

*Proposed Revised and Redrafted International  
Standard on Auditing*

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



## REQUEST FOR COMMENTS

The International Auditing and Assurance Standards Board (IAASB), an independent standard-setting body within the International Federation of Accountants (IFAC), approved the exposure draft of proposed International Standard on Auditing (ISA) 706 (Revised and Redrafted), “Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor’s Report” for publication in July 2007. The proposed ISA may be modified in light of comments received before being issued in final form.

Please submit your comments, preferably by e-mail, so that they will be received by **November 30, 2007**. All comments will be considered a matter of public record. Comments should be addressed to:

International Federation of Accountants  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, New York 10017 USA

Comments should be emailed to [Edcomments@ifac.org](mailto:Edcomments@ifac.org). They may also be faxed to +1-212-286-9570 or mailed to the above address.

Copies of the exposure drafts may be downloaded free-of-charge from the IFAC website at <http://www.ifac.org>.

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## EXPLANATORY MEMORANDUM

### Introduction

This memorandum provides background to proposed International Standard on Auditing (ISA) 706 (Revised and Redrafted), “Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor’s Report.” The proposed ISA has been redrafted in accordance with conventions agreed by the International Auditing and Assurance Standards Board (IAASB) to be applied to all ISAs. The IAASB approved the proposed redrafted ISA for exposure in July 2007.

### Background

When the IAASB undertook to revise the original ISA 700, “The Auditor’s Report on Financial Statements,” it agreed to restrict the revision to engagements where the auditor is able to express an unmodified opinion on the financial statements and no other modifications to the auditor’s report are necessary. To facilitate this revision, the standards and guidance on modifications to the auditor’s report (including Emphasis of Matter paragraphs (EOMs)) in the original ISA 700 were moved to a new ISA, i.e., ISA 701, “Modifications to the Independent Auditor’s Report,” which was approved in December 2004. The IAASB then undertook to revise ISA 701 to enhance the standards and guidance on modifications to the auditor’s opinion and EOMs, as well as increase consistency in reporting among jurisdictions.

The project to revise ISA 701 led to the issue of an exposure draft in March 2005 of two separate standards, proposed ISA 705 (Revised), “Modifications to the Opinion in the Independent Auditor’s Report” and proposed ISA 706 (Revised), “Emphasis of Matter Paragraphs and Other Matters Paragraphs in the Independent Auditor’s Report.”

In July 2006, the IAASB approved “close off” documents of ISA 705 (Revised) and ISA 706 (Revised) in the “old style” (i.e., following the IAASB’s current drafting conventions). The close off documents incorporate the changes based on the comments received on the March 2005 exposure draft, and form the basis for the proposed ISA 705 (Revised and Redrafted) and proposed ISA 706 (Revised and Redrafted).

The Basis for Conclusions: ISA 706 (Revised) and related close off document are available on the IAASB website at <http://www.ifac.org/Guidance/EXD-Details.php?EDID=0092>. They are referenced here for information purposes only and do not form part of the exposure draft.

The conventions used by the IAASB in redrafting the close off document of ISA 706 (Revised), and the authority and obligation attaching to those conventions, are established in proposed ISA 200 (Revised and Redrafted), “Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing” approved by the IAASB as an exposure draft in April 2007, and in the amended “Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services”<sup>1</sup> (Preface) approved by the IAASB in September 2006.

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<sup>1</sup> The amended Preface can be accessed at [http://web.ifac.org/download/IAASB\\_Preface.pdf](http://web.ifac.org/download/IAASB_Preface.pdf). Proposed ISA 200 (Revised and Redrafted) can be accessed at <http://www.ifac.org/Guidance/EXD-Details.php?EDID=0079>.

## Effective Date

The current timetable envisages that all ISAs will have been revised and redrafted, or redrafted only, by late 2008 and the IAASB has provisionally agreed that the complete set of ISAs will be effective for audits of financial statements for periods beginning on or after December 15, 2008. This date will depend on satisfactory progress being made, and will be amended to a later date should that prove necessary. The IAASB believes that it is in the interests of auditors and others who use the ISAs that the ISAs should be released as soon as they are approved so as to facilitate their implementation.

## Significant Matter

### New Requirement to Include an Emphasis of Matter Paragraph

The requirement for an Emphasis of Matter paragraph in the close off document of ISA 706 (Revised) deals with the form and content of such a paragraph, while the equivalent requirement for an Other Matter(s) paragraph also deals with the circumstances in which the auditor would include such a paragraph in the auditor's report.

To align these requirements and clarify the circumstances in which an auditor would include an Emphasis of Matter paragraph in the auditor's report, the IAASB has included a requirement in paragraph 7 of proposed ISA 706 (Revised and Redrafted) that provides for the auditor to use an Emphasis of Matter only if the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements. It also requires that an Emphasis of Matter paragraph only refer to information presented or disclosed in the financial statements. This reinforces the fact that an Emphasis of Matter may not be used as an alternative to a modified opinion, but leaves the question of whether to include one at all to the judgment of the auditor.

## Guide for Respondents

The IAASB is seeking comments **only** on changes resulting from applying the clarity drafting conventions, including the matter discussed above, and their effect on the content of the close off document of ISA 706 (Revised). Respondents are asked to respond in particular to the following questions:

1. Is the objective to be achieved by the auditor, stated in the proposed redrafted ISA, appropriate?
2. Have the criteria identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and reporting, and the use of professional judgment by auditors?<sup>2</sup>

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<sup>2</sup> The IAASB has identified the following criteria for determining the requirements of a Standard:

- The requirement is necessary to achieve the objective stated in the Standard;
- The requirement is expected to be applicable in virtually all engagements to which the Standard is relevant; and

Recognizing that the final ISA will apply to audits of all sizes and in all sectors of the economy, the IAASB is also interested in comments on matters set out below.

- *Special Considerations in the Audit of Small Entities*—Respondents are asked to comment whether, in their opinion, considerations in the audit of small entities have been dealt with appropriately in the proposed redrafted ISA.
- *Special Considerations in the Audit of Public Sector Entities*—Respondents are asked to comment whether, in their opinion, special considerations in the audit of public sector entities have been dealt with appropriately in the proposed redrafted ISA.
- *Developing Nations*—Recognizing that many developing nations have adopted or are in the process of adopting the ISAs, the IAASB invites respondents from these nations to comment, in particular, on any foreseeable difficulties in applying the proposed redrafted ISA in a developing nation environment.
- *Translations*—Recognizing that many respondents intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues noted in reviewing the proposed redrafted ISA.

Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in the exposure draft, it will be helpful for the IAASB to be made aware of this view.

Respondents are also invited to comment on any undue costs, set against the benefits of more consistent auditor performance, arising from the fact that the proposed redrafted ISA includes requirements that would previously have been guidance under the old drafting conventions, as in the close off document of ISA 706 (Revised) (see below). In commenting on this matter, respondents should bear in mind the criteria that the IAASB has applied in redrafting the proposed ISA (see footnote 2) and the fact that the IAASB is seeking to clarify that there was some guidance in extant ISAs that was more in the nature of requirements and would already have been followed by many auditors.

## **Supplement to the Exposure Draft**

To assist respondents in tracking changes, IAASB staff has prepared an analysis of the decisions that have been made by the IAASB with respect to the treatment of the present tense in the explanatory paragraphs of the close off document of ISA 706 (Revised). This analysis also demonstrates how the material in the close off document has been reflected in the proposed redrafted ISA. In particular, the analysis:

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- The objective stated in the Standard is unlikely to have been met by the requirements of other Standards.

In determining the requirements of a Standard, the IAASB will consider whether the requirements are proportionate to the importance of the subject matter of the Standard in relation to the overall objective of the engagement.

The criteria, which are intended only to assist the IAASB in appropriately and consistently determining requirements, may be refined as further experience is gained.

EXPLANATORY MEMORANDUM

- Identifies existing sentences in the present tense and whether they are now treated as a requirement or as application material;
- Maps the material of the close off document to the proposed redrafted ISA; and
- Identifies explanatory material that is proposed to be eliminated or repositioned as a result of redrafting.

These staff-prepared mapping documents are available on the IAASB website at <http://www.ifac.org/Guidance/EXD-Details.php?EDID=0092>. They are for information purposes only and do not form part of the exposure draft.

To be considered, responses should be emailed to [Edcomments@ifac.org](mailto:Edcomments@ifac.org). They may also be faxed to +1-212-286-9570 or mailed to 545 Fifth Avenue, 14th Floor, New York, NY 10017, USA. They should be received by **November 30, 2007**.

**PROPOSED INTERNATIONAL STANDARD ON AUDITING 706**

**(REVISED AND REDRAFTED)**

**EMPHASIS OF MATTER PARAGRAPHS AND OTHER MATTER(S)  
PARAGRAPHS IN THE INDEPENDENT AUDITOR’S REPORT**

(Effective for audits of financial statements for periods beginning on or after [date]\*)

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International Standard on Auditing (ISA) 706 (Revised and Redrafted), “Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor’s Report” should be read in conjunction with [proposed] ISA 200 (Revised and Redrafted), “Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing.”

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\* See footnote 1.



## Introduction

### Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's consideration of the inclusion in the auditor's report of:
  - (a) An Emphasis of Matter paragraph to draw users' attention to a matter presented or disclosed in the financial statements that the auditor judges important to their understanding of the financial statements; or
  - (b) An Other Matter(s) paragraph to draw users' attention to any other matter that may be relevant to their understanding of the financial statements or the audit.
2. The requirements and guidance in this ISA are established in the context of engagements to report on general purpose financial statements prepared and presented in accordance with a fair presentation framework. However, in the context of an engagement to report on special purpose financial statements or specific elements, accounts or items of a financial statement, or when the applicable financial reporting framework is a compliance framework, these requirements and guidance equally apply, adapted as necessary.

#### *Nature of an Emphasis of Matter Paragraph*

3. In rare circumstances, the auditor may consider a matter presented or disclosed in the financial statements to be of such importance to users' understanding of the financial statements as a whole that it would be appropriate to draw their attention to it. An Emphasis of Matter paragraph in the auditor's report provides the means for the auditor to do so. However, a widespread use of Emphasis of Matter paragraphs diminishes the effectiveness of the auditor's communication of such matters. (Ref: Para. A1-A2)

#### *Nature of an Other Matter(s) Paragraph*

4. The auditor may consider it appropriate to use the auditor's report as a means of communicating information relating to matters, other than those that are presented or disclosed in the financial statements, that may be relevant to users' understanding of the financial statements or the audit. Such information is referred to in this ISA as "Other Matter(s)" in order to distinguish it from a matter highlighted in an Emphasis of Matter paragraph.

### Effective Date

5. This ISA is effective for audits of financial statements for periods beginning on or after [date].<sup>1</sup>

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<sup>1</sup> This date will not be earlier than December 15, 2008.

## **Objective**

6. The objective of the auditor is to include clear additional communication in the auditor's report when, in the auditor's judgment, such communication is appropriate to draw users' attention to a matter presented or disclosed in the financial statements or to any other matter which may be relevant to their understanding of the financial statements or the audit.

## **Requirements**

### **Form and Placement of an Emphasis of Matter Paragraph in the Auditor's Report**

7. When the auditor considers it appropriate to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to the 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. A3)
8. 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;"
  - (c) Include in the paragraph a clear reference to the matter being emphasized 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 emphasized. (Ref: Para. A4-A5)

### **Other Matter(s) in the Auditor's Report**

9. When the auditor considers it appropriate to communicate matters other than those that are presented or disclosed in the financial statements, the auditor shall use an Other Matter(s) paragraph for such matters with the heading "Other Matter(s)," placed after the auditor's opinion and any Emphasis of Matter paragraph. (Ref: Para. A6-A8)

### **Communication with Those Charged with Governance**

10. When the auditor expects to include an Emphasis of Matter or an Other Matter(s) 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. A9)

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## Application and Other Explanatory Material

### Nature of an Emphasis of Matter Paragraph (Ref: Para. 3)

- A1. Circumstances where the auditor may consider it appropriate or necessary to emphasize in the auditor’s report a matter presented or disclosed in the financial statements include, for example:
- [Proposed] ISA 560 (Redrafted), “Subsequent Events” deals with circumstances where it is necessary for the auditor to issue a new auditor’s report on amended financial statements as a result of the auditor becoming aware of a fact that existed at the date of the auditor’s report that, if known at that date, would have caused the financial statements to be amended or the auditor to modify the auditor’s opinion. In those circumstances, [proposed] ISA 560 (Redrafted) requires the auditor to include an Emphasis of Matter paragraph in the new auditor’s report referring to a note to the financial statements that more extensively discusses the reason for the amendment of the previously issued financial statements and to the earlier report issued by the auditor.
  - [Proposed] ISA 570 (Redrafted), “Going Concern” requires the auditor to include an Emphasis of Matter paragraph in the auditor’s report on financial statements to highlight the existence of a material uncertainty regarding an entity’s ability to continue as a going concern. The Emphasis of Matter paragraph draws attention to the disclosure in the financial statements that discusses the going concern uncertainty.
- A2. Examples of other circumstances where the auditor may determine that an Emphasis of Matter paragraph is appropriate include:
- An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.
  - Application of a new accounting standard (for example, a new International Financial Reporting Standard) that has a pervasive effect on the financial statements in advance of its effective date (i.e., where early application is permitted).
  - A major catastrophe that has had, or continues to have, a significant effect on the entity’s financial position.

### Form and Placement of an Emphasis of Matter Paragraph in the Auditor’s Report (Ref: Para. 7-8)

- A3. 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.
- A4. The inclusion of an Emphasis of Matter paragraph in the auditor’s report does not affect the auditor’s opinion. An emphasis of matter 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 [proposed] ISA 705 (Revised and Redrafted), “Modifications to the Opinion in the Independent Auditor’s Report”); or

- (b) Disclosures in the financial statements that the applicable financial reporting framework requires management to make.
- A5. The illustrative report in the Appendix includes an Emphasis of Matter paragraph in an auditor’s report that contains a qualified opinion.

**Other Matter(s) in the Auditor’s Report** (Ref: Para. 9)

- A6. When law, regulation or generally accepted practice in a jurisdiction 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, [proposed] ISA 700 (Redrafted), “The Independent Auditor’s Report on General Purpose Financial Statements,” requires the auditor to address such matters under the Other Matter(s) heading with, where relevant, one or more sub-headings that describe the content of the Other Matter(s) paragraph.
- A7. Other matters to which the auditor may wish to refer in an Other Matter(s) paragraph but which are not required to be presented or disclosed in the financial statements by the applicable financial reporting framework include, for example, the following:
- (a) Information in a document containing audited financial statements that is materially inconsistent with those financial statements (see [proposed] ISA 720 (Redrafted), “The Auditor’s Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements”).
  - (b) A predecessor auditor’s report on the corresponding figures in the incoming auditor’s report for the current period where the incoming auditor is permitted to make such a reference (see ISA 710, “Comparatives”).
  - (c) In rare circumstances, other matters that the auditor considers necessary to communicate to the user, for example, where the auditor judges it necessary to explain why the auditor is unable to resign from the engagement even though the possible effect of an inability to obtain sufficient appropriate audit evidence due to a scope limitation imposed by management is pervasive.
- A8. An Other Matter(s) paragraph does not deal with circumstances where the auditor has additional reporting responsibilities that are supplementary to the auditor’s responsibility to express an opinion on the financial statements, or where the auditor has been asked to perform and report on additional specified procedures, or to express an opinion on specific matters (see “Other Reporting Responsibilities” section in [proposed] ISA 700 (Redrafted)).

**Communication with Those Charged with Governance** (Ref: Para. 10)

- A9. 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(s) 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**

(Ref.: Para. A5)

**Illustration of an Auditor’s Report that Includes an Emphasis of Matter Paragraph**

**Circumstances include the following:**

- **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, the auditor has other reporting responsibilities required under local law.**

**INDEPENDENT AUDITOR’S REPORT**

[Appropriate Addressee]

**Report on the Financial Statements<sup>2</sup>**

We have audited the accompanying financial statements of ABC Company, 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 notes.

*Management’s Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation<sup>3</sup> of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

<sup>2</sup> The subtitle “Report on the Financial Statements” is unnecessary in circumstances when the second subtitle “Report on Other Legal and Regulatory Requirements” is not applicable.

<sup>3</sup> Depending on the circumstances, this sentence may read: “Management is responsible for the preparation and presentation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards.”

*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. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance 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 judgment, 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 considers internal control relevant to the entity's preparation and fair presentation<sup>4</sup> of the financial statements 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 made by management, 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 qualified audit opinion.

*Basis for Qualified Opinion*

The company's short-term marketable securities are carried in the balance sheet 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 Standards. The company's records indicate that had management marked the marketable securities to market, the company would have recognized an unrealized 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*

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements present fairly, in all material respects (*or "give a true and fair view of"*) the financial position of ABC Company as at December 31, 20X1, and of its financial

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<sup>4</sup> 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 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> 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 and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances." In the case of footnote 4, this sentence may read: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and presentation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances."

performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

*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 Company. Our opinion is not qualified in respect of this matter.

**Report on Other Legal and Regulatory Requirements** (see “Other Reporting Responsibilities” section in [proposed] ISA 700 (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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<sup>6</sup> In highlighting the uncertainty, the auditor uses the same terminology that is used in the note to the financial statements.







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