

February 2013

Revision to ISA (UK and Ireland) 700

Requiring the auditor's report to address risks of material misstatement, materiality and a summary of the audit scope

(For audits of entities that report on how they have applied the UK Corporate Governance Code)

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Section 1 – Invitation to comment

Overview of proposed changes

1. The proposed changes to ISA (UK and Ireland) 700 “The auditor’s report on financial statements” apply only to auditor’s reports of those entities that report on how they have applied the UK Corporate Governance Code.
2. In overview, it is proposed to require the auditor’s report to:
 - (a) Describe those assessed risks of material misstatement that were identified by the auditor and which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team;
 - (b) Provide an explanation of how the auditor applied the concept of materiality in planning and performing the audit; and
 - (c) Provide a summary of the audit scope, including an explanation of how the scope was responsive to the assessed risks of material misstatement and the auditor’s application of the concept of materiality, as disclosed in the auditor’s report.¹
3. The risks of material misstatement described in paragraph 2(a) are not intended to be coincident with the “significant risks” (as defined in the ISAs (UK and Ireland)). The auditor determines which of the significant risks and which other identified risks should be described.
4. Application and other explanatory material relating to the proposed change is set out in paragraphs A9A to A9C (see pages 21 to 22 of Section 2).

Relationship of proposed changes to those made in October 2012

5. In October 2012 the FRC issued revised ISAs (UK and Ireland), including ISA (UK and Ireland) 700, in conjunction with changes to the UK Corporate Governance Code published in September 2012, to give effect to the decisions announced in *Effective Company Stewardship: Next Steps* (published by the FRC in September 2011).
6. The October 2012 changes to the ISAs (UK and Ireland) were mainly directed at:
 - (a) Enhancing auditor communications by requiring the auditor to communicate to the audit committee:
 - i. information relevant to the board (and if applicable the audit committee) in fulfilling its responsibility for making the statement that the annual report is fair, balanced and understandable and for reviewing the effectiveness of the company’s risk management and internal control systems; and
 - ii. information that the auditor believes the audit committee will need to understand the significant professional judgments made in the course of the audit and in reaching their

¹ The proposed changes to the requirements are set out in paragraph 16A (see page 17 of Section 2)

audit opinion and the auditor's insights about the entity's internal control system based on their audit work; and

- (b) Extending auditor reporting by requiring the auditor to report, by exception, if the board's statement that the annual report and accounts taken as a whole is fair balanced and understandable is inconsistent with the knowledge acquired by the auditor in the course of performing the audit, or if the matters disclosed in the report from the audit committee do not appropriately address matters communicated by the auditor to the committee.
7. Prior to the implementation of the October 2012 changes to ISA (UK and Ireland) 700, the FRC undertook a stakeholder outreach programme, to assist in developing the FRC response to the IAASB's Invitation to Comment, which sets out the IAASB's proposals for enhancing auditor reporting under the International Standards on Auditing. A particular objective of the FRC outreach was to seek views on how the IAASB's proposals should be reconciled with the FRC's October 2012 changes that were about to be launched. In order to assist with this objective, a modified version of the IAASB illustrative auditor's report (which sought to create an illustrative UK and Ireland auditor's report that was consistent both with the concepts in the IAASB Invitation to Comment and with the expected October 2012 changes to the ISAs (UK and Ireland)) was developed by a working group of the FRC's Audit and Assurance Council. This was shared and discussed with stakeholders during the outreach. The following views and conclusions emerged from that outreach.
8. The IAASB's illustrative revised auditor's report included a new "auditor commentary" section designed to give the auditor the opportunity to highlight those matters arising from the audit "that are in the auditor's judgment likely to be most important to users' understanding of the audited financial statements or the audit". Despite this reference to "the audit", the emphasis in the commentary in the illustrative auditor's report was mainly on the outputs of the audit in relation to the key judgments made in the preparation of the accounts rather than on the key judgments made about the inputs to the scope of the audit, such as the auditor's assessments of risk and materiality.
9. Under the September 2012 revisions to the UK Corporate Governance Code, the section of the annual report describing the significant issues that the audit committee considered in relation to the financial statements and how these issues were addressed is expected to have regard to matters communicated to it by the auditor². Under the October 2012 revisions to the ISAs (UK and Ireland), the auditor does not repeat these matters in the auditor's report but is required to address them if it concludes that the annual report does not appropriately address matters it had communicated to the audit committee. The conclusion was drawn that broadly the same information as that required to be communicated under the proposed international approach, in the auditor's report, would be communicated under the September/October 2012 changes to the Code and the ISAs (UK and Ireland), in the annual report, though this would be through different channels.
10. Another conclusion reached was that, in contrast to the IAASB proposed auditor commentary approach, the auditor's report under the October 2012 changes to the ISAs (UK and Ireland) would

² See the FRC's *Guidance on Audit Committees*, September 2013 – paragraph 5.2

consist largely of standardised language, unless the directors' failed to fulfil their reporting responsibilities properly. There was concern that standardised language in the auditor's report has less communicative value, and provides less incentive for shareholders and other stakeholders to read and engage with the report, than more company-specific information would.

11. A further conclusion was that although, as described above, the September 2012 changes to the UK Corporate Governance Code would provide information to shareholders and other users of financial statements with regard to the outcome of the audit³, those users may also derive considerable benefit from being provided with information about:
 - (a) The auditor's assessment of the material risks of misstatement identified in the audit;
 - (b) The auditor's assessment of materiality; and
 - (c) The audit scope, including how this responds to the assessments of risk and materiality.
12. In order to explore this, the illustrative modified UK and Ireland auditor's report developed and explored with stakeholders during the outreach included a section addressing these matters (see Section 3). There was strong support from investors, a number of whom expressed support for the provision of this information in their responses to the IAASB consultation, whilst the views from other stakeholders were mixed.
13. Such information is typically communicated to the audit committee by the auditor and could, therefore, be disclosed in the annual report under the changes to the Code introduced in September 2012, as important judgments the audit committee considered in carrying out its work. However, many expressed the view that boards may be uncomfortable disclosing and discussing such information (which they may see as more naturally in the auditor's domain) and, therefore, that it would be more appropriate for such information to be disclosed by the auditor in the auditor's report.

Potential benefits to investors and other users of financial statements

14. Many investors comment that auditors' reports currently contain largely standardised language, which has little informational value beyond the binary audit opinion and any emphasis of matter paragraph. Some investors believe that the auditor's report could usefully provide a platform of information about the audit which they could use as a basis for engagement about the audit. The proposed information about the auditor's assessment of risks and materiality and how the scope of the audit was responsive to these assessments would make the company-specific application of the auditing standards more transparent. It was also seen by investors as providing a "hook" on which they could start a dialogue with a company (and perhaps in due course with the auditor) about the audit. This may help to close the audit expectation gap.
15. Investors saw particular value in understanding the auditor's assessment of the risks of material misstatement for the audited entity as this would provide a view of certain aspects of the entity

³ Other than by exception, such information would be provided by the board's statement in the annual report concerning the audit committee's consideration of the significant professional judgments made in the audit.

through the auditor's eyes and, therefore, provide real informational value beyond the information that the directors provide, without undermining the directors' responsibilities.

16. For example, UK and other investors' responses to the IAASB's invitation to comment included the following comments:

"An audit report with more opportunities for comment provides more leverage points to get better reporting more generally. It also provides a broader basis for dialogue between shareholders and companies in which they invest. ... We firmly believe that there should be a greater focus on auditing judgments in the auditor's report – issues about which it is appropriate for the auditor to make initial disclosures. By auditing judgments, we mean a disclosure of the key risks as assessed at the start of the audit, and any change in that assessment over the life of the audit, the key areas of focus for the audit team, the level of audit coverage of subsidiaries and segments, and the materiality threshold, both overall and in terms of performance materiality. All of these are vital insights into the quality of the audit and enable investors to assess the value they are getting for the money they are paying for the audit, as well as providing a helpful basis for dialogue between investors and those charged with governance." **[UK asset manager]**

"[Auditor commentary should include] key financial statement and audit risks the auditor has considered when conducting the audit, and the extent, if any, as to how the auditor addressed those risks." **[US public pension fund]**

"The Auditor Commentary provides shareholders with valuable insights regarding how the audit procedures were designed and applied, as well as useful objective signposts to key accounting and audit issues in respect of the matters included in the financial statements. ... We understand that the [FRC] is giving consideration to disclosure by auditors of their approach to evaluating materiality. Our informal discussions with the FRC about this lead us to conclude that the information will be very useful to us in assessing not only the audited financial statements but also the quality of the audit." **[UK based global investor]**

"Additional areas where we would like to see the auditor commentary touch upon are:

- *Some detail on its key audit judgments, including a sense of the risks associated with these and the tolerable error to which the audit is subject; ... [and]*
- *The key areas of focus for the audit team, the main areas of risk identified and the auditor's approach to materiality."* **[UK workplace pension fund representative body]**

"[The] auditor should always consider including in the commentary information on the important aspects of his audit, such as materiality and the scope of the audit, and important findings on the financial statements." **[Global corporate governance network]**

"A concern of investors is that the judgments made and processes followed during the preparation of the accounts and their audit are often opaque. ... Moreover, many of the concerns investors have about the quality of audits are a product of the fact that they feel excluded from the audit process

and real findings. This includes evaluating: risks and controls; valuation judgments; and write downs and impairments. But currently the only communication auditors have with investors is through an audit report which is of limited use with its binary opinion, pass or fail, and boilerplate, technical language. ... Auditors should disclose the level at which they have set audit materiality and how it is used. ... [and] auditors should disclose areas of significant management judgment, significant and unusual transactions, and matters of significant audit risk.” [UK investor representative body]

Potential costs and other impacts

17. Feedback from auditors and preparers of financial statements, both during the outreach and subsequently, has suggested that many acknowledge at least some of the potential benefits perceived by investors and other users. However, some question how valuable the potential benefits would be in practice to investors and other users and perceive that there may be risks in implementing them. Nonetheless, there has been a willingness to engage further on these issues to better understand how those calling for such information would expect to use it and how they would obtain benefits from it, and to discuss how the perceived risks might be avoided or mitigated.
18. For example, one individual audit partner made the following personal comments which suggest a different way of approaching the proposed requirements:

“At the moment the debate appears to be focused on reporting more based on the “current” audit; in that context adding auditor commentary would be a good incremental step. ... I am against providing numerical materiality type disclosures or broad descriptions of audit scope as these are just too difficult to do in a way that would enhance insight into the audit; any important features in these areas for a particular company would naturally come out in an “issues” based approach. If the auditor commentary is focused on issues that the auditor focused on this would naturally lead to a discussion of:

- *Why this is an issue and where in the financial statements, the OFR and the audit committee report key items/disclosures in relation to it are*
- *Where the auditor spent the bulk of its effort*
- *How the auditor approached auditing the particular issue (use of specialist, approach to estimate, local visit/interaction, lower materiality for audit of directors’ remuneration information, use of a balance sheet based materiality measure for an R&D/exploration type company etc etc).*

This would act as a natural bridge to the audit committee reporting. Having a granular discussion with shareholders on what they really want, based perhaps on a cross section of case studies, could help take this forward.”

19. Some of the potential risks that auditors raised included the following:
 - (a) The assessment of materiality and of the risks of material misstatement and an explanation of how the scope of the audit was responsive to them may be complex and could be difficult to fully appreciate without the opportunity for two-way communication that is possible, for

example, when these matters are discussed with the audit committee. They noted that the audit committee considers these matters as a proxy for users and thought they could be more readily addressed in papers for, and meetings with, the audit committee than in the auditor's report. They, therefore, perceived a risk that, in addressing such matters relatively briefly in the auditor's report, important context could be lost and this might arouse unnecessary concerns or questions.

- (b) There is a risk that the auditor might, with the benefit of hindsight, be regarded as having been negligent if they did not discuss a particular risk of material misstatement in the auditor's report and it later became evident that the risk had given rise to a significant adverse outcome for the entity; and that this may be so whether or not the auditor had identified the risk and irrespective of their assessment of, and response to, it.
20. A number of preparers of financial statements believe that the binary auditor's opinion should provide the most important information that an auditor can convey to users of financial statements. In particular, they questioned whether it is an appropriate role for the auditor to enrich investors' understanding of the entity, which they consider to be the responsibility of the directors, or of the audit. They argue that audit committees, not investors, should be concerned with understanding company-specific aspects of the audit.
 21. Some preparers also considered that a requirement to disclose risks of material misstatement may lead to the auditor providing information about the company which the entity has not already published because those risks may differ from the principal risks described by the directors in the annual report and accounts. They regarded this possibility as being undesirable as they do not regard the provision of information about the entity as being the auditor's role.
 22. Investors either did not generally find the risks identified by auditors and preparers very convincing or believed that the concerns could be effectively avoided or managed. For example, the risk that auditors could provide information about the entity that the directors have not already published is arguably not a new issue. The auditor has the obligation under the October 2012 changes to the ISAs (UK and Ireland) to disclose matters that it has communicated to the audit committee that it concludes have not been appropriately disclosed by the directors. If the auditor thought it appropriate to discuss a particular risk of material misstatement, the directors would have the opportunity to do so themselves in the annual report or accounts and, therefore, to mitigate any risk they perceived.
 23. Investors did not think that cost would be a significant issue as the costs would largely be related to the additional consideration of public reporting of matters likely to have been already fully addressed in the audit and reported to the audit committee. Cost was not raised as a prohibitive issue by other commentators in the outreach.

EU audit proposals

24. The 2011 European Commission proposals regarding the statutory audit of public interest entities include proposed requirements for the auditor's report to address the level of materiality applied to perform the audit and to identify key areas of risk of material misstatement of the financial statements including critical accounting estimates or areas of measurement uncertainty. The initial report of the Rapporteur of the Committee on Legal Affairs of the European Parliament proposes amendments to these proposals but suggests that the audit report should nonetheless include: a description of the most important assessed risks of material misstatement including those arising from fraud; a summary of the auditor's response to those risks; and key observations from that audit work.
25. The consideration of these matters continues to be debated at EU level and the FRC believes that the proposals in this Consultation Paper and responses to it could provide useful input to that debate.

Academic research highlighted in response to IAASB

26. One response to the IAASB's ITC was submitted by a subset of a group of academics who had recently completed a research synthesis on the Audit Reporting Model⁴. They state in their response:

"Most of the tangible suggestions being considered by the IAASB seem to be about the entity being audited, with significant possible changes to enhancements in an "audit commentary" section (pp.21-28) and "going concern" section (pp.18-20). ...

Where there are less tangible changes being considered by the IAASB in the "Invitation to Comment" on a new auditor's report, they relate to provision of more information about the audit that was conducted. Our research synthesis found users perceive more disclosure on the materiality levels used in the audit that was conducted to be important [research references omitted]. This was consistent with the literature review conducted by [research reference omitted].

Another area perceived as important relates to more information on key risk areas identified as part of the audit process [research reference omitted]. A limitation of research that evaluates users' perceptions on what they want from an audit report is that it is limited to behavioral type studies, because it evaluates disclosures that do not exist in practice. Similarly, evidence on the use of this type of information is limited for the same reason. Despite the above limitations, the evidence that is available and has been cited from our research synthesis consistently suggests that more information about the audit that was conducted would be valued by users of financial statements.

⁴ Mock, T., J. Bedard, P. Coram, S. Davis, R. Espahbodi, and R. Warne. 2013. The Audit Reporting Model: Current Research Synthesis and Implications. *Auditing: A Journal of Practice & Theory* forthcoming.

This should be relevant and important to regulators and standard setters as it represents the research reflecting the responses of more than 1,400 participants.

The potential cost of these additional disclosures is also an issue that is difficult to address in evaluating disclosures that do not exist in practice. There is limited information available on what these additional disclosures might cost. Further, it is unclear whether users' perceptions on this expanded audit disclosure would vary if they became aware of the costs associated with it. Mock et al. (2009) note that much of this type of disclosure about the audit that was conducted is already reported to management. We relate this to the cost issue in our synthesis by making the following point, ...for disclosures on information that the auditors already examined or collected under existing professional guidance, it cannot be assumed that public disclosure will increase audit costs or fees substantially."

Balancing the perceived benefits, costs and other impacts

27. Many investors who contributed views during the earlier outreach believed that the above mentioned benefits of the proposed changes would in principle be tangible and significant. Similarly, many of the auditors and preparers who contributed views considered that there could be significant risks but many investors were not convinced that the impact of those risks would be damaging or else believed that they should be capable of being avoided or managed.
28. However, the outreach was necessarily exploratory and those who expressed views did so on the basis of the illustrative auditor's report and not on the basis of specific proposals for revisions to ISA (UK and Ireland) 700. The FRC, therefore, wishes to obtain wider input from stakeholders on the benefits that may result from implementing the changes being proposed. If confirmed, the benefits of the proposed transparency of the auditor's assessments of the risks of material misstatement and materiality, and of how the scope of the audit has been responsive to them, as perceived by investors who commented in the course of the outreach, appear to be a goal worth striving for and could have the potential to enable engagement about, and make a significant contribution to building confidence in, the audit.
29. The FRC also wishes to understand stakeholders' views about the potential costs and any other impacts of the proposed changes (whether or not identified above) and whether those impacts could be damaging and, if so, how they might be avoided or managed effectively.

Proposed amendment to title of ISA (UK and Ireland) 700

30. A conforming amendment to the title of ISA (UK and Ireland) 700, to align it with the titles of ISAs (UK and Ireland) 705 and 706, is also proposed, to insert the adjective "independent" to describe the auditor.

Proposed effective date

31. The proposed effective date is for periods commencing on or after 1 October 2012. This would mean that the effective date would be the same as that for the October 2012 changes to ISA (UK and Ireland) 700 and also the changes to the ISAs (UK and Ireland) and the proposed new Guidance on Going Concern to implement the recommendations of the Sharman Panel⁵, that are being consulted on separately.

Illustration of the proposed disclosures

32. The text in Section 3 is intended to provide a possible illustration of the proposals for information about risks of material misstatement, materiality and the audit scope to be included in the auditor's report. It provides one possible interpretation of an auditor's response to the proposed changes that may provoke other views on how the proposed new requirements should be interpreted and whether those proposals are appropriate, in responding to this Consultation paper.
33. It is not intended that such illustrative text would be included in the examples in the FRC's compendia audit report Bulletins. Rather, those examples would include a square bracketed comment to the effect that the auditor should include a description of these matters, as required by ISA (UK and Ireland) 700, in order to avoid encouraging the use of standardised text.

Commenting on the proposals

34. The FRC is issuing this consultation paper in order to solicit views to assist it in determining whether the proposed revisions to ISA (UK and Ireland) 700, set out in Section 2, would be appropriate and practical. The FRC also invites comments on the illustrative disclosures in the auditor's report set out in Section 3.
35. In particular, the FRC invites commentators to address the questions set out overleaf, where appropriate indicating whether and to what extent the illustrative disclosures would give rise to or address the comments made, or could be improved in light of them. The FRC would prefer to receive letters of comment (in word format) by e-mail to s.leonard@frc.org.uk. If this is not possible, please send letters of comment to:

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⁵ A separate consultation paper on the implementation of the recommendations of the Sharman Inquiry has been published.

36. Letters of comment should be sent so as to be received no later than 30 April 2013. All comments will be regarded as being on the public record unless otherwise requested, and will be posted to the FRC's website soon after receipt.
37. The FRC complies, where possible, with best practice for consultations and has, therefore, set a three month consultation period ending on 30 April 2013. The FRC will evaluate all comments received with a view to issuing the updated ISA (UK and Ireland) by 30 June 2013.

Consultation Questions

Overall view

Question 1: *Do you agree that the auditor's report should include a description of the auditor's assessed risks of material misstatement, materiality and the audit scope? If not, why not?*

Question 2: *Do you agree that these proposals should be limited to entities that explain how they comply with the Code? If not, why not?*

Question 3:

(a) *Do you consider that the provision of such information by the auditor will be of benefit to shareholders and other users of the financial statements and, if so, can you explain what those benefits would be and how they would arise?*

(b) *Do you believe such information would provide an effective "hook" for investors and other users to start a dialogue with the company about the audit?*

Question 4: *Do you believe that directors are likely to disclose information about the audit (of the type that would be required in accordance with these proposals) under the September 2012 changes to the Code? Is it more appropriate for such information to be provided in the auditor's report or by the board in the section of the annual report addressing the work of the audit committee, and why?*

Assessed risks of material misstatement

Question 5: *What do you believe would be, if any, the benefits, costs and other impacts of the proposed requirement to describe in the auditor's report certain risks of material misstatement that were identified by the auditor?*

Question 6: *Do you agree that the basis for determining the risks of material misstatement to be described in the auditor's report (see proposed paragraph 16A(a) of ISA (UK&I) 700) is appropriate?*

Question 7: *The risks disclosed by the auditor in complying with proposed paragraph 16A(a) of ISA (UK&I) 700 may well differ from the principal risks disclosed by the directors in the business review in the annual report. What are your views about this possibility?*

Question 8: *Do you believe that the omission from the auditor's report of a particular risk of material misstatement would pose a threat of significant loss or damage to the auditor if, after the event, it became evident that the risk had given rise to significant damage to the company?*

Materiality

Question 9: *How do you assess the benefits, costs and other impacts of the proposed requirement to provide in the auditor's report an explanation of how the auditor applied the concept of materiality*

in planning and performing the audit, including specifying the threshold used by the auditor as being materiality for the financial statements as a whole, and the balance between them?

Summary of audit scope

Question 10: *How do you assess the benefits, costs and other impacts of the proposed requirement to provide in the auditor's report a summary of the audit scope, and the balance between them? Does the illustrative disclosure in Section 3 provide a sufficient explanation of how the audit scope was responsive to the auditor's assessment of risks and materiality?*

Avoiding standardised language

Question 11: *Do you believe that the wording of paragraph 16A and paragraphs A9A to A9C is sufficiently principle-based so as to avoid standardised language?*

Effective date

Question 12: *Do you foresee any difficulty if the effective date is periods commencing on or after 1 October 2012?*

Section 2 – Exposure Draft

ISA (UK and Ireland) 700 – (Revised [January] 2013)

**INTERNATIONAL STANDARD ON AUDITING
(UK AND IRELAND) 700 (REVISED ~~OCTOBER 2012~~ MONTH 2013)**

THE INDEPENDENT AUDITOR’S REPORT ON FINANCIAL STATEMENTS

(Effective for audits of financial statements for periods commencing on or after 1 October 2012)

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International Standard on Auditing (UK and Ireland) (ISA (UK and Ireland) 700, “The Independent Auditor’s Report on Financial Statements (Revised ~~October 2012~~Insert Date)” should be read in conjunction with ISA (UK and Ireland) 200, “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (UK and Ireland).”

NOTE: The FRC has not ~~at this time~~ adopted ISA 700 “Forming an Opinion and Reporting on Financial Statements”. The FRC has instead issued ISA (UK and Ireland) 700 “The Independent Auditor’s Report on Financial Statements (Revised ~~October 2012~~Insert Date)”. The main effect of this is that the form of auditor’s reports ~~may be~~ not ~~be exactly~~ aligned with the ~~precise~~ format required by ISA 700 issued by the IAASB. However, ISA (UK and Ireland) 700 (Revised ~~October 2012~~Insert Date) has been drafted such that compliance with it will not preclude the auditor from being able to assert compliance with the ISAs issued by the IAASB.

Introduction

Scope of this ISA (UK and Ireland)

1. This International Standard on Auditing (UK and Ireland) (ISA (UK and Ireland)) establishes standards and provides 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.
2. This ISA (UK and Ireland) is written to address both "true and fair frameworks"¹ and "compliance frameworks". A "true and fair framework" is one that requires compliance with the framework but which acknowledges that to achieve a true and fair view:
 - (a) It may be necessary to provide disclosures additional to those specifically required by the framework²; and
 - (b) It may be necessary to depart from a requirement of the framework³.A "compliance framework" is one that requires compliance with the framework and does not contain the acknowledgements in (a) or (b) above.
3. Illustrative examples of auditor's reports tailored for use with audits conducted in accordance with ISAs (UK and Ireland) are provided in compendia Bulletins issued by the FRC⁴. Illustrative examples of auditor's reports on regulatory returns are provided in various Practice Notes issued by the FRC.
4. ISA (UK and Ireland) 705 and ISA (UK and Ireland) 706 deal with how the form and content of the auditor's report are affected when the auditor expresses a modified opinion or includes an Emphasis of Matter paragraph or an Other Matter paragraph in the auditor's report.

Status of this ISA (UK and Ireland)

5. Paragraph 43 of ISA 700, "Forming an opinion and reporting on financial statements," as issued by the IAASB specifies the minimum elements of auditor's reports where the regulation of a specific jurisdiction specify wording of the auditor's report. Reports prepared in accordance with ISA (UK and Ireland) 700 contain those minimum elements and consequently

¹ True and fair frameworks are sometimes referred to as "fair presentation frameworks".

² In the IFRS Framework this is acknowledged in paragraph 17(c) of IAS 1. In UK GAAP this is acknowledged in Sections 396(4) and 404(4) of the Companies Act 2006. Under Generally Accepted Accounting Practice in Ireland this is acknowledged, for example, in Section 3(c) of the Companies (Amendment) Act 1986 and Regulation 14 of the European Communities (Companies: Group Accounts) Regulations 1992.

³ This is sometimes referred to as the "true and fair override". In the IFRS Framework this is acknowledged in paragraph 19 of IAS 1. In UK GAAP this is acknowledged in Sections 396(5) and 404(5) of the Companies Act 2006. Under Generally Accepted Accounting Practice in Ireland this is acknowledged, for example, in Section 3(d) of the Companies (Amendment) Act 1986 and Regulation 14(3) of the European Communities (Companies: Group Accounts) Regulations 1992.

⁴ At the date of publication of this ISA (UK and Ireland), Bulletins 2010/2 (Revised) "Compendium of Illustrative Auditor's Reports on United Kingdom Private Sector Financial Statements for periods ended on or after 15 December 2010" and 1(l) "Compendium of Illustrative Auditor's Reports on Irish Financial Statements" were the current compendia Bulletins.

compliance with this ISA (UK and Ireland) does not preclude the auditor from being able to assert compliance with International Standards on Auditing issued by the IAASB.

Effective Date

6. This ISA (UK and Ireland) is effective for audits of financial statements for periods commencing on or after 1 October 2012. Except for the requirements in paragraphs 22A and 22B, earlier adoption is permitted.

Objectives

7. The objectives of the auditor are to:
- (a) Form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and
 - (b) Express clearly that opinion through a written report that also describes the basis for the opinion.

Requirements

Forming an Opinion on the Financial Statements

8. The auditor's report on the financial statements shall 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 as to whether the financial statements as a whole are free from material misstatement, whether due to fraud or error has been obtained;
 - (b) Uncorrected misstatements are material, individually or in aggregate. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments; (Ref: Para. A1-A3)
 - (c) In respect of a true and fair framework, the financial statements, including the related notes, give a true and fair view; and
 - (d) In respect of all frameworks the financial statements have been prepared in all material respects in accordance with the framework, including the requirements of applicable law.
9. In particular, the auditor shall 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) Accounting estimates 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; and
 - (g) The terminology used in the financial statements, including the title of each financial statement, is appropriate.
10. With respect to compliance frameworks an unqualified opinion on the financial statements shall be expressed only when the auditor concludes that they have been prepared in accordance with the identified financial reporting framework, including the requirements of applicable law.
11. With respect to true and fair frameworks an unqualified opinion on the financial statements shall be expressed only when the auditor concludes that they have been prepared in accordance with the identified financial reporting framework, including the requirements of applicable law, and the financial statements give a true and fair view.

Auditor's Report

Title

12. The auditor's report shall have an appropriate title. (Ref: Para A4)

Addressee

13. The auditor's report shall be appropriately addressed as required by the circumstances of the engagement. (Ref: Para A5)

Introductory Paragraph

14. The auditor's report shall 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

15. The auditor's report shall include a statement that those charged with governance are responsible for the preparation 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 and International Standards on Auditing (UK and Ireland). The report shall also state that those standards require the auditor to comply with the APB's Ethical Standards for Auditors. (Ref: Para A6 - A7)

Scope of the Audit of the Financial Statements

16. The auditor's report shall either:
- (a) Cross refer to the applicable version of a "Statement of the Scope of an Audit" that is maintained on the FRC's web-site; or
 - (b) Cross refer to a "Statement of the Scope of an Audit" that is included elsewhere within the Annual Report; or
 - (c) Include the following description of the scope of an audit.

"An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the *[describe nature of entity]* circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by *[describe those charged with governance]*; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the *[describe the annual report]* to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report." (Ref: Para A8 – A9)

16A. In the case of entities⁸ that are required, and those that choose voluntarily, to report on how they have applied the UK Corporate Governance Code, or to explain why they have not, the auditor's report shall:

- (a) Describe those assessed risks of material misstatement that were identified by the auditor and which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team;
- (b) Provide an explanation of how the auditor applied the concept of materiality in planning and performing the audit. Such explanation shall specify the threshold used by the auditor as being materiality for the financial statements as a whole⁵; and
- (c) Provide a summary of the audit scope⁶, including an explanation of how such scope was responsive to the assessed risks disclosed in accordance with (a) and the auditor's application of materiality disclosed in accordance with (b). (Ref. Para A9A – A9C)

Opinion on the Financial Statements

⁵ As required by paragraph 10 of ISA (UK and Ireland) 320 "Materiality in planning and performing an audit".

⁶ See also paragraphs A11 to A15 of ISA (UK and Ireland) 260 "Communication with Those Charged with Governance"

17. The opinion paragraph of the auditor's report shall clearly state the auditor's opinion as required by the relevant financial reporting framework used to prepare the financial statements, including applicable law.
18. When expressing an unqualified opinion on financial statements prepared in accordance with a true and fair framework the opinion paragraph shall clearly state that the financial statements give a true and fair view⁷. It is not sufficient for the auditor to conclude that the financial statements give a true and fair view solely on the basis that the financial statements were prepared in accordance with accounting standards and any other applicable legal requirements. (Ref: Para A10 – A12)

Opinion in Respect of an Additional Financial Reporting Framework

19. When an auditor is engaged to issue an opinion on the compliance of the financial statements with an additional financial reporting framework the second opinion shall be clearly separated from the first opinion on the financial statements, by use of an appropriate heading. (Ref: Para A13)

Requirement Specific to Public Sector Entities where an Opinion on Regularity is Given.

20. The auditor shall address other reporting responsibilities in [a] separate section[s] of the auditor's report following the opinion[s] on the financial statements and, where there is one, the opinion on regularity. (Ref: Para A14)

Opinions on Other Matters

21. When the auditor addresses other reporting responsibilities within the auditor's report on the financial statements, the opinion arising from such other responsibilities shall be set out in a separate section of the auditor's report following the opinion[s] on the financial statements or, where there is one, the opinion on regularity. (Ref: Para A15 – A16)
22. If the auditor is required to report on certain matters by exception the auditor shall describe its responsibilities under the heading "Matters on which we are required to report by exception" and incorporate a suitable conclusion in respect of such matters. (Ref: Para A17 - A18)
- 22A. In the case of entities that are required⁸, and those that choose voluntarily, to report on how they have applied the UK Corporate Governance Code or to explain why they have not, the auditor shall report by exception if, when

⁷ United Kingdom auditor's reports prepared in accordance with section 495(3) of the UK Companies Act 2006 will meet this requirement. Irish auditor's reports prepared in accordance with Section 193(4C) of the Irish Companies Act 1990 and, therefore, expressing an opinion in terms of "true and fair view, in accordance with the relevant financial reporting framework" also meets this requirement. This is supported by recital 10 of EU Directive 2003/51/EC which states "The fundamental requirement that an audit opinion states whether the annual or consolidated accounts give a true and fair view in accordance with the relevant financial reporting framework does not represent a restriction of the scope of that opinion but clarifies the context in which it is expressed".

⁸ In the UK, these include companies with a Premium listing of equity shares regardless of whether they are incorporated in the UK or elsewhere. In Ireland, these include Irish incorporated companies with a primary or secondary listing of equity shares on the Irish Stock Exchange.

reading the other financial and non-financial information included in the annual report, the auditor has identified information that is materially inconsistent with the information in the audited financial statements or is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by the auditor in the course of performing the audit or that is otherwise misleading. (Ref: Para A18A)

22B. Matters that the auditor shall report on by exception in accordance with paragraph 22A include circumstances where the annual report includes:

- (a) A statement given by the directors that they consider the annual report and accounts taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the entity's performance, business model and strategy, that is inconsistent with the knowledge acquired by the auditor in the course of performing the audit; or
- (b) A section describing the work of the audit committee that does not appropriately address matters communicated by the auditor to the audit committee; or
- (c) An explanation, as to why the annual report does not include such a statement or section, that is materially inconsistent with the knowledge acquired by the auditor in the course of performing the audit; or
- (d) Other information that, in the auditor's judgment, contains a material inconsistency or a material misstatement of fact.

The auditor shall include a suitable conclusion on these matters in the auditor's report in accordance with paragraph 22 and, if applicable, shall describe why the auditor believes that any such statement, section, explanation or other information is materially inconsistent with the knowledge acquired by the auditor in the course of performing the audit or otherwise contains a material inconsistency or a material misstatement of fact. If a section of the annual report describing the work of the audit committee does not appropriately disclose any matters communicated by the auditor to the audit committee that in the auditor's judgment should have been disclosed, or if the annual report does not contain such a section, the auditor's report shall also include any such information.

Date of Report

23. The date of an auditor's report on a reporting entity's financial statements shall be the date on which the auditor signed the report expressing an opinion on those financial statements. (Ref. Para A19)

24. The auditor shall not sign, and hence 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. (Ref. Para A20 – A23)

Location of Auditor's Office

25. The report shall name the location of the office where the auditor is based.

Auditor's Signature

26. The auditor's report shall state the name of the auditor and be signed and dated. (Ref. Para A24)

Application and Other Explanatory Material

Qualitative Aspects of the Entity's Accounting Practices (Ref: Para 8)

A1. Management makes a number of judgments about the amounts and disclosures in the financial statements.

A2. ISA (UK and Ireland) 260 contains a discussion of the qualitative aspects of accounting practices.⁹ In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that the cumulative effect of a lack of neutrality, together with the effect of uncorrected misstatements, causes the financial statements as a whole to be materially misstated. Indicators of a lack of neutrality that may affect the auditor's evaluation of whether the financial statements as a whole are materially misstated include the following:

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

A3. ISA (UK and Ireland) 540 addresses possible management bias in making accounting estimates.¹⁰ Indicators of possible management bias do not constitute misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates. They may, however, affect the auditor's evaluation of whether the financial statements as a whole are free from material misstatement.

Auditor's Report

Title (Ref: Para 12)

A4. 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 those charged with governance, or from the reports of other auditors who may not have to comply with the APB's Ethical Standards for Auditors.

⁹ ISA (UK and Ireland) 260, "Communication with Those Charged with Governance," Appendix 2.

¹⁰ ISA (UK and Ireland) 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures," paragraph 21.

Addressee (Ref: Para 13)

A5. The Companies Acts¹¹ 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.

Respective Responsibilities of Those Charged with Governance and Auditors (Ref: Para 15)

A6. 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.

A7. 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.

Scope of the Audit of the Financial Statements (Ref: Para 16)

A8. The [APBFRC](#) maintains on [its](#) web-site^s descriptions of the scope of an audit of the financial statements of private sector entities¹². These descriptions address the auditor's responsibilities under ISAs (UK and Ireland).

A9. Where the scope of the audit is described within the Annual Report but not in the auditor's report, such description includes the prescribed text set out in paragraph 16 (c). The content of the description of the scope of the audit is determined by the auditor regardless of whether it is incorporated into the auditor's report or published as a separate statement elsewhere in the annual report.

A9A. Such assessed risks are likely to have been identified by the auditor in meeting the requirements of ISA (UK and Ireland) 315 "Identifying and assessing the risks of material misstatement through understanding the entity and its environment"¹³. If the auditor significantly revises its risk assessment during the audit the auditor considers whether to disclose that fact and the circumstances giving rise to the changed assessment.

¹¹ In the United Kingdom the Companies Act 2006 establishes this requirement. In Ireland the Companies Acts 1963 to 2006 establish this requirement.

¹² The web-site reference relevant to the UK is www.frc.org.uk/apb/scope/private.cfm and the web-site reference relevant to Ireland is www.frc.org.uk/audit-scope-ireland.

¹³ The relevant section of ISA (UK and Ireland) 315 is "Identifying and Assessing the Risks of Material Misstatement" (paragraphs 25 to 31).

A9B. The explanation of how the auditor applied the concept of materiality in planning and performing the audit is tailored to the particular circumstances of the audit and, in addition to specifying the threshold used by the auditor as being materiality for the financial statements as a whole, might include:

- Materiality level or levels for those classes of transactions, account balances or disclosures where such materiality levels are lower than materiality for the financial statements as a whole (as described in paragraph 10 of ISA (UK and Ireland) 320.
- Performance materiality (as described in paragraph 11 of ISA (UK and Ireland) 320).
- Any significant revisions of materiality thresholds that were made as the audit progressed.
- The threshold used for reporting unadjusted differences to the audit committee.
- Significant qualitative considerations relating to the auditor's evaluation of materiality.

A9C. The content of the summary of the planned scope of the audit is tailored to the particular circumstances of the audit and how the planned scope was influenced by the auditor's application of materiality and was responsive to the assessed risks. Such a summary might also include, for example:

- The effect of the group structure on the planned scope. For example the group may consist of a large number of autonomous subsidiary companies or may consist of a number of non-autonomous divisions.
- The number of locations visited by the group auditor as a proportion of the total number of locations and whether these locations were subject to a full or partial audit.
- The rationale, in terms of audit coverage, underlying any programme of planned visits.
- The coverage of consolidated total assets and profit before tax achieved by auditing these locations.
- The group auditor's activities in relation to subsidiaries not audited by the group auditor's network firm.
- The audit approach to associated companies and joint ventures and the extent of involvement of the group auditor.

Opinion on the Financial Statements (Ref: Para 18)

A10. 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)¹⁴. 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 standards¹⁵.

¹⁴ The opinion can be downloaded from the FRC web-site at <http://www.frc.org.uk/about/trueandfair.cfm>

¹⁵ UK and Irish law differ but follow similar principles.

A11. 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”.

A12. 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. The financial reporting framework is normally one of:

- “International Financial Reporting Standards (IFRSs) as adopted by the European Union”, and the national law that is applicable when using IFRSs and, in the case of consolidated financial statements of publicly traded companies¹⁶, Article 4 of the IAS Regulation (1606/2002/EC); or
- “Generally Accepted Accounting Practice in Ireland”, which comprises applicable Irish law and accounting standards issued by the Accounting Standards Board (ASB) and promulgated by the Institute of Chartered Accountants in Ireland; or
- “UK Generally Accepted Accounting Practice”, which comprises applicable UK law and UK Accounting Standards as issued by the ASB.

Opinion in Respect of an Additional Financial Reporting Framework (Ref: Para 19)

A13. The financial statements of some entities may comply with two financial reporting frameworks (for example “IFRSs as issued by the IASB” and “IFRSs as adopted by the European Union” and those charged with governance may engage the auditor to express an opinion in respect of both frameworks. 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.

Requirement Specific to Public Sector Entities where an Opinion on Regularity is Given. (Ref: Para 20)

A14. For the audit of certain public sector entities the audit mandate may require the auditor to express an opinion on regularity¹⁷. Regularity is the requirement that financial transactions are in accordance with the legislation authorising them.

¹⁶ A publicly traded company is one whose securities are admitted to trading on a regulated market in any Member State in the European Union.

¹⁷ 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)” and Practice Note 10 (I) “Audit of Central Government Financial Statements in the Republic of Ireland”.

Opinion on Other Matters (Ref: Para 21 – 22B)

A15. The auditor sets out its opinion[s] on these other reporting responsibilities in [a] separate section[s] of the report in order to clearly distinguish it from the auditor's opinion[s] on the financial statements.

A16. 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 engagement¹⁸. Such matters may be required to be dealt with by either:

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

An example of (a) arises where the auditor of a company is required to state whether, in the auditor's opinion, the information given in the directors' report for the financial year for which the accounts are prepared is consistent with those accounts¹⁹. An example of (b) arises in the United Kingdom where company legislation requires the auditor of a company to report when a company has not maintained adequate accounting records²⁰. An example of (b) arises in Ireland where company legislation requires the auditor to report when the disclosures of directors' remuneration and transactions specified by law are not made²¹.

A17. Where the auditor has discharged such responsibilities and has nothing to report in respect of them, the conclusion could be expressed in the form of the following phrase: "We have nothing to report in respect of the following".

A18. Where the auditor expresses a modified conclusion in respect of other reporting responsibilities (including those on which they are required to report by exception) this may give rise to a modification 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 on the financial statements includes a qualified opinion or disclaimer of opinion arising from that limitation.²²

A18A. For entities that apply the UK Corporate Governance Code, the directors are required to give a statement in the annual report that they consider the annual report and accounts taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the entity's performance, business model and strategy. Such entities are also required to include a separate section of the annual report that

¹⁸ 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.

¹⁹ In the UK section 496 of the Companies Act 2006 and in Ireland section 15 of Companies (Amendment Act) 1986.

²⁰ Section 498(2) of the Companies Act 2006

²¹ Section 191(8) of the Companies Act 1963 and section 46 of the Companies Act 1990.

²² International Standard on Auditing (UK and Ireland) 705 "Modifications to the opinion in the independent auditor's report" sets out the requirements relating to qualified opinions and disclaimer of opinions on financial statements.

describes the work of the audit committee in discharging its responsibilities. This should include, inter alia, the significant issues that the audit committee considered in relation to the financial statements, including appropriate matters considered that were communicated to it by the auditor, and how these issues were addressed.

Date of Report (Ref: Para 23 – 24)

- A19. 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.
- A20. 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 the audit to take account of the need to ensure, before expressing an opinion on financial statements, that those charged with governance have approved the financial statements and any accompanying other information and that the auditor has completed a sufficient review of post balance sheet events.
- A21. The date of the auditor's report is, therefore, the date on which the auditor signs the auditor's report expressing an opinion on the financial statements for distribution with those financial statements, 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,
- A22. 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.

A23. 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 its procedures for reviewing subsequent events cover the period up to that date.

Auditor's Signature (Ref: Para 26)

A24. The report is signed in the name of the audit firm, the personal name of the auditor or both, as required by law. In the case of a UK company and certain other entities UK law requires:

- (a) where the auditor is an individual that the report is signed by the individual; or
- (b) where the auditor is a firm that the report is signed by the senior statutory auditor²³ in his or her own name, for and on behalf of the auditor.

In the case of an Irish company and certain other entities Irish law requires:

- where the auditor is a statutory auditor (a natural person) that the report is signed by that person; or
- where the auditor is a statutory audit firm:
 - that the report is signed by the statutory auditor designated by the statutory audit firm as being primarily responsible for carrying out the statutory audit on behalf of the audit firm; or
 - in the case of a group audit at least the statutory auditor designated by the statutory audit firm as being primarily responsible for carrying out the statutory audit at the level of the group;

in his or her own name, for and on behalf of, the audit firm²⁴.

²³ See Bulletin 2008/6 "The "Senior Statutory Auditor" under the United Kingdom Companies Act 2006". That Bulletin at paragraphs 8-10 also explains the meaning of "signing the auditor's report" in a UK context.

²⁴ See Statutory Instrument 220 of 2010.

Section 3 – Illustrative Disclosures in the Auditor’s Report

INDEPENDENT AUDITOR’S REPORT TO THE MEMBERS OF XYZ PLC

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Our assessment of risks significant to our audit

We identified the following risks that we believe to have had the greatest impact on our audit strategy and scope:

- The timing of revenue recognition, including that relating to long-term contracts in the Services business;
- Internal control failures in the Far Eastern businesses, including the risk of fraud and illegal payments;
- Impairment of fixed assets and goodwill in the European businesses; and
- The group’s exposure to unpredictable tax and legal risks in emerging markets.

Our assessment of materiality

We determined planning materiality¹ for the group to be £600 million (£550 million), which is below 5% (20X0 5%) of normalised¹ pre-tax profit, and below 1% (20X0 1%) of equity. On the basis of our risk assessments, together with our assessment of the group’s overall control environment, our judgment was that overall performance materiality¹ for the group should be 75% (20X0 75%) of planning materiality, namely £450 million (20X0 £413 million). Our objective in adopting this approach was to ensure that total detected and undetected audit differences in all accounts did not exceed our planning materiality level.

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £30 million (20X0 27.5 million), as well as differences below that threshold that, in our view warranted reporting on qualitative grounds.

Companies within the Group in emerging markets are defendants in certain legal actions alleging damage to the environment arising from the company’s activities. Often there is considerable uncertainty over both the merits of such claims and their ultimate outcome. Given that, in this case, the reasonable range of potential outcomes exceeded our quantitative measure of planning materiality, we evaluated materiality in relation to the disclosures about these matters qualitatively. Our evaluation was primarily based on our assessment of the extent to which a description of the uncertainties and of the range of potential outcomes, in the relevant notes to the financial statements, would be relevant to the economic decisions of a shareholder taken on the basis of the financial statements as a whole.

The scope of our audit

Our Group audit scope focused primarily on the audit work at 12 locations. Five of these were subject to a full audit, whilst the remaining seven were subject to a partial audit where the extent of our testing was based on our assessment of the risks of material misstatement and of the materiality of the Group’s business operations at those locations. These 12 locations represent the principal business units within the Group’s three reportable segments and account for 72% (68%) of the group’s total assets and 63% (66%) of the group’s profit before tax. They were also selected to provide an appropriate basis for

¹ The terms planning materiality, normalised pre-tax profit and performance materiality are explained in the description of the scope of an audit at www.frc.org.uk/apb/scope/private.cfm

undertaking audit work to address the risks of material misstatement identified above. We performed statutory audits at a further 60 (58) locations, which represent a further 25% (27%) of the group's total assets and 32% (29%) of the group's profit before tax. Our audit work at the 12 locations and our statutory audits were executed at levels of materiality applicable to each individual entity which were much lower than Group materiality.

The Group audit team continued to follow a programme of planned visits that has been designed to ensure that the Senior Statutory Auditor visits each of the locations where the Group audit scope was focused at least once every two years and the most significant of them at least once a year.

The Group has interests in a number of material joint ventures some of which are not operated by the Group and of which we are not the auditor. In all of these cases, the Group has audit rights that provide us with the necessary access in order to perform specific procedures. Approximately 18% (15%) of the Group's total assets 16% (17%) of the Group's profit before tax fell into this category.

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