



International Federation of Accountants

545 Fifth Avenue, 14th Floor, New York, NY 10017 USA

Tel +1 (212) 286-9344 Fax +1 (212) 286-9570 www.ifac.org

Agenda Item 3

Committee: IAASB
Meeting Location: New York
Meeting Date: September 13-17, 2004

Auditor's Report on Financial Statements

Objectives of Agenda Item

To review and discuss proposed final wording of the revision to *ISA 700, The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements*, which is presented at this meeting for a first read.

Also included is the proposed final wording of the related amendments to:

- *ISA 200, Objectives and General Principles Governing an Audit of Financial Statements*
- *ISA 210, Terms of Audit Engagements*

and of the conforming amendments to:

- *ISA 560, Subsequent Events*
- *ISA 701, Modifications to the Independent Auditor's Report*
- *ISA 800, The Auditor's Report on Special Purpose Audit Engagements*

Background

The IAASB began its discussion of the project to revise ISA 700 at its June 2002 meeting and approved the final agreed scope of the project at its December 2002 meeting. It was agreed that the focus of the project would be on the wording of an unmodified audit report and that the revisions to the basic principles, essential procedures and guidance on modified reports should be addressed in a separate project "ISA 701."

In addition to proposed new wording for the auditor's report, the revisions proposed new guidance in the ISAs on the following:

- Forming the auditor's opinion at the conclusion of the audit
- The applicable financial reporting framework
- Supplementary information included with the financial statements
- Date of the auditor's report
- Conducting the audit in accordance with ISAs and national standards
- Other reporting responsibilities

The IAASB approved the exposure draft in December 2003. Comments were requested by March 31, 2004.

At the IAASB meeting in June 2004 in Copenhagen, IAASB reviewed significant issues raised by commentators on the Exposure Draft.

With respect the approach and timing, IAASB agreed that the Task Force should continue on the presumption that modifications to the auditor's report would be addressed in a separate ISA and to work towards having the ISA 700 revisions approved at the December 2004 IAASB meeting.

Activities since Last IAASB discussions

The Task Force had a two-day meeting at the end of July to reflect on the input received from IAASB in Copenhagen and to complete its review of all of the comments received.

Agenda Item 3-C is a mark-up showing all of the Task Force's recommended changes to the entire Exposure Draft wording. A clean copy of the wording is provided in Agenda Item 3-B.

This covering Agenda Item summarizes how the Task Force has addressed the Board's comments on the significant issues discussed at the Copenhagen meeting in June – i.e., the proposed wording for the sections on forming the auditor's opinion, the applicable financial reporting framework and the date of the auditor's report. Note that, while the mark-up to the Exposure Draft wording shows all changes from the Exposure Draft wording, changes made in the wording for the sections discussed in Copenhagen are highlighted with shading so that Board members can see the changes made in response to their comments in June.

The Board did not have an opportunity to discuss all of the issues in Agenda Item 8-E that was included in the Agenda papers for Copenhagen. This Agenda Item has been carried forward as Agenda Item 3-A, updated to reflect how the Task Force has addressed these issues in the proposed final wording. Since June, the Task Force has also included a new section D in that agenda paper the sets out the Task Force's recommendations on proposed revisions to the wording of the auditor's report in light of comments received on exposure.

Detailed analyses documenting how the Task Force has responded to each comment received has been prepared to document the Task Force's due consideration of each comment (see Agenda Items 3-D.1 – 3-D.7). These analyses are organized by the ISA to which the comments relate (and are in the order in which they appear in the Exposure Draft). Given the importance of the wording of the auditor's report, the comments related to the auditor's report are set out separately in Agenda Item 3-D.7 The Task Force does not propose to discuss these documents in detail at the September meeting. However, Board members are asked to review the analyses and be prepared to ask any questions they may have regarding how the Task Force has addressed specific comments received on exposure.

For reference, a list of the respondents to the Exposure Draft is set out in Appendix 1 to this Agenda Paper.

Discussion of significant issues

FORMING AN OPINION ON THE FINANCIAL STATEMENTS

In Copenhagen, the Board debated two key issues related to the section in ISA 700 on forming an opinion on the auditor's report:

1. *Whether "true and fair" and "presents fairly, in all material respects" are equivalent.*

The Board agreed in Copenhagen that it was preferable to reinstate the qualifier that these two phrases are equivalent. A sentence has been added in paragraph 6 to reinstate that assertion.

The Board also agreed that ISA 700 should have flexibility to accommodate different wording of the audit opinion when prescribed by law or regulations in relation to the audit of general purpose financial statements.

The Task Force has introduced flexibility into the guidance, emphasizing the following points:

- Unless required by law or regulation to use different wording, the auditor's opinion on a complete set of general purpose financial statements should use the phrases "give a true and fair view" or "are presented fairly, in all material respects".
- Although the auditor may be obliged to use the prescribed wording, the auditor's responsibilities in forming the auditor's opinion, as described in the ISA, remain the same.
- When wording prescribed by law or regulation differs significantly from the phrases "give a true and fair view" or "are presented fairly, in all material respects", the auditor needs to carefully consider whether there is a risk that users might misunderstand the assurance obtained in an audit of financial statements. The auditor may be able to mitigate that risk through explanation in an emphasis of matter paragraph (the implication being that, if not, the auditor shouldn't accept the engagement unless able to issue an appropriately worded report).

This guidance has been introduced because the Task Force was concerned that, without such caveats, the ISA would imply that the auditor is obliged to use wording prescribed by law or regulation even if it is clearly inappropriate and misleading.

The new guidance is set out in proposed new paragraphs 6a. and 6b. of ISA 700. However, changes were also needed to paragraph 36 in ISA 700, which set out the black-lettered requirements for the wording of the auditor's opinion.

2. *Whether "fair presentation" is an accounting or auditing concept or both*

In Copenhagen, IAASB debated how to describe the auditor's evaluation of the fair presentation of the financial statements as a whole. The Board agreed with the principle

that, in an audit of general purpose financial statements, the auditor must consider the overall financial statement presentation. The Board also agreed that this evaluation is necessary even if the financial reporting framework doesn't explicitly refer to the fair presentation of the financial statements as a whole. However, the Board agreed that the financial reporting framework does, nevertheless, provide the broad context within which the auditor's evaluation is made. The Board asked that the guidance make this point more explicitly. In addition, the Board asked that the guidance more clearly distinguish between the evaluation of the fair presentation of the financial statements within the framework, and the rare circumstances when compliance with a specific requirement in the financial reporting framework results in misleading information.

In response to these comments, the Task Force proposes the following changes to the guidance:

- Paragraph 8a has been deleted as a separate paragraph. Instead, parts a and b of it have been repositioned as the introductory sentences to paragraphs 9 and 9a respectively. Both now reinforce that the auditor's consideration of both compliance with specific requirements of the applicable financial reporting framework and evaluation of the fair presentation of the financial statements are within the context of the financial reporting framework.
- Former paragraph 9b has been moved to follow paragraph 7 (the discussion of the applicable financial reporting framework). This paragraph explains that, by definition, frameworks that the auditor has determined to be acceptable for general purpose financial statements will, except in extremely rare circumstances, result in financial statements that achieve fair presentation. It also discusses how the broad principles embodied in the framework can be drawn upon if the framework doesn't specify how to account or report a particular type of transaction or event and, thereby, provides a context for the auditor's opinion on whether the financial statements give a true and fair view or are presented fairly, in all material respects.
- A new heading has been introduced before paragraph 10 to distinguish the guidance on extremely rare circumstances when complying with a specific requirement in the financial reporting framework results in misleading financial statements. In addition, as suggested by Board members paragraphs 10 and 11 have been combined.

THE APPLICABLE FINANCIAL REPORTING FRAMEWORK

Extent to which the auditor should be required to assess the acceptability of a financial reporting framework identified/established by regulatory authorities

In Copenhagen, in order to respond to ED comments, the Task Force recommended that IAASB consider expanding the description of financial reporting frameworks that are presumed to be acceptable for general purpose financial statements to include financial reporting frameworks identified in legislation and regulatory requirements governing the preparation of general purpose financial statements.

The IAASB debated the Task Force recommendation and concluded that it went too far for the following reasons:

- Often financial reporting requirements specified by regulatory authorities (that are not requirements to follow IFRSs or other forms of GAAP) are intended to address the needs/objectives of these regulatory authorities, even when the financial statements are widely distributed. Engagements to audit such financial statements are special purpose audit engagements within the scope of ISA 800 not ISA 700.
- Treating such frameworks as acceptable for general purpose audit engagements would cause further problems for auditors when, as part of forming an opinion on the financial statements, they apply the ISA 700 requirements and try to assess the fair presentation of the financial statements as a whole. Significant deficiencies in regulatory frameworks presumed at the outset to be acceptable may make it difficult for auditors to conclude on the fair presentation of the financial statements.
- Adoption of the Task Force recommendation has the potential of opening the door to unmodified true and fair/presents fairly audit opinions on general purpose financial statements prepared by reference to significantly deficient bases of accounting specified by regulatory authorities. This was considered to be a backward step for the auditing profession and not in the public interest.

The Task Force agreed that permitting the auditor to presume that a financial reporting framework identified in legislation or regulatory requirements is acceptable for general purpose financial statements is probably going too far. This presumption has therefore been removed from the revised ED.

However, the Task Force also agreed with ED respondents who were concerned that it is impracticable for ISA 210 to state that auditors should not accept engagements for audits of financial statements prepared by reference to financial reporting frameworks required by legislation or regulatory requirements even if those frameworks have significant deficiencies. The Task Force has therefore revised ISA 210.12 to permit the auditor to accept such engagements when the auditor is able to adequately explain the deficiencies to avoid misleading users. The paragraph also makes reference to ISA 701, "Modifications in the Auditor's Report"

DATE OF THE AUDITOR'S REPORT

The need to clarify who must approve the financial statement for the auditor's purposes

In Copenhagen, in response to suggestions and concerns expressed by respondents, the Task Force recommended that IAASB consider linking the approval of the financial statements by management for audit purposes to the date the statements are authorized for issue by those with primary responsibility for the entity and its financial statements. The Task Force concluded that wording the requirement in this way had the advantage of making it consistent with IAS 10.

IAASB were concerned that the date on which financial statements are approved for issue can be affected by a number of factors relating to entity approval and governance processes. This could

unnecessarily push the date out too far since the date that is important from the auditor's perspective is the date on which management/directors determines that the statements are complete and therefore approves them.

The ED has therefore been revised so that it focuses on the date on which those who are recognized to have the authority to approve the financial statements determine that a complete set of financial statements has been prepared and approve such statements.

The document also acknowledges that:

1. the date of approval will be influenced by a number of factors including statutory requirements and procedures the entity follows in preparing and finalizing the financial statements;
2. for jurisdictions that also require final approval of the financial statements by the shareholders, the date of approval for audit purposes is still the date determined in 1. above; not the date of final approval by shareholders.

Appropriateness of dating the report before communicating weaknesses in internal control to those charged with governance

IAASB agreed it is possible that the auditor may not have fulfilled all responsibilities related to the audit prior dating the auditor's report. However, IAASB also agreed with concerns raised by respondents regarding communication of weaknesses in internal control and the need to communicate such matters to the audit committee before dating the report.

This example has been deleted from the revised ED. The ED now states that the auditor may not yet have fulfilled all responsibilities related to the audit. For example, the auditor may not yet have had an opportunity to communicate matters of governance interest that arose from the audit but that do not form part of the audit evidence on which to base the opinion on the financial statements.

OTHER MATTERS FOR FUTURE CONSIDERATION

In analyzing the Exposure Draft responses, there were certain issues raised that the Task Force felt were beyond the scope of its mandate, but suggests that they be referred to the IAASB Steering Committee for future consideration:

- Guidance on "reasonable assurance" in ISA 200 paragraphs 17-21 (respondents' comments on this issue are discussed more fully in Agenda Paper 3-A, issue B.1).
- Some respondents questioned the reference to the ISAs containing "basic principles and essential procedures together with related guidance in the form of explanatory and other material, including appendices." However, this is the current wording in the Preface and, pending exposure of proposed changes in the Clarity project, the Task Force did not believe that it was appropriate to change this wording now.

- Paragraph 3 of the Preface says “A professional accountant should not represent compliance with the IAASB’s Engagement Standards unless the professional accountant has complied fully with all of those relevant to the engagement.” (underlying added for emphasis). The Exposure Draft proposed to incorporate this principle into a bold-lettered requirement (paragraph 14) in ISA 200 and, overall, respondents supported that proposal in principle. There were, however, some comments that suggested confusion regarding the intended meaning of this statement. Is it intended to mean that the auditor must comply fully with all requirements of each relevant ISA, even if aspects of that ISA are not relevant in the circumstances? Or, can it be interpreted to mean that the auditor must comply fully with all relevant aspects of ISAs that are relevant to the audit? The Task Force believes that addressing this issue is a matter of some urgency, as it could have implications in relation to the interpretation of documentation requirements.

Material Presented

Agenda Item 3-A
(Pages 1265 – 1294)

Other issues (carried forward and updated from Copenhagen):

Section A

- A.1 Level of prescription
- A.2 Respective responsibilities of management and the auditor

Section B

- B.1 Clarification of reasonable assurance
- B.2 Reasonable, but not absolute, assurance
- B.3 Reasonable assurance in relation to fraud or error
- B.4 Auditor’s independence
- B.5 Limitations of an audit and internal control
- B.6 Description of the auditor’s responsibilities with respect to internal control
- B.7 Using the assurance framework for other reporting responsibilities

Section C

- C.1 Scope of the audit
- C.2 Linkage between the ISAs and the code of ethics
- C.3 Inclusion of sub-headings
- C.4 Including the level of audit materiality in the auditor’s report
- C.5 Unqualified audit report
- C.6 The auditor’s responsibilities for other information
- C.7 Acceptability of the financial reporting framework
- C.8 Redundant statement in the audit report
- C.9 Supplementary information

Section D

- D.1 Recommended amendments to the auditor’s report wording

- D.2 Summary of significant suggestions not included in the revised wording or discussed in the context of the other issues
- D.3 Proposed revised wording in the auditor's report

Agenda Item 3-B
(Pages 1295 – 1342) Clean copy of the proposed revised ISA 700 wording and related amendments/conforming amendments to ISA 200, 210, 560, 701 and 800

Agenda Item 3-C
(Pages 1343 – 1396) Mark-up showing proposed changes to the Exposure Draft wording

Agenda Item 3-D
(Pages 1397 – 1644) Detailed Analysis of Responses

- D.1 ISA 700 Detailed responses by paragraph
- D.2 ISA 200 Detailed responses by paragraph
- D.3 ISA 210 Detailed responses by paragraph
- D.4 ISA 560 Detailed responses by paragraph
- D.5 ISA 701 Detailed responses by paragraph
- D.6 ISA 800 Detailed responses by paragraph
- D.7 Detailed comments on the wording of the auditor's report

Action Required

The IAASB is asked to review the proposed changes to the Exposure Draft wording in response to the comments received on exposure and be prepared to suggest specific changes, if any.

SUMMARY OF RESPONDENTS

File Number	Organisation	Reference	Organisation Type
1	Foreningen af Statsautoriserede Revisorer	FSR	Member Body
2	Krajowa Izba Bieglych Rewidentow	KIBR	Member Body
3	Institute of Chartered Accountants of New Zealand	ICANZ	Member Body
4	Auditing Practices Board	APB	Standard Setter
5	FAR	FAR	Member Body
6	Richard Regal	RR	Other
7	Fédération des Experts Comptables Européens	FEE	Member Body
8	Institute of Chartered Accountants in Ireland	ICAI	Member Body
9	Compagnie des Commissaires aux Comptes	CNCC/OEC	Member Body
10	Certified General Accountants Association of Canada	CGA	Member Body
11	Institute of Chartered Accountants Scotland	ICAS	Member Body
12	Institut des Réviseurs d'Entreprises	IRE	Member Body
13	The Japanese Institute of Certified Public Accountants	JICPA	Member Body
14	The Institute of Chartered Accountants of Pakistan	ICAP	Member Body
15	London Society of Chartered Accountants Technical Committee	LSCA	Other
16	Association of Chartered Certified Accountants	ACCA	Member Body
17	Jesse Hughes ¹	JH	Other
18	The Canadian Institute of Chartered Accountants	CICA	Member Body
19	Public Accountants' & Auditors' Board and South African Institute of Chartered Accountants	PAAB	Standard Setter/ Member Body
20	Grant Thornton International	GT	Firm
21	PricewaterhouseCoopers	PwC	Firm
22	Institute of Certified Public Accountants of Kenya	ICPA	Member Body
23	Den Norske Revisorforening	DNR	Member Body
24	KPMG	KPMG	Firm
25	Australian Auditing & Assurance Standards Board	AuASB	Standard Setter
26	APB (APB e-mail and letter have been combined as 4)	N/A	N/A
27	Australasian Council of Auditors General	ACAG	Other
28	American Institute of Certified Public Accountants	AICPA	Member Body
29	Deloitte & Touche	DT	Firm
30	Hong Kong Society of Accountants	HKSA	Member Body
31	Institut der Wirtschaftsprüfer in Deutschland	IDW	Member Body
32	BASEL Committee	BASEL	Regulator
33	Auditing Standards Board of Royal NIVRA	NIVRA	Member body

¹ This letter did not include specific comments relating to the exposure draft.

34	BDO Stoy Hayward	BDO	Firm
35	Ernst and Young	EY	Firm
<i>Note: there is no Response # 36</i>			
37	Malaysian Institute of Accountants	MICPA	Member Body
38	Danish Commerce and companies Agency	DCCA	Regulator
39	IOSCO	IOSCO	Regulator