

## **The Auditor's Report on Financial Statements**

### **Proposed New ISA 700**

#### **ISA 700, THE INDEPENDENT AUDITOR'S REPORT ON GENERAL PURPOSE FINANCIAL STATEMENTS**

1. The purpose of this International Standard on Auditing (ISA) is to establish standards and provide guidance on the form and content of the independent auditor's report issued as a result of an audit of general purpose financial statements of an entity (as described in ISA 200, "Objective and General Principles Governing an Audit of Financial Statements"). It also provides guidance on the matters the auditor considers in forming an opinion on the financial statements.
2. ISA 800, "The Auditor's Report on Special Purpose Audit Engagements" establishes standards and guidance for the auditor's report on special purpose audit engagements, including summarized financial statements, a component of financial statements (for example an individual financial statement, such as a balance sheet; or specified accounts, elements of accounts, or items in a financial statement), or financial statements prepared in accordance with a financial reporting framework that is a comprehensive basis of accounting other than International Financial Reporting Standards (IFRS) or national standards (as defined in ISA 200, "Objective and General Principles Governing An Audit of Financial Statements").
3. This ISA addresses circumstances when the auditor is able to express an unqualified opinion and no modification to the audit report is necessary. ISA 701, "Modifications to the Auditor's Report", establishes standards and guidance on the modifications to this report for an emphasis of matter, a qualified opinion, a disclaimer of opinion, or an adverse opinion.
4. **The auditor should evaluate the conclusions drawn from the audit evidence obtained as the basis for forming an opinion on the financial statements.**

#### **The Auditor's Opinion on Financial Statements**

5. The objective of an audit of general purpose financial statements is to enable the auditor to express an opinion whether the financial statements "give a true and fair view" or "present fairly in all material respects" the financial position, financial performance and cash flows of the entity in accordance with the applicable financial reporting framework
6. The terms used to express the auditor's opinion on an audit of general purpose financial statements are "give a true and fair view" or "presents fairly, in all material respects" and are equivalent. One of the underlying premises of both terms is that the auditor considers only those matters that are material to the financial statements. Which of these terms the auditor uses will be determined by the law or regulations governing the audit of financial statements in that jurisdiction, or by general convention in that jurisdiction as reflected, for example, in national standards.

*Applicable financial reporting framework*

7. The auditor's judgment regarding whether the financial statements give a true and fair view of, or fairly present, in all material respects, the financial position, financial performance and cash flows is made in the context of the applicable financial reporting framework. Without an appropriate framework, the auditor would not have a uniform standard for judging the entity's presentation of its financial position, financial performance and cash flows.
8. ISA 200, "Objective and General Principles Governing an Audit of Financial Statements", describes what constitutes a financial reporting framework for general purpose financial statements. ISA 210, "Terms of Audit Engagement", requires the terms of the engagement to identify the applicable financial reporting framework and describes the matters considered by the auditor in agreeing on the applicable financial reporting framework with the client.
9. ISA 200 and ISA 210 presume that International Financial Reporting Standards or national accounting standards issued by authorized national organizations (as defined in ISA 200, paragraph 28) are appropriate financial reporting frameworks for general purpose financial statements. ISA 210 addresses the auditor's responsibilities when the entity uses a different financial reporting framework to prepare its general purpose financial statements. It requires the auditor to consider whether the financial reporting framework chosen by management is authoritative and comprehensive. Guidance to assist the auditor in this regard is provided in ISA 200 paragraph 30. ISA 210 does not permit the auditor to accept an engagement to audit general purpose financial statements when the auditor concludes that the financial reporting framework chosen by management in these circumstances is not comprehensive and authoritative. General purpose financial statements prepared using a framework that is not comprehensive and authoritative will not result in financial statements that present fairly the financial position, financial performance and cash flows of the entity.
10. If after accepting an engagement involving a financial reporting framework chosen by management, the auditor identifies deficiencies in the financial reporting framework that were not anticipated when the engagement was accepted, the auditor discusses the reasons for the deficiencies with management and encourages management to address these deficiencies. When management believes that the framework is appropriate, the discussion with management may also involve reconsidering the purpose of the financial statements and whether they are, in fact, intended to be used as general purpose financial statements. In such circumstances, the auditor refers to the standards and guidance in ISA 800, "The Auditor's Report on Special Purpose Audit Engagements".
11. However, if after considering these factors, the auditor concludes that the financial statements are general purpose financial statements (which in the remainder of this ISA are referred to as "financial statements") and that there are deficiencies in the financial reporting framework such that, as a result, the financial reporting framework is not comprehensive and authoritative, the auditor expresses a disclaimer of opinion or withdraws from the engagement, as discussed in ISA 701, "Modifications to the Auditor's Report"<sup>1</sup>.

<sup>1</sup> Proposed wording for ISA 701, "**If after accepting the engagement, the auditor concludes the financial reporting framework is not comprehensive and authoritative, and management refuses to address the deficiencies, the auditor should express a disclaimer of opinion or withdraw from the engagement.** The auditor expresses a disclaimer of opinion since, in the absence of a comprehensive and authoritative financial reporting framework, the auditor has no basis on which to form an opinion on the financial statements.

*Forming an opinion on the financial statements*

12. In forming the opinion, the auditor considers all audit evidence obtained and evaluates whether that evidence provides reasonable assurance that the financial statements taken as a whole are free of material misstatement (ISA XX, “The Auditor’s Procedures in Response to Assessed Risk” establishes standards and guidance on the auditor’s evaluation of the sufficiency and appropriateness of audit evidence obtained, and ISA 320, “Audit Materiality” establishes standards and guidance on the auditor’s evaluation of the effects of misstatements). The auditor considers whether, in the auditor’s judgment:
- (a) the accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate in the circumstances (see ISA XX, “Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement” paragraphs 34-35);
  - (b) the information presented in the financial statements, including accounting policies, is presented in a manner that provides relevant, reliable, comparable and understandable information; and
  - (c) the financial statements reflect the underlying transactions and events in a manner that presents fairly the financial position, financial performance, and cash flows of the entity.
13. **The auditor’s report should be in writing and should contain a clear expression of the auditor’s opinion on the financial statements.**

**Basic Elements of the Auditor’s Report**

14. The auditor’s report includes the following basic elements, ordinarily in the following layout:
- (a) title;
  - (b) addressee;
  - (c) opening or introductory paragraph that identifies the financial statements audited;
  - (d) a section describing management’s responsibilities for the preparation and fair presentation of the financial statements;
  - (e) a section describing the auditor’s responsibilities and the scope of the audit, which includes:
    - (i) a reference to the ISAs, or to both the ISAs and relevant national standards, when appropriate; and
    - (ii) a description of the work an auditor performs in an audit;
  - (f) an opinion paragraph containing:
    - (i) a reference to the applicable financial reporting framework used to prepare the financial statements (including identifying the country of origin<sup>2</sup> of the financial reporting framework when International Financial Reporting Standards are not used, and identifying any additional legal and regulatory requirements with which the entity is also required to comply in preparing the financial statements); and

<sup>2</sup> In some circumstances it also may be necessary to refer to a particular jurisdiction within the country of origin to identify clearly the financial reporting framework used.

- (ii) an expression of opinion on the financial statements;
  - (g) date of the report;
  - (h) auditor's address; and
  - (i) auditor's signature.
15. Consistency in the structure, content and wording of the audit report when the audit has been conducted in accordance with the ISAs promotes credibility in the global marketplace by making more readily identifiable those audits that have been conducted in accordance with globally recognized standards. It also helps to promote the reader's understanding and to identify unusual circumstances when they occur. Consistency is therefore strongly encouraged. For this reason, at a minimum, the auditor's report should contain all of the basic elements described in this ISA and summarized in paragraph 14 (that is, it is important that the content of the auditor's report be consistent). However, this ISA does not mandate the structure and wording because it is recognized that they may need to be tailored to respond to the specific environment in a particular jurisdiction. Furthermore, when the audit is designed to enable the auditor to comply with both the ISAs and relevant national standards, the auditor may be obliged by national law or regulation to prepare the auditor's report differently, as discussed in paragraph 38.
16. Each of the basic elements of the auditor's report is discussed more fully below.

*Title*

17. **The auditor's report should have a title that clearly indicates that it is the report of an independent auditor.**
18. The title "Independent Auditor's Report" affirms that the auditor has met all of the independence and ethical requirements of an independent auditor and, therefore, distinguishes the auditor's report from reports that might be issued by others. If, however, the words used to describe the auditor in a particular jurisdiction clearly conveys the meaning that the auditor is independent, it is not necessary to add the term "independent" to the title.

*Addressee*

19. **The auditor's report should be appropriately addressed as required by the circumstances of the engagement and local regulations.** The report is ordinarily addressed either to the shareholders or the board of directors of the entity whose financial statements are being audited.

*Opening or Introductory Paragraph*

20. **The auditor's report should identify the financial statements of the entity that have been audited, including the date of and period covered by the financial statements. The report should specifically identify the title of each of the components that comprise the financial statements on which the auditor is expressing an opinion, including the related notes.**
21. Ordinarily, the opening paragraph would identify the financial statements by stating that the auditor has audited the accompanying financial statements of the entity, which comprise [*state the titles of the financial statements required by the applicable financial reporting*

*framework, such as the balance sheet as at December 31, 20X1, and the income statement, the statement of changes in equity and cash flows statement for the year then ended]* and the related notes.

22. The auditor's opinion covers the components of the complete set of financial statements as defined by the applicable financial reporting framework. Ordinarily, this includes: a balance sheet, an income statement, a statement of changes in equity, a cash flow statement, and a summary of significant accounting policies and other explanatory notes. If the entity has not included a component that is required by the applicable financial reporting framework, the auditor expresses either a qualified opinion or an adverse opinion, as appropriate depending on the nature of the departure, as discussed in ISA 701, "Modifications to the Auditor's Report."
23. In some circumstances, the entity may also choose to voluntarily present together with the financial statements supplementary information that is not required by the financial reporting framework. Supplementary information might be presented to, for example, enhance a user's understanding of the financial reporting framework or to provide further explanation of specific financial statements items. Such information is normally presented in either supplementary schedules or as additional explanatory notes. The auditor's opinion may or may not cover the supplementary information and it is therefore important for the auditor to be satisfied that any supplementary information that is not covered by the auditor's opinion is clearly differentiated.
24. Certain supplementary information, by its nature or how it is presented, would be considered by a reasonable user to be an integral part of the entity's financial statements and, therefore, if presented by the entity is considered to be covered by the auditor's opinion. For example, explanatory notes or supplementary schedules that are cross-referenced from the financial statements are portrayed as being an integral part of the financial statements and are covered by the auditor's opinion. Equally, the nature of the subject matter may be such that it is so interrelated to the entity's presentation of its financial position, financial performance and cash flows that it is covered by the auditor's opinion because it is not possible to differentiate it sufficiently from the audited financial statements. This would be the case, for example, with a statement in the notes to the financial statements regarding the extent to which the financial statements comply with another financial reporting framework.
25. Supplementary information that is presented as an integral part of the financial statements does not need to be specifically referred to in the auditor's report because the reference to the explanatory notes in the description of the components of the financial statements in the introductory paragraph is sufficient.
26. **The auditor should be satisfied that any supplementary information presented together with the financial statements that is not covered by the auditor's opinion is clearly differentiated from the audited financial statements.**
27. The auditor considers whether any unaudited information is presented in a manner that could be construed as being covered by the auditor's opinion and, if so, asks the entity to change how the information is presented. The auditor considers, for example, where the unaudited information is presented in relation to the financial statements and any audited supplementary information, and whether it is clearly labeled as "unaudited". The auditor asks the entity to remove any cross references from the financial statements to unaudited

supplementary schedules or explanatory notes because the demarcation between the audited and unaudited information would not be sufficiently clear. Unaudited explanatory notes that are intermingled with the audited notes can also be misinterpreted as being audited. Therefore, the auditor asks the entity to place the unaudited information outside of the set of financial statements, or, if that is not possible in the circumstances, at a minimum, place the unaudited explanatory notes together at the end of the required notes to the financial statements and clearly label them as unaudited.

28. The fact that supplementary information is unaudited does not relieve the auditor of the responsibility to read that information to identify material inconsistencies with the audited financial statements. The auditor's responsibilities with respect to unaudited supplementary information are consistent with those described in ISA 720, "Other Information in Documents Containing Audited Financial Statements".

*Management's responsibilities*

29. **The auditor's report should include a section that describes management's responsibilities. This section should include the following statements:**

- (a) **management is responsible for the preparation of financial statements that fairly present the financial position, financial performance and cash flows of the company in accordance with the applicable financial reporting framework; and**
- (b) **to obtain an understanding of the financial position, financial performance and cash flows of the entity, users should read the accompanying financial statements prepared by management.**

**This section should also include a description of important aspects of management's responsibility, which should include, as a minimum:**

- (a) **maintaining internal controls that are designed to prevent and detect fraud and error;**
- (b) **selecting and applying accounting policies that are consistent with the applicable financial reporting framework and appropriate in the circumstances; and**
- (c) **making necessary accounting estimates.**

30. Financial statements are the representations of management. Management is responsible for preparing financial statements that fairly present the financial position, financial performance and cash flows of the company in accordance the applicable financial reporting framework. In order to fulfill this responsibility, management maintains internal controls that are designed to prevent and detect fraud and error in order to ensure the reliability of the entity's financial reporting. The preparation of the statements requires management to make necessary accounting estimates, as well as to select and apply appropriate accounting principles. This determination will be made in the context of the applicable financial reporting framework.

31. The description of the key aspects of management's responsibilities may vary depending on the legal obligations of management in a particular jurisdiction. In addition, the term management has been used in the ISA as an illustration. The term used to describe those responsible for the financial statements will vary according to the legal framework in each jurisdiction. For example, in some jurisdictions, reference may be made to the directors,

rather than to management. In others, it may also be appropriate to refer to those charged with governance.

32. The auditor's report includes a statement that users should read the accompanying financial statements to emphasize that the auditor's report does not provide information about the entity's financial position, financial performance and cash flows and, therefore, is not a substitute for users' own due diligence in obtaining an understanding of these matters.

*Auditor's responsibilities*

33. **The auditor's report should include a section that describes the auditor's responsibilities and the scope of the audit. This section should include a statement that the responsibility of the auditor is to express an opinion on the financial statements based on the audit.**
34. The section in the auditor's report that describes the auditor's responsibilities begins with the statement that the auditor's responsibility is to express an opinion on the financial statements based on the audit in order to contrast it to management's responsibility for the preparation and presentation of the financial statements.
35. **This section should also describe the scope of the audit by stating that the audit was conducted in accordance with ISAs or in accordance with both the International Standards on Auditing and relevant national standards, when appropriate. When reference is made to relevant national standards, the auditor's report should identify the country of origin of the national standards.**
36. The term "scope of an audit" refers to the audit procedures deemed necessary in the circumstances to achieve the objective of an audit. The reference to the standards used conveys to the reader that the audit has been carried out in accordance with established standards.
37. ISA 200, "Objective and General Principles Governing an Audit of Financial Statements" specifies what is required in order to conduct an audit in accordance with the ISAs. Paragraph 7d. in that ISA states that the auditor should not describe the audit as being conducted in accordance with the ISAs unless the auditor has complied with all of the requirements of the ISAs.
38. The auditor may, however, design the audit to enable the auditor to comply with both the ISAs and relevant national standards. In such circumstances, the auditor complies with the requirements of the ISAs regarding the conduct of the audit and also performs any additional procedures necessary to comply with the relevant national standards. While the auditor can always perform the procedures necessary to comply with both the ISAs and relevant national standards, there may be inconsistencies in the reporting requirements of the ISAs and the relevant national standards. In such circumstances, it is desirable for the auditor to prepare the auditor's report on the audit of financial statements in accordance with this ISA because, as noted in paragraph 15, consistency in the audit reports of audits that have been conducted in accordance with the ISAs promotes credibility in the global marketplace by making more readily identifiable those audits that have been conducted in accordance with globally recognized standards. The auditor may be obliged, however, by national law or regulation to prepare the auditor's report differently. In such circumstances, the auditor ensures that the report following the national report format contains all of the requirements of the ISAs

regarding the content of the auditor's report even if the report structure, format or wording is different.

39. **The description of the auditor's responsibilities should include a statement that the audit was planned and performed to obtain reasonable, but not absolute, assurance whether the financial statements are free of material misstatement caused by fraud and error. It should also describe an audit as including:**
- (a) **obtaining an understanding of the entity and its environment, including internal control, to assess the risks of material misstatement of the financial statements, and performing audit procedures to address those risks;**
  - (b) **examining, on a selective basis, accounting records underlying the financial statements and other information that provides evidence supporting the amounts and disclosures in the financial statements;**
  - (c) **evaluating the appropriateness of the accounting principles adopted;**
  - (d) **evaluating the reasonableness of significant accounting estimates made by management; and**
  - (e) **evaluating the overall financial statement presentation and disclosures.**
40. **This section should also explain that while the auditor obtained an understanding of the entity's internal controls as a basis for determining the nature, timing and extent of the audit procedures, the auditor's understanding and procedures do not provide a sufficient basis for expressing an opinion on the design or effective operation of the entity's internal controls.**
41. **This section should include a statement by the auditor that the auditor has obtained sufficient appropriate evidence to be able to express an opinion on the financial statements.**
42. Audits performed under the ISA's will include various procedures that are designed to respond to the risk of material misstatement in the financial statements being audited. However, the auditor's report should describe the audit using the wording described in paragraph 39 to promote a common understanding of the nature of an audit performed under the ISA's. In rare circumstances, an auditor may conclude that the report should also describe additional procedures that the auditor performed or matters related to the procedures described in paragraphs 39. In such circumstances, the auditor may describe such procedures in an emphasis of a matter paragraph (as described in ISA 701, "Modifications to the Auditor's Report"). However, the auditor should not describe procedures performed as a result of "other reporting responsibilities" as described in paragraphs 47 to 48 in an emphasis of a matter paragraph, but instead should follow the guidance in those paragraphs.

*The auditor's opinion*

43. **The opinion paragraph of the auditor's report should clearly identify the applicable financial reporting framework used to prepare the financial statements (including identifying the country of origin of the financial reporting framework when International Financial Reporting Standards are not used and identifying any additional legal and regulatory requirements with which the entity is also required to**

**comply in preparing the financial statements) and state the auditor's opinion as to whether the financial statements give a true and fair view (or are presented fairly, in all material respects,) the financial position, financial performance and cash flows of the entity in accordance with the applicable financial reporting framework.**

44. To advise the reader of the context in which the auditor's opinion is expressed, the auditor's opinion identifies the applicable financial reporting framework upon which the financial statements are based. When the applicable financial reporting framework is not International Financial Reporting Standards, the auditor's opinion also identifies the country of origin for the applicable financial reporting framework. The auditor identifies the applicable financial reporting framework in such terms as:

- "...in accordance with International Financial Reporting Standards" or
- "...in accordance with accounting principles generally accepted in Country X..."

45. In addition to specifying the financial reporting framework with which financial statements are to be prepared, legislation or regulation in some jurisdictions sometimes also requires the financial statements to comply with certain specified requirements. In these jurisdictions, the applicable financial reporting framework encompasses both the financial reporting framework specified in the legislation and the additional legal and regulatory requirements. In these circumstances, the auditor identified the applicable financial reporting framework in such terms as:

"...in accordance with International Financial Reporting Standards and the requirements of Country X Corporations Act."

46. **An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view (or are presented fairly, in all material respects,) in accordance with the applicable financial reporting framework. An unqualified opinion also indicates implicitly that any changes in accounting policies or in the method of their application, and the effects thereof, have been properly determined and disclosed in the financial statements.**

*Other reporting responsibilities*

47. Some jurisdictions may also require the auditor to address other reporting responsibilities, that is, in addition to the responsibility to report whether the financial statements have been prepared, in all material respect, in accordance with the applicable financial reporting framework. In some cases, the relevant standards or laws may require the auditor to report on these other responsibilities within the auditor's report on the financial statements. In other cases, the auditor may be required to report separately on these matters.
48. **When the auditor is required to report on other reporting responsibilities in the auditor's report on the financial statements, these reporting responsibilities and the auditor's conclusions thereon should be identified clearly and distinguished from the auditor's responsibilities for and opinion on the financial statements.** This is ordinarily achieved by addressing the other reporting responsibilities in a separate section of the report that follows the opinion paragraph, and when applicable, any emphasis of matter paragraph on the financial statements.

*Date of Report*

49. **The auditor should date the report as of the date on which the auditor has obtained sufficient appropriate audit evidence to support the auditor's opinion.**
50. The date of the auditor's report indicates the date of the completion of the audit, which is considered to be the date on which the auditor has obtained sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion. The auditor may not yet have fulfilled all responsibilities related to the audit, for example, the auditor may not yet have had an opportunity to communicate the audit matters of governance interest that arose from the audit to those charged with governance. However, the auditor has completed the work necessary to support the auditor's opinion on the financial statements. It is important that the auditor's report include this date because it informs the reader that the auditor has considered the effect on the financial statements and on the report of events and transactions of which the auditor became aware and that occurred up to that date.
51. **Since the auditor's responsibility is to report on the financial statements as prepared and presented by management, the auditor should not date the report earlier than the date of approval of the financial statements.** ISA 560, "Subsequent Events" defines the date of approval of the financial statements and how it relates to other important dates that influence the auditor's responsibilities regarding subsequent events.

*Auditor's Address*

51. **The report should name a specific location, ordinarily a city, in the jurisdiction where the auditor practices.**

*Auditor's Signature*

52. **The report should be signed in the name of the audit firm, the personal name of the auditor or both, as appropriate for the particular jurisdiction.**

**The Auditor's Report**

53. The following is an illustration of the auditor's report expressing an unqualified opinion and incorporating the basic elements set forth above.

## INDEPENDENT AUDITOR'S REPORT

*(Appropriate Addressee)*

**Report on the financial statements**

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 flows statement for the year then ended and the related notes.

*Management's responsibility*

Management is responsible for the preparation of financial statements that fairly present the financial position, financial performance and cash flows of the company in accordance with International Financial Reporting Standards. To obtain an understanding of these matters, users should read the accompanying financial statements that have been

prepared by management. Management's responsibility includes: maintaining internal controls that are designed to prevent and detect fraud and error; selecting and applying accounting policies that are consistent with the financial reporting framework and appropriate in the circumstances; and making necessary accounting estimates.

#### *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 plan and perform the audit to obtain reasonable, but not absolute, assurance whether the financial statements are free of material misstatements caused by fraud or error. An audit includes:

- obtaining an understanding of the company and its environment, including internal control, to assess the risks of material misstatements in the financial statements, and performing audit procedures to address those risks.
- examining, on a selective basis, accounting records underlying the financial statements and other information that provide evidence supporting the amounts and disclosures in the financial statements.
- evaluating the appropriateness of the accounting policies adopted.
- evaluating the reasonableness of significant estimates made by management.
- evaluating the overall financial statement presentation and disclosures.

While we obtained an understanding of the company's internal controls as a basis for determining the nature, timing and extent of our audit procedures, our understanding and procedures do not provide a sufficient basis for expressing an opinion on the design or effective operation of those internal controls.

We believe that we have obtained sufficient appropriate evidence to be able to express an opinion on the financial statements.

#### *Our opinion*

In our opinion, the financial statements give a true and fair view of [or "*present fairly, in all material respects*"] the financial position of the Company as of December 31, 20X1, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

#### **Report on other legal and regulatory requirements**

We also performed the specific additional procedures with respect to other disclosures by the Company required by law in accordance with professional standards applied in Country X.

We confirm that the management report contains appropriate disclosures as to the acquisition of shares and controlling interests.

AUDITOR

Date

Address

## **Public Sector Perspective**

*[To be developed following the July IAASB meeting.]*