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AUASB Meeting 23-24 February 2009
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EXPOSURE DRAFT

ED 03/09
(February 2009)

Proposed Auditing Standard ASA 706 *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report* (Revised and Redrafted) (Re-issuance of ASA 701)

Draft

Issued for Comment by the **Auditing and Assurance Standards Board**

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Australian Government
Auditing and Assurance Standards Board

Commenting on this Exposure Draft

Comments on this Exposure Draft should be forwarded so as to arrive by no later than 31 March 2009. Comments should be addressed to:

The Chairman
Auditing and Assurance Standards Board
PO Box 204
Collins Street West
Melbourne Victoria 8007
AUSTRALIA
E-mail: edcomments@auasb.gov.au

A copy of all non-confidential submissions will be placed on public record on the AUASB website: www.auasb.gov.au.

Obtaining a Copy of this Exposure Draft

This Exposure Draft is available on the AUASB website: www.auasb.gov.au. Alternatively, any individual or organisation may obtain one printed copy of this Exposure Draft without charge until no later than 31 March 2009 by contacting:

The Auditing and Assurance Standards Board
Level 7
600 Bourke Street
Melbourne Victoria 3000
AUSTRALIA

Phone: (03) 8080 7400
Fax: (03) 8080 7450
E-mail: enquiries@auasb.gov.au

Postal Address:
PO Box 204
Collins Street West
Melbourne Victoria 8007
AUSTRALIA

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Proposed Auditing Standard ASA 706
***Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report* (Revised and Redrafted) (Re-issuance of ASA 701)**

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PREFACE

Reasons for Issuing ED 03/09

The Auditing and Assurance Standards Board (AUASB) is proposing to re-issue Auditing Standard ASA 701 *Modifications to the Auditor's Report* pursuant to the requirements of the legislative provisions and the Strategic Direction explained below.

The AUASB is an independent statutory board of the Australian Government established under section 227A of the *Australian Securities and Investments Commission Act 2001*, as amended (ASIC Act). Under section 336 of the *Corporations Act 2001*, the AUASB may make Australian Auditing Standards for the purposes of the corporations legislation. These Auditing Standards are legislative instruments under the *Legislative Instruments Act 2003*.

The International Auditing and Assurance Standards Board (IAASB), an independent standard-setting board of the International Federation of Accountants (IFAC), has undertaken a programme to redraft, in "clarity" format, the entire suite of International Standards on Auditing (ISAs). In some cases, and in accordance with normal practice, the ISAs have been revised in addition to being redrafted. The redrafted ISAs are effective for audits of financial statements for periods beginning on or after 15 December 2009.

Under the Strategic Direction given to the AUASB by the Financial Reporting Council (FRC), the AUASB is required to have regard to any programme initiated by the IAASB for the revision and enhancement of the ISAs and to make appropriate consequential amendments to the Australian Auditing Standards. Accordingly, the AUASB has decided to revise and redraft the Australian Auditing Standards using the equivalent redrafted ISAs.

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Main Proposals

This proposed Auditing Standard establishes mandatory Requirements and provides Application and Other Explanatory Material regarding the auditor's responsibility to provide additional communication in the auditor's report when the auditor considers it necessary to draw users' attention to a matter.

Proposed Operative Date

It is intended that this proposed Auditing Standard will be operative for financial reporting periods commencing on or after 1 January 2010.

Main changes from existing ASA 701 *Modifications to the Auditor's Report* (April 2006)

The main differences between this proposed Auditing Standard and the Auditing Standard that it supersedes, ASA 701 *Modifications to the Auditor's Report* (April 2006 as amended), are included in the Tables of Differences provided as an attachment to this Exposure Draft.

Request for Comments

Comments are invited on this Exposure Draft of the proposed re-issuance of Auditing Standard ASA 701, *Modifications to the Auditor's Report* by no later than 31 March 2009. The AUASB is seeking comments on the main changes from the existing ASA 701. In addition, respondents are asked to consider and respond to the following questions:

1. Have applicable laws and regulations been appropriately addressed in the proposed standard?

2. Are there any references to relevant laws or regulations that have been omitted?

3. Are there any laws or regulations that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?

4. What, if any, are the additional significant costs to/benefits for auditors and the business community arising from compliance with the main changes to the Requirements of this proposed Auditing

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Standard? If there are significant costs, do these outweigh the benefits to the users of audit services?

5. Are there any other significant public interest matters that constituents wish to raise?

The AUASB prefers that respondents express a clear opinion on whether the main changes to the Requirements of this proposed Auditing Standard are supported and that this opinion be supplemented by detailed comments, whether supportive or critical, on the above matters. The AUASB regards both supportive and critical comments as essential to a balanced review of the Auditing Standard.

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AUASB Information Note

The IAASB's "Clarity" project is not yet complete, and accordingly there is a possibility that the equivalent underlying ISA standard to this Exposure Draft will include conforming amendments arising from standards not yet approved by the IAASB. While all currently known conforming amendments are incorporated into this Exposure Draft, readers are advised that the AUASB may decide to make further conforming amendments, in line with those of the IAASB.

AUTHORITY STATEMENT

The Auditing and Assurance Standards Board (AUASB) makes this Auditing Standard ASA 706 *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report* (Revised and Redrafted) pursuant to section 227B of the *Australian Securities and Investments Commission Act 2001* and section 336 of the *Corporations Act 2001*.

This Auditing Standard is to be read in conjunction with ASA 100 *Preamble to AUASB Standards*, which sets out the intentions of the AUASB on how the Australian Auditing Standards are to be understood, interpreted and applied.

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AUDITING STANDARD ASA 706

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

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Application

Aus 0.1 This Auditing Standard applies to:

(a) an audit of a financial report or a single financial statement for a financial year, or an audit of a financial report for a half-year, in accordance with ~~Part 2M.3 of~~ the *Corporations Act 2001*; and

(b) an audit of a financial report or a complete set of financial statements for any other purpose.

Aus 0.2 This Auditing Standard also applies, as appropriate, to an audit of other historical financial information.

Operative Date

Aus 0.3 This Auditing Standard is operative for financial reporting periods commencing on or after 1 January 2010.

Introduction

Scope of this ASA

1. This Auditing Standard deals with the auditor's responsibility regarding additional communication in the auditor's report when the auditor considers it necessary to:

(a) Draw users' attention to a matter or matters presented or disclosed in the financial ~~statements~~report that are of such importance that they are fundamental to users' understanding of the financial ~~statements~~report; or

(b) Draw users' attention to any matter or matters other than those presented or disclosed in the financial ~~statements~~report that are relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

2. Appendices 1 and 2 identify ~~ISAs~~ Australian Auditing Standards that contain specific requirements for the auditor to include Emphasis of Matter paragraphs or Other Matter paragraphs in the auditor's report. In those circumstances, the requirements in this ~~ISA~~ Auditing Standard regarding the form and placement of such paragraphs apply.

Effective Date

3. [Deleted by the AUASB. Refer Aus 0.3]

Objective

4. The objective of the auditor, having formed an opinion on the financial ~~statements~~report, is to draw users' attention, when in the auditor's judgment it is necessary to do so, by way of clear additional communication in the auditor's report, to:

   (a) A matter, although appropriately presented or disclosed in the financial ~~statements~~report, that is of such importance that it is fundamental to users' understanding of the financial ~~statements~~report; or

   (b) As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

Definitions

5. For the purposes of the Australian Auditing Standards, the following terms have the meanings attributed below:

   (a) Emphasis of Matter paragraph ~~—~~means a~~A~~ paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial ~~statements~~report that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial ~~statements~~report.

   (b) Other Matter paragraph ~~—~~means a~~A~~ paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial ~~statements~~report that, in the auditor's judgment, is relevant to users'

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understanding of the audit, the auditor's responsibilities or the auditor's report.

Requirements

Emphasis of Matter Paragraphs in the Auditor's Report

6. If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial ~~statements~~report that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial ~~statements~~report, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial ~~statements~~report. Such a paragraph shall refer only to information presented or disclosed in the financial ~~statements~~report. (Ref: Para. A1-A2)

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

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

   (b) Use the heading "Emphasis of Matter," or other appropriate heading;

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

   (d) Indicate that the auditor's opinion is not modified in respect of the matter emphasis~~z~~ed. (Ref: Para. A3-A4)

Aus 7.1 When the financial report has been prepared in accordance with Australian Accounting Standards but additional disclosures have been made in the financial report on the basis that, or which imply that, application of a particular Accounting Standard has resulted in the financial report being potentially misleading, and the auditor is of the opinion that:

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(a) it is likely, in the absence of the additional disclosures, that users would be misled when making evaluations or decisions about the allocation of scarce resources; and

(b) the additional disclosures contain all, and only, relevant and reliable information, and are presented in such a manner as to ensure the financial report as a whole is comparable and understandable in meeting the objectives of the financial report,

the auditor's report shall include an emphasis of matter paragraph headed "Application of Australian Accounting Standard AASB ..." which:

(i) draws attention to the additional disclosures;

(ii) states that in the auditor's opinion application of the particular Accounting Standard has, in this instance, resulted in the financial report being potentially misleading;

(iii) states the specific reasons why the auditor believes the additional disclosures are necessary to ensure the financial report as a whole is not misleading (the auditor's reasons are to be stated in the auditor's report itself rather than only by reference to the reasons included in the financial report); and

(iv) states that, in the auditor's opinion, the additional disclosures are relevant and reliable in meeting the objectives of the financial report.

Other Matter Paragraphs in the Auditor's Report

8. If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial ~~statements~~report that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report and this is not prohibited by law or regulation, the auditor shall do so in a paragraph in the auditor's report, with the heading "Other Matter," or other appropriate heading. The auditor

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shall include this paragraph immediately after the Opinion paragraph and any Emphasis of Matter paragraph, or elsewhere in the auditor's report if the content of the Other Matter paragraph is relevant to the Other Reporting Responsibilities section. (Ref: Para. A5-A11)

Communication with Those Charged with Governance

9. If the auditor expects to include an Emphasis of Matter or an Other Matter paragraph in the auditor's report, the auditor shall communicate with those charged with governance regarding this expectation and the proposed wording of this paragraph. (Ref: Para. A12)

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Application and Other Explanatory Material

Emphasis of Matter Paragraphs in the Auditor's Report

Circumstances in Which an Emphasis of Matter Paragraph May Be Necessary (Ref: Para. 6)

A1. Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:

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

A2. A widespread use of Emphasis of Matter paragraphs diminishes the effectiveness of the auditor's communication of such matters. Additionally, to include more information in an Emphasis of Matter paragraph than is presented or disclosed in the financial ~~statements~~report may imply that the matter has not been appropriately presented or disclosed; accordingly, paragraph 6 limits the use of an Emphasis of Matter paragraph to matters presented or disclosed in the financial ~~statements~~report.

Including an Emphasis of Matter Paragraph in the Auditor's Report (Ref: Para. 7)

A3. The inclusion of an Emphasis of Matter paragraph in the auditor's report does not affect the auditor's opinion. An Emphasis of Matter paragraph is not a substitute for either:

(a) The auditor expressing a qualified opinion or an adverse opinion, or disclaiming an opinion, when required by the

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circumstances of a specific audit engagement (see A~~I~~SA 705 (Revised and Redrafted)[1]); or

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

A4. The illustrative report in Appendix 3 includes an Emphasis of Matter paragraph in an auditor's report that contains a qualified opinion.

Aus A4.1 When an auditor's report is prepared on a financial report prepared under the *Corporations Act 2001*, section 308(3B) requires that if the financial report includes additional information under paragraph 295(3)(c) (additional information included to give a true and fair view of the entity's financial position and performance), the auditor's report includes the auditor's opinion on whether the additional information was necessary to give a true and fair view. Appendix 3, Illustration 2 provides an example of such reporting requirements in the context of the circumstances described in paragraph Aus 7.1 of this Auditing Standard. See also ASA 700 (Revised and Redrafted) for Requirements and explanatory guidance on other reporting responsibilities.

Other Matter Paragraphs in the Auditor's Report (Ref: Para. 8)

Circumstances in Which an Other Matter Paragraph May Be Necessary

Relevant to Users' Understanding of the Audit

A5. In the rare circumstance where the auditor is unable to resign from an engagement even though the possible effect of an inability to obtain sufficient appropriate audit evidence due to a limitation on the scope of the audit imposed by management is pervasive,[2] the auditor may consider it necessary to include an Other Matter paragraph in the auditor's report to explain why it is not possible for the auditor to resign from the engagement.

---

[1] See A~~I~~SA 705 (Revised and Redrafted)~~,~~ "*Modifications to the Opinion in the Independent Auditor's Report*."

[2] See paragraph 13(b)(ii) of A~~I~~SA 705 (Revised and Redrafted) for a discussion of this circumstance.

Relevant to Users' Understanding of the Auditor's Responsibilities or the Auditor's Report

A6. Law, regulation or generally accepted practice in a jurisdiction may require or permit the auditor to elaborate on matters that provide further explanation of the auditor's responsibilities in the audit of the financial ~~statements~~report or of the auditor's report thereon. Where relevant, one or more sub-headings may be used that describe the content of the Other Matter paragraph.

A7. An Other Matter paragraph does not deal with circumstances where the auditor has other reporting responsibilities that are in addition to the auditor's responsibility under the ~~ISAs~~ Australian Auditing Standards to report on the financial ~~statements~~report (see "Other Reporting Responsibilities" section in A~~I~~SA 700 (Revised and Redrafted)[3]), or where the auditor has been asked to perform and report on additional specified procedures, or to express an opinion on specific matters.

Reporting on more than one ~~set of~~ financial ~~statements~~report

A8. An entity may prepare one ~~set of~~ financial ~~statements~~report in accordance with a general purpose framework (e.g., the national framework) and another ~~set of~~ financial ~~statements~~report in accordance with another general purpose framework (e.g., International Financial Reporting Standards), and engage the auditor to report on both ~~sets of~~ financial ~~statements~~reports. If the auditor has determined that the frameworks are acceptable in the respective circumstances, the auditor may include an Other Matter paragraph in the auditor's report, referring to the fact that another ~~set of~~ financial ~~statements~~report has been prepared by the same entity in accordance with another general purpose framework and that the auditor has issued a report on ~~those~~that financial ~~statements~~report.

Restriction on distribution or use of the auditor's report

A9. A f~~F~~inancial ~~statements~~report prepared for a specific purpose may be prepared in accordance with a general purpose framework because the intended users have determined that such general purpose financial ~~statements~~ report meets their financial information

[3] See ~~[~~A~~I~~SA 700 (Revised and Redrafted)~~,~~ ~~"~~*Forming an Opinion and Reporting on a Financial ~~Statements~~Report*,~~"~~ paragraph [to be inserted].]

needs. Since the auditor's report is intended for specific users, the auditor may consider it necessary in the circumstances to include an Other Matter paragraph, stating that the auditor's report is intended solely for the intended users, and should not be distributed to or used by other parties.

Including an Other Matter Paragraph in the Auditor's Report

A10. The content of an Other Matter paragraph reflects clearly that such other matter is not required to be presented and disclosed in the financial ~~statements~~report. An Other Matter paragraph does not include information that the auditor is prohibited from providing by law, regulation or other standards, for example, ethical standards relating to confidentiality of information. An Other Matter paragraph also does not include information that is required to be provided by management.

A11. The placement of an Other Matter paragraph depends on the nature of the information to be communicated. When an Other Matter paragraph is included to draw users' attention to a matter relevant to their understanding of the audit of the financial ~~statements~~report, the paragraph is included immediately after the Opinion paragraph and any Emphasis of Matter paragraph. When an Other Matter paragraph is included to draw users' attention to a matter relating to Other Reporting Responsibilities addressed in the auditor's report, the paragraph may be included in the section sub-titled "Report on Other Legal and Regulatory Requirements." Alternatively, when relevant to all the auditor's responsibilities or users' understanding of the auditor's report, the Other Matter paragraph may be included as a separate section following the Report on the Financial ~~Statements~~Report and the Report on Other Legal and Regulatory Requirements.

Communication with Those Charged with Governance (Ref:~~-~~ Para. 9)

A12. Such communication enables those charged with governance to be made aware of the nature of any specific matters that the auditor intends to highlight in the auditor's report, and provides them with an opportunity to obtain further clarification from the auditor where necessary. Where the inclusion of an Other Matter paragraph on a particular matter in the auditor's report recurs on each successive engagement, the auditor may determine that it is unnecessary to repeat the communication on each engagement.

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Conformity with International Standards on Auditing

Except as noted below, this Auditing Standard conforms with International Standard on Auditing ISA 706 *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report* (Revised and Redrafted), issued by the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting board of the International Federation of Accountants (IFAC).

Paragraphs that have been added to this Auditing Standard (and do not appear in the text of the equivalent ISA) are identified with the prefix "Aus".

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The main difference between this Auditing Standard and ISA 706 is:

- This Auditing Standard includes the following Requirement that is not included as a Requirement in ISA 706:

  - When the financial report has been prepared in accordance with Australian Accounting Standards but additional disclosures have been made in the financial report on the basis that, or which imply that, application of a particular Accounting Standard has resulted in the financial report being potentially misleading, and the auditor is of the opinion that:

    (a) it is likely, in the absence of the additional disclosures, that users would be misled when making evaluations or decisions about the allocation of scarce resources; and

    (b) the additional disclosures contain all, and only, relevant and reliable information, and are presented in such a manner as to ensure the financial report as a whole is comparable and understandable in meeting the objectives of the financial report,

    the auditor's report shall include an emphasis of matter paragraph headed "Application of Australian Accounting Standard AASB ..." which:

    (i) draws attention to the additional disclosures;

(ii) states that in the auditor's opinion application of the particular Accounting Standard has, in this instance, resulted in the financial report being potentially misleading;

(iii) states the specific reasons why the auditor believes the additional disclosures are necessary to ensure the financial report as a whole is not misleading (the auditor's reasons are to be stated in the auditor's report itself rather than only by reference to the reasons included in the financial report); and

(iv) states that, in the auditor's opinion, the additional disclosures are relevant and reliable in meeting the objectives of the financial report. (Paragraph Aus 7.1)

Compliance with this Auditing Standard enables compliance with ISA 706.

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Appendix 1

(Ref: Para. 2)

List of ~~ISAs~~ Australian Auditing Standards Containing Requirements for Emphasis of Matter Paragraphs

This appendix identifies paragraphs in other ~~ISAs~~ Australian Auditing Standards as at [~~December 31, 2008~~1 January 2010] that require the auditor to include an Emphasis of Matter paragraph in the auditor's report in certain circumstances. The list is not a substitute for considering the requirements and related application and other explanatory material in ~~ISAs~~the Australian Auditing Standards.

~~[Proposed]~~ A~~I~~SA 210 (Revised and Redrafted)~~,~~ ~~"~~*Agreeing the Terms of Audit Engagements*~~"~~ – paragraph [19]

A~~I~~SA 560 (Revised and Redrafted)~~,~~ ~~"~~*Subsequent Events*~~"~~ – paragraphs 12(b) and 16

A~~I~~SA 570 (Revised and Redrafted)~~,~~ ~~"~~*Going Concern*~~"~~ – paragraph 19

ASA 800 (Revised and Redrafted) *Special Considerations—Audit~~s~~ of a Financial Report Prepared in Accordance with a Special Purpose Framework~~s~~* – paragraph 14

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Appendix 2

(Ref: Para. 2)

List of Australian Auditing Standards ~~ISAs~~ Containing Requirements for Other Matter Paragraphs

This appendix identifies paragraphs in other Australian Auditing Standards ~~ISAs~~ as at [~~December 31, 2008~~1 January 2010] that require the auditor to include an Other Matter paragraph in the auditor's report in certain circumstances. The list is not a substitute for considering the requirements and related application and other explanatory material in ~~ISAs~~the Australian Auditing Standards.

A~~I~~SA 560 (Revised and Redrafted)~~,~~ ~~"~~*Subsequent Events*~~"~~ – paragraphs 12(b) and 16

~~[Proposed]~~ A~~I~~SA 710 (Revised and Redrafted)~~,~~ ~~"~~*Comparative Information—Corresponding Figures and Comparative Financial ~~Statements~~Reports*~~"~~ – paragraphs [12-13] and [15-16]

A~~I~~SA 720 (Revised and Redrafted)~~,~~ ~~"~~*The Auditor's Responsibility in Relation to Other Information in Documents Containing an Audited Financial ~~Statements~~Report*~~"~~ – paragraph 10

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Appendix 3

(Ref: Para. A4)

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

Illustration 1

Circumstances include the following:

- **Audit of a ~~complete set of~~ general purpose financial ~~statements~~ report prepared by management of the entity in accordance with ~~International Financial Reporting~~ Australian Accounting Standards.**
- **The terms of the audit engagement reflect the description of management's responsibility for the financial ~~statements~~ report in ~~[proposed]~~ A~~I~~SA 210 (Revised and Redrafted).**[4]
- **There is uncertainty relating to a pending exceptional litigation matter.**
- **A departure from the applicable financial reporting framework resulted in a qualified opinion.**
- **In addition to the audit of the financial ~~statements~~report, the auditor has other reporting responsibilities required under local law.**

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Report on the Financial ~~Statements~~Report[5]

[4] ~~[Proposed]~~ See A~~I~~SA 210~~,~~ ~~"~~*Agreeing the Terms of Audit Engagements.*~~"~~

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We have audited the accompanying financial ~~statements~~report of ABC Company, which comprises the ~~balance sheet~~statement of financial position as at ~~December 31~~30 June, 20X1, and ~~the~~ the statement of comprehensive income ~~statement~~, statement of changes in equity and statement of cash flows ~~statement~~ for the year then ended, and notes comprising a summary of significant accounting policies and other explanatory information.

Management's[6] *Responsibility for the Financial ~~Statements~~Report*

Management is responsible for the preparation and fair presentation[7] of the~~se~~ financial ~~statements~~report in accordance with ~~International Financial Reporting~~Australian Accounting Standards; this includes the ~~design, implementation~~establishment and maintenance of internal control relevant to the preparation and fair presentation of the financial ~~statements~~report that ~~are~~ is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the~~se~~ financial ~~statements~~report based on our audit. We conducted our audit in accordance with ~~International Standards on~~ Australian Auditing Standards. Those standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance about whether the financial ~~statements~~report ~~are~~ is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial ~~statements~~report. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial ~~statements~~report, whether due to fraud or error. In making those risk assessments, the auditor considers

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

6 Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

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

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internal control relevant to the entity's preparation and fair presentation[8] of the financial ~~statements~~report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.[9] An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial ~~statements~~report.

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

Basis for Qualified Opinion

The company's short-term marketable securities are carried in the ~~balance sheet~~statement of financial position at xxx. Management has not marked these securities to market but has instead stated them at cost, which constitutes a departure from ~~International Financial Reporting~~ Australian Accounting Standards. The company's records indicate that had management marked the marketable securities to market, the company would have recognis~~z~~ed an unreals~~z~~ed loss of xxx in the ~~income~~ statement of comprehensive income for the year. The carrying amount of the securities in the ~~balance sheet~~statement of financial position would have been reduced by the same amount at 30 June~~December 31~~, 20X1, and income tax, net income and shareholders' equity would have been reduced by xxx, xxx and xxx, respectively.

Qualified Opinion

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial ~~statements~~report presents fairly, in

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

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

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all material respects (or "give a true and fair view of") the financial position of ABC Company as at 30 June~~December 31~~, 20X1, and of its financial performance and its cash flows for the year then ended in accordance with ~~International Financial Reporting~~ Australian Accounting Standards.

Emphasis of Matter

We draw attention to Note X to the financial statements which describes the uncertainty[10] related to the outcome of the lawsuit filed against the company by XYZ Company. Our opinion is not qualified in respect of this matter.

Report on Other Legal and Regulatory Requirements (see "Other Reporting Responsibilities" section in A~~I~~SA 700 (Revised and Redrafted))

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

[Auditor's signature][*]

[Date of the auditor's report]

[Auditor's address]

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

[*] The auditor's report needs to be signed in one or more of the name of the audit firm, the name of the audit company or the personal name of the auditor as appropriate.

Illustration of an Auditor's Report that Includes an Emphasis of Matter Paragraph – concurrence with 'additional disclosures'

Illustration 2

Circumstances include the following:

- **Audit of a general purpose financial report prepared by the directors of a company in accordance with the *Corporations Act 2001* and the Australian Accounting Standards.**
- **The directors have included a statement of compliance with International Financial Reporting Standards in accordance with AASB 101.**
- **The terms of the audit engagement reflect the description of management's responsibility for the financial report in ASA 210 (Revised and Redrafted).**[11]
- **Application of the ~~ABC~~XXX method of accounting for (item) in accordance with Accounting Standard AASB 10XX has not resulted in the financial report giving a true and fair view as required by the *Corporations Act 2001*. Accordingly, the directors have provided additional disclosures.**
- **The auditor is required by section 308 (3B) of the *Corporations Act 2001* to express an opinion on the additional information. The auditor concurs with the additional information.**
- **In addition to the audit of the financial report, the auditor has other reporting responsibilities required under local law.**

[11] See ASA 210 *Agreeing the Terms of Audit Engagements*.

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INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Report on the Financial Report[12]

We have audited the accompanying financial report of ABC Company, which comprises the ~~balance sheet~~ statement of financial performance at 30 June 20X1, and the ~~income~~ statement of comprehensive income, statement of changes in equity and statement of cash flows ~~statement~~ for the year then ended, and notes comprising a summary of significant accounting policies, other explanatory information and the directors' declaration.

Directors' Responsibility for the Financial Report

The directors of the company are responsible for the preparation and presentation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards ~~(including the Australian Accounting Interpretations)~~ and the *Corporations Act 2001*; this ~~responsibility~~ includes the ~~design, implementation~~establishment and maintenance of internal control relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error. In Note XX, the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that ~~compliance with the Australian equivalents to International Financial Reporting Standards ensures that~~the financial report~~, comprising the financial statements and notes,~~ complies with International Financial Reporting Standards.[#]

Auditor's Responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. Those standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance about whether the financial report is free from material misstatement.

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

[#] Insert only where the entity has included in the notes to the financial statements, an explicit and unreserved statement of compliance with *International Financial Reporting Standards* in accordance with AASB 101.

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An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and presentation of the financial report that gives a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

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

Independence

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*.

Opinion

In our opinion:

(c) the financial report of [name of company]is in accordance with the *Corporations Act 2001*, including:

(i) giving a true and fair view of the company's financial position as at 30 June 20X1 and of its performance for the year ended on that date; and

(ii) complying with Australian Accounting Standards ~~(including the Australian Accounting Interpretations)~~ and the *Corporations Regulations 2001*; and

(d) the financial report also complies with International Financial Reporting Standards as disclosed in Note XX.

Application of Australian Accounting Standard AASB 10XX

Without qualification to the opinion expressed above, attention is drawn to the following matter. As required by the *Corporations Act 2001*, the

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company has, in the preparation of its ~~balance sheet~~statement of financial position and ~~income~~ statement of comprehensive income, applied the ~~ABC~~XXX method of accounting for (item) in accordance with Accounting Standard AASB 10XX.

The directors are of the opinion, however, that application of the ~~ABC~~XXX method has not resulted in the financial report giving a true and fair view as required by the *Corporations Act 2001* and is so misleading that it conflicts with the objectives of the AASB framework for the preparation and presentation of financial statements. The directors have therefore provided the additional disclosures in Note X which indicate that had the LMN method of accounting for (item) been adopted, the financial report would, in the directors' opinion, have given a true and fair view and would meet the objectives of the AASB framework for the preparation and presentation of financial statements . The effect of adopting the LMN method rather than the ~~ABC~~XXX method is disclosed in Note X.

Because of [state the auditor's reasons in full], it is our opinion that:

(a) application of the ~~ABC~~XXX method in accordance with Accounting Standard AASB 10XX has, in this instance, resulted in the treatment of (item) leading to the~~balance sheet~~ statement of financial position, the ~~income~~ statement of comprehensive income and statement of changes in equity being potentially misleading;

(b) the additional disclosures provided by the directors in Note X are necessary to give the true and fair view required by the *Corporations Act 2001* and ensure the financial report as a whole is not misleading; and

(c) the information in Note X, including application of the LMN method as the most appropriate alternative method, is relevant and reliable.

Report on Other Legal and Regulatory Requirements (see "Other Reporting Responsibilities" section in ASA 700 (Revised and Redrafted))

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

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[Auditor's signature][*]

[Date of the auditor's report]

[Auditor's address]

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[*] The auditor's report needs to be signed in one or more of the name of the audit firm, the name of the audit company or the personal name of the auditor as appropriate.

Tables of Differences — ASA 706 (Revised and Redrafted) and Extant ASA 701

Underlying Standard

ISA 706 *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report* (Redrafted or Revised and Redrafted) is used as the underlying Auditing Standard for the purpose of re-drafting this proposed Auditing Standard. The underlying Auditing Standard will be amended for the following matters:

- Australian Laws and Regulations (including the *Corporations Act 2001*);
- Changes considered necessary because this Auditing Standard is a legislative instrument; and
- Changes considered necessary in the public interest.

Summary of Main Differences — ASA 706 (Revised and Redrafted) and Extant ASA 701

The table below details the main differences (excluding editorial amendments) between this proposed Auditing Standard and extant ASA 701.

Requirements in ASA (Revised and Redrafted) not in Extant ASA

Item #	ASA (Revised and Redrafted)Para. #	ASA (Revised and Redrafted) Requirements	Commentary
Objectives			
1	4	The objective of the auditor, having formed an opinion on the financial report, is to draw users' attention, when in the auditor's judgment it is necessary to do so, by way of clear additional communication in the auditor's report, to: (a) A matter, although appropriately presented or disclosed in the financial report, that is of such importance that it is fundamental to users' understanding of the financial report; or	New Objective.

Item #	ASA (Revised and Redrafted)Para. #	ASA (Revised and Redrafted) Requirements	Commentary
		(b) As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.	
Definitions			
2	5	For the purposes of the Australian Auditing Standards, the following terms have the meanings attributed below: (a) Emphasis of Matter paragraph means a paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial report that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial report. (b) Other Matter paragraph means a paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial report that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.	New Definitions.
Emphasis of Matter Paragraphs in the Auditor's Report			
3	6	If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial report that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial report, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial report. Such a paragraph shall refer only to information presented or disclosed in the financial report.	New Requirement The new Requirement explicitly places responsibility on the auditor to determine whether or not to use an EOM. In addition, the appendix to ASA 706 lists those ASAs that (specifically) require an EOM.

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Item #	ASA (Revised and Redrafted)Para. #	ASA (Revised and Redrafted) Requirements	Commentary
4	7	When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall: (a) Include it immediately after the Opinion paragraph in the auditor's report; (b) Use the heading "Emphasis of Matter," or other appropriate heading; (c) Include in the paragraph a clear reference to the matter being emphasised and to where relevant disclosures that fully describe the matter can be found in the financial report; and (d) Indicate that the auditor's opinion is not modified in respect of the matter emphasised	Elevation of extant ASA Explanatory Guidance [Extant ASA 701 para 8 *and* illustrative examples 1 and 2 in Appendix 2—equivalent Explanatory Guidance]
Other Matter Paragraphs in the Auditor's Report			
5	8	If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial report that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report and this is not prohibited by law or regulation, the auditor shall do so in a paragraph in the auditor's report, with the heading "Other Matter," or other appropriate heading. The auditor shall include this paragraph immediately after the Opinion paragraph and any Emphasis of Matter paragraph, or elsewhere in the auditor's report if the content of the Other Matter paragraph is relevant to the Other Reporting Responsibilities section.	New Requirement NOTE: An "Other Matter" paragraph is not to be confused with "Report on Other Legal and Regulatory Requirements" which is dealt with in ASA 700 (R&R) paras 38 and 39.
Communication with Those Charged with Governance			
6	9	If the auditor expects to include an Emphasis of Matter or an Other Matter	New Requirement.

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Item #	ASA (Revised and Redrafted)Para. #	ASA (Revised and Redrafted) Requirements	Commentary
		paragraph in the auditor's report, the auditor shall communicate with those charged with governance regarding this expectation and the proposed wording of this paragraph.	NOTE: Although a new requirement in this standard, the equivalent obligation currently exists in extant ASA 260 *Communication of Audit Matters with Those Charged with Governance* [see Requirement para 15 and Guidance para 16].

Requirements in Extant ASA not in ASA (Revised and Redrafted)

Item #	Extant ASA Para. #	Extant ASA Requirements	Commentary
Significant Uncertainty – Going Concern			
1	9	The auditor shall modify the auditor's report by adding a paragraph to highlight a significant uncertainty regarding a going concern problem	NOTE: The equivalent requirement is (now) found in ASA 570 (R&R) *Going Concern* paras 18 & 19. Therefore there is no reduction in an auditor's obligations, merely a re-location of the Requirement.
2	11	The auditor shall modify the auditor's report by adding a paragraph if there is a significant uncertainty (other than a significant uncertainty regarding a going concern problem), the resolution of which is dependent upon future events and which may materially affect the financial report.	NOTE: The equivalent requirement is found in ASA 706 (R&R) paras 6. This Requirement does not specifically refer to "uncertainty" however, the

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Item #	Extant ASA Para. #	Extant ASA Requirements	Commentary
			related guidance at para A1 lists "uncertainly" as one of the examples of circumstances that may prompt an EOM. One example of the long-standing difference between ISAs and ASAs whereby the ASA *prescribes* this circumstance where an EOM paragraph is required, however, the ISA leaves it to the auditor's judgement.
3	17	When information in a document containing the audited financial report is materially inconsistent with that financial report, the auditor's report shall include an emphasis of matter section describing the material inconsistency.	NOTE: The equivalent requirement is now found in ASA 720 (R&R) paras 10 (a) [*Other Information in Documents Containing the Audited Financial Report*]. In these circumstances, an "Other Matter" paragraph is now required whereas under the extant standard, an EOM paragraph was required. Therefore there is no reduction in an auditor's obligations, merely a change in format of the Requirement.
4	19	When a financial report and the auditor's report thereon have been issued, and a fact is discovered that leads those charged with governance to prepare a revised financial report, the new auditor's report on the revised financial report shall include an emphasis of matter paragraph. That paragraph shall refer to a note to the financial statements that more extensively discusses the reason for the revision of the previously issued financial report, and to the earlier report issued by the auditor.	NOTE: The equivalent requirement is now found in ASA 560 (R&R) para 16 [*Subsequent Events*]. In these circumstances, an "Other Matter" paragraph is now permitted as an alternative to an EOM paragraph. Therefore there is no reduction in an auditor's obligations, merely a re-location of the Requirement and an alternative format now permitted.

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Significant Differences in Guidance —ASA (Revised and Redrafted) and Extant ASA

Item #	ASA (Revised and Redrafted) Para. #	ASA (Revised and Redrafted) Guidance	Commentary
Other Matter Paragraphs in the Auditor's Report Restriction on distribution or use of the auditor's report			
1	A9	A financial report prepared for a specific purpose may be prepared in accordance with a general purpose framework because the intended users have determined that such general purpose financial report meets their financial information needs. Since the auditor's report is intended for specific users, the auditor may consider it necessary in the circumstances to include an Other Matter paragraph, stating that the auditor's report is intended solely for the intended users, and should not be distributed to or used by other parties.	New guidance on distribution and use of the *auditor's report* relating to a special purpose financial report.

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