

Analysis of comments Approach and timing

Introduction

There were two issues raised by respondents regarding the IAASB's approach to the revision of ISA 700:

- the decision to split extant ISA 700 into two ISAs.
- timing of the revisions of ISA 701 and ISA 800 in relation to the release of a new ISA 700.

The Task Force thought it important to raise these issues first, as decisions on them could influence IAASB's plans for timing and approach to the various reporting projects.

1. Split between ISA 700 and ISA 701

A number of respondents (ACCA, AICPA, AuASB, CNCC/OEC, EYN, FSR, ICANZ, ICAI, KIBR, PAAB, RR) cautioned against the split of extant 700 into two ISAs. There were a number of reasons why the combined approach was preferred, including:

- both cover the subject of how to express the auditor's opinion on the audit of financial statements
- easier to use, as audit reporting guidance would be all in one place
- at a national level, professional accountants refer to and utilize audit report standards and guidance frequently and are accustomed to having all guidance related to the audit reporting in one place
- it separates and decouples linked concepts and related requirements
- material is duplicated
- the auditor's thought process has to be explained (and regulated) in different standards depending upon what the results of that thought process lead to
- references in ISA 700 to types of audit opinions are not defined or discussed in ISA 700.
- guidance on disclaimers of opinion is provided in proposed ISA 701 but no reference to this proposed standard is made in ISA 700

It was also pointed out that, if they are split, the guidance for the emphasis of matter paragraph – which is not in fact a qualification to the opinion but a modification – should be included in ISA 700 and not ISA 701.

DISCUSSION

The Task Force considered the comments and identified three approaches:

1. Combine ISA 700 and ISA 701 now, making it clear to readers that the section of the ISA on modified reports has been modified for conforming wording only and is under revision.

2. Keep ISA 700 and ISA 701 separate in the IAASB Handbook for now pending the completion of the ISA 701 project. Once the revisions are completed, recombine into a single standard as a conforming amendment to ISA 701.
3. Continue with the current plan to keep ISA 700 and ISA 701 separate.

The responses above articulate well the arguments in support of combining ISA 700 and ISA 701 (approach 1).

Arguments that support the approach that had been proposed in the Exposure Draft (3: keeping ISA 700 and ISA 701 separate) include the following:

- It allows IAASB to deal with modifications of audit reports on both general purpose financial statements (ISA 700) and on special purpose audits (ISA 800) in one ISA, as it is reasonable to expect that the same concepts would apply. If ISA 700 and ISA 701 were recombined into one standard, the scope of ISA 800 would have to be expanded to include guidance on modifications.
- It facilitates future revisions as all of the guidance on audit reporting need not re-opened.
- Assuming IAASB decides to keep the ISA 700, ISA 701 and ISA 800 projects on their current timetables (see discussion on timing on page), keeping IAS 700 and 701 separate at least for now, at a minimum, has merit for logistical and administrative reasons. If they were recombined at this point (prior to the completion of the ISA 701 revision), it would be difficult to convey to readers which part of the ISA has been revised and which part is pending revision.

A decision on this issue is needed quickly, as it will have implications for the work of both the ISA 701 and ISA 800 Task Forces.

Task Force Recommendation

For logistical and administrative reasons, the Task Force proposes to keep ISA 700 and ISA 701 separate for now pending the completion of the ISA 701 revision.

Given the large number of respondents who expressed a preference to keep the guidance on both unmodified and modified reports in one document, however, on completion of the ISA 701 project, the Task Force recommends that ISA 701 should form part of ISA 700 again.

The ISA 701 Exposure Draft will need to explain what is being proposed and why and be exposed with paragraph numbers beginning where ISA 700 paragraph numbers end. The ISA 800 Task Force will need to consider how best to address modifications to special purpose reports.

2. Timing of ISA 700 revisions

Five respondents (AICPA, EY, EYN, GT and IOSCO) commented on the phased approach to the ISA 700/701/800 revisions.

AICPA and GT expressed significant concerns about the phased approach and argued strongly that ISA 700 should not be finalized until the comprehensive reviews and revisions of ISA 701 and ISA 800 are completed (GT also suggests waiting pending revision to ISA 710, *Comparatives*, as well). Indeed AICPA stated that they would consider that the issuance of ISA 700 alone to be a fatal flaw and question whether the issuance of the Exposure Draft of ISA 700 alone constituted due process. Although the projects for ISA 701 and 800 have now begun, AICPA's and GT's main concerns are that commentators on the proposed standard are not being given the opportunity to see the whole picture and that it is not possible to anticipate the implications of the proposed standard without knowing what the revisions to ISA 701 and ISA 800 will entail. Thus, there could be an unintended fatal flaw in proposed revised ISA 700 but it may not be identified until the comprehensive review of all reporting guidance is completed.

Both AICPA and GT cite, as an example, the United States practice in which non-public broker-dealers of securities file a balance sheet only, with related disclosures, with the SEC. In practice, auditors report on this presentation as a complete presentation, (albeit understood that this presentation is for regulatory purposes and for broker-dealer customers). The proposed Exposure Draft would include that report within the scope of ISA 800. AICPA and GT feel that they cannot comment on the appropriateness of excluding this type of report from the scope of the proposed ISA 700 because it is not yet known how ISA 800 will treat reporting on this purportedly "incomplete" set of financial statements.

GT also argue that a piecemeal approach provides poor guidance during the interim period.

AICPA and IOSCO note that the agenda materials for the Modifications Paper at the April 2004 IAASB meeting included a proposal to move emphasis of matter guidance to ISA 700 as part of a conforming change. They question whether this would, in fact, be a conforming change rather than quite a significant amendment. RR makes a slightly different point although somewhat related in that he suggests that the IAASB should consider whether the promulgation of a series of conforming changes really is more helpful than leaving the text of existing standards alone unless revision of the entire standard is clearly called for.

EY and EYN also had reservations about the timing but said they would be comfortable finalizing ISA 700 once IAASB has had an opportunity to fully debate and approve the *scope* of the revision to ISA 800 in order to ensure that all relevant reporting matters are duly considered and no important issues are omitted

BASEL expressed the view that the two-stage approach was appropriate but encouraged the Board to proceed swiftly with the project dealing with ISA 701. Similarly, IOSCO stated that they would not object to a phased approach if the remaining work on other aspects of auditor's reports is done promptly and further changes that may need to be made to this ISA as a result of that work is properly coordinated. However, IOSCO are concerned about making significant

conforming changes to ISAs and therefore question whether the project on ISA 700 should be extended to take into account impacts from the ISA 701 project. IOSCO also encouraged IAASB to take stock of recent developments and ascertain the impact on the both ISA 700 and ISA 701.

DISCUSSION

Although there were strong views expressed on this issue, the vast majority of respondents didn't comment on the split or object to the proposed phased approach. IAASB fully debated the relative scopes of ISA 700 and ISA 800 prior to exposure and the responses did not raise new issues that weren't considered when IAASB approved the Exposure Draft.

One of the key drivers for the project was the fact that Europe was looking to adopt a common audit report. Some may argue that, with Europe's adoption of the ISAs being deferred until 2006, there is less pressure to get the ISA on the audit report wording completed and released. However, debate on the wording of the "common audit report" for Europe continues. It is very much hoped that the ISA 700 audit report will serve as the basis for the new audit report in Europe. If IAASB delays the finalization of ISA 700 significantly, it could negatively impact the influence that IAASB and ISA 700 could have in discussions in Europe. Equally, however, prematurely finalizing the ISA might not be the best strategy in this regard—ongoing dialogue will be important.

There remain valid reasons to proceed with finalizing ISA 700 and not to delay it unduly pending completion of ISA 701 and ISA 800. Perhaps the most compelling reason is that the new Audit Risk ISAs come into effect for 2005 audits. Since the revised wording of the auditor's report reflects the new audit risk approach, it would seem important that ISA 700 be released so that auditors can use the new report wording for the 2005 audits conducted using the new Audit Risk ISAs. The proposed ISA 700 revision also fills some gaps in the ISA literature with respect to, for example, the applicable financial reporting framework, supplementary information, and reporting under both ISAs and national standards and it would seem unfortunate to delay issuing that guidance unduly.

In addition, the Task Force continues to hold the view that there are unlikely to be fundamental changes to the principles in ISA 700 as a result of the development of ISA 701 and ISA 800.

That being said, in the current planning for all three projects, IAASB will have an opportunity to see how the three proposed ISAs will all fit together at the December 2004 meeting. Both the ISA 701 and ISA 800 Task Forces expect to present Exposure Draft wording at that meeting and it will not be until December that IAASB will be asked to consider final approval of ISA 700. Therefore, IAASB members will have the opportunity to see "the whole picture" before making a decision on whether or not to approve the final wording of ISA 700 and the timing of its release.

Task Force recommendation:

Proceed with the analysis of the responses to the ISA 700 Exposure Draft, with the expectation of presenting the proposed final ISA for approval in December 2004.