

# FORUM OF FIRMS

October 6, 2005

To the Members of the IAASB,

This letter highlights a practice problem that arises from new requirements in ISAs 200 and 210 affecting engagement acceptance that come into effect before the finalization and adoption of what we believe are less restrictive requirements in ISA 701. It is therefore possible that, in order to comply with ISAs 200/210 starting in December 2005, auditors will be required to change their practices by declining engagements that they could accept if ISA 701 is approved as issued.

## **Recommendation to IAASB**

To avoid this problem, we recommend that IAASB consider delaying the effective date of relevant paragraphs in ISAs 200 and 210 until ISA 701 is finalized and the differences that contribute to the practice problem are resolved.

## **Description of practice problem**

The practice problem we have identified relates to engagements involving general purpose financial statements prepared using financial reporting frameworks that have deficiencies but are nevertheless:

- required to be used by law or regulation; and
- based on widely recognized and prevalent industry practices.

ISAs 200/210 and proposed ISA 701 lead the auditor to different actions in these circumstances because both the criteria for assessing the acceptability of the framework and the remedies when the framework has deficiencies differ.

The remainder of this letter describes the problem we have identified in relation to the above engagements.

## ***Engagements involving financial reporting frameworks required to be used by law or regulation***

Our primary concern relates to engagements involving financial reporting frameworks required to be used by law or regulation that have not been developed by a recognized standards setter. The specific reasons for our recommendation in relation to these engagements are that:

- The engagement acceptance criteria in ISA 210.10 to 210.15 relating to agreement on the applicable financial reporting framework apply to all engagements involving general purpose financial statements. This therefore includes engagements contemplated by proposed ISA 701 as well as ISA 700. However, ISA 701 does not make reference to the fact that ISA 210 applies to the acceptance of general purpose financial statements within its scope, creating ambiguity about its applicability.

- ISA 210.13 permits an auditor to accept an engagement involving a financial reporting framework required by law or regulation only when any deficiencies in the financial reporting framework can be adequately explained in the auditor's report to avoid misleading users. Furthermore, ISA 210.14 specifies that, in such circumstances, the auditor does not use the terms "give a true and fair view or "are presented fairly in all material respects" to express his or her opinion, unless required to do so by law or regulation.
- ISA 701.11 together with ISA 701.16 are similar to ISA 210 because they state that the auditor's opinion does not make reference to true and fair/presents fairly in such circumstances unless such wording is required by law or regulation. However more importantly, unlike ISA 210, ISA 701.11 does not require the auditor to consider the suitability of a framework required to be used by law or regulation (in fact, such frameworks are excluded from needing to consider the suitability of the framework) nor does it require the auditor to describe the deficiencies of the financial reporting framework in the auditor's report.

Given the above, we believe that there is significant scope for confusion since proposed ISA 701 can be interpreted as enabling auditors to accept engagements that would otherwise not be acceptable under ISA 210. Such an interpretation will cause a significant practice problem as it is difficult to see how auditors can be expected to comply with the requirements of ISA 210 after December 15, 2005 and not accept certain engagements when there is a possibility that the same engagements may become acceptable when ISA 701 is finalized. It is hoped that IAASB will reconcile these differences when finalizing ISA 701, but we cannot predict with certainty which approach the Board will decide is best. It could, for example, decide to reverse its earlier decision and conform ISA 210 to the ISA 701 principles.

***Engagements involving financial reporting frameworks based on widely recognized and prevalent industry practices.***

These engagements are of less concern because they are not as common as the first set of engagements. They do nevertheless pose significant practice problems for the following reasons:

- When faced with an engagement involving a financial reporting framework established by prevalent industry practice, ISA 210 would require the auditor to assess the financial reporting framework based on criteria set out in ISA 200 and it would preclude the auditor from accepting an engagement when the framework is determined to be unacceptable.
- Since the financial reporting framework in this circumstance is not established by a recognized standard-setter, the entity could opt to be in ISA 701 rather than ISA 700 by arguing that the financial reporting framework is not designed to achieve fair presentation. The impact of that decision would be that the audit opinion would not be able to refer to true and fair/fairly presents, but a compliance report might be acceptable in the circumstances.
- ISA 701.11 would also require the auditor to assess the suitability of a framework established by prevalent industry practice. However, unlike ISA 200, ISA 701. 11 expands the matters the auditor takes into account in assessing the suitability of the financial reporting framework and, in doing so, introduces considerations that are more lenient in their impact on the auditor's decision in such circumstances.

- ISA 701 also does not directly address how/whether the engagement acceptance criteria in ISA 210 affect an engagement involving such a financial reporting framework. Although there is a misleading test in ISA 701.24-.25, the same broader considerations are referred to and, therefore, it is less likely that the auditor would conclude the framework is misleading.

So, when faced with an unsuitable framework that is based on prevalent industry practice, it appears that the only remedy proposed by ISA 701 is to preclude the auditor from issuing an opinion that makes reference to true and fair/presents fairly. ISA 701 therefore does not appear to go as far as ISA 210 to explicitly preclude the auditor from accepting engagements involving such financial reporting frameworks.

Accordingly, as in the case for financial reporting frameworks specified by law or regulation, there is a possibility that engagements considered unacceptable after December may become acceptable when ISA 701 is finalized. Again, it is difficult to see how we can insist that auditors change their engagement acceptance practices for engagements involving frameworks based on prevalent industry practice in December in order to comply with ISA 210, when it is possible that auditors will be able to revert back to old practices when ISA 701 is finalized.

Yours truly,

A handwritten signature in black ink, consisting of a large, stylized 'D' followed by a horizontal line, positioned to the left of a vertical red line.

Roger Dassen, Transnational Auditors Committee Chair  
On Behalf of the Transnational Auditors Committee