



International Federation of Accountants

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Agenda Item

13

Committee: IAASB
Meeting Location: Lima
Meeting Date: March 7-11, 2005

Proposed ISA 701, “Modifications to the Opinion in the Independent Auditor’s Report,” and Proposed ISA 702, “Emphasis of Matter Paragraphs and Other Matters Paragraphs in the Independent Auditor’s Report”

Objectives of Agenda Item

To review the proposed revised ISA 701, *Modifications to the Opinion in the Independent Auditor’s Report*, and ISA 702, *Emphasis of Matter Paragraphs and Other Matters Paragraphs in the Independent Auditor’s Report*, and if appropriate, approve them for public exposure.

Background

The task force has representation from INTOSAI. Members of the task force are:

- Jan Bo Hansen, Chair
- Philip Ashton (IAASB), supported by Josephine Jackson
- Craig Crawford (IAASB and US ASB)
- Bettina Jakobsen (INTOSAI)
- Roger Simnett (IAASB)
- Sylvia Smith (Technical Advisor)

The IAASB provided comments to the task force during IAASB discussions of issues at the April (Toronto), September (New York) and December (New Orleans) 2004 IAASB meetings.

Activities Since the Last IAASB Meeting

The task force has held one conference call and met in San Diego on January 27 and 28, 2005.

The task force believes that it has responded to the comments of the IAASB discussed at the December 2004 meeting. Agenda Items 13B (ISA 701) and 13D (ISA 702) show the changes processed since the December 2004 IAASB meeting in marked format.

Matters for Consideration by the IAASB

1. Split Between ISA 701 and ISA 702

In developing guidance on modifications to the independent auditor’s report (ISA 701), the guidance has been split as follows:

- ISA 701, “Modifications to the Opinion in the Independent Auditor’s Report.”
- ISA 702, “Emphasis of Matter Paragraphs and Other Matters Paragraphs in the Independent Auditor’s Report.”

The task force believes that the split between ISA 701 and ISA 702 would help clarify the difference between the following:

- An auditor’s report with a modified opinion is one that contains an except for opinion, an adverse opinion or a disclaimer of opinion on the financial statements because of (1) a disagreement with management or (2) an inability to obtain sufficient appropriate audit evidence. (ISA 701)
- An auditor’s report that contains an emphasis of matter paragraph or an other matters paragraph (ISA 702). Inclusion of an emphasis of matter paragraph or an other matters paragraph in the auditor’s report does not give rise to a modification to the auditor’s opinion.

Auditors would be less likely to confuse or unnecessarily link the requirements for emphasis of matter paragraphs or other matters paragraphs with modifications to the auditor’s opinion if the guidance on those two topics is contained in separate ISAs.

Does the IAASB support the division of the guidance into ISA 701 and ISA 702?

2. Terminology in ISA 701: “Modifications to the Opinion” and “Modified Opinions” vs. “Qualifications to the Opinion” and “Qualified Opinions”

In developing the proposed guidance contained in this exposure draft, members of the IAASB ultimately took the view that neither disclaimers of opinion nor adverse opinions can be described as qualified opinions; such opinions are not qualified in any way. Thus the exposure draft uses the term “modifications to the opinion in the auditor’s report” to describe “except for opinions,” “adverse opinions,” and “disclaimers of opinion.” The auditor expresses an “except for opinion” when the auditor concludes that an unmodified opinion cannot be expressed but the effect of any disagreement with management, or limitation on scope, is material but not pervasive so as to require an adverse opinion or a disclaimer of opinion.

Does the IAASB support this proposed terminology?

3. More Guidance in ISA 701 on Moving from an “Except for Opinion” to an “Adverse Opinion”

The task force has revised the guidance in ISA 701 to provide more guidance on when an except for opinion is appropriate and when an adverse opinion is appropriate.

Does the IAASB support this expanded guidance on moving from an “except for opinion” to an “adverse opinion?”

4. Paragraph Headings for Modified Opinions and Basis for Modified Opinion

When the opinion is modified, the opinion paragraph should have the heading “Modified Opinion,” “Adverse Opinion,” or “Disclaimer of Opinion.”

The paragraph that describes the basis for the modified opinion should have the heading, “Basis for Modified Opinion,” “Basis for Adverse Opinion,” or “Basis for Disclaimer of Opinion,” as appropriate.

Does the IAASB support the paragraph headings proposed in ISA 701?

5. Examples of Auditor’s Reports with Modified Opinions in ISA 701

The task force has developed 8 examples of auditor’s reports which are included in the Appendix to ISA 701. The example reports include:

- 1) An example of an auditor’s report with an except for opinion due to a disagreement with management
- 2) Two examples of an auditor’s report with an adverse opinion due to a disagreement with management
- 3) Three examples of an auditor’s report with an except for opinion due to an inability to obtain sufficient audit evidence, and
- 4) Two examples of an auditor’s report with a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence.

Does the IAASB support the report examples included in the Appendix to ISA 701?

6. Split in ISA 702 between Emphasis of Matter Paragraphs and “Other Matters Paragraphs”

In ISA 702, the ISA 701 task force has created two different categories:

- 1) “Emphasis of matter paragraphs” will be used by the auditor to draw the reader’s attention to matters that are presented or disclosed in the financial statements or the notes thereto; these matters might include matters such as significant uncertainties
- 2) “Other matters paragraphs” will be used by the auditor to address matters that are not required to be included in the financial statements or notes thereto.

Under this proposal, the auditor may include in an emphasis of matter paragraph only regarding matters that are required to be presented or disclosed in the financial statements or the notes thereto. The auditor may include other matters, which are not required to be presented or disclosed in the financial statements or notes thereto, in an “other matters paragraph” to follow the opinion paragraph in the independent auditor’s report.

ISA 702 - Does the IAASB support the two proposed categories in ISA 702 of (1) emphasis of matter paragraphs and (2) other matters paragraphs?

7. New Description in ISA 702 of “fundamental importance”

The overarching principle for an emphasis of matter paragraph is that the auditor should consider emphasizing in the auditor’s report a matter in the financial statements when both of the following conditions are met:

- (a) The matter is of fundamental importance to the user’s understanding of the true and fair view of the financial statements.
- (b) The matter is unusual.

Ordinarily the auditor determines a matter to be of *fundamental importance* to the user’s understanding of the financial statements if the possible consequences of the matter could significantly affect the entity’s financial position, financial performance and cash flows.

The auditor ordinarily considers a matter to be *unusual* if it occurs infrequently or is out of the ordinary course of business.

ISA 702 - Does the IAASB support the proposed new description of “fundamental importance?”

Explanatory Memorandum

The explanatory memorandum is included for information purposes only. If you have any major comments on the explanatory memorandum please provide them to us after the discussion at the Lima meeting.

Material Presented

Agenda Item 13-A (Pages 465 – 492)	Draft ED, ISA 701 (Clean)
Agenda Item 13-B (Pages 493 – 526)	Draft ED, ISA 701 (Marked)
Agenda Item 13-C (Pages 527 – 544)	Draft ED, ISA 702 (Clean)
Agenda Item 13-D (Pages 545 – 564)	Draft ED, ISA 702 (Marked)
Agenda Item 13-E (Pages 565 – 578)	Conforming Amendments to the ISAs for ISA 701 and ISA 702
Agenda Item 13-F (Pages 579 – 586)	Explanatory Memorandum for ISA 701 and ISA 702

Action Requested

The IAASB is asked to review the proposed standards and, if appropriate, approve them for public exposure.

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