

Practice Problem Arising from ISA 200, ISA 210 and Proposed ISA 701**Note for IAASB discussion***Introduction*

1. Agenda Item 6-A is a letter from the Forum of Firms drawing the attention of the IAASB to a practice problem arising from possible inconsistencies or uncertainties between the requirements of ISAs 200, 210 and proposed 701. The points at issue are somewhat technical, requiring a close reading and analysis of the relevant ISAs and proposed ISAs. It is not suggested that the IAASB seek to determine a solution to the technical issues at this stage. This is because proposed ISA 701 is currently being exposed for comments (due by October 31, 2005), and it would be inappropriate for the IAASB to take any view on the content of the final standard without the benefit of those comments and without considering the standard as a whole. It is to be hoped that, this issue having been raised and made widely known through the IAASB's agenda papers, those who have yet to comment will express their views on the technical issues raised in the letter.
2. There may be members of the IAASB who consider that there is, in fact, no potential inconsistency or confusion of the kind raised by the letter, and that the IAASB need do nothing or need only issue some form of clarification. The latter course would be subject to the same objections as any attempt to solve the technical problem, if any; that is, it would involve seeking to clarify an exposure draft when the results of the exposure process are unknown. It is therefore likely to be inappropriate. Similarly, the option of doing nothing would be undesirable; whether or not the IAASB agrees with the points raised, the fact is that a significant group of practitioners consider that there is uncertainty and the IAASB should therefore seek to resolve it in finalising ISA 701, and take such action in the meantime to assist practitioners as can be taken without prejudice to the eventual solution.
3. The source of the problem is this: ISA 700 has been issued with effect for reports dated on or after December 31, 2006. This, for the majority of cases, means for audits of annual financial statements for 2006. An important feature of ISA 700 was the enhanced guidance on consideration of the presentation of the financial statements and, as a necessary prerequisite, satisfaction over the accounting framework. Consequently, revisions were made to ISA 200, discussing the nature of an acceptable accounting framework, and ISA 210, dealing with the effect of the framework on the acceptability of the engagement. These revisions are effective for audits of financial periods beginning on or after December 15, 2005. Although this was all done in the context of general purpose financial statements prepared under a framework intended to provide fair presentation, ISAs 200 and 210 equally apply in general to audits of financial statements falling within the scope of proposed ISA 701. It is therefore important that the whole body of related standards should fit together satisfactorily.
4. It was intended, and may yet prove to be possible, that proposed ISA 701 should become effective at the same time as revised ISA 700. It will not, however, contrary to the original expectations, be finalised before the revisions to ISA 200 and 210 come into effect.

Proposed solution

5. The letter from the Forum of Firms recommends that the effective date of 'relevant paragraphs in ISAs 200 and 210' be delayed until ISA 701 is finalised. This is a sensible proposal, but the question arises over which paragraphs should be deferred. It is essential that an easily understandable solution be adopted, that can be readily communicated to auditors. It is suggested that two possibilities be considered:
 - Deferral of the whole of one or both of ISAs 200 and 210; or
 - Deferral of discrete sections of one or both ISAs.
6. Deferral of the whole would have the advantage of simplicity. In the case of ISA 200, it would have the disadvantage of delaying (other than the financial reporting framework material), albeit for a relatively short time, improvements to that ISA, in relation to compliance with ISAs and the Ethics Code, and management responsibility. In the case of ISA 210, the substance of the amendments related to the financial reporting framework, and so there are no further disadvantages in a complete deferral.
7. It is therefore recommended that the IAASB approve the following:
 - The effective date of parts of ISA 200 Amended as a Result of ISA 700 (Revised) should be deferred until ISA 701 becomes effective (a date yet to be determined); in particular:
 - The final sentence of paragraph 3; and
 - Paragraphs 37 to 48 (Determining the Acceptability of the Financial Reporting Framework').
 - The effective date of ISA 210 Amended as a Result of ISA 700 (Revised) should likewise be deferred.
8. There would need to be some explanation in ISA 700 to deal with cross references:
 - Paragraph 1 – the cross reference could be deleted (the sentence does very well without it), or the delay of the relevant paragraph of ISA 200 could be footnoted (it is probably desirable to deal with all such matters by footnote, to avoid amending ISA 700).
 - Paragraph 9 – the second and third sentences require a footnote.
 - Paragraph 15 – the first sentence contains a reference to ISA 210 that also requires a footnote.

Effect of the proposal

9. The proposal will defer, probably by about a year, the guidance and requirements on determining the acceptability of the financial reporting framework, and the need to have an acceptable one before accepting an audit engagement. This is unfortunate, but it should be recalled that there is no such guidance at present; there is therefore no relaxation of current standards, simply a delay in an improvement. It is also probably true to say that auditors in most cases are well aware of the need to ensure the framework is acceptable before accepting an engagement. It is therefore suggested that the balance of advantage is in favour of deferral and implementation when the reporting standards are complete and clearly consistent.