on the financial statements of the matter for which insufficient evidence is available. When the possible effect is, in the opinion of the auditor, material to the financial statements, there will be insufficient evidence to support an unqualified opinion.

## Effective Date

72. This ISA (UK and Ireland) is effective for audits of financial statements for periods ending on or after [5 April 2009].

## Public Sector Perspective

Additional guidance for auditors of public sector bodies in the UK and Ireland is given in:

- Practice Note 10 "Audit of Financial Statements of Public Sector Bodies in the United Kingdom (Revised)"

- Practice Note 10(l) “Audit of Central Government Financial Statements in the Republic of Ireland” (Revised)

*While the basic principles contained in this ISA (UK and Ireland) apply to the audit of financial statements in the public sector, the legislation giving rise to the audit mandate may specify the nature, content and form of the auditor’s report.*



# EXPOSURE DRAFT OF A PROPOSED STATEMENT OF THE SCOPE OF AN AUDIT AND THE AUDITOR'S REPORTING RESPONSIBILITIES IN RESPECT OF A PUBLICLY TRADED COMPANY INCORPORATED IN THE UNITED KINGDOM

*This statement may be cross referred to from auditor's reports that are effective for accounting periods ending on or after 5 April 2009<sup>15</sup>*

*This statement is intended to provide a brief summary only. It is not a substitute for reading the applicable laws and regulations and International Standards on Auditing (UK and Ireland).*

## 1. AUDITOR'S REPORTING RESPONSIBILITIES WITH RESPECT TO THE FINANCIAL STATEMENTS ARISING FROM LAW AND REGULATIONS

The Companies Act 2006 (CA 2006) requires the auditor to make a report to the company's members that must state clearly whether, in the auditor's opinion, the financial statements:

- have been properly prepared in accordance with the relevant financial reporting framework.

*With respect to the consolidated financial statements of publicly traded companies<sup>16</sup> the relevant financial reporting framework is "International Financial Reporting Standards (IFRSs) as adopted by the European Union" and applicable UK and European Company law.*

*All other financial statements are prepared either in accordance with the framework described above or in accordance with "UK Generally Accepted Accounting Practice", which comprises applicable UK company law and UK Accounting Standards as issued by the Accounting Standards Board.*

- have been prepared in accordance with the requirements of the CA 2006 and, in the case of the consolidated accounts of publicly traded companies, the requirements of Article 4 of the IAS Regulation<sup>17</sup>.
- give a true and fair view.

<sup>15</sup> In order to keep the auditor's report concise ISA (UK and Ireland) 700 (Revised) permits, but does not require, the report to cross refer to this statement in preference to the report itself including a description of the auditor's responsibilities and the scope of an audit.

<sup>16</sup> A publicly traded company is one whose securities are admitted to trading on a regulated market.

<sup>17</sup> Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards.

*CA 2006 requires the auditor to have regard to the directors' duty not to approve the financial statements unless they are satisfied that they give a true and fair view.*

CA 2006 further requires the auditor's report on the financial statements to be either unqualified or qualified and to include a reference to any matters to which the auditor wishes to draw attention by way of emphasis without qualifying the report. Requirements of International Standards on Auditing (ISAs) (UK and Ireland) regarding qualified reports, unqualified reports and emphasis of matter paragraphs are discussed further in the second part of this summary.

## **2. THE SCOPE OF AN AUDIT OF FINANCIAL STATEMENTS ARISING FROM THE REQUIREMENTS OF ISAs (UK AND IRELAND)**

### ***Overall objective***

In conducting an audit of financial statements, the overall objectives of the auditor are to:

- (a) obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error; and
- (b) report on the financial statements and communicate, as required by ISAs (UK and Ireland), the auditor's findings.

### ***Compliance with ISAs (UK and Ireland) and APB's Ethical Standards***

The auditor is required to fully comply with:

- (a) all ISAs (UK and Ireland) that are relevant to the audit; and
- (b) APB's Ethical Standards.

ISAs (UK and Ireland) and the APB's Ethical Standards contain basic principles and essential procedures together with related guidance. It is necessary for the auditor to consider the whole text of an ISA (UK and Ireland) or Ethical Standard in order to understand and apply the basic principles and essential procedures. The nature of these Standards require an auditor to exercise professional judgment in applying them.

Some ISAs (UK and Ireland) address the core aspects of the audit process such as:

- Planning.
- Determining materiality.
- Understanding the company and its environment.

- Assessing the risks of material misstatement.

Other ISAs (UK and Ireland) establish requirements in relation to those areas of the auditor's work where it is particularly important that the views of auditors and users of financial statements, regarding the nature and extent of work to be performed, are aligned. Such areas include:

- Going concern.
- The auditor's responsibility to consider fraud.
- Laws and regulations.

### ***Reasonable assurance***

ISAs (UK and Ireland) require the auditor to obtain reasonable assurance about whether the financial statements taken as a whole are free from material misstatement. Reasonable assurance is a high, but not absolute, level of assurance<sup>18</sup>. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce the risk of an auditor expressing an inappropriate opinion, when the financial statements are misstated, to an acceptably low level. Reasonable assurance is not an absolute level of assurance, because there are inherent limitations of an audit which result in most of the audit evidence, on which the auditor draws conclusions and bases the auditor's opinion, being persuasive rather than conclusive.

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 statement, whether due to fraud or error. In making those risk assessments that auditor considers internal control relevant to the company's preparation and presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. Internal control is not considered for the purpose of expressing an opinion on the effectiveness of the company's internal control.

### ***Other information in the Annual Report***

ISAs (UK and Ireland) require the auditor to read all financial and non-financial information which is included in a document<sup>19</sup> containing audited financial statements and consider whether such "other information" is consistent with the audited financial statements. The auditor considers the implications for the auditor's report if it becomes aware of any material

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<sup>18</sup> Paragraph 8 of ISA (UK and Ireland) 200 "Objective and general principles governing an audit of financial statements.

<sup>19</sup> APB Bulletin 2001/1 "The electronic publication of auditor's reports" provides guidance for auditors where annual financial statements and the auditor's report thereon are published on an entity's web site.

inconsistencies with the financial statements or any apparent misstatements in the other information.

### ***Communicating audit matters of governance interest***

The auditor is required to communicate “audit matters of governance interest” arising from the audit with those charged with governance of the entity. Governance is the term used in ISAs (UK and Ireland) to describe the role of persons entrusted with the supervision, control and direction of an entity. “Audit matters of governance interest” are those matters that arise from the audit of the financial statements and, in the opinion of the auditor, are both important and relevant to those charged with governance in overseeing the financial reporting and disclosure process.

ISAs (UK and Ireland) require the auditor to communicate in writing with those charged with governance regarding the significant findings from the audit which may include the auditor’s views about the qualitative aspects of the entity’s accounting practices and financial reporting and uncorrected misstatements.

### ***Reporting on the financial statements***

The auditor’s report is required to contain a clear expression of opinion on the financial statements taken as a whole.

To form an opinion on the financial statements the auditor concludes as to whether:

- (a) sufficient appropriate audit evidence has been obtained;
- (b) uncorrected misstatements are material, individually or in aggregate;
- (c) the financial statements are prepared and presented, in all material respects, in accordance with the requirements of the relevant financial reporting framework, including the requirements of applicable law; and
- (d) the financial statements give a true and fair view.

In particular an audit involves evaluating whether:

- (a) the financial statements adequately refer to or describe the relevant financial reporting framework;
- (b) the financial statements adequately disclose the significant accounting policies selected and applied;
- (c) the accounting policies selected and applied are consistent with the applicable financial reporting framework, and are appropriate in the circumstances;

- (d) the accounting estimates made by management are reasonable;
- (e) the information presented in the financial statements is relevant, reliable comparable and understandable;
- (f) the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements;
- (g) the terminology used in the financial statements, including the title of each financial statement, is appropriate; and
- (h) the financial statements, including the related notes, faithfully represent the underlying transactions and events in a manner that achieves a true and fair view.

### ***Expressing an unqualified opinion***

An unqualified opinion is expressed when the auditor is able to conclude that the financial statements comply with the applicable financial reporting framework (including applicable law) and give a true and fair view.

### ***Qualifying the auditor's opinion***

An auditor expresses a qualified opinion when either of the following circumstances exist and, in the auditor's judgment, the effect of the matter is or may be material to the financial statements:

- (a) There is a limitation on the scope of the auditor's work that has prevented the auditor from obtaining sufficient appropriate audit evidence; or
- (b) There is a disagreement with management regarding the acceptability of the accounting policies selected, the method of their application or the adequacy of financial statement disclosures.

The circumstances in (a) could lead to either a qualified opinion or a disclaimer of opinion whereas those in (b) could lead to either a qualified opinion or an adverse opinion.

### ***Emphasising certain matters without qualifying the opinion***

In certain circumstances an auditor's report includes an emphasis of matter paragraph to highlight a matter affecting the financial statements. An emphasis of matter paragraph does not affect the auditor's opinion.

The auditor is required to consider adding an emphasis of matter paragraph where there is a significant uncertainty the resolution of which is dependent upon future events and which may

affect the financial statements. However, the auditor is required to add an emphasis of matter paragraph to highlight a material matter regarding a going concern problem.

### **3. OTHER LEGAL AND REGULATORY REQUIREMENTS**

#### **Requirements of CA 2006**

##### ***Directors' report***

The auditor is required to report its opinion as to whether the information given in the directors' report (including, where required, the business review) for the financial year for which the financial statements are prepared is consistent with those financial statements.

##### ***Directors' remuneration report (Applies to quoted companies only)***

If the company is a quoted company<sup>20</sup> the auditor is required to report whether the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the requirements of CA 2006.

##### ***Duty to report on certain matters by exception***

If the auditor is of the opinion:

- (a) that adequate accounting records have not been kept, or that returns adequate for the audit have not been received from branches not visited by the auditor; or
- (b) that the company's individual accounts are not in agreement with the accounting records and returns; or
- (c) in the case of a quoted company, that the part of the Directors' Remuneration Report to be audited is not in agreement with the accounting records and returns,

the auditor is required to state that fact in the auditor's report.

If the auditor fails to obtain all the information and explanations which, to the best of the auditor's knowledge and belief, are necessary for the purposes of the audit, the auditor is required to state that fact in its report.

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<sup>20</sup> A quoted company is a company whose equity share capital –

- (a) has been included in the official list in accordance with the provisions of Part 6 of the Financial Services and Markets Act 2000 (c. 8), or
- (b) is officially listed in an EEA state, or
- (c) is admitted to dealing on either the New York Stock Exchange or the exchange known as NASDAQ.

If the directors of the company have prepared accounts and report in accordance with the small companies regime and in the auditor's opinion they were not entitled so to do, the auditor is required to state that fact in the auditor's report.

***Duty of the auditor to include certain particulars, which have been omitted from the financial statements, in the auditor's report***

If:

- (a) the requirements concerning the disclosure of directors' benefits: remuneration, pensions and compensation for loss of office are not complied with in the accounts; or
- (b) in the case of a quoted company, the requirements as to information forming the part of the Directors' Remuneration Report to be audited are not complied with in that report,

the auditor is required to include in the auditor's report, so far as it is reasonably able to do so, a statement giving the required particulars.

***Corporate Governance (Applies to listed companies only)***

The Listing Rules of the Financial Services Authority (the FSA) require listed companies<sup>21</sup> to ensure that their auditor reviews each of the following statements required by the Listing Rules, before the annual report is published:

- (a) the statement by the directors that the business is a going concern;
- (b) the parts of the statement by the directors that relate to the following provisions of the Combined Code:
  - C.1.1;
  - C.2.1; and
  - C.3.1 to C.3.7

If, based on its review, the auditor disagrees with the statement by the directors on going concern or concludes that the Corporate Governance Statement does not appropriately reflect the company's compliance with the nine provisions of the Combined Code the auditor reports that under the heading "Other matter" in its report.

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<sup>21</sup> A listed company is a company that has any class of its securities admitted to the Official List maintained by the FSA in accordance with section 74 of the Financial Services and Markets Act 2000.



## **TYPES OF ENTITY FOR WHICH APB WILL DEVELOP “STATEMENTS OF THE SCOPE OF AN AUDIT AND THE AUDITOR’S REPORTING RESPONSIBILITIES”**

### **UNITED KINGDOM PRIVATE SECTOR**

- **Non-publicly traded companies**
  - UK GAAP applicable to smaller entities
  - UK GAAP
- **Publicly traded companies**
- **Charitable companies**
  - Financial statements prepared under the Companies Act 2006
  - Financial statements prepared under the Charities Act 1993
  - Scottish Charitable Companies
- **Non-company charities**
  - England & Wales
  - Scotland
- **Registered Social Landlords**
- **Occupational Pension Schemes**
- **Building Societies**
- **Lloyds Syndicates**
- **Friendly Societies**
- **Credit Unions**

### **UNITED KINGDOM PUBLIC SECTOR**

- **Government Departments that prepare a Resource Account**
- **Non Departmental Public Bodies (NDPB) or Trading Funds that prepare an accruals account**
- **Local government bodies in England**

- **Local government bodies in Wales**
- **Local government bodies in Scotland**
- **Local government bodies in Northern Ireland**
- **NHS Trusts in England**
- **NHS Primary Care Trusts/Strategic Health Authorities in England**

## **IRISH PRIVATE SECTOR**

- **Non-publicly traded companies**
  - Preparing financial statements in accordance with Irish GAAP applicable to smaller entities
  - Preparing financial statements in accordance with Irish GAAP
- **Publicly traded companies**
- **Occupational Pension Schemes**
- **Credit Unions**

## **IRISH PUBLIC SECTOR**

- **State Sponsored Agencies**
- **Bodies Created by Registration under Company Law**

# FEEDBACK PAPER ON “THE AUDITOR’S REPORT: A TIME FOR CHANGE?” DISCUSSION PAPER AND APB FUTURE PLANS REGARDING THE FORM AND CONTENT OF UK AUDITOR’S REPORTS.

## Introduction

- 1.1 In December 2007 the APB issued a Discussion Paper “The Auditor’s Report: A time for change?” The Discussion Paper sought views on what changes were needed to existing UK auditor’s reports to reflect the coming into force of CA 2006 and whether other, more wide ranging, changes should be made to the form and content of the auditor’s report.
- 1.2 “The Auditor’s Report: A time for change?” had been prepared in the light of responses to an earlier FRC paper<sup>22</sup> which revealed a variety of views on the usefulness of the auditor’s report. These responses suggested that a number of stakeholder groups considered current auditor’s reports to be overly legalistic and to contain so many caveats and provisos that their usefulness was limited.
- 1.3 “The Auditor’s Report: A time for change?” noted that the extent to which the content of UK auditor’s reports can be determined by the APB alone is constrained by decisions, yet to be taken, by the EC with respect to the Statutory Audit Directive. Under the Statutory Audit Directive the EC is able either to require auditors to apply those international auditing standards that are adopted by the Commission (This could be the Clarity version of ISA 700), or to develop its own auditor’s report<sup>23</sup>. Any such “European Auditor’s Report” would have to be applied in all European countries, including the UK and Ireland.
- 1.4 The purpose of this Paper is to:
  - (a) summarise the comments received in response to “The Auditor’s Report: A time for change?”, and
  - (b) explain the actions that the APB intends to take regarding the form and content of UK and Irish auditor’s reports.

## Comments received on the Discussion Paper “The Auditor’s Report: A Time for change?”

- 2.1 The APB received 31 comment letters from the following stakeholder groups<sup>24</sup>:

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<sup>22</sup> “Promoting Audit Quality” November 2006.

<sup>23</sup> Article 28 of the Statutory Audit Directive specifies that the Commission may “adopt a common standard for audit reports for annual or consolidated accounts which have been prepared in accordance with approved international accounting standards, in order to enhance public confidence in the audit function”.

<sup>24</sup> A full list of respondents is set out in Appendix 1.

• Institutional investors	3
• Organisations representing preparers	3
• Auditing firms and accountancy bodies	16
• Public sector bodies	4
• Individual responses	<u>5</u>
	<u>31</u>

- 2.2 In addition an open meeting was held on 26 March 2008 to obtain views of stakeholders. Not all those who attended the meeting responded in writing to the APB.
- 2.3 While inevitably views varied, there was quite a high degree of consistency in the responses within the different stakeholder groups and quite marked differences of view between the stakeholder groups. The views expressed are summarised below.

### **Institutional investors**

- 2.4 Although the number of responses from institutional investors was relatively small the responses that were received were from organisations representing major investors in companies whose securities are traded on regulated markets. These organisations took the view that the auditor’s report should be made more informative and that this could be achieved through a more discursive approach, balanced by a reduction in the current content which appears to be designed primarily to minimise prospective liability.
- 2.5 One investor called for a move to an auditor’s report which was genuinely a report to shareholders of the findings of the audit and which provided shareholders with some insight into the company and into the quality of work which the auditors have carried out.
- 2.6 Another response suggested that one way of providing information of this nature was to make greater use of “Emphasis of Matter” paragraphs and called for the requirements for such paragraphs to be drawn more widely.
- 2.7 On the specifics of the auditor’s report institutional investors generally:
- (a) favoured the auditor making an explicit statement that adequate accounting records had been kept;
  - (b) supported the auditor’s report stating that there were no matters that need to be reported on by exception; and
  - (c) believed that auditor’s reports should include a statement that there are no matters that the auditor wishes to emphasise.

**Organisations representing preparers of financial statements.**

- 2.8 Organisations representing preparers concluded that this is the time for change and the APB should shorten auditor's reports to make them clearer and less ambiguous. They took the view that the argument that there is an expectations gap that needs to be addressed by setting out the respective responsibilities of directors and auditors seems much less clear-cut following all the recent debates and publicity surrounding director and auditor responsibilities and recent regulatory developments.
- 2.9 On the specifics of the auditor's report the views of preparers were less supportive of change. In particular they did not generally support:
- (a) adding more company specific narrative on the bases that financial statements should contain all relevant disclosures;
  - (b) the auditor making an explicit statement that adequate accounting records had been kept;
  - (c) stating that there were no matters that need to be reported on by exception; or
  - (d) including a statement that there are no matters that the auditor wishes to emphasise.

**Auditing firms and accountancy bodies.**

- 2.10 The principal concern of most of the auditing firms and accountancy bodies was that UK auditing standards should not diverge from International Standards on Auditing (ISAs) to the extent that the ability of the UK to demonstrate compliance with international standards (especially if they were to be adopted for use within the EU) would be put at risk.
- 2.11 These respondents also argued that, because of the increasing globalisation of capital markets, it is important to achieve international harmonisation of auditor's reports to the maximum extent possible and that this was best achieved through adoption of ISA 700.
- 2.12 Furthermore, to minimise the frequency of significant change to auditor's reports in the future, at this stage, they recommended that the APB only make the minimum changes needed to comply with the requirements of CA 2006 and wait until there is clarity on the EU direction before making more significant changes. One audit firm commented that it would add further confusion to the market if APB was to make sweeping changes to the auditor's report only for further changes to be necessary within a couple of years.
- 2.13 Many, although not all, of the auditing firms and accountancy bodies were also concerned at proposals that could be thought to extend the scope of the auditor's responsibilities. In particular they did not:

- (a) support the auditor making an explicit statement as to whether adequate accounting records had been kept, as this would be going beyond the CA 2006 requirements;
- (b) support the auditor’s report stating that there were no matters that need to be reported on by exception;
- (c) believe that auditor reports should include a statement that there are no matters that the auditor wishes to emphasise (Emphasis of Matter paragraphs); and
- (d) favour adding more company specific narrative on the bases that financial statements should contain all relevant disclosures and that additional narrative would detract from clarity and the appropriate focus on the "truth and fairness" of the financial statements.

2.14 A number of auditing firms and accountancy bodies observed that, based on legal advice, the “Bannerman disclaimer” should not be removed from the auditor’s report<sup>25</sup>.

2.15 A number of auditing firms and accountancy bodies emphasised the importance of APB issuing guidance, as a matter of urgency on reports under CA 2006 for “short accounting periods”<sup>26</sup>.

2.16 A few auditing firms were more positive about possible changes to the auditor’s report. In particular one audit firm took the view that auditor’s reports have become too lengthy and complex and that the APB should take the opportunity, whilst amending its auditor’s reports to reflect the CA 2006, to shorten significantly auditor’s reports to achieve clarity. This firm took the view that virtually all of the material addressing expectation gaps could be removed; some other audit firms supported this approach provided that such information was readily available to users from another source.

### Public sector bodies

2.17 Public sector responses supported change and the view was expressed that the level of detail currently required in auditor’s reports detracted from the auditor’s opinion on the accounts. That said there was a call for the APB to have regard to the differing reporting frameworks of public sector auditors (eg the need to report on the regularity of expenditure) and a concern was expressed that over-simplification of the auditor’s report could allow a public sector expectation gap to develop. With this in mind, it was

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<sup>25</sup> A number of accountancy bodies have issued guidance recommending to their members that an additional disclaimer paragraph be included in auditor’s reports. The APB does not participate in the auditing profession’s risk management activities and accordingly has not promulgated this guidance.

<sup>26</sup> Short accounting periods are accounting periods commencing on or after 6 April 2008 (and for which therefore the new requirements of CA 2006 apply) but ending before 6 April 2009.

noted that proposals for separate publication of information regarding management and auditor responsibilities would need to be carefully considered as to the impact this could have on the public sector audience.

### **Individual responses**

- 2.18 A number of individual responses were received which expressed views on specific issues. Issues commented on included the need to build the auditor's report from a clear statement of the degree of auditor liability, the benefits of the current French model and the possible development of a financial statements "expectation gap" as a result of increasing requirements for fair values in accounting standards.

### **Actions that APB intends to take in response to comments received**

- 3.1 The APB agrees with the view of institutional investors, organisations representing preparers, public sector bodies and some accounting firms and individuals that this is "the time for change" and that action should be taken to change auditor reports. The APB has therefore decided to use the introduction of CA 2006 as an appropriate opportunity for making changes to UK auditor's reports.
- 3.2 Responses to the Discussion Paper suggest that there are two key issues:
- (a) eliminating unnecessary wording, and
  - (b) making auditor's reports more informative.
- 3.3 Unnecessary wording was thought to exist in current auditor's reports due to attempts made by past standard setters (including the APB) to minimise the so called "expectation gap" by including in the auditor's report wording to describe the directors' and auditor's responsibilities and to describe what an audit involves. A number of commentators observed that such information was no longer necessary. While some other commentators thought the information was still necessary, they recognised that, especially as financial statements are now often accessed through the internet, there were other ways in which the information could be provided. The new responsibility statements required by the Disclosure and Transparency Rules have made the extant wording in the auditor's report on directors' responsibilities somewhat redundant and potentially confusing.
- 3.4 A greater challenge exists with regard to making auditor' reports more informative. Because of this the APB intends to explore this issue further and participate in related international initiatives with a view to contributing to future changes in international auditing standards.
- 3.5 The APB has therefore decided to adopt a two phase strategy involving:

- (a) revising ISA (UK and Ireland) 700 to facilitate, for audits of accounting periods ending on or after 5 April 2009, audit firms to issue “streamlined” auditor’s reports (see pages 11 to 14)<sup>27</sup>, and
  - (b) commencing a research programme to establish whether there is consensus as to what sort of additional information in auditor’s reports would be of assistance to investors and then to explore the feasibility of it being provided.
- 3.6 One of the benefits of adopting this two phase strategy is that the APB believes that phase 1 can be done in a way that will mean that UK auditing standards remain “ISA compliant”, thereby alleviating one of the main concerns expressed by the majority of auditing firms and accountancy bodies (see paragraph 2.10).
- 3.7 Many of the auditing firms and accountancy bodies also wished to minimise the number of future changes to the auditor’s report. The APB shares the objective of minimising the number of future changes in the auditor’s report, but based on the following analysis, believes that a new UK standard would have a “shelf-life” of at least 3 years:
- The APB believes that, when finalising the Clarity version of ISA 700 later in 2008, it is unlikely that the IAASB will make significant changes to the exposure draft issued in August 2007. The IAASB has, however, announced<sup>28</sup> that in early 2009 it look again at ISA 700 in the light of research and other developments. This could lead to an exposure draft of further revisions to ISA 700 being issued in 2011 which might therefore be finalised in 2012 and become effective in 2013.
  - The form and content of the auditor’s report is likely to be one of the issues to be discussed in detail as part of the European adoption process for the ISAs. The APB believes that:
    - (a) it is unlikely that the EC will have adopted the ISAs for application in 2010,
    - (b) if the EC adopts the ISAs in 2011 there is likely to be a transitional period during which APB will be able to, and may decide to, retain its existing auditor’s reports, and
    - (c) any such transitional period is also likely to apply to any “European Auditor’s Report” developed by the EC.
- 3.8 The APB has therefore concluded that there is a “window of opportunity” during which it can influence international decisions on the auditor’s report by having implemented a

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<sup>27</sup> These examples are very similar to Example 2 in “The Auditor’s Report: A time for change?”

<sup>28</sup> In its Strategy and Work Program, 2009-2011.

“streamlined” auditor’s report and having commenced research to better understand what can realistically be done to make auditor’s report more informative.

3.9 The APB also believes that this approach will have the benefit of easing the transition of UK auditing standards to the Clarity ISAs at an early stage as, unless APB takes action on auditor’s reports, there is a danger that disenchantment with the current version of ISA (UK and Ireland) 700 will act as an impediment to the adoption of the Clarity ISAs<sup>29</sup>.

3.10 The APB therefore intends to:

- (a) issue for exposure ISA (UK and Ireland) 700 (Revised) “The Auditor’s Report on Financial Statements” to take effect for accounting periods ending on, or after, 5 April 2009 to facilitate a “streamlining” of existing UK and Irish auditor’s reports;
- (b) issue an updated Bulletin 2006/6 which contains illustrative examples of auditor’s reports based on the example on pages 11 and 12 (which in turn is derived from Example 2 in “The Auditor’s Report: A time for change?”. in spring 2009.
- (c) issue on its website in spring 2009 a number of summaries of auditor responsibilities and a description of an audit to allow such material to be cross referenced by future UK and Irish auditor’s reports (see pages 41 and 42);
- (d) issue a Bulletin in summer 2008 providing illustrative auditor’s reports for accounting periods commencing on or after 6 April 2008 but ending before 5 April 2009 (ie “short accounting periods”);
- (e) initiate research to better understand what can realistically be done to make auditor’s report more informative; and
- (f) progress guidance on adequate accounting records together with the broader FRC initiative.

Further information on these planned actions is set out below.

### **Exposure Draft of ISA (UK and Ireland) 700 (Revised) “The Auditor’s Report on Financial Statements”**

3.11 ISA (UK and Ireland) 700, which was issued in December 2004, specifies a number of minimum requirements for UK auditor’s reports. In order to achieve the desired

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<sup>29</sup> The APB consulted on the adoption of ISA 700 (revised) in 2005. Reasons why the APB deferred adoption of ISA 700 (Revised) are described in paragraph 2.17 to 2.19 of “The Auditor’s Report: A time for change?”.

streamlining of auditor's reports some of these minimum requirements need to be withdrawn.

- 3.12 It is planned that ISA (UK and Ireland) 700 (Revised) will be issued in spring 2009 and take effect for accounting periods ending on, or after, 5 April 2009 to facilitate a "streamlining" of existing UK and Irish auditor's as soon as the CA 2006 requirements apply to full accounting periods.
- 3.13 The APB will soon be consulting on plans to adopt the Clarified ISAs within the UK and Ireland. Irrespective of whether APB adopts the Clarity ISAs it is anticipated that the basic requirements of ISA (UK and Ireland) 700 (Revised) should apply in the foreseeable future<sup>30</sup> as APB plans to take advantage of the provisions set out in paragraphs 40 and 42 of the exposure draft of the Clarity version of ISA 700<sup>31</sup>. These paragraphs, which are reproduced in Appendix 2 of this paper, allow a statement of compliance with ISAs to be made where, because of national law or auditing standards, a different auditor's report is required.

#### **Updated Bulletin 2006/6 to be issued in spring 2009.**

- 3.14 Bulletin 2006/6 contains illustrative examples of auditor's reports. It is planned that this Bulletin would be updated based on the example on pages 11 and 12 of this paper<sup>32</sup>.
- 3.15 The updated Bulletin 2006/6 will be expanded to include example auditor's reports of certain specialised audits (for example charities and pension schemes) to assist auditing firms implement the new regime during 2009.

#### **Statement(s) of the scope of an audit and the auditor's reporting responsibilities to be issued in spring 2009.**

- 3.16 APB plans to publish on its website a number of Statements of the scope of an audit and the auditor's reporting responsibilities to allow such material to be cross referred to from auditor's reports. APB expects that audit firms will, in the short term, wish to cross refer to the information on APB's website. In the medium term there may be the potential for alternatives mechanisms for providing this information.
- 3.17 Descriptions of auditor's reporting responsibilities and the nature of an audit were arguably included in auditor's reports to help overcome aspects of the expectation gap. Such descriptions were curtailed because of the desire to keep published auditor's reports as short as was practical. Providing this information on a website gives the APB

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<sup>30</sup> Although conforming changes will likely be needed to it if, and when, APB adopts the Clarity ISAs.

<sup>31</sup> The APB expects these paragraphs to be promulgated, in substance, in the final Clarity version of ISA 700.

<sup>32</sup> Bulletin 2006/1 relating to Ireland would be similarly updated.

the opportunity of providing rather more comprehensive descriptions to help users of auditor's reports enhance their understanding of those matters.

- 3.18 The APB expects to publish such statements in relation to a range of entities (including specialised audits currently addressed by APB Practice Notes). These descriptions are likely to be based on existing APB material and, because APB does not participate in the auditing profession's risk management activities, will not contain the "Bannerman disclaimer". The APB recognises that given their responses to "The Auditor's Report: A time for change?" many audit firms will wish to continue to include this disclaimer in their auditor's report.

**Bulletin providing illustrative auditor's reports for accounting periods commencing on or after 6 April 2008 but ending before 6 April 2009**

- 3.19 In their responses to "The Auditor's Report: A time for change?" a number of auditing firms and accountancy bodies emphasised the importance of APB issuing guidance, as a matter of urgency on reports under CA 2006 for "short accounting periods". To assist the firms the APB will issue Bulletin 2008/8 containing a number of examples. Because auditor's reports on short accounting periods will need to comply with the existing ISA (UK and Ireland) 700 ( and because ISA (UK and Ireland) 700 Revised will not be finalised until spring 2009) the examples in the Bulletin will reflect relatively minor modifications to the current auditor's report and do not reflect the "streamlining" planned for 2009<sup>33</sup>.

**Initiate research to better understand what can realistically be done to make auditor's report more informative.**

- 3.20 Responses from institutional investors supported a reduction in the current content of the auditor's report which they viewed as being designed primarily to minimise prospective liability but also called for reports to be made more informative. This view was not supported by audit firms or organisations representing preparers. Because of this difference in views the APB intends to explore this issue further both with UK stakeholders and internationally with a view to contributing to future changes to international auditing standards.
- 3.21 In particular more work is needed to establish whether there is consensus as to what sort of additional information would be of assistance to investors and then to explore the feasibility of it being provided.

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<sup>33</sup> The examples will be based on the example provided in "The Auditor's Report: A time for change?" on pages 19 to 21.

3.22 Examples of additional information needs provided to APB to date include:

- (a) auditors highlighting the aspects of the financial statements, that although disclosed within the financial statements, are of particular importance to investors;
- (b) auditors reporting important risks and uncertainties that they are aware of that may be, or may not, be disclosed in the annual report. For example the Business Review to be included in the Directors Report requires disclosure of the principal risks and uncertainties facing the company<sup>34</sup>;
- (c) information on the main issues that the auditors discussed with the audit committee during the finalisation of the audit; and
- (d) information to explain the main judgments made by the auditors during the audit.

These examples differ both in terms of the information to be provided and the nature and extent of the difficulties in auditors providing such information.

3.23 There are also other FRC initiatives which may impact this issue, including work to explore the complexity and relevance of the requirements relating to corporate reports.

3.24 The APB will explore this issue further and participate in international initiatives with a view to contributing to future changes to international auditing standards. Issues to be considered include:

- To what extent have developments in in company law / accounting standard<sup>35</sup> provided the information that UK investor groups were seeking in auditor's reports?
- To what extent will reports from audit committees provide such information?
- What are the current expectations of users regarding the auditor's responsibilities in relation other information in the annual report (eg the Business Review included in the Directors Report)?

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<sup>34</sup> CA 2006 Section 417.

<sup>35</sup> In particular paragraphs 122 and 125 of IAS 1 on disclosures of key accounting policies and judgments and estimation uncertainties.

## **APPENDIX 1**

### **RESPONDENTS TO “THE AUDITOR’S REPORT: A TIME FOR CHANGE?”**

#### **Institutional investors**

- 1) Association of British Insurers
- 2) Hermes
- 3) Investment Management Association

#### **Organisations representing preparers of financial statements**

- 4) Confederation of British Industry (CBI)
- 5) One Hundred Group of Finance Directors
- 6) Quoted Companies Alliance (QCA)

#### **Auditing firms and accountancy bodies**

- 7) ACCA (The Association of Chartered Certified Accountants)
- 8) The Association of International Accountants (AIA)
- 9) Baker Tilly UK Audit LLP
- 10) BDO Stoy Hayward LLP
- 11) CIPFA (The Chartered Institute of Public Finance and Accountancy)
- 12) Deloitte & Touche LLP
- 13) Ernst & Young LLP
- 14) Grant Thornton UK LLP
- 15) ICAEW (The Institute of Chartered Accountants in England and Wales)
- 16) ICAI (The Institute of Chartered Accountants in Ireland)
- 17) ICAS (The Institute of Chartered Accountants of Scotland)
- 18) Kingston Smith LLP
- 19) KPMG LLP
- 20) London Society of Chartered Accountants
- 21) Mazars LLP
- 22) PricewaterhouseCoopers LLP

#### **Public sector bodies**

- 23) Audit Commission
- 24) Audit Scotland
- 25) National Audit Office
- 26) Wales Audit Office

#### **Private individuals**

- 27) Duncan Alexander
- 28) PL Bunting
- 29) Mrs Margaret R Downes
- 30) Dr. Andrew Higson, Loughborough University
- 31) Harry Wilkinson

In addition an open meeting was held on 26 March 2008 to obtain views of stakeholders. The APB has had regard of views expressed at that meeting even where participants did not respond in writing to the APB.

## APPENDIX 2

### EXTRACTS FROM THE CLARITY VERSION OF ISA 700<sup>36</sup>

#### ***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:
- (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

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<sup>36</sup> These extracts are from the IAASB’s Exposure Draft of the Clarity version of ISA 700. The APB expects these paragraphs to be promulgated by the IAASB, in substance, in the final version of ISA 700 (Redrafted).

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.

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