



## INTERNATIONAL STANDARD ON AUDITING (NEW ZEALAND) 706

### Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report (ISA (NZ) 706)

Issued July 2011

Effective for audits of historical financial statements for periods beginning on or after 1 September, 2011.

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## INTERNATIONAL STANDARD ON AUDITING (NEW ZEALAND) 706

EMPHASIS OF MATTER PARAGRAPHS AND OTHER MATTER PARAGRAPHS IN THE  
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International Standard on Auditing (New Zealand) (ISA (NZ)) 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" should be read in conjunction with ISA (NZ) 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (New Zealand)."

## History of Amendments

### Table of pronouncements – ISA (NZ) 706 *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report*

This table lists the pronouncements establishing and amending ISA (NZ) 706.

Pronouncements	Date approved	Early operative date	Effective date
International Standard on Auditing (New Zealand) 706	July 2011	-	This ISA (NZ) is effective for audits of historical financial statements for periods beginning on or after 1 September, 2011.

## Introduction

### Scope of this ISA (NZ)

1. This International Standard on Auditing (New Zealand) (ISA (NZ)) deals with 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 that are of such importance that they are fundamental to users' understanding of the financial statements; or
  - (b) Draw users' attention to any matter or matters other than those presented or disclosed in the financial statements 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 (NZ) 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 (NZ) regarding the form and placement of such paragraphs apply.

### Effective Date

3. This ISA (NZ) is effective for audits of financial statements for periods beginning on or after 1 September, 2011.

### Objective

4. The objective of the auditor, having formed an opinion on the financial statements, is to draw users' attention, when in the auditor's judgement 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, that is of such importance that it is fundamental to users' understanding of the financial statements; 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 ISAs (NZ), the following terms have the meanings attributed below:
  - (a) Emphasis of Matter paragraph – A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgement, is of such importance that it is fundamental to users' understanding of the financial statements.
  - (b) Other Matter paragraph – A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgement, is relevant to users' 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 that, in the auditor's judgement, is of such importance that it is fundamental to users' understanding of the financial statements, 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. Such a paragraph shall refer only to information presented or disclosed in the financial statements. (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 emphasised and to where relevant disclosures that fully describe the matter can be found in the financial statements; and
  - (d) Indicate that the auditor's opinion is not modified in respect of the matter emphasised. (Ref: Para. A3-A4)

### 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 that, in the auditor's judgement, 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. (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 New Zealand Equivalent to an International Financial Reporting Standard) that has a pervasive effect on the financial statements 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 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.

*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 circumstances of a specific audit engagement (see ISA (NZ) 705<sup>1</sup>); or
  - (b) Disclosures in the financial statements that the applicable financial reporting framework requires the entity 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.

### 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 withdraw 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 or those charged with governance is pervasive,<sup>2</sup> the auditor may consider it necessary to

<sup>1</sup> ISA (NZ) 705, "Modifications to the Opinion in the Independent Auditor's Report."

<sup>2</sup> See paragraph 13(b)(ii) of ISA (NZ) 705 for a discussion of this circumstance.

include an Other Matter paragraph in the auditor's report to explain why it is not possible for the auditor to withdraw from the engagement.

#### 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 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 (NZ) to report on the financial statements (see "Other Reporting Responsibilities" section in ISA (NZ) 700<sup>3</sup>), 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

- A8. An entity may prepare one set of financial statements in accordance with a general purpose framework (for example, the national framework) and another set of financial statements in accordance with another general purpose framework (for example, International Financial Reporting Standards), and engage the auditor to report on both sets of financial statements. 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 has been prepared by the same entity in accordance with another general purpose framework and that the auditor has issued a report on those financial statements.

#### Restriction on distribution or use of the auditor's report

- A9. Financial statements 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 meet 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.

#### *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. An Other Matter paragraph does not include information that the auditor is prohibited from providing by law, regulation or other professional 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 the entity.

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<sup>3</sup> ISA (NZ) 700, "Forming an Opinion and Reporting on Financial Statements," paragraphs 38-39.



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, 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 subtitled "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 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.

***Appendix 1***

(Ref: Para. 2)

**List of ISAs (NZ) Containing Requirements for Emphasis of Matter Paragraphs**

This appendix identifies paragraphs in other ISAs (NZ) in effect for audits of financial statements for periods beginning on or after 1 July, 2011 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 (NZ).

ISA (NZ) 210, "Agreeing the Terms of Audit Engagements" – paragraph 19(b)

ISA (NZ) 560, "Subsequent Events" – paragraphs 12(b) and 16

ISA (NZ) 570, "Going Concern" – paragraph 19

ISA (NZ) 800, "Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks" – paragraph 14

## **Appendix 2**

(Ref: Para. 2)

### **List of ISAs (NZ) Containing Requirements for Other Matter Paragraphs**

This appendix identifies paragraphs in other ISAs (NZ) in effect for audits of financial statements for periods beginning on or after 1 July, 2011 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 (NZ).

ISA (NZ) 560, "Subsequent Events" – paragraphs 12(b) and 16

ISA (NZ) 710, "Comparative Information—Corresponding Figures and Comparative Financial Statements" – paragraphs 13-14,16-17 and 19

ISA (NZ) 720, "The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements" – paragraph 10(a)

**Appendix 3**

(Ref: Para. A4)

**Illustration of an Auditor's Report that Includes an Emphasis of Matter Paragraph****Circumstances include the following:**

- **Audit of a complete set of general purpose financial statements for a reporting entity as defined by the Financial Reporting Act 1993.**
- **The terms of the audit engagement reflect the description of the responsibility of those charged with governance for the financial statements in ISA (NZ) 210.<sup>4</sup>**
- **There is uncertainty relating to a pending exceptional litigation matter.**
- **A departure from the applicable financial reporting framework resulted in a qualified opinion.**

## INDEPENDENT AUDITOR'S REPORT

To the Shareholders of ABC Limited

**Report on the Financial Statements**

We have audited the financial statements of ABC Limited on pages .... to ....., which comprise the balance sheet as at December 31, 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

*Directors' Responsibility for the Financial Statements*

The directors are responsible for the preparation of financial statements in accordance with generally accepted accounting practice in New Zealand and that give a true and fair view of the matters to which they relate, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

*Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (New Zealand). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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<sup>4</sup> ISA (NZ) 210, "Agreeing the Terms of Audit Engagements."

considers internal control relevant to the entity's preparation of financial statements that give 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.<sup>5</sup> An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence that we have obtained is sufficient and appropriate to provide a basis for our unmodified opinion on the cash flows and our qualified audit opinion on the financial position and financial performance.

Other than in our capacity as auditor we have no relationship with, or interests in, ABC Limited.

#### *Basis for Qualified Opinion on Financial Position and Financial Performance*

The company's short-term marketable securities are carried in the balance sheet at xxx. The entity has not marked these securities to market but has instead stated them at cost, which constitutes a departure from New Zealand Equivalents to International Financial Reporting Standards. The company's records indicate that had the entity marked the marketable securities to market, the company would have recognised an unrealised loss of xxx in the income statement for the year. The carrying amount of the securities in the balance sheet would have been reduced by the same amount at December 31, 20X1, and income tax, net income and shareholders' equity would have been reduced by xxx, xxx and xxx, respectively.

#### *Qualified Opinion on Financial Position and Financial Performance*

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements on pages .... to .....

- comply with generally accepted accounting practice in New Zealand;
- give a true and fair view of the financial position of ABC Limited as at December 31, 20X1, and of its financial performance for the year then ended.

#### *Opinion on Cash Flows*

In our opinion the financial statements on pages .... to .....give a true and fair view of the cash flows of ABC Limited for the year ended December 31, 20X1.

#### *Emphasis of Matter*

We draw attention to Note X to the financial statements which describes the uncertainty<sup>6</sup> related to the outcome of the lawsuit filed against the company by XYZ Limited. Our opinion is not qualified in respect of this matter.

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<sup>5</sup> 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, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view of the matters to which they relate in order to design audit procedures that are appropriate in the circumstances."

<sup>6</sup> In highlighting the uncertainty, the auditor uses the same terminology that is used in the note to the financial statements.

**Report on Other Legal and Regulatory Requirements**

In accordance with the Financial Reporting Act 1993, we report that:

- We have obtained all the information and explanations that we have required.
- In our opinion proper accounting records have been kept by ABC Limited as far as appears from our examination of those records.

[Add any matters required to be included under any other legislation or regulation.]

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

## **ACCOMPANYING ATTACHMENT: SIMILARITY TO THE INTERNATIONAL STANDARDS ON AUDITING**

This conformity statement accompanies but is not part of ISA (NZ) 706.

### **Conformity with International Standards on Auditing**

This International Standard on Auditing (New Zealand) (ISA (NZ)) conforms to International Standard on Auditing (ISA) 706 *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*, 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 ISA (NZ) (and do not appear in the text of the equivalent ISA) are identified with the prefix "NZ".

This ISA (NZ) incorporates terminology and definitions used in New Zealand.

Compliance with this ISA (NZ) enables compliance with ISA 706.

### **Comparison with Australian Auditing Standards**

In Australia the Australian Auditing and Assurance Standards Board (AUASB) has issued Australian Auditing Standard ASA 706 *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*.

ASA 706 conforms to ISA 706.

The following requirements are additional to ISA 706 and ISA (NZ) 706:

- In addition to the requirements in paragraph 6 of this Auditing Standard, the auditor shall include an Emphasis of Matter paragraph in the auditor's report where required by other Auditing Standards. (Ref: Appendix 1) [Ref: Para. Aus 6.1]
- 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; or
  - ◆ that, in the opinion of those charged with governance, are necessary to present a true and fair view; and

the auditor is of the opinion that:

- ◆ 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
- ◆ 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 shall include in the auditor's report an Emphasis of Matter paragraph headed "Application of Australian Accounting Standard AASB ..." or an appropriate alternative which:

- ◆ draws attention to the additional disclosures;
  - ◆ where relevant, 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;
  - ◆ 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
  - ◆ states that, in the auditor's opinion, the additional disclosures are relevant and reliable in meeting the objectives of the financial report. [Ref: Para Aus 7.1]
- In addition to the requirements in paragraph 8 of this Auditing Standard, the auditor shall include an Other Matter paragraph in the auditor's report where required by other Auditing Standards. (Ref: Appendix 1) [Ref: Para. Aus 8.1]