



International Federation of Accountants

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Agenda Item

8

Committee: IAASB
Meeting Location: New Orleans
Meeting Date: December 6-10, 2004

Auditor's Report on Financial Statements

Objectives of Agenda Item

To approve the revision to *ISA 700, The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements*, and the related amendments to:

- *ISA 200, Objectives and General Principles Governing an Audit of Financial Statements*
- *ISA 210, Terms of Audit Engagements*

and conforming amendments to:

- *ISA 560, Subsequent Events*
- *ISA 701, Modifications to the Independent Auditor's Report*
- *ISA 800, The Auditor's Report on Special Purpose Audit Engagements*

Background

The IAASB began its discussion of the project to revise ISA 700 at its June 2002 meeting and approved the final agreed scope of the project at its December 2002 meeting. It was agreed that the focus of the project would be on the wording of an unmodified audit report of a complete set of general purpose financial statements and that the revisions to the basic principles, essential procedures and guidance on modified reports should be addressed in a separate project "ISA 701."

In addition to proposed new wording for the auditor's report, the revisions proposed new guidance in the ISAs on the following:

- Forming the auditor's opinion at the conclusion of the audit
- The applicable financial reporting framework
- Supplementary information included with the financial statements
- Date of the auditor's report
- Conducting the audit in accordance with ISAs and national standards
- Other reporting responsibilities

The IAASB approved the exposure draft in December 2003. Comments were requested by March 31, 2004.

At the IAASB meeting in June 2004 in Copenhagen, IAASB reviewed significant issues raised by commentators on the Exposure Draft. The Board agreed that Task Force should continue on the presumption that modifications to the auditor's report would be addressed in a separate ISA and to work towards having the ISA 700 revisions approved at the December 2004 IAASB meeting.

The Board had a first read of the proposed final wording in New York in September 2004.

Activities since Last IAASB discussions

The Task Force had a two-day meeting in October and a conference call in November to finalize the wording of ISA 700 and the related amendments, taking into account the Board's comments from the September IAASB meeting. As agreed in New York, between the Task Force's October and November meetings, the Task Force circulated to IAASB members proposed revised wording of the guidance on the date of the auditor's report.

The proposed final wording is being presented to the CAG at their meeting 29-30 November.

Agenda Item 8-B is a mark-up showing the Task Force's recommended changes to wording presented to the Board for discussion in September. A clean copy of the wording is provided in Agenda Item 8-A. Agenda Item 8-C is a mark-up showing all changes to the Exposure Draft wording (including the changes made by the Task Force since September).

Discussion of significant issues

DATE OF THE AUDITOR'S REPORT

In New York, the Board debated the proposed dual test for the date of the auditor's report, being no earlier than the date of approval of the financial statements and no earlier than the date on which sufficient appropriate audit evidence has been obtained. The IAASB concluded that it would be preferable to subsume the concept of approval of financial statements into the principle of sufficient appropriate audit evidence since approval of the financial statements is a form of evidence that those with the recognized authority have determined that a complete set of financial statements has been prepared. Paragraphs 52 to 56 of ISA 700 (revised numbering as reflected in the clean and mark-up versions for this meeting) and the corresponding paragraphs in ISA 560 have been revised to reflect the IAASB's conclusion.

DETERMINING THE ACCEPTABILITY OF GENERALLY RECOGNIZED ACCOUNTING CONVENTIONS IN A PARTICULAR JURISDICTION

Paragraph 43 of ISA 200 (revised numbering) states that, in the absence of an authorized or recognized standards setting organization, entities may use accounting conventions that are generally recognized as the applicable financial reporting framework in a particular jurisdiction. In these circumstances, the auditor is required to determine whether the accounting conventions collectively constitute an acceptable financial reporting framework.

In New York, concern was expressed that this type of requirement may place an undue burden on each practitioner to individually assess the acceptability of such conventions. It was agreed that, in many jurisdictions, the evaluation would likely be carried out by professional bodies on behalf of auditors. Paragraph 43 of ISA 200 has been revised to recognize that this.

The Task Force has also revisited the wording of paragraph 41 of ISA 200 on frameworks that are presumed to be acceptable for general purpose financial statements. The Task Force believes that the reference to the need for “exposure of proposals for comment” may be unduly restrictive, as it is the consideration of the views of relevant stakeholders that is important rather than the process by which those views are obtained. Thus, the wording has been amended to refer to “organizations that follow an established and transparent process involving deliberation and consideration of the views of a wide range of stakeholders”.

FRAMEWORKS RESULTING IN MISLEADING FINANCIAL STATEMENTS

In New York, concern was expressed that the wording of paragraph 10 of ISA 700 (now renumbered as paragraph 15) could be interpreted to unduly expose the auditor to risk for failing to conclude that the financial statements do not result in misleading information as a result of an omission in the framework itself. There was also confusion regarding the relationship between this paragraph and the requirement in ISA 210 to accept the engagement only when the financial reporting framework is acceptable or when deficiencies in frameworks required by law or regulation can be adequately explained.

The circumstances addressed in paragraph 15 of ISA 700 are intended to address only those circumstances when application of a specific requirement of the framework in the particular circumstances of the entity results in misleading information. The acceptability of the financial reporting framework as a whole is addressed in ISA 200 and ISA 210 and is a matter for consideration in engagement acceptance. Wording has been added to paragraph 15 to clarify the relationship between paragraph 15 and ISA 210 and to more clearly explain that the focus of paragraph 15 is on the application of the framework in the particular circumstances of the entity.

REFERENCE TO INTERNAL CONTROL

As requested by the Board in New York, the footnote that discussed the implications for the wording of the auditor's responsibilities with respect to internal control in circumstances when the auditor also reports on the effectiveness of internal control has been elevated into the body of the bold lettered requirement.

AUDITOR'S ADDRESS

At the September meeting, it was suggested that the Task Force consider using the wording in the ISAE 3000 to describe how the auditor should report the auditor's address. ISAE 3000 refers to “a specific location, which ordinarily is the city where the practitioner maintains the office that has responsibility for the engagement”. The Task Force proposes to amend the wording of the requirement in ISA 700 to refer to “the specific location in the country or jurisdiction where the auditor practices”. The Task Force did not, however, adopt all of the wording of ISAE 3000 as it did not seem readily applicable to all circumstances in audits of financial statements. For example, the Task Force has not included a reference to “the city” as a number of comments were received on exposure pointing out that the location of the office may not be in a “city”.

There was also concern about making reference to where the practitioner maintains the office, as that wording does not apply easily to partnerships and circumstances when a partner in a larger audit firm works from more than one office.

Consideration of whether there is a need to re-expose

The Task Force debated whether re-exposure is necessary. Re-exposure would be necessary when, as a result of comments received on exposure, the Board has made substantial changes to the exposed ISA wording and the nature of those changes warrants re-exposure. For the reasons set out below, the Task Force recommends to the Board that re-exposure is not necessary in this circumstance.

While there are a few areas in which the guidance has been rewritten, in the Task Force's view, the changes to the guidance do not represent fundamental changes to the principles set out in the Exposure Draft, but rather respond to the request from respondents to clarify the Board's positions.

Wording of the auditor's report

The structure and wording of the auditor's report was well received by respondents and, as a result, changes made to the report wording proposed in the Exposure Draft are minimal. The most significant of the changes are set out below:

Change	Nature of change
Included reference to compliance with ethical requirements in the auditor's responsibilities.	As compliance with ethical requirements is embedded within the ISAs, this is merely amplification of the auditor's responsibilities under the ISAs.
Amended the wording of the reference to "reasonable, but not absolute, assurance".	The change reverts to the existing wording in the extant ISA 700 in response to considerable reaction by ED respondents to the proposed change to the existing wording. Pending further consideration of the concept of reasonable assurance by IAASB, it seems appropriate to retain the status quo.
Wording of the last sentence in the Auditor's Responsibility section.	Clarification of the wording only to create a stronger link to the ISAs.

The Task Force believes that these changes are not substantive changes that would warrant re-exposure.

Virtually all respondents supported promoting greater consistency in the wording of an ISA audit report and the two-part audit report structure. Therefore, although the guidance has been strengthened to avoid ambiguity in this regard, it is entirely consistent with respondents' views.

Since the Exposure Draft, guidance has been introduced that allows for different wording of the auditor's opinion if law or regulation governing the audit of general purpose financial statements prescribes wording other than "true and fair view" or "presents fairly, in all material respects". This provides sufficient flexibility to deal with practical realities that exist in certain jurisdictions

– an issue raised in a few responses to the Exposure Draft. Even though this is a change from even the existing ISA 700 guidance, its impact in practice is likely to be quite limited and lessening over time as laws and regulations are updated. Also, the guidance is not entirely open-ended, as it builds in safeguards if the prescribed wording could mislead readers on the level of assurance provided by recommending that the auditor consider whether the risk of misunderstanding can be addressed through appropriate explanation in the auditor's report.

Forming the Opinion on the Financial Statements

While there have undoubtedly been significant drafting changes to the wording of guidance on forming the opinion on the financial statements, those changes clarify the Board's original intent and do not represent fundamental changes in the following underlying themes in the guidance:

- The need for the auditor to “stand-back” when forming the audit opinion at the end of the audit to consider the fair presentation of the financial statements, by considering both compliance with specific requirements of the applicable financial reporting framework and the overall presentation of the financial statements.
- Recognition that there may be rare circumstances when application of a specific requirement in the framework results in misleading financial statements in the particular circumstances of the entity and that the auditor needs to consider appropriate action in the circumstances.

Also supporting the position that there has not been fundamental change in this section is the fact that the bold-lettered requirements in this section have not changed, although they have been re-ordered.

Date of the auditor's report

Similarly, although there have been substantive changes in the wording of the guidance on the date of the auditor's report, the changes are designed to provide greater clarity on how to apply the intended principles in particular circumstances. The underlying premise remains that the auditor's report should not be dated earlier than the date on which sufficient appropriate audit evidence has been obtained. The revised wording, however, explains how this relates to the completion and approval of the financial statements.

Applicable financial reporting framework

In response to comments on the Exposure Draft wording, a number of changes were made to the paragraphs in ISA 200 describing the auditor's responsibilities in relation to the acceptability of the financial reporting framework and to the guidance in ISA 210 on the considerations in this regard when considering whether to accept an engagement. The most significant change made relates to frameworks required by law or regulation that do not have all of the attributes of a framework that is acceptable for general purpose financial statements. The Exposure Draft had taken the view that the auditor should not accept the engagement in such circumstances. Exposure Draft respondents strongly suggested that the proposals put the auditor in the difficult position of not being able to accept these regulatory engagements. The final position is less restrictive and allows the auditor to accept such engagements as long as the deficiencies in the framework can be adequately explained to avoid misleading users. The proposed guidance puts in appropriate safeguards in the public interest to ensure that users are not misled and that auditors do not associated themselves with misleading information.

Material Presented

Agenda Item 8-A (Pages 2253 – 2298)	Clean copy of the proposed revised ISA 700 wording and related amendments/conforming amendments to ISA 200, 210, 560, 701 and 800
Agenda Item 8-B (Pages 2299 – 2346)	Mark-up showing proposed changes to the wording discussed by IAASB in September
Agenda Item 8-C (Pages 2347 – 2398)	Mark-up showing all proposed changes to the Exposure Draft wording

Action Required

The IAASB is asked to review the final proposed wording with a view to approving the final ISA 700 and related amendments.