

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

### **Overview of the Project (as prepared for the CAG meeting)**

#### **Background**

Over time, a number of questions and suggestions have been raised regarding the guidance in the ISAs on the form and content of the auditor's report.

One of IAASB's key objectives is to establish auditing standards and guidance for financial statement audits of such high quality that they are acceptable to auditors, governments, securities regulators and other key stakeholders across the world. A major development in this regard is the proposal currently being contemplated by the EU to require auditors to comply with and report in accordance with ISAs by 2005. It is also not unreasonable to expect IOSCO to have endorsed the use of the ISAs for cross border offerings and listings of securities by 2005. Thus, by 2005, there will be a substantial and increasing number of auditors reporting under the ISAs in a number of major economies around the world.

Given the visibility of the auditor's report, consistent and generally accepted guidance on the form and content of the auditor's report will be important to gaining stakeholders' understanding and acceptance of the ISAs. Clear reporting guidance will be equally important to an increasing number of auditors who may be looking to the ISAs for the first time for guidance on how they should word their auditor's reports.

It is for these reasons that the IAASB approved a project to revisit ISA 700 "The Auditor's Report on Financial Statements."

#### **Scope of the Project**

The number of reporting issues that could be addressed is large and trying to address them all simultaneously impracticable. In order to develop a logical strategy and approach, IAASB analyzed the list of potential issues from the perspective of their strategic importance, the barriers to consensus, and the type of guidance needed. In light of the importance of 2005, when many auditors may be reporting in accordance with the ISAs for the first time, it was agreed that IAASB should focus on addressing the reporting issues related to the audit of financial statements first, with the goal of having a revision to ISA 700 approved and in effect by January 1, 2005. The key issues that will be addressed are summarized below.

There were also a number of issues related to special purpose audit engagements, review engagements, and engagements for which ISAs do not yet provide guidance. These issues (a list of which is attached to this overview) will be addressed in future as and when IAASB has the resources and agenda time available.

## Issues to be Addressed

Reporting issues	Description
1. Referring to the audit having been conducted in accordance with ISAs and national standards and practices.	<p>ISA 700 currently says that the auditor should refer in the scope paragraph to “ISAs or relevant national standards or practices.” Some have questioned whether this position remains viable as the ISAs are increasingly recognised as a generally accepted set of standards in their own right. In addition, no guidance is currently provided on the auditor’s responsibilities and the reporting implications when the auditor intends to comply with both ISAs and national auditing standards. This will be a key issue as more and more countries move from using national standards as the predominant auditing standards with which they comply in conducting audits to using the ISAs as the predominant auditing standards.</p> <p>Issues that will need to be addressed include:</p> <ul style="list-style-type: none"> <li>▪ The knowledge and competency required of the auditor when reporting under different auditing standards.</li> <li>▪ The work effort required in order to be able to report that the audit has been conducted in accordance with the ISAs and another set of auditing standards.</li> <li>▪ The reporting implications when:               <ul style="list-style-type: none"> <li>- procedures under ISAs and the other standards differ</li> <li>- reporting standards differ</li> <li>- reporting standards conflict.</li> </ul> </li> </ul>
2. How auditors should report on additional or ancillary reporting responsibilities.	<p>In addition to being asked to express an opinion on the financial statements, auditors may be asked to address additional matters in their auditor’s reports.</p> <p>In some jurisdictions, auditors may be required to provide positive assurance on certain specified matters, in addition to reporting on the financial statements. These matters can include:</p> <ul style="list-style-type: none"> <li>• reporting on supplementary financial information included with the financial statements; or</li> <li>• reporting on specific matters, such as the adequacy of internal controls or the completeness of an entity’s book and records.</li> </ul> <p>Reporting on such matters are considered to be additional reporting responsibilities because they involve providing assurance on the matters identified and thus carrying out procedures in addition to those that would normally be carried out in order to provide an opinion on the financial statements.</p> <p>In other cases, auditors may be required to comment on specific matters that come to their attention during the course of the financial statement audit. These are referred to as ancillary responsibilities because auditors are not required to carry out any procedures other than those required to provide an opinion on the financial statements.</p> <p>As auditors increasingly use ISAs, it would be useful to have a common approach to how these additional reporting responsibilities are reported on in relation to the auditor’s opinion on the financial statements.</p> <p>The nature of these reporting requirements may influence how they should be reported.</p>

Reporting issues	Description
3. Whether there is a need for greater clarification on the date of the auditor's report.	<p>This issue was raised in responses to the ED on the revisions to ISA 700, but has also been flagged as a growing issue by the firms given the increasing use of the ISAs. ISA 700 has significantly less detail regarding guidance on the date of the auditor's report than many national auditing standards. Since the date of the auditor's report can be quite significant in legal disputes, additional guidance may be useful and increasingly relevant as ISAs are used as the primary standards.</p> <p>ISA 700 requires the auditor to date the auditor's report as of the completion date of the audit, with the caveat in a second requirement that the auditor should not date the report earlier than the day on which the financial statements are signed or approved by management. Some national auditing standards date the auditor's report as of the date fieldwork is completed rather than on completion of the audit (i.e., date the report earlier than the date the report is officially signed). The relationship between the date fieldwork is completed and the date of statement approval needs to be clarified, because it establishes the extent of the auditor's responsibilities in relation to subsequent events and whether "dual dating" is an option. In addition, at least some national standards are silent on management's approval of the financial statement, which may relate in part to the fact that such a formal requirement may not be part of their governing legislation for financial reporting.</p>
4. The form of reporting appropriate when the auditor is reporting on the financial statements of a parent when either no consolidated financial statements are prepared, or where consolidated statements are prepared but published separately.	IAS 27 "Consolidated Financial Statements" says if the entity is a parent undertaking, the entity must prepare group financial statements except under limited circumstances. In some countries, however, entities are required to prepare both consolidated and unconsolidated financial statements, which might be issued together or separately. Some question whether it is appropriate to express an opinion on whether the financial statements fairly present, or are true and fair, in accordance with IAS if the financial statements of the parent are not the consolidated financial statements and do not meet the criteria for exemption under IAS 27. National accounting and auditing standards in some countries specifically address this issue and recommend a specific form of modified report. In others, practice has been to express a clean opinion – at least in certain circumstances (e.g., if the unconsolidated financial statements are issued together with the consolidated financial statements). It appears that there are, therefore, differences in current practice on this issue in major jurisdictions.
5. Whether identification of the country of origin of the financial reporting framework is adequate disclosure, particularly in those circumstances when the financial reporting framework used differs significantly from IAS.	<p>The lack of disclosure regarding inadequacies in the financial reporting framework was the issue that originally led to the World Bank criticism of the profession during the Asian financial crisis.</p> <p>Legends (i.e., explanatory paragraphs cautioning readers on the financial reporting framework) are used in auditor's reports in some countries. However, arguments have been made that to promote transparency an explanatory paragraph should be included in all auditor's reports that are not prepared in accordance with IAS – even in those countries with well-established capital markets, such as the US or UK.</p>
6. Whether the definition of a "financial reporting framework" is needed.	ISA 700 currently says that, "the financial reporting framework is determined by IAS, rules issued by recognized standard setting bodies, and the development of general practice within a country, with appropriate consideration of fairness and with due regard to local legislation." It is unclear whether this is simply a list of acceptable frameworks, or a hierarchy of sources of guidance in applying a

Reporting issues	Description
	framework. Nevertheless, the description does not provide sufficient guidance to assess whether the accounting principles adopted by an entity are an “acceptable” framework for general purpose financial statements, although ISA 700 refers to the use of an “acceptable” financial reporting framework. This is an issue in those countries where there is no national financial reporting framework promulgated by a standard-setting authority or regulator.
7. Whether the current standard wording of the auditor's report adequately conveys the auditor's responsibilities and the assurance provided.	<p>Some have argued that the current wording of the standard auditor's report continues to be a major cause of the “expectation gap” because it uses cryptic language and does not adequately convey what auditors do and the assurance that can be justifiably taken from the audit.</p> <p>Post Enron, some have also questioned whether the auditor's report should continue to state “whether the financial statements give a true and fair view (or are presented fairly, in all material respects,) in accordance with the financial reporting framework” or whether there should be a “two-part” opinion (i.e., financial statements are in accordance with the framework <u>and</u> are true and fair/fairly presented).</p> <p>Revisions to other ISAs currently in process (e.g., the audit risk model, fraud and accounting estimates projects) might also have implications for the wording of the auditor's report.</p>
8. Whether additional guidance is needed for circumstances when the financial statements have been prepared or refer to IAS.	IAASB approved at its September 2002 meeting an ED of an IAPS that provides guidance on reporting on financial statements that report on compliance with the IAS/IFRS. Consideration will be given to whether any additional guidance might be needed to deal with any further issues.
9. The reference to the titles of the relevant financial statements rather than just page numbers.	This issue was raised in ED responses to the recent revisions to ISA 700. ISA 700 currently requires the auditor's report to “identify the financial statements of the entity that have been audited”. While it does not specifically state that the auditor must refer to the title of the statements, all of the illustrative reports do so. Consideration will be given to whether additional guidance might be warranted.
10. The inclusion of more documents within the scope of the auditor's report than is currently mentioned.	This issue was raised in ED responses to the recent revisions to ISA 700. ISA 700 currently requires the auditor's report to “identify the financial statements of the entity that have been audited.” The illustrative examples refer to the balance sheet and the related statements of income and cash flows. The ISA is silent on how to deal with additional documents. (To be addressed together with issue 2.)

There were a few additional issues that might be expected to be on the list of issues to be addressed, but which at present IAASB does not intend to address.

- *Whether or not the auditor's report should have an addressee.*

This issue was identified in the ED comments on the recent revisions to ISA 700. ISA 700, paragraph 7, currently requires the auditor's report to be appropriately addressed. Some jurisdictions do not require an addressee. In others, the identification of the addressee is important from a legal perspective because it influences to whom the auditor owes a duty of care and legal liability.

The current wording, while not specific, does set the principle that the report should have an addressee and allows the auditor to use professional judgment to determine to whom the report should be addressed in the particular circumstances. That decision would be influenced by legal frameworks in different jurisdictions, which do differ. For that reason, it would be difficult to be more specific in the international standard.

- *Whether to require auditors to sign in their own names as well as that of the firm of which they are part.*

ISA 700 currently requires the auditor's report to be signed in the name of the audit firm, the personal name of the auditor, or both. The guidance notes that the auditor's report is ordinarily signed in the name of the firm because the firm assumes responsibility for the audit.

IAASB is currently not intending to address this issue because legal and regulatory structures (including the disciplinary structures) governing the profession influence who the appropriate signatory would be in any particular jurisdiction. It is unlikely that the ISA could be more specific given the diversity in legal/regulatory structures around the world.

- *Whether additional guidance is needed for circumstances when the financial statements have been prepared in accordance with a "foreign" financial reporting framework*

This issue deals with circumstances when the financial statements have been prepared in accordance with a "foreign" financial reporting framework (i.e., a different national financial reporting framework than the country in which the entity is located). IAASB is in the process of developing guidance for circumstances when an entity reports in accordance with the IFRS in addition to the local national financial reporting framework. But it seems more appropriate for guidance on circumstances when an entity prepares financial statements under two national financial reporting frameworks to be addressed at a national auditing standards level.

### Project Milestones

As noted above, the objective is to have the revised ISA 700 approved and in place by January 1, 2005. In order to meet that target, the following milestones and key dates will need to be met:

IAASB Meeting	Milestone
December 2002/March 2003	Issues paper and confirmation of scope and principles
March 2003/June 2003	Preliminary review of ED wording
September 2003	IAASB approval of ED
March 2004	IAASB review of issues raised by ED respondents and proposed resolution of them
June 2004	IAASB approval of final ISA

### **Task Force and Resources**

The project has been assigned to an IAASB Task Force chaired by Philip Ashton, with members from Canada, France, Malaysia, the UK and US.

Background research and project development is being carried out by a drafting team provided by the firms represented on the Task Force, under the coordination of a small central team led by Philip Ashton.

**Attachment**

<b>Reporting issues other than those relating to ISA 700 recommended to be deferred until resources are available</b>	
1.	Whether clarification is needed on how the auditor should report when he or she has identified an event or condition that may cast significant doubt on the entity's ability to continue as a going concern but is satisfied that management's plans for future actions mitigate the risk.
2.	Whether guidance is needed on auditor's reports on pro forma financial information.
3.	Whether the guidance in ISA 800 "The Auditor's Report on Special Purpose Audit Engagements" on reports on a component of financial statements needs to be revised.
4.	Whether auditor's reports on a single financial statement (e.g., a balance sheet) should be modified to indicate that other primary statements are not presented.
5.	Whether guidance is required on the auditor's responsibilities when the auditor's report are posted on the entity's website.
6.	Whether additional guidance is needed on auditor's reports on summarized financial statements.
7.	Whether revisions to ISA 910 "Engagements to Review Financial Statements" are needed to require the reference to the country of origin of the financial reporting framework.

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