

**Meeting:** IESBA  
**Meeting Location:** New York, NY  
**Meeting Date:** July 7-9, 2014

## Agenda Item

# 6

### Auditor Reporting – Independence and Other Relevant Ethical Requirements

#### Objective of Agenda Item

1. To provide an update on the IAASB's deliberations at its June 2014 meeting, and to obtain the IESBA's views about the IAASB's proposal to require a statement about compliance with independence and other relevant ethical requirements in the auditor's report.

#### Background

2. At the IESBA's April 2014 meeting, the IAASB sought views on a number of possible options with respect to requiring a statement about independence and other relevant ethical requirements in the auditor's report.<sup>1</sup>
3. IESBA members were of the view that having some information about the source(s) of independence and other relevant ethical requirements in the auditor's report would not only provide value to users, but also emphasize the important role of independence and ethics in the audit of financial statements. Directionally, the majority of IESBA members expressed a preference for having a statement in the auditor's report about the source(s) that did not include citation of the applicable standards, but instead identified the source using a more generic statement referencing the geographic origin of the standards, for example, "...*ethical requirements that are relevant to the audit of the financial statements in [jurisdiction X]*."
4. Among other matters, the IESBA made the following suggestions:
  - The IAASB should seek to mirror how auditing standards are referenced in the auditor's report in developing the approach for listing sources in the auditor's report about independence and other relevant ethical requirements.
  - When applicable, an appropriate alternative would be to include within the auditor's report a reference to the International Ethics Standards Board for Accountants (IESBA) *Code of Ethics for Professional Accountants* (IESBA Code). This would have the benefit of signaling that the auditor has complied with a meaningful benchmark. IESBA members acknowledged that it would not be possible for the IAASB to mandate such a reference in the auditor's report, but suggested that the use of such a reference be encouraged when the IESBA Code applied to the audit.

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<sup>1</sup> Further details about options presented are included in Agenda Item 8 of the IESBA April 2014 meeting materials, which is available at: <http://www.ifac.org/sites/default/files/meetings/files/Agenda%20Item%208-Auditor%20Reporting%20-%20Independence%20and%20Ethical%20Requirements.pdf>.

5. To facilitate timely input on the IAASB's Drafting Team's work on this topic, an IESBA member was added to the ISA 700<sup>2</sup> Drafting Team as a correspondent member. The IESBA member participated in Drafting Team meetings and teleconferences and, provided input on the Drafting Team's work, specifically as it related to the revisions to the proposed requirement about independence and other relevant ethical requirements.

#### IAASB's Decisions at Its June 2014 Meeting

6. At its June 2014 meeting, the IAASB reconfirmed its March 2014 decision to require that the auditor's report include an explicit statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements. The IAASB also tentatively agreed to require a statement that (i) identifies the jurisdiction of origin of the independence and other relevant ethical requirements or, (ii) when the relevant ethical requirements are those of the IESBA Code, refers to the IESBA Code.
7. The IAASB was of a view that identifying the jurisdiction of origin of the relevant ethical requirements relating to the audit increases transparency about the independence and other relevant ethical requirements that applied to the particular engagement. The proposed requirement:
- Is principles-based, thereby allowing for further specification by law, regulation or national auditing standards to reflect circumstances within each jurisdiction. For example, when independence and other relevant ethical requirements are contained in a limited number of sources, the auditor may choose to name all the relevant sources, or may refer to a term that is commonly understood and that appropriately summarizes those sources (for example, independence requirements for audits of private entities in Jurisdiction X); and
  - Is accompanied by application material to assist auditors of multi-location or group engagements.
8. The IAASB intends to finalize this proposed requirement as part as part of the overall approval of new and revised auditor reporting standards at its September 2014 meeting.

#### The IAASB's Revised Proposal

9. The IAASB's revised proposal, reflective of the IESBA's previous input and its June 2014 discussions, is presented below.

#### *Illustrative Wording*

##### **Basis for Opinion**

...We are independent of the Group in accordance with the ethical requirements that are relevant to the audit of the consolidated financial statements in *[jurisdiction]* and have fulfilled our other ethical responsibilities in accordance with these requirements. ...

[Or]

... We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code) and have fulfilled our other

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<sup>2</sup> ISA 700, *Forming an Opinion and Reporting on Financial Statements*

ethical responsibilities in accordance with these requirements. ...

*Revisions to the Requirement in Proposed ISA 700 (Revised)*

Basis for Opinion

28. The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion" that: (Ref: Para. A32)
- (a) ...
  - (b) ....
  - (c) Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements. The statement shall identify the jurisdiction of origin of the independence and other relevant ethical requirements or, when the relevant requirements are those of the IESBA Code, refer to the IESBA Code; and (Ref: Para. A34–A39)

*Revisions to Application Material in Proposed ISA 700 (Revised)*

Basis for Opinion (Ref. Para: 28)

A32. ...

A33. ...

A34. The identification of the jurisdiction of origin of relevant ethical requirements increases transparency about those requirements relating to the particular audit engagement. In some jurisdictions, relevant ethical requirements may exist in several different sources, such as the ethical code(s) and additional rules and requirements within law and regulation. When the independence and other relevant ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant source(s) (for example, the name of the code, rule or regulation applicable in the jurisdiction), or may refer to a term that is commonly understood and that appropriately summarizes those sources (for example, independence requirements for audits of private entities in Jurisdiction X).

A35. Law or regulation, national auditing standards or the terms of an audit engagement may require the auditor to provide in the auditor's report more specific information about the sources of the relevant ethical requirements, including those pertaining to independence, which applied to the audit of the financial statements.

A36. In determining the appropriate amount of information to include in the auditor's report when there are multiple sources of relevant ethical requirements relating to the audit of the financial statements, an important consideration is balancing transparency against the risk of obscuring other useful information in the auditor's report.

A37. In group audits when there are multiple sources of relevant ethical requirements, including those pertaining to independence, the reference in the auditor's report to the jurisdiction ordinarily relates to the relevant ethical requirements that are applicable to the group engagement team.

This is because, in a group audit, component auditors are also subject to ethical requirements that are relevant to the group audit.<sup>3</sup>

A38. The ISAs do not establish specific independence or ethical requirements for auditors, including component auditors, and thus do not extend, or otherwise override, the independence requirements of the IESBA Code or other ethical requirements to which the group engagement team is subject, nor do the ISAs require that the component auditor in all cases to be subject to the same specific independence requirements that are applicable to the group engagement team.

A39. Although relevant ethical requirements, including those pertaining to independence, in a group audit situation may be complex, an understanding of the auditor's responsibilities under ISA 600<sup>4</sup> provides guidance for auditors in performing work on the financial information of a component for a group audit, including those situations where the component auditor does not meet the independence requirements that are relevant to the group audit. ISA 200<sup>5</sup> indicates that the auditor shall not represent compliance with ISAs in the auditor's report unless the auditor has complied with the requirements of ISA 200 and all other ISAs relevant to the audit. This includes complying with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements.<sup>6</sup>

### Rationale for the IAASB's Revised Proposal

10. The IAASB is of the view that its proposal achieves an appropriate balance between having transparency about the sources of independence and other relevant ethical requirements, while addressing the practical challenges of listing all sources of independence and other relevant ethical requirements in the auditor's report.
11. Specifically, the revised wording addresses the practical challenges cited by respondents, while retaining the degree of transparency envisioned in the original ED, and is:
  - (a) Based on existing ISA concepts and terminology, in particular from ISAs 200, 220<sup>7</sup> and 600; and
  - (b) Intended to provide a certain degree of flexibility for jurisdictions to further tailor the IAASB's requirements to encourage more specific information about sources to be disclosed in the auditor's report where possible, provided that such information does not detract from the informational value of the auditor's report as a whole. The proposed requirement allows for such jurisdiction specification by law, regulation or national auditing standards.

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<sup>3</sup> ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, paragraph A37

<sup>4</sup> ISA 600, paragraphs 19–20

<sup>5</sup> ISA 200, *Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph 13(a)

<sup>6</sup> ISA 200, paragraphs 14 and 20

<sup>7</sup> ISA 220, *Quality Control for an Audit of Financial Statements*

**Matters for IESBA Consideration**

1. IESBA members are asked for views about the IAASB's illustrative wording and proposed requirement relating to a statement in the auditor's report about independence and other ethical requirements.
2. IESBA members are also asked whether the proposed application material is sufficient to assist auditors in applying the proposed requirement, in light of the fact that different source(s) of relevant ethical requirements (including the IESBA Code) may apply in a particular engagement.