

## **Auditor's Report on Financial Statements – Modified Reports**

### **Introduction**

1. This agenda paper discusses how the Task Force has responded to comments raised by the IAASB at the December 2002 meeting regarding the need to review/revise/expand the guidance in ISA 700 on modified reports.

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

Read through the Task Force's proposals regarding revisions to the section of ISA 700 dealing with modified reports.

Consider the questions for discussion on page 3 and whether you agree with the Task Force's recommended approach?

### **Modifications to the Auditor's Report**

2. The project proposal approved by IAASB in June 2002 proposed that the revisions to ISA 700 focus on the basic elements of the auditor's report and the illustrated auditor's report, and that no changes would be made, at this time, to the bold-letter principles or guidance for modified reports (other than any necessary conforming amendments arising from the revisions to the wording to unmodified reports). When approving the project proposal, however, the IAASB asked the Task Force to seek views on the scope of the issues to be addressed in the project from the IAASB Consultative Advisory Group (CAG) and deferred making a final decision on the scope pending the outcome of those discussions. Input from CAG and others was supportive of the proposed scope.
3. While there was general support for the proposed scope of the project at the December 2002 IAASB meeting, some members expressed the view that additional/revised guidance was needed on modified reports. Members commented that there might be a need to revise the guidance now in ISA 700 on modified reports:
  - For consequential conforming amendments arising from proposed changes in the wording of the first part of ISA 700;
  - To provide additional guidance on the application of existing principles in ISA 700, such as expanding the guidance to illustrate when modifications are needed and how the auditor's report should be modified in particular circumstances; and
  - To revisit the guidance now in ISA 700 on multiple uncertainties.
4. While the Task Force recognizes the valid concerns raised by IAASB members, after weighing all of the pros and cons, the Task Force continues to hold the view that:
  - With the exception of any consequential conforming amendments arising from proposed changes in the wording of a "clean" auditor's report, modifications to the auditor's report can be addressed separately.
  - Revisions to the guidance in ISA 700 on modifications to the auditor's report should be addressed as a separate project.

- The types of issues raised by some IAASB members with respect to modified reports represent a major undertaking. A number of the suggestions were not simply seeking illustrative examples and additional guidance on how to apply the existing principles, but rather argued for a fundamental reconsideration of basic principles themselves. (It should be noted that these fundamental issues were not raised in the Task Force's consultations with stakeholders, including regulators and users of auditor's reports.)
  - Although it may be desirable to issue revisions to the wording of the "standard" report and to modifications simultaneously, it is the Task Force's view that our goal to have an exposure draft issued by October 2003 in order to have the new ISA 700 guidance on standard wording of the auditor's report in place by 2005 would be seriously jeopardized if IAASB decided to follow this approach. A delay to the ISA 700 revision would be unfortunate because IAASB would lose the opportunity to facilitate convergence of a common auditor's report in Europe (which the EU has stated it wants in place by 2005) – something that could prove instrumental in achieving adoption of ISAs in the EU for 2005 and would bring IAASB closer to global acceptance.
  - There are no compelling reasons why the two parts of ISA 700 cannot be addressed separately and under separate timetables. Additional guidance on modifications would be welcomed, but is not critical by 2005, as auditors have been issuing reports on the basis of the guidance on modifications for a number of years. Guidance helpful in applying the principles now in ISA 700 could be issued at any time. A more fundamental reconsideration of the underlying principles, however, would benefit from well-grounded research. It would be better to take the time and deal with that comprehensively rather than rush to meet the 2005 target.
5. The Task Force appreciates the concern that if IAASB issues a revision to ISA 700 that only updates the first part of ISA 700, readers might assume that IAASB believes no revisions are needed on the guidance on modified reports. One way to manage this issue would be to split ISA 700 into two new ISAs – the first addressing the auditor's "standard" report (without modification) and a new ISA (for example, ISA 701) that would focus on modifications to the auditor's report. This project could focus on the first, keeping the scope manageable so that IAASB has a good probability of achieving its goal of issuing the revision to ISA 700 so that it is in place by 2005. The existing guidance on modified reports would be moved to a new ISA 701 with only the minimal changes necessary to accomplish that as part of the first phase, with a more fundamental review/revision/expansion of the principles and guidance on modified reports in the second phase.
5. In order to move this idea forward, the Task Force sent a note to the IAASB members and technical advisors in January 2003 seeking their views on the proposed strategy and asking for examples of areas in which members believe the principles and guidance on modified reports need to be reviewed or could be expanded.
6. Although not unanimous, on balance, responses received from IAASB members to date is supportive of the approach and, based on that input, a project proposal is being prepared and will be discussed by the Planning Committee at its meeting on March 16, 2003. The Chair will report back to the IAASB on the Planning Committee's discussions and recommendations at the March 2003 IAASB meeting.
7. However, the Task Force believes that it is important to obtain the IAASB's support for this approach at the March 2003 meeting so that IAASB can communicate its strategy on the revisions to ISA 700 to stakeholders and manage expectations.

**Questions for Discussion**

Do you agree that ISA 700 should be revised in two separate projects: the current project addressing the wording of an unmodified auditor's report, and a separate project that would provide comprehensive guidance on modified reports?

Do you agree that IAASB's first priority should be to revise ISA 700 with respect to the wording of an unmodified auditor's report?

Do you support the decision to split ISA 700 into two new ISAs – ISA 700 on the wording of an auditor's report without modification and ISA 701 addressing modifications to the auditor's report?

Do you agree that the existing guidance on modified reports could be moved to the new ISA 701 with only the minimal changes necessary with a more fundamental review/revision/expansion of the principles and guidance on modified reports developed separately in a second phase?

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