

## **The Auditor's Report on Financial Statements Scope of Project**

### **Purpose of this Agenda Paper**

1. This agenda paper describes the Task Force's recommendations regarding the scope of the project.

### **ISA 700 History**

2. The existing ISA 700 was approved by the IAPC in November 1993 and released together with the codification of the former International Auditing Guidelines (IAG's) as ISAs in September 1994. The IAG on which ISA 700 was based (IAG 13) had been issued originally in 1983 and revised in 1989. However, rather than being simply codified into the new ISA structure, IAPC improved and modernized the guidance in IAG 13 before it was issued as the new ISA 700 in 1994.
3. The existing ISA 700 reflects similar wording for the auditor's report on financial statements as that adopted by a number of national standard-setters in the late 1980's and early 1990's to better explain the auditor's responsibilities and scope of the audit. Since then, some national standard setters have amended the wording of their standard reports, often in response to new regulatory requirements (for example, Germany and the UK). Many other countries, however, including the US and Canada, have not made significant changes to the auditor's report wording in the last decade – in particular, there have been few changes to the description of the auditor's responsibilities.
4. A limited revision was made to ISA 700 in June 2001 to require the auditor's report to identify the country of origin of the financial reporting framework – a change adopted by most national standard setters worldwide as well.

### **Issues Identified in the June 2002 Project Proposal**

5. The project proposal approved by the IAASB in June 2002 proposed to address the ten issues that are shown in the table on the next page.
6. When the IAASB approved commencement of the project in June 2002, the Board reserved making a final decision on the scope of the project pending research on the issues and consultation with stakeholders. The Task Force believes that based on the research completed to date and consultations, the IAASB should now be in a position to confirm the scope of the project.

### **Support from Stakeholders**

7. Input on the scope of the project was sought from the IAASB's Consultative Advisory Group (CAG) at its meeting October, 17-18 and the meeting October 21 of representatives from 24 European national auditing standard setters organized by FEE. In both meetings, there was general support for the scope as defined – accepting that certain issues, while not perhaps relevant in their own environment, needed to be addressed from the perspective of the IAASB's worldwide constituency (e.g., issues related to financial reporting frameworks other than IAS/IFRS, which will not be relevant in the EU after 2005). Reassuringly, there

seemed to be concurrence that the issues that need to be addressed to facilitate convergence towards a common auditor's report in Europe are included in the proposed scope of the project. Reasons for proposing to exclude certain issues were accepted as reasonable, and although some additional issues were raised, none seemed to garner broad-based support. Overall, there appears to be agreement that the issues identified in the project proposal are those that are the most critical to resolve before 2005.

<b>ISSUES IDENTIFIED IN THE JUNE 2002 PROJECT PROPOSAL</b>		
<i>Issue</i>	<i>Description of the issue</i>	<i>Disposition</i>
1	Issues arising when the audit has been conducted in accordance with ISAs as well as national standards and practices.	Agenda Item 3-C Paragraphs 38-49
2	How the auditor should report on special reporting responsibilities imposed by law or regulation.	Agenda Item 3-C Paragraphs 8-37
3	Whether there is a need for greater clarification on the date of the auditor's report.	Agenda Item 3-C Paragraphs 50-60
4	The form of reporting appropriate when the auditor is reporting on the accounts of a parent when either no consolidated financial statements are prepared, or where consolidated statements are prepared but are published separately.	March 2003
5	Whether it is adequate disclosure to identify in the auditor's report the country of origin of the financial reporting framework used, particularly in those circumstances when the financial reporting framework differs significantly from IAS/IFRS.	Agenda Item 3-C Paragraphs 78-87
6	The definition of a financial reporting framework.	March 2003
7	Whether the standard auditor's report adequately conveys the auditor's responsibilities and the assurance provided.	Agenda Item 3-C Paragraphs 61-77
8	Guidance for circumstances when the financial statements have been prepared or make reference to IAS/IFRS.	Proposed IAPS exposed for comment
9	How the auditor's report should refer to the financial statements in the introductory paragraph – for example, by referring to the titles of the financial statements, the page number they are on, or a more general reference.	Agenda Item 3-C Paragraphs 88-93
10	Reporting implications when the financial statements include more information than is required under the financial reporting framework (e.g., supplementary financial statement information).	March 2003

### **2005 as a Key Date**

8. The Task Force is of the view that it is important that the revisions to ISA 700 be approved and in effect for auditor's reports issued in 2005. In order to achieve the vision of an integrated European securities market, there is general recognition of the need for convergence towards a common auditor's report (and equally common standards for the audit of financial statements), at the same time as European companies adopt IAS/IFRS in 2005. Differences in the form, structure and content of the auditor's report will impede the

goal of an integrated European securities market. The IAASB has an opportunity to take leadership in this process and, in so doing, achieve substantial convergence of auditor's reports not only in Europe but auditor's reports for all audits conducted in accordance with ISAs worldwide. A commitment by the IAASB to use best efforts to revise ISA 700 to address those issues necessary to facilitate consistent reporting by auditors in Europe by January 2005 is likely to be viewed very positively by the EC and, therefore, could significantly influence the probability of the ISAs being adopted in Europe by 2005 – which is being seriously considered by the European Commission, but is not yet a done deal. Setting a target to have revisions to ISA 700 approved and effective for auditor's reports issued in 2005 is, therefore, consistent with the IAASB's strategic goals.

9. If January 2005 is supported as being a firm target, the scope of the project needs to be manageable. Now that ISA 700 is "open", there have been, and no doubt will continue to be, a number of suggestions for additional matters to be addressed in the project and scope creep is a very real risk. Therefore, the Task Force is proposing the following parameters for the scope of the project and seeks the IAASB's support for them.

#### **Focus on the Audit of Financial Statements Only**

10. In focusing more closely on the wording of the auditor's report, there may be a desire to debate more broadly the nature and scope of the auditor's responsibilities. While that may be a valuable debate, it is not one that is limited to the auditor's report and deserves to be discussed in a broader forum. For that reason, the Task Force proposes starting from the objective of an audit in ISA 200 "Objective and General Principles Governing an Audit of Financial Statements" paragraph 2:

The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework.

Starting from this base does not necessary prevent the IAASB from debating the wording of the auditor's opinion and the guidance on the judgments necessary to form that opinion, but it does help to define the scope and nature of the engagement and the subject matter on which the auditor is reporting.

11. The primary objective of the project is, therefore, revisions to ISA 700. It will not address the form and content of other types of reports in other ISAs, although there may be a need to make conforming amendments to illustrative reports in other ISAs where some of the content of those reports is drawn directly from ISA 700 (e.g., illustrative reports in ISA 710 "Comparatives"). The Task Force recognizes that decisions made in the project on certain issues might lead to the need for conforming amendments in basic principles or guidance in other ISAs. However, the need for such conforming amendments would be discussed fully as they arise (see for example preliminary views on possible conforming amendments needed in relation to the date of the auditor's report in Agenda Item 3-C, paragraph 60).

#### **Unmodified Reports Only**

12. The Task Force also proposes to focus on revisions to the basic elements of the auditor's report and the illustrated auditor's report, and not to address the structure of and basic principles in the section in ISA 700 on modified reports (e.g., qualified opinions, disclaimer of opinions, adverse opinions and emphasis of matters).

13. None of the issues in the project proposal deal specifically with the basic principles underlying modified reports. Furthermore, the EC has indicated that a new directive under development is based on the structure for modified reports now in ISA 700 and it would complicate that process if the section were re-opened at this time. That is not to say that the guidance on modified reports might not need review to expand the section to ensure consistent interpretation as auditors increasingly look for guidance when making judgments on reporting. In fact, a few of the suggested issues that could have been addressed in this project related to modified reports (e.g., revisiting the guidance on multiple uncertainties in ISA 700 paragraph 34). However, the Task Force is of the view that including issues related to modified reports in this project would expand the scope of the project significantly and could jeopardize the IAASB's ability to complete the project before 2005. It is also a topic that could be addressed independently in its own project if and when appropriate.
14. Just for clarification, however, in addressing a few of the issues, the project might propose that certain matters should be included in an emphasis of matter paragraph. But, such recommendations would be within the structure and basic principles of the current guidance in ISA 700 on such paragraphs.

#### **Further Refining Scope in Approach to Issues**

15. Further refinement of the scope of the project will come as the IAASB debates and agrees on the approach to a number of the issues. In particular, the Task Force is aware that there is a risk that the consultation and debate that may be involved to reach consensus on any fundamental change to the description of the auditor's responsibilities and what an audit is could significantly lengthen the project. However, how the auditor's report communicates what auditors do is both important and topical. The IAASB would likely be criticized if the project did not address that issue. Therefore, the Task Force recommends that the IAASB use best efforts to address this issue prior to 2005, with the knowledge that we may subsequently have to adopt a fall back strategy of issuing the revisions to ISA 700 in two stages.

#### **Action Required by IAASB**

Do you agree with the proposed scope of the project:

- Focusing on the basic elements of the auditor's report and the illustrated auditor's report on the financial statements in ISA 700?
- Addressing the ten issues identified in the project proposal?
- Not revisiting the guidance in ISA 700 on modified reports at this time?