



International Federation of Accountants

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Agenda Item

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Committee: IAASB

Meeting Location: New York

Meeting Date: May 22-26, 2006

Special Reports – Proposed ISA 701, “The Independent Auditor’s Report on Other Historical Financial Information”

Objectives of Agenda Item

To conduct a first read of proposed ISA 701 and the proposed changes to ISA 200, “Objective and General Principles Governing an Audit of Financial Statements,” ISA 210, “Terms of Audit Engagements” and ISA 700 (Revised), “The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements.”

Task Force

Members of the Task Force are:

- Sukanta Dutt Chair and IAASB Member
- John Archambault Former IAASB Member
(Supported by Technical Advisor Susan Jones)
- Josef Ferlings IAASB Member (Supported by Technical Advisor, Wolf Boehm)
- Jonas Hällström Non-IAASB Member – INTOSAI
- John Kelly Non-IAASB Member – South Africa
- Sylvia Smith Technical Advisor to IAASB Member

Activities since Last IAASB Discussions

The Task Force met in April 2006 to discuss the comments received during the March 2006 IAASB meeting. The Task Force’s consideration of these comments is summarized below.

March 2006 IAASB Comments

ISSUE 1: WHETHER ISA 200 AND ISA 210 APPLY TO ALL FINANCIAL STATEMENTS OR TO GENERAL PURPOSE FINANCIAL STATEMENTS ONLY

1. The IAASB agreed that that ISA 200 and ISA 210 should be revised to make it clear that they apply to audits of both general purpose and special purpose financial statements within the scopes of ISA 700 and ISA 701. The proposed changes to ISA 200 (Agenda Item 2-A) and ISA 210 (Agenda Item 2-B) reflect this decision.
2. The IAASB also agreed that the ISAs should recognize differences that may exist in the audits of general purpose financial statements and the audits of special purpose financial statements, without providing detailed guidance in the ISAs. These differences are not

limited to reporting considerations, but include performance considerations. They are considered to exist only for a limited number of ISAs (e.g., communications with those charged with governance, materiality, going concern, and the auditor's report).

ISSUE 2: THE DESCRIPTION OF FINANCIAL REPORTING FRAMEWORK

3. The Task Force recommended that the description of financial reporting framework in the ED-ISA 701, appropriately amended, be retained and moved to ISA 200. It also recommended that new guidance in ISA 200 clarify that the auditor considers the relative authority of the different sources from which the accounting principles are derived, and, where conflicts exist amongst them, that the source with the highest authority prevails.
4. The IAASB supported the Task Force's recommendation, but asked that the Task Force in describing the financial reporting framework distinguish between (a) financial reporting standards established by authorized or recognized standards setting organizations and legislative and regulatory requirements (or, in the case of special purpose financial statements, the financial reporting provisions of a contract); and (b) the different sources that provide direction on the application of the financial reporting standards and legislative and regulatory requirements (or the financial reporting provisions of a contract). This decision is reflected in paragraphs 36a-d of ISA 200 (see Agenda Item 2-A).
5. The Task Force debated whether paragraph 36d of ISA 200 (see Agenda Item 2-A) should be a requirement. Some Task Force members were of the view that, based on the proposed description of the financial reporting framework (i.e., the fact that it may encompass sources other than financial reporting standards or legislative or regulatory requirements), the auditor should be required to identify the different sources encompassed in the applicable financial reporting framework and consider their relative authority. Other Task Force members noted that paragraph 37 of ISA 200 (see Agenda Item 2-A) requires the auditor to determine whether the applicable financial reporting framework is acceptable. This presupposes that the auditor knows what the framework is, making it unnecessary to require the auditor to identify every source of the framework and establish its hierarchy. Also, such a requirement runs the risk of having auditors searching for additional authoritative/non-authoritative sources to no particular effect. **The IAASB is asked for its view in this regard.**

ISSUE 3: WHEN IT IS APPROPRIATE TO USE THE PHRASE "TRUE AND FAIR/FAIRLY PRESENTS" IN AUDIT OPINIONS

6. The Task Force explained its view that the form of opinion is determined by the applicable financial reporting framework.
7. The Task Force presented alternative responses to the comments received on ED-ISA 701 relating to the form of opinion. These alternatives were presented in the context of complete sets of financial statements. The majority of IAASB members supported the alternative that linked the form of opinion exclusively to whether the applicable financial reporting framework is a fair presentation framework. (Paragraph 51a of ISA 200 (see Agenda Item 2-A) describes a fair presentation financial reporting framework.) Thus, in the case of a fair presentation framework, the opinion would be either that "the financial statements give a true and fair view of or present fairly, in all material respects, the financial position, financial performance and cash flows of the entity in accordance with the framework;" or

- “the financial statements are fairly presented, in all material respects, in accordance with the framework.” In all other cases, the opinion would be that the financial statements are prepared, in all material respects, in accordance with the framework. This decision is reflected in paragraphs 51b-c of ISA 200 (see Agenda Item 2-A).
8. The Task Force explained that it had identified two alternative approaches to the form of opinion on single financial statements. Both depend on the financial reporting framework.
- In the first approach, a fair presentation framework would be presumed to lead to fair presentation in respect of a single financial statement. Thus, the alternative described in paragraph 7 would be followed. However, if a financial reporting framework, though a fair presentation one, explicitly provides that a single financial statement on its own cannot give a true and fair view or present fairly, in all material respects, the presumption would be rebutted. In such cases, the required opinion would be a compliance audit opinion.
 - The second approach would be to require compliance audit opinions for all single financial statements. The presumption would be that a financial reporting framework, even if a fair presentation one, did not lead to fair presentation of anything other than a complete set of financial statements. This presumption could be rebutted by the provisions of applicable law or regulation, or explicit confirmation in the applicable financial reporting framework that a single financial statement is capable of achieving fair presentation (of, for example in the case of a balance sheet, the financial position). A very small majority of IAASB members preferred this approach.
9. The Task Force reconsidered the alternative approaches to the form of opinion on single financial statements. It noted that a number of jurisdictions, through law or regulation or custom or practice, did permit fair presentation opinions on single statements; in some such cases the financial reporting framework was silent on the issue. Further, the responses to the exposure draft indicated that few, if any, frameworks explicitly expressed views on the issue. The Task Force concluded that the direction from the IAASB was not sufficiently conclusive to force an approach that may require significant changes in practice in some jurisdictions. Furthermore, the Task Force is of the view that this issue has mainly arisen as a result of theoretical debates about IFRS, and its application in the context of first-time application or various regulatory filings, and that a definitive solution, therefore, lies with the IASB, other authorized or recognized standards setting organizations or regulators. The Task Force is not aware of the matter being raised as an issue under other frameworks. Paragraphs 51b-c of ISA 200 (see Agenda Item 2-A) therefore reflects the first approach described in paragraph 8.

ISSUE 4: WHETHER THE RIGHT SPLIT HAS BEEN MADE BETWEEN THE SCOPE OF ISA 700 (REVISED) AND THAT OF ED-ISA 701

10. The IAASB agreed that ISA 700 (Revised) should address auditors' reports on general purpose financial statements and proposed ISA 701 should address auditors' reports on special purpose financial statements. Both ISAs should address complete sets of financial statements and single financial statements (i.e., financial statements as defined in paragraph 1a of ISA 200 (see Agenda Item 2-A)).
11. Proposed ISA 701 and ISA 700 (Revised) have been revised to reflect the decision in paragraph 10 (see Agenda Item 2-C). To assist in broadening the scope of ISA 700

(Revised) to include auditors' reports on financial statements prepared in accordance with compliance frameworks, the requirements and guidance on form of opinion and forming an opinion, appropriately amended, have been moved to ISA 200. This may also assist clarifying that both general purpose and special purpose financial statements are within the scope of IA 200. However, the Task Force agrees with the IAASB that the requirements and guidance on forming an opinion in paragraphs 51d-51h of ISA 200 (see Agenda Item 2-A) should be moved to a separate ISA (as suggested by the Materiality Task Force at the December 2005 IAASB meeting). Until an ISA on forming an opinion is developed, the Task Force recommends that the text be retained in ISA 200.

12. Based on the similarity of the requirements and guidance in proposed ISA 701 and ISA 700 (Revised), evidenced by the cross-references to ISA 700 (Revised) in proposed ISA 701, the Task Force recommends that the IAASB consider combining proposed ISA 701 and ISA 700 (Revised) in a single ISA on the independent auditor's reports on financial statements. Reporting considerations specific to special purpose financial statements could be highlighted in separate section(s) or paragraph(s) in such an ISA.

New Matter for Consideration by the IAASB – Defining “General Purpose Financial Statements” and “Special Purpose Financial Statements”

13. In developing the proposed changes to ISA 200, the Task Force debated whether “general purpose financial statements” and “special purpose financial statements” should be defined with reference to (a) the purpose for which the financial reporting framework applied in preparing and presenting the financial statements has been designed, or (b) the purpose for which the financial statements have been prepared (i.e., their intended use).
14. The proposed changes to ISA 200 (see Agenda Item 2-A) define general purpose and special purpose financial statements with reference to the design of the financial reporting framework (i.e., (a) of paragraph 13 above). Applying definitions based on the design of the framework, however, makes it necessary also to include caveats, such as the following:
 - Financial statements prepared and presented in accordance with a financial reporting framework designed to meet the financial information needs of specific users may be the only financial statements prepared by an entity and, in such circumstances, are often used by users in addition to those for whom the financial reporting framework is designed. Despite the broad distribution of the financial statements in those circumstances, the financial statements are still considered to be special purpose financial statements. (See paragraph 48b of ISA 200 (Agenda Item 2-A).)
 - Financial statements prepared to meet the financial information needs of specific users are considered to be special purpose financial statements, even though they might have been prepared and presented in accordance with a financial reporting framework designed to meet the common financial information needs of a wide range of users. (See paragraphs 40 and 48c of ISA 200 (Agenda Item 2-A).)

Some Task Force members are of the view that, with the appropriate caveats, this approach precludes neither financial statements prepared in accordance with a framework designed to meet the common financial information needs of a wide range of users from being prepared from being prepared for and used by specific users, nor financial statements prepared in accordance with a framework designed to meet the financial information needs of specific users from being prepared for an used by a wide range of users. Certainly, the auditor still

needs to consider the acceptability of the framework in light of the circumstances of the engagement.

15. Other Task Force members argue that the relevance of the applicable financial reporting framework is driven by the needs of the users and that the users therefore are the real drivers, not the framework. That is, general purpose financial statements are financial statements prepared for a wide range of users and special purpose financial statements are financial statements prepared for specific users.
16. **In reviewing the proposed changes to ISA 200, the IAASB is asked to consider the proposed definitions of general purpose and special purpose financial statements, the effect they have on the requirements and guidance, and whether definitions based on the purpose for which the financial statements have been prepared may simplify matters.**

ISSUE 5: WHETHER THE ISAS SHOULD ADDRESS AUDITS OF SPECIFIC ELEMENTS, ACCOUNTS OR ITEMS OF A FINANCIAL STATEMENT AND THE PRACTICALITY OF LEAVING IT TO THE AUDITOR'S JUDGMENT TO DETERMINE WHICH ISAS OR REQUIREMENTS THEREOF ARE RELEVANT TO SUCH AUDITS

17. The IAASB agreed that ED-ISA 701.7,¹ appropriately amended to take account of the comments on ED-ISA 701 to the extent possible in the circumstances, should be moved to ISA 200, and that the reporting requirements and guidance, including examples, within extant ISA 800 should be retained in ISA 701.
18. This decision is reflected in paragraphs 51i-l of ISA 200 (see Agenda Item 2-A) and paragraphs 15-19 of proposed ISA 701 (see Agenda Item 2-C). The text is from ED-ISA 701, appropriately amended to take account of the comments on ED-ISA 701 to the extent possible in the circumstances. The Task Force compared the requirements and guidance to those in extant ISA 800 to ensure that they address the special considerations noted in extant ISA 800.

Material Presented

Agenda Item 2-A (Pages 713 – 726)	Proposed Changes to ISA 200, “Objective and General Principles Governing an Audit of Financial Statements” (CLEAN)
Agenda Item 2-B (Pages 727 – 730)	Proposed Changes to ISA 210, “Terms of Audit Engagements” (CLEAN)

¹ ED-ISA 701.7 reads as follows: ISA 200, paragraph 4, requires the auditor to comply with relevant ethical requirements relating to an audit engagement. ISA 200, paragraph 11, requires the auditor, in determining the audit procedures to be performed in conducting an audit in accordance with ISAs, to comply with each of the ISAs relevant to that audit. These requirements apply to an audit of a specific element, account or item of a financial statement. If an audit of a specific element, account or item of a financial statement is conducted in conjunction with the audit of the financial statements of which it forms a part, this is unlikely to cause difficulty. If such an audit, however, is carried out separately, compliance with each of the ISAs relevant to the audit requires careful consideration and may not be practicable. Where an audit in accordance with ISAs is not practicable, the auditor discusses with the responsible party whether another type of engagement may be more practicable.

Agenda Item 2-C (Pages 731 – 754)	Proposed Changes to ISA 700 (Revised) and proposed ISA 701 (CLEAN)
Agenda Item 2-D (Pages 755 – 766)	Proposed Examples of Auditor’s Reports on Financial Statements
Agenda Item 2-E (Pages 767 – 782)	Proposed Changes to ISA 200, “Objective and General Principles Governing an Audit of Financial Statements” (MARK-UP)
Agenda Item 2-F (Pages 783 – 786)	Proposed Changes to ISA 210, “Terms of Audit Engagements” (MARK-UP)
Agenda Item 2-G (Pages 787 – 822)	Proposed Changes to ISA 700 (Revised) and proposed ISA 701 (MARK-UP)

Action Requested

The IAASB is asked to conduct a first read of proposed ISA 701 and the proposed changes to ISA 200, ISA 210 and ISA 700 (Revised).

AGENDA ITEMS 2-A, 2-B, 2-C AND 2-D (I.E., THE CLEAN VERSIONS OF ISAs 200, 210, 700 AND 701) WILL BE USED FOR PURPOSES OF THE DISCUSSIONS AT THE MEETING.