

Reporting on Compliance with International Financial Reporting Standards – Issues Paper

Introduction

1. This issues paper provides an overview of the comments received and related issues and provides a summary of the proposed changes to the IAPS. The overview section summarizes common and/or significant comments received and the proposed response, and is intended to facilitate the discussion of issues by the IAASB. The summary section highlights the significant changes made to the draft IAPS and is intended to facilitate the review of the revised draft IAPS. A listing of all comments received and the proposed disposition is included for informational purposes as Agenda Item 5-D.
2. A total of 22 comment letters were received during the exposure period. With the exception of one respondent, the commentators supported the IAASB's efforts to issue guidance on this subject matter, subject to certain clarifications. The one respondent that did not support the project cited scope issues as the reason for lack of support of issuance of the IAPS. This commentator requested the scope to be extended to matters that the Board has previously concluded not to address in this limited-scope project.

Overview of Comments Received and Related Issues

1. **Scope issues.** Additional guidance was requested on matters such as the transition to IFRS, risk assessment and audit procedures, definition of an “acceptable”/“appropriate” financial reporting framework, when separate financial statements of members of a group are issued, and materiality.

No additional guidance on these matters is being proposed. These matters are being considered as part of other IAASB projects underway, and are considered outside the scope of this limited-scope project. Particular comments received that are relevant to these other IAASB projects will be forwarded to the appropriate task force.

<i>Does the IAASB continue to believe that the scope of the IAPS is appropriate?</i>
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2. **Inconsistency of 1(a) – 1(c) with the table of contents and headers.** Many commentators felt the IAPS was confusing because of the inconsistency of the descriptions in 1(a) – 1(c) with the headers and table of contents.

The table of contents, headers and items 1(a) through 1(c) were all revised and made consistent. The viewpoint for all sections of the IAPS was revised to make it clear that each section relates to compliance with IFRS. For example, the header and wording in paragraphs 5 through 7 were changed from “compliance with more than one financial reporting framework” to “compliance with IFRS and a national financial reporting framework.”

<i>Does the IAASB agree with the approach taken?</i>
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3. ***Lack of reference in paragraph 3 to the IAS 1 “true and fair” override.*** The third sentence of paragraph three indicates “the auditor does not express an unqualified opinion that indicates that financial statements have been prepared in accordance with IFRSs if the financial statements contain any departure from IFRSs and the departure has a material effect on the financial statements.” This statement failed to acknowledge the “true and fair” override in IAS 1.

A footnote was added to address this concern.

<i>Does the IAASB agree with the approach taken?</i>

4. ***Whether it is “rare”/ “unlikely” for financial statements to simultaneously comply with IFRS and a national financial reporting framework as indicated in paragraphs 5 and 6.*** Paragraph 5 stated that it is “unlikely” that financial statements would simultaneously comply with a national financial reporting framework and IFRS. Paragraph six stated such situation is “rare”. Most commentators agreed with this guidance and some actually suggested strengthening of the guidance in this regard. The minority view wanted the guidance to be weakened, particularly the penultimate sentence of paragraph 5, which stated “even if the requirements are similar enough to be able to prepare one balance sheet, one income statement and one cash flow statement, the notes to the financial statements *are likely to be confusing for all but the most straightforward entities.*”

The guidance in paragraph 5 and paragraph 6 was strengthened and conformed to “extremely unlikely.” At the same time, the penultimate sentence of paragraph 5 was revised from “likely to be” to “may be” and the language “for all but the most straightforward entities” was deleted since this does not appear to be interpreted or substantiated. These changes appear to be appropriate and balance the concerns of commentators.

<i>Does the IAASB agree with the proposed changes? Does the IAASB agree with the phrase “extremely unlikely”?</i>
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5. ***Encouraging management in paragraph 6 to choose the “predominant” financial reporting framework instead of asserting compliance with multiple financial reporting frameworks.*** Many commentators opposed to the guidance in paragraph 6 that the auditor encourages management to apply only the “predominant” financial reporting framework as opposed to asserting compliance with more than one financial reporting framework. Commentators felt this guidance resulted in the auditor making a management decision, and also opposed the reference to “predominant” financial reporting framework since there is no guidance on what is predominant.

The reference to “predominant” financial reporting framework was removed and the guidance on the auditor’s communication was revised to indicate the auditor advises management and those charged with governance of the possibility of a qualified and/or adverse opinion since it is extremely unlikely for there to be simultaneous compliance with IFRS and a national financial reporting framework.

<i>Does the IAASB agree with the revised guidance on the auditor’s advice to management?</i>

6. ***Inconsistency of paragraphs 5-7 with paragraphs 8-9.*** One commentator noted that paragraphs 5-7 are not entirely consistent with paragraphs 8-9. This inconsistency was noted to be due to the lack of a statement in paragraphs 5-7 that when separately assessing the fairness of financial statements that management asserts fully comply with both IFRS and a national financial reporting framework, the auditor considers whether the failure to comply with one framework (e.g., IFRS) is so material and pervasive as to result in the failure to fully comply with the other framework (e.g., the national financial reporting framework). This appeared to be a very valid point since this is also required in paragraphs 8-9.

Guidance was added to the second and third sentences of paragraph 7 to make the guidance consistent with that in paragraphs 8-9. In addition, an example opinion was added at the end of paragraph 7 for a situation where there is full compliance with IFRS but the auditor determines the need to qualify the opinion on compliance with the national financial reporting framework.

Does the IAASB agree with these changes? Is the example opinion considered appropriate?

7. ***Clarification on what is “misleading” when there is disclosure of the extent of compliance with IFRS.*** Many commentators requested additional guidance on what is considered misleading enough to result in a qualified or adverse opinion when there is a note that references the extent of compliance with IFRSs. These commentators felt the current guidance was insufficient and would result in inconsistency in practice. In particular, the commentators were curious if quantification of the effects of not appropriately complying with IFRS always cures the misleading issue.

Changes were made to paragraphs 9 and 10 (previously paragraphs 8 and 9). The revised guidance in these paragraphs, and in particular, items 10(a) and 10(b) make it clear that if the effect of not properly applying a particular IFRS is material and pervasive then this is misleading whether or not there is quantification. Otherwise, if the lack of application is not material and pervasive, then quantification cures the issue of misleading. Other changes were made, such as eliminating “because of inadequate or inaccurate disclosure in the financial statements” in third sentence of revised paragraph 10 in order to prevent further confusion.

Does the IAASB agree with the revised approach? Is more guidance considered necessary on what is misleading?

8. ***Whether additional guidance is needed on when the auditor qualifies or issues an adverse opinion when the disclosure of the extent of compliance with IFRS is misleading.*** Many commentators requested additional guidance on what the auditor considers in determining whether to issue a qualified opinion or adverse opinion when the reference to extent of compliance with IFRS is considered misleading. Many commentators felt the current guidance would result in an inconsistency of application in practice unless more clarification was provided.

No changes were made since the basic principles are in ISA 700.

Does the IAASB agree with Staff's view in responding to this issue?

9. ***The guidance in paragraphs 8 through 9 will discourage voluntary disclosures as to the extent of compliance with IFRS.*** Several comment letters indicated the concern that the IAPS would discourage voluntary reporting of the extent of compliance with IFRS in a footnote to financial statements prepared in accordance with a national financial reporting framework. While many commentators expressed such concerns, an overall consensus on the importance of this issue was clearly not received. In fact, some commentators were not concerned with this issue and a few actually suggested the guidance should be strengthened on the need to qualify or issue an adverse opinion. For those commentators that requested the guidance to be balanced (for example, through the use of an emphasis of matter paragraph when a footnote on the extent of compliance with IFRS is not misleading), they generally acknowledged that when a footnote is misleading, the opinion on compliance with the national financial reporting framework should be modified through a qualified or adverse opinion.

Paragraph 11 was added to acknowledge that a footnote on the extent of compliance with IFRS is not always misleading and therefore does not always result in the need to qualify or issue an adverse opinion. Guidance on use of an emphasis of matter paragraph was added, although not overemphasized. A statement that the use of an emphasis of matter paragraph is not a substitute for a qualified or adverse opinion was also made.

Does the IAASB agree with the addition of paragraph 11? Does the additional guidance on emphasis of matter properly balance the discussion and address commentators' concerns, or does it result in the potential for inconsistency in practice? Alternatively, should a statement be added that an emphasis of matter paragraph is always required where there is a note on the extent of compliance with IFRS and the note is not considered misleading?

10. ***The example qualified opinion in paragraph 9 is deficient.*** Most commentators believed the example opinion was deficient, mainly because it was not clear whether the qualification was due to the reference to “substantial compliance”, the lack of quantification of the effects of not applying IAS 39, and/or the material and pervasiveness of not complying with IAS 39. Other commentators felt the example did not comply with the requirements of ISA 700 paragraph 40.

The example opinion was revised based on the commentators' suggestions. It is now clear in the revised opinion that the qualification is due to the material and pervasive effect of not applying IAS 39.

Does the IAASB agree with the wording of the revised opinion? Is use of the phrase “material and pervasive” in the revised opinion considered appropriate?

Summary of Proposed Changes to IAPS

Paragraph 1

- Revised 1(a) – 1(c) to conform to the revised headers and table of contents. The headers were revised for clarity and to put the IAPS in the context of compliance with IFRS for all sections.

- Added “that are asserted by management to be” in the fourth sentence to make it clear that management makes the decision as to financial statement compliance.
- Revised “relevant national standards or practices” to “national financial reporting framework” for consistency and to prevent confusion. This change was made throughout the IAPS.
- Added example to the statement that this IAPS may be applied by analogy to financial statements not prepared in accordance with IFRS.

Paragraph 2

- Revised header to include “solely” in order to make it clearer that this section does not apply to situations where the financial statements are prepared in accordance with the national financial reporting framework and there is a note reference to IFRS.
- Deleted the last sentence in footnote 1 since the IAS revisions project will not be complete at the time of issuance of this IAPS. Conforming changes will be made when the revisions process is complete.
- Revised the bullets to make it clear that the reference to “note” is the accounting policy footnote to prevent confusion with the guidance in paragraphs 8-11.

Paragraph 3

- Added footnote 3 to acknowledge the “true and fair” override in IAS 1.
- Amended the penultimate sentence to mirror the language in ISA 700 paragraph 36 item (b).

Paragraph 4

- Amended the first sentence for clarity and brevity based on comments received.

Paragraph 5

- The first two sentences were combined to reflect the change in viewpoint of paragraphs 5 through 7 from compliance with multiple financial reporting frameworks (could be more than two) to compliance with IFRS and a national financial reporting framework.
- In the seventh sentence, “extremely” was inserted before “likely” in order to strengthen the language on the likelihood of simultaneous compliance with IFRS and a national financial reporting language.
- The phrase “or has eliminated all barriers for compliance with IFRSs” was inserted at the end of the seventh sentence to acknowledge that simultaneous compliance with IFRS and a national financial reporting framework may be possible in situations where there are accounting policy choices that can be made that are acceptable under both frameworks or where the national financial reporting framework does not have guidance on a certain subject matter, but allows the application of IFRS on such subject matter.
- Reference to the statement of changes in equity was added to the seventh sentence since this required by IFRS.
- The phrase “likely to be” in the penultimate sentence was revised to “may be” based on various comments received.
- The phrase “for all but the most straightforward entities” at the end of the penultimate sentence was deleted since this not really interpreted or substantiated.

Paragraph 6

- The first sentence was changed consistent with the decision to revise the viewpoint from compliance with multiple financial reporting frameworks to compliance with IFRS and a national financial reporting framework.
- The second sentence was revised to eliminate the reference to “predominant” financial reporting framework and the implication that the auditor makes management decisions based on multiple comments received that opposed this language.
- The third sentence was revised to add the consideration of relevant laws and regulations when choosing the financial reporting framework.

Paragraph 7

- The first sentence was changed consistent with the decision to revise the viewpoint from compliance with multiple financial reporting frameworks to compliance with IFRS and a national financial reporting framework.
- The third sentence was revised and the fourth sentence was added in order for this guidance to be consistent with the guidance in paragraphs 8-9, which states that lack of compliance with one financial reporting framework can be so misleading as to result in lack of compliance with the other financial reporting framework.
- An example opinion where there is an unqualified opinion on compliance with IFRS and a qualified opinion on compliance with the national financial reporting framework was added based on commentators request for an example opinion.

Paragraph 8

- The header was revised to be consistent with the revised paragraph 1(c).
- The first sentence was conformed to “national” financial reporting framework for consistency and also to eliminate the reference to “acceptable” financial reporting framework since “acceptable” is not defined or interpreted in the IAPS or ISA 700.
- The second sentence was added in order to indicate why management may disclose the extent of compliance with IFRSs. Several commentators requested such addition.
- In the last sentence “factually correct” was changed to “accurate” since “factually correct” is not a common phrase used in the ISAs and “accurate” is used in the definition of assertions.

Paragraph 9 (Previously Paragraph 8)

- This paragraph was previously part of paragraph 8, but was separated into a new paragraph given the length of paragraph 8.
- The first sentence was revised for clarity and also the phrase “without fully disclosing the effect of not applying that standard” was deleted since the disclosure could be misleading even if there is quantification of the expected effects of applying a particular IAS (e.g., a multinational financial institution that does not adopt IAS 39).

Paragraph 10 (Previously Paragraph 9)

- The phrase “because of inadequate or inaccurate disclosure” was deleted because it appears the purpose of items (a) and (b) is to describe how financial statement disclosure of the extent of compliance with IFRS can be misleading and this phrase appears to overly confuse the discussion.
- Item (a) was revised to indicate that if the disclosure has materially inaccurate or material and pervasive incomplete information, this may be misleading regardless of whether there is quantification of the possible effects of proper application. An example was added to illustrate. The term “untruthful” was deleted since it is not a commonly used term and appears unnecessary.

- Item (b) was revised in order for the example to be clearer and to not conflict with the changes to item (a).
- The example qualified opinion was revised based on comments received and it was made clear that the qualification stems from item (a) in order to prevent confusion as to why the opinion is qualified.

Paragraph 11

- This paragraph was added to balance the discussion and indicate that disclosure of the extent of compliance with IFRSs does not always result in the need to qualify or issue an adverse opinion.
- A reference to the use of an emphasis of matter paragraph was added based on the comments received; however it was not overemphasized. In particular, a statement that the use of an emphasis of matter paragraph is not a substitute for a qualified or adverse opinion was made.
- A final statement was added to indicate that if the auditor does not qualify or issue an adverse opinion, then this implicitly means the auditor does not consider the disclosure misleading.

Does the IAASB agree with the changes made?

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