



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

22 September 2005

By e-mail < EDComments@ifac.org > and by fax (0062 1 212 286 9570)

Our Ref.: C/AASC

Technical Director,
International Auditing and Assurance Standards Board,
International Federation of Accountants,
545 Fifth Avenue, 14th Floor,
New York,
New York 10017,
USA.

Dear Sir,

[IAASB Exposure Drafts on ISA 705 “Modifications to the Opinion in the Independent Auditor’s Report” and ISA 706 “Emphasis of Matter Paragraphs and Other Matters Paragraphs in the Independent Auditor’s Report”](#)

The Hong Kong Institute of Certified Public Accountants welcomes the opportunity to provide you with our comments on the captioned IAASB Exposure Drafts.

--- We set out in the attachment our comments on the proposed ISA 705 and ISA 706 for your consideration.

We trust that our comments are of assistance to you. If you require any clarifications on our comments, please contact the undersigned at schan@hkiipa.org.hk.

Yours faithfully,

Stephen Chan
Executive Director

SSLC/PM/jc
Encl.



ATTACHMENT

**HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS' COMMENTS ON
THE IAASB EXPOSURE DRAFTS ON ISA 705 "MODIFICATIONS TO THE OPINION
IN THE INDEPENDENT AUDITOR'S REPORT" AND ISA 706 "EMPHASIS OF
MATTER PARAGRAPHS AND OTHER MATTERS PARAGRAPHS IN THE
INDEPENDENT AUDITOR'S REPORT"**

We are supportive of the proposed ISA 705 and ISA 706 and believe it is both important and helpful to practitioners. However, we have the following key and other specific comments which we request that they be considered carefully by the IAASB before finalizing the ISAs.

We believe that by splitting the former ISA 700 into ISA 700 revised and new ISAs 705 and 706, practitioners may be confused as to where to find relevant guidance when faced with a particular reporting matter and more important, they may be distracted from the notion that, despite the various modifications and emphases of matter that may affect a particular report, the auditor should step back and evaluate the report as a whole and assess whether it will deliver the right overall message to the readers. For these reasons, we recommend that IAASB consider whether all of the Audit Report Standards (i.e. ISAs 700, 705 and 706) should be put back together into one ISA.

KEY COMMENTS TO THE QUESTIONS IN THE GUIDE FOR COMMENTATORS

1. Multiple Significant Uncertainties and Disclaimers – Paragraph 33 of ISA 705

Paragraph 33 (non bold) states that the existence of one or more significant uncertainties does not in itself result in an inability for the auditor to form an opinion. In extreme cases involving multiple uncertainties, the auditor may, however, conclude that the cumulative nature and possible effect of the multiple uncertainties are such that it is not possible to form an opinion and, accordingly, the auditor expresses a disclaimer of opinion.

The IAASB concluded that it is important to retain this guidance, which is to be applied in extreme circumstances involving multiple uncertainties. However, it is concerned that this guidance may make it difficult for practitioners to know when to include an emphasis of matter paragraph and when to disclaim an opinion in the auditor's report in the case of multiple uncertainties.

We are of the view that it is important to retain the guidance in paragraph 33, regarding the possibility to express a disclaimer of opinion, where the auditor concludes that the possible effects of multiple uncertainties are such that it is not possible to form an opinion on the financial statements. This guidance has been applied in practice for many years under the current ISA 700 and consequently, we do not believe that paragraph 33 will be confusing for practitioners or that it will make it difficult for them to conclude whether to include an emphasis of matter or to disclaim the opinion.



2. Use of Sub-headings

The proposed ISA 705 mandates the use of sub-headings in the auditors' report because they will highlight the modification to the opinion for the reader of the auditor's report and, as a result, drive consistency of practice.

We support the use of sub-headings, which is the extant practice in Hong Kong. In this context, we note that the required sub-headings and example reports given in the appendix to ISA 705 do not distinguish between qualified opinions arising from a disagreement, and qualified opinions arising from an inability to obtain sufficient appropriate audit evidence. We believe that the required sub-headings should make this distinction.

3. "Significant" and "Material" Uncertainties

The proposed ISA 706, paragraph 12, uses the term "significant uncertainty" as an example of a matter that the auditor includes in an emphasis of matter paragraph in the auditor's report if, in the auditor's judgment, it is both unusual and of fundamental importance to the user's understanding of the financial statements. ISA 570, "Going Concern", however uses the term "material uncertainty" as used in IAS 1 in discussing uncertainties related to events or conditions which may cast significant doubt on the enterprise's ability to continue as a going concern.

We are of the view that if the two terms are meant to be understood as equivalent, the text of ISA 706 should say so to avoid confusion. If the two terms were not meant to be understood as equivalent, the difference would have to be explained or, alternatively the term used in ISA 570 would have to be changed to "significant uncertainty" and the difference to IAS 1 explained there.

OTHER SPECIFIC COMMENTS ON PARAGRAPHS

1. **Paragraph 32 of ISA 705 on Disclaimer of Opinion**

Paragraph 32 (non bold) states that the auditor ordinarily expresses a disclaimer of opinion when it is not possible to determine which financial statement line items are or may be affected by an inability to obtain sufficient appropriate audit evidence and accordingly it may be difficult or impossible for the auditor to clearly describe in the auditor's report the effect on the financial statements.

We question the purpose of having the word "ordinarily" in the above paragraph.

2. **Paragraph 34 of ISA 705 on Piecemeal Opinions**

Paragraph 34 (non bold) states that a piecemeal opinion is an opinion where the auditor expresses an adverse opinion or a disclaimer of opinion on the financial statements as a whole, but includes a supplementary unmodified opinion on one or more specific elements, accounts or line items of a financial statement. Such an opinion tends to overshadow or contradict the adverse opinion or the disclaimer of opinion and is not permitted.



In this regard, we believe that additional explanation is needed regarding what it is meant by “specific elements, accounts or lines of the financial statements”. We would like the IAASB to also consider the following example for its clarification regarding the notion of “piecemeal opinions”.

IAS 27.9 requires a parent to prepare consolidated financial statements. Failure to do so, other than under the exemptions offered by IAS 27.1, represents non-compliance with IFRS. A failure to provide consolidated statements is likely to have a material and pervasive impact on the financial statements and therefore results in an adverse audit opinion on the Company’s separate financial statements. Even though the separate financial statements alone may comply with all other requirements of IFRS, it would not be appropriate to express an unmodified opinion on such separate financial statements.

In addition, the IAASB may need to consider how the notion of “piecemeal opinions” applies to other reporting responsibilities as stated in paragraphs 46-49 of ISA 700. For example, whether the auditors can opine that the financial statements are properly prepared in accordance with the requirements of Country X Corporation Act if it is an adverse or a disclaimer opinion in accordance with the IFRS.

3. Paragraph 37(b) of ISA 705 on Disagreement with management about disclosures

Paragraph 37(b) (bold) states that whenever the auditor expresses a modified opinion on the financial statements, the auditor should include a paragraph that provides, in the event of a disagreement with management about disclosures, a description of the omitted disclosures, unless impracticable or prohibited by law or regulation.

In this regard, we are concerned that practitioners may have difficulty in practice in determining the extent to which information omitted by management should be provided. We believe that the Standard needs to be clear as to what “description of the omitted disclosures” actually means and whether the auditor should provide the omitted information unless impracticable. We also believe that additional clarification on the notion of practicability and the limits between auditors and management’s responsibilities should be provided. For example, if management choose not to include disclosures related to the entity’s pension obligations although management had the information available, would we expect the auditor to include such extensive disclosures in the auditor’s report?

4. Paragraph 6 of ISA 706 on Emphasis of Matter Paragraph in the Auditor’s Report

Paragraph 6 (bold) states that the auditor should emphasize in the auditor’s report a matter in the financial statements when, in the auditor’s judgment, both of the following conditions are met:



- (a) The matter is of fundamental importance to the user's understanding of the financial statements, and
- (b) The matter is unusual.

We are not comfortable that the ISA include a requirement that mandates the use of an emphasis of matter paragraph if the matter is of fundamental importance and unusual. We believe that the decision on the use of the emphasis of matter paragraph should be based on the auditor's judgment, which would be made in the context of attitudes and practice in different jurisdictions. We would rather that ISA 706 provide guidance on matters the auditor would consider when deciding whether or not to include an emphasis of matter paragraph, and include requirements on how such paragraphs should be included in the auditor's report if the auditor decides that an emphasis of matter paragraph is appropriate in the circumstances.

5. Paragraph 17 of ISA 706 on Other Matters Paragraph in the Auditor's Report

Paragraph 17 (non bold) states that in some jurisdictions, the auditor's report may be the only means of communicating to readers of the report and as a result, the auditor may find it necessary to use the auditor's report as a means of communicating information relating to matters other than those that are required to be presented or disclosed in the financial statements and thus the subject of an emphasis of matter paragraph. Such information is referred to in this ISA as "Other Matters".

In this regard, we recommend the IAASB to clarify whether the comparatives in the financial statements should be referred to in the "emphasis of matters paragraphs" or "other matters paragraphs" and reconsider the proposed conforming amendments (treating it in "other matters paragraphs") in paragraphs 16 and 25 of ISA 710 "Comparatives".

6. Multiple matters leading to modification

There may be situations where auditors have to deal with more than one matter giving rise to modification of the report, and each matter in isolation may lead to different types of opinions. For example, the same audit engagement may involve scope limitations and accounting departure from the IFRS. We would recommend that the IAASB include guidance for multiple matters leading to modification, such as:

- (a) What are circumstances/factors to be used in weighing the relative significance of scope limitations, accounting departure and uncertainties.
- (b) What type of overall opinion should be given after considering all circumstances. For example, there is a disagreement with management related to the going concern assumption and also insufficient appropriate audit evidence for the completeness of accounting records due to lack of control over sales. Should the auditor give an overall adverse opinion or a disclaimer opinion?

~ END ~