

Auditor's Report on Financial Statements Summary of Decisions on Key Issues

Introduction

1. The project proposal approved by the IAASB in June 2002 identified ten issues that were to be addressed in the project. This Agenda Paper summarises the decisions the IAASB has made with respect to the both the overarching principles for the project and the approach to and key principles related to those ten issues.

Summary of overarching principles

2. There have been mixed views on how prescriptive ISA 700 should be with respect to the structure of the report and its wording. On the one hand, increased standardization of the structure, content and wording would enhance consistency and make an ISA 700 audit report more recognizable in the global marketplace. On the other hand, consistency may impede innovation. There is also a recognition that, at least in certain circumstances, the wording of the report may need to be tailored to respond to the specific national environment. For these reasons, IAASB concluded at the March meeting that, while ISA 700 should specify the matters to be addressed in the audit report (i.e., the content), it should include strong encouragement for, but not mandate, the structure and report wording.
3. At the CAG meeting in May, over two-thirds of the participants expressed a preference for a more consistent audit report. The predominant message was that a consistent structure is crucial – perhaps more so than the wording of the report itself, although some believed that it was equally important that the wording of the audit opinion be consistent. CAG members noted that, as audit reports are used across borders, it's important to approach the issue from a global, rather than national, perspective and expressed the belief that from global perspective, the benefits of a consistent structure outweighed the benefits of flexibility.
4. In discussing the feedback from CAG at the May IAASB meeting, IAASB members continued to believe that the appropriate approach for ISA 700 is to identify the required elements of the audit report, but not to mandate the structure and wording. It was noted that the wording of the audit opinion is necessarily driven by legal requirements, which are not consistent globally. Therefore, it would not be possible for ISAAB on its own to mandate consistent wording to the audit opinion.
5. Revised overarching principles, taking into account the Board's views at the March and May meetings, are as follows:
 - To increase consistency in **reporting between jurisdictions**:
 - The auditor's report for audits conducted in accordance with ISAs should be, to the extent practicable, consistent and be readily identifiable. ISA 700 will, therefore, identify the required content of the audit report. It will also indicate the preferred structure and wording of an unmodified auditor's report, but would do so more by way of strong encouragement in the guidance and illustrative example rather than by mandating specific wording for the ISA 700 report.
 - The auditor's report should identify clearly the report on the audit of financial statements

and other reporting responsibilities of the statutory auditor. By way of illustrative example and strong encouragement, this would be through the use of a two-part report structure.

- To increase the **understandability** of the auditor's role and of the auditor's report, in revising the wording of the auditor's report, IAASB will aim to:
 - Use simple, understandable language.
 - Be as concise as possible, while still aiming to be informative and include clear explanations.

SUMMARY OF DECISIONS ON SPECIFIC ISSUES			
<i>Issue</i>	<i>Description of the issue</i>	<i>Status</i>	<i>Approved approach & principles</i>
1	Issues arising when the audit has been conducted in accordance with ISAs as well as national standards and practices.	<p>Proposed approach & principles supported by IAASB in December 2002.</p> <p>IAASB suggested care in drafting ISA 200 ¶7 to ensure that we don't inadvertently undo the structure carefully established in separating ISQC from ISA 220.</p> <p>IAASB asked the TF in March 2003 to reconsider referring to "practices" when discussing national standards. The TF has deleted the reference.</p>	<ul style="list-style-type: none"> ▪ ISA 700 should be written in the first instance from the perspective of the audit being planned and performed in accordance with the ISAs alone. The ISA would separately provide guidance on audits conducted in accordance with both ISAs and national auditing standards. ▪ ISA 700 ¶12 will be amended to require the auditor's report to describe the scope of the audit by referring to the audit having been conducted in accordance with the ISAs. ▪ ISA 200 ¶7 will be amended to revise the guidance on the procedures required to conduct an audit in accordance with ISAs. By virtue of cross-references from the ISAs, an audit conducted in accordance with the ISAs also compels the auditor to comply with the IFAC Code of Ethics, including the independence requirements, and the new quality control standards for firms, once they are issued. ▪ ISA 700 should also provide specific guidance on how the auditor should report if the audit has been conducted to comply with both ISAs and national auditing standards. This guidance will: <ul style="list-style-type: none"> - Be based on the presumption that the national standards are those of the country in which the auditor is qualified and, therefore, will not include guidance on the knowledge and experience requirements necessary to have the expertise to fully comply with another country's auditing standards (such guidance may be appropriate at a national auditing standards level). - The auditor's report should refer to both sets of standards in the scope paragraph. The audit report will not try to communicate the differences between the ISAs and the national standards. - In those limited circumstances when there are inconsistencies in the reporting requirements of the ISAs and the national auditing standards, ISA 700 will express a preference for the auditor's report to use the content, structure and form of the report that is recommended by ISA 700. However, ISA 700 should acknowledge that the auditor might be obliged by national law or regulation to prepare the auditor's report differently. In such circumstances the auditor will be required to ensure that the report following the national report format contains all of the requirements in ISA 700 regarding the content of the auditor's report even if the structure or format is different.

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2	How the auditor should report on special reporting responsibilities imposed by law or regulation.	Approach & principles discussed in March 2003 and reconfirmed in May.	<ul style="list-style-type: none"> ▪ ISA 700 should address the auditor's other reporting responsibilities. ▪ The auditor's report on the audit of financial statements and other reporting responsibilities of the statutory auditor or auditor of record should each be clearly identifiable. By way of strong encouragement in the guidance and illustrative example, ISA 700 would express a preference to do this by way of a consistent structure whereby the auditor's other reporting responsibilities are in a section of the auditor's report that follows the opinion paragraph on the financial statements, and when applicable, any emphasis of matter paragraph on the financial statements. ▪ ISA 700 will not provide guidance on the form and content of the section on other reporting responsibilities. The form and content of this section of the report would be determined by local requirements that impose the other responsibilities on the auditor. ▪ The description of the auditor's responsibilities in the report on the audit of the financial statements will not refer to the ISA 720 responsibility with respect to other information in documents containing audited financial statements.
3	Whether there is a need for greater clarification on the date of the auditor's report.	<p>Proposed approach & principles generally well received in December 2002.</p> <p>At the May 2003 meeting, IAASB supported the approach of basing the date of the audit report on when the auditor has obtained sufficient appropriate evidence to support the audit opinion.</p>	<ul style="list-style-type: none"> ▪ The following terms should be adopted as the terminology to describe the key dates and responsibilities related to the processes of preparing, approving and issuing the financial statements and the auditor's report, and the dating of the auditor's report: <ul style="list-style-type: none"> - Date of the financial statements. - Date of approval of the financial statements. - Date of the auditor's report = the point when the auditor has sufficient appropriate evidence to support the audit opinion - Date of management's written representations. - Date of issuance of the auditor's report. - Country specific filing and regulatory dates. ▪ Conforming amendments to ISA 560, "Subsequent Events", and ISA 580, "Management Representations" should be made simultaneously to reflect these terms and definitions so that the guidance in all three ISAs is consistent and appropriately linked.

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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.	Preliminary discussions held with IASB staff. Further discussions with IASB are planned.	<ul style="list-style-type: none"> With the proposed revisions to IAS 1 & IAS 27 that recognise separate parent-only financial statements prepared in addition to consolidated financial statements (expected in October 2003), there is a view that both the parent-only and consolidated financial statements will be considered to comply with IFRS if they meet the necessary disclosure requirements. There may continue to be issues with respect to whether a cross reference from the parent financial statements to the consolidated financial statements is sufficient, or whether the consolidated financial statements must accompany the parent only financial statements or be “available to the reader”.
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.	<p>Proposed approach re “legends” for all non-IFRS or national GAAP financial statements not accepted by IAASB in December.</p> <p>A suggestion to include a discussion of readers’ responsibilities (eg be sufficiently knowledgeable, etc) in the auditor’s report was not fully supported by legal counsel. However, there was support for directing the reader to the financial statements to obtain an understanding of the entity’s financial performance.</p>	<ul style="list-style-type: none"> Proposed that the audit report will include a statement to the effect that readers need to look to the financial statements to gain an understanding of the financial position, performance and changes in financial position of the entity as the audit report does not provide that information. Guidance on the auditor’s responsibilities with respect to the entity’s choice of financial reporting framework is more fully described in ISA 200, IS 210 and ISA 700. Emphasis is on ascertaining whether the financial reporting framework is suitable for general purpose financial statements. If the auditor is able to conclude that the framework is not suitable before accepting the engagement, the auditor would not accept it. If questions regarding the suitability of the criteria only become apparent during the audit, the auditor either expresses a disclaimer of opinion or withdraws from the engagement. This approach is consistent with the Assurance Framework.

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6	The definition of a financial reporting framework.	<p>Proposed approach & principles were discussed in March and May 2003.</p> <p>Overall principles were well received by IAASB, however, position presented in draft exposure draft has been revised to address comments raised by IAASB.</p>	<ul style="list-style-type: none"> ▪ Discussion of financial reporting framework is made in the context of general purpose financial statements. Proposed revised wording emphasises that ISA 700 focuses on financial statements that address common information needs of a wide range of users (i.e., general purpose financial statements); special circumstances are addressed in ISA 800. ▪ Proposed wording builds on principles underlying the IAS Framework and IAS 1, i.e., common information needs of users are normally addressed by financial statements that provide information about financial position, financial performance and changes in financial position. IFRS or national accounting standards that meet certain criteria would be considered appropriate financial reporting frameworks for general purpose financial statements. ▪ The legislative and regulatory obligations of a reporting entity will ordinarily determine the financial reporting framework to be used by management in preparing the entity's financial statements, hereinafter referred to as the applicable financial reporting framework. ▪ When the reporting entity is registered or operating in a jurisdiction where there are no such legislative and regulatory obligations, the entity identifies an applicable framework. The entity's choice will be governed by local practice, industry practice, user needs, or other factors. ▪ The proposed standards do not permit an auditor to accept an engagement for an audit of general purpose financial statements when the financial reporting framework chosen by management is not comprehensive and authoritative since application of such a financial reporting framework will likely result in financial statements that do not present fairly the financial position, financial performance and cash flows of the entity. The proposed standards provide criteria for the auditor to use in assessing whether a financial reporting framework is comprehensive and authoritative. ▪ The auditor's opinion identifies the applicable financial reporting framework.

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7	Whether the standard auditor's report adequately conveys the auditor's responsibilities and the assurance provided.	<p>Preliminary discussions in December 2002 and March 2003.</p> <p>IAASB has tentatively agreed on the proposals noted in the next column, but asked the TF to give further consideration to a number of suggestions, in particular suggestions for the paragraph that describe the nature of an audit.</p>	<ul style="list-style-type: none"> ▪ The opening paragraph will be amended to identify the titles of the financial statements and refer to the related notes. ▪ The description of management's responsibilities will include a general reference to management's responsibility for the preparation and fair presentation of the financial statements. ISA 700 will also require the audit report to describe relevant aspects of that responsibility, include responsibility for such matters as selecting and applying accounting policies that are consistent with the financial reporting framework and appropriate in the circumstances, and making estimates and preparing financial statements that are free of material misstatements – whether due to fraud or error. The wording of this description will not be mandated as it may depend on the legal obligations of management in a particular country. ▪ A reference should be made to inform readers that they need to read the financial statements and related notes to obtain an understanding of the financial position, performance and changes in financial position. ▪ The audit opinion will be worded as “a true and fair view” or “present fairly”, with the assertion that they are equivalent terms. ▪ The audit opinion will continue to include a reference to the financial reporting framework. ▪ ISA 700 will include guidance on judgments the auditor takes into account when forming the opinion. ▪ The revision to ISA 700 will not, at this time, consider: <ul style="list-style-type: none"> - Whether or not the auditor should disclose any departures from the ISAs in the audit report, pending comments on the Exposure Draft of revisions to the Preface. - Whether the auditor should comment on changes in accounting principles.

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8	Guidance for circumstances when the financial statements have been prepared or make reference to IAS/IFRS.	Guidance completed.	IAPS 1014 approved.
9	How the financial statements 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.	Proposed approach & principles supported by IAASB in December 2002.	<ul style="list-style-type: none"> ▪ ISA 700 should require the audit report to identify the titles of the financial statements and eliminate the option to refer to page numbers only. Given the importance of the notes to the financial statements, the introductory paragraph should also make specific reference of the notes. ▪ Proposed illustrative wording would be as follows: <p><i>We have audited the accompanying financial statements of ABC Company, which comprise [state the primary financial statements such as the balance sheet as at the period end, and the income statement, statement of changes in equity and cash flow statement for the period then ended] and the related notes.</i></p>

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10	Reporting implications when the financial statements include more information than is required under the financial reporting framework (eg supplementary financial statement information).	Proposed approach & principles presented in March 2003 but there was not sufficient time to discuss them. IAASB members provided input offline.	<p><i>Proposed positions to be confirmed by IAASB in New York.</i></p> <p>Proposed model is to say that the auditor's opinion covers:</p> <ul style="list-style-type: none"> ▪ The components of a complete set of financial statements as defined by the applicable financial reporting framework. ▪ Voluntary supplementary information provided by the entity as additional explanatory notes or supplementary schedules when that information would be considered by a reasonable user to be an integral part of the entity's financial statements. This would include explanatory notes or supplementary schedules that are cross-referenced from the financial statements, or information that by nature is so interrelated to the entity's presentation of its financial position, financial performance and cash flows that it is not possible to differentiate it sufficiently from the financial statements. <p>If supplementary information is not to be covered by the auditor's report, the auditor must be satisfied that it is clearly differentiated, by considering where the unaudited information is presented in relation to the financial statements, and whether it is clearly labeled as unaudited.</p>

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