



EUROPEAN COMMISSION

Internal Market and Services DG

FREE MOVEMENT OF CAPITAL, COMPANY LAW AND CORPORATE GOVERNANCE
Director

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Brussels,
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Mr Jim Sylph
International Auditing and
Assurance Standards Board
by e-mail: Edcomments@ifac.org

Subject: Comment on the Exposure Draft of Proposed ISA 706 (Revised and Redrafted) – *Emphasis of Matter Paragraphs ('EOM') and Other Matter Paragraphs ('OM') in the Independent Auditor's Report*

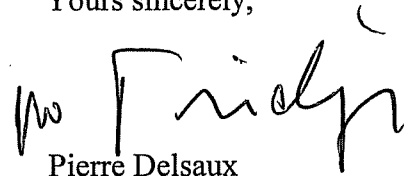
Dear Mr Sylph,

1. We appreciate the opportunity to comment on the IAASB proposal for a redrafted International Standard on Auditing on emphasis of matter and other information to be found in the auditor's report. Our comments should be read in conjunction with the comments provided to the IAASB on the exposure draft of ISA 700.
2. Proposed ISA 706 clarifies how the auditor can emphasize information in the financial statements or add other information in the auditor's report. We subscribe to the purpose of this ISA. We noticed however an apparent loss of the general thrust during the clarification process of this ISA, leading finally to less clarity for practitioners, audit regulators and investors. We believe a number of items should be further clarified:
 - We call for a clearer, "cross ISA" presentation and consistency of 'Other Matters' paragraph, their respective scope, content and limitations. The interplay of ISA 700, 706 and 720, all dealing to a certain extent with Other Matters paragraphs, should be explained. We suggest to place these explanations in ISA 706;
 - ISA 706 should distinguish more clearly in para. 6, 7 and 9 the situations where the auditor is required to include an EOM or an OM by law, regulation or ISAs, from the situations where the auditor applies professional judgement in deciding to make use of such paragraphs. In particular, ISA 706 should state in a much clearer way the boundaries within which an auditor may decide to make use of an Other Matters paragraph;
 - The messages in the application material are sometimes confusing, such as in para. A3 or A7. Para. A3 describes a situation where an auditor would include more information in an EOM than what is in the financial statements. In our

opinion this could typically be a situation where the auditor's report should be qualified. We support the deletion of para. A3, or alternatively a thorough redrafting towards consistency. We explain further in Annex our views on para. A7.

3. I would like to emphasise that this comment letter cannot pre-empt any future official position of the European Commission. In particular, our position on the above ISA, and the objectives therein, may be modified depending on the outcome of the future revision of other ISA's in the frame of the Clarity Project.
4. The comments in this letter have taken account of the views expressed within the European Group of Auditors' Oversight Bodies (EGAOB), and/or within the 'ISA Sub-group' of the EGAOB. The ISA Sub-group is comprised of participants from European organisations including audit regulators, standard setters on auditing, professional bodies, and companies. Those comments may not necessarily reflect in all circumstances unanimous views of the members of the EGAOB and/or of the participants to the EGAOB ISA Sub-group.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Pierre Delsaux', with a stylized flourish at the end.

Pierre Delsaux

Cc: Jürgen Tiedje, European Commission, Members of the EGAOB.

The acronyms 'EOM' and 'OM' in this letter are used to refer respectively to Emphasis of Matter paragraph, and Other Matter paragraph.

REQUEST FOR SPECIFIC COMMENTS

Is the Objective of the auditor appropriate?

1. The objective refers to additional communication in the auditor's report only when such communication is appropriate. The objective seems to not address the cases where it is necessary – usually by law or regulation or ISAs – to use an EOM or an OM. We recommend that para. 6 also refers to mandatory communication.
2. Our final position on the objective may also depend on the outcome of the ongoing revision of ISA 200.

Identification of requirements

3. We see the general thrust of this ISA as follows:
 - The auditor may refer to information stated in the financial statements via an EOM, based on his professional judgement. The auditor shall make use of an EOM in circumstances specified by law, regulation or ISA.
 - In rare and duly justified circumstances, the auditor may decide to use an OM to dispense further information relevant for the understanding of issues not covered by an audit opinion elsewhere in the report. This means e.g. that an OM should include no material relating directly to the financial statements. In circumstances specified by law, regulation or ISA, he shall make use of an OM.
4. We explain in the cover letter that one of the reasons the above is not fully reflected in the exposure draft may be that a number of ISAs refer to OM (ISA 700, ISA 720, ISA 706) and that insufficient explanations on the articulation is provided.
5. Other reasons are to be found in the body of ISA 706. We have identified the following:
 1. **EOM**: para. 7 starts with the words 'when the auditor considers it appropriate...'. This is a problem as it may appear that by construct, para. 7 rules out the case where the auditor is required by ISAs, laws or regulation to include an EOM in the auditor's report. In addition the guidance describing the circumstances when the auditor shall use an EOM is located in A1 and A2, attaching to paragraph 3. We therefore suggest:
 - 1.1. to at least modify the wording of para 7 so as to also include the cases where the auditor is required by law, regulation or ISAs to include an EOM;
 - 1.2. to cross reference para. A1 and A2 with para 7 instead of para 3;
 - 1.3. to modify the chapeau sentence of A1 so as to clarify that the circumstances described here are such that the auditor is required to use an EOM, instead of 'considering' the use; and

- 1.4. to repeat the essence of para. 3 as essential guidance to para 7.
2. **OM:** Para. 4 and 9 should distinguish the use of an OM under law, regulation or ISA (with reference to ISA 700 and ISA 720), from the case where an auditor decides to provide information. In the latter case, the limits should be clearly spelled out. For instance, the requirements and application material should underpin in conjunction that the auditor may dispense further information in an OM only in rare and duly justified circumstances, to the extent the matters in the OM are not already covered elsewhere in the auditor's report, etc.
 3. The examples given in A7 (b) and A7 (c) in the cases where an auditor decides to make use of an OM are ambiguous, at least in a European context. ISA 706 should contain much clearer examples. We support deleting the examples, should ISA 706 specify the limitations to the possible content of an OM. Para 7(b) refers to an environment where a reference to a predecessor auditor's report is "permitted". Assuming this ISA would apply in a jurisdiction mandating such reference, there are many chances that the auditor would include a reference to the predecessor auditor opinion directly in the body of the opinion. Assuming the law would be silent but permitting such reference, we disagree with ISA 706 encouraging the use of an OM whereas our understanding is that nowhere else in the ISAs is it encouraged to refer to a predecessor report. Para. 7(c)'s example of an auditor explaining why he cannot resign seems to not add much value.
 6. The auditor should obtain sufficient and appropriate audit evidence for the other matter paragraph, as is required for the emphasis of matter paragraph. For example, in the situation of paragraph A7 (a), where information contained in the other material is inconsistent with the audited financial statements, we would expect that the auditor not only reports such information according to ISA 720, but also that he needs to obtain sufficient and appropriate audit evidence underlying his findings and the Other Matter paragraph. We invite the IAASB to amend ISA 706 accordingly.

Special considerations in the audit of small entities, public sector entities, developing nations and translations

7. We have identified no issues specific to these areas.