

Mark-up from May 2006 IAASB Draft

Proposed Amended ISA 200, “Objective and General Principles Governing an Audit of Financial Statements”

Introduction

1. The purpose of this International Standard on Auditing (ISA) is to establish standards and provide guidance on the objective and general principles governing an audit of financial statements. ~~It also describes management’s responsibility for preparing and presenting the financial statements and for identifying the financial reporting framework to be used in preparing and presenting the financial statements, referred to in the ISAs as the “applicable financial reporting framework.”~~
- 1a. The ISAs apply to the audit of historical financial information. For the purposes of the ISAs, “historical financial information” is defined as information expressed in financial terms in relation to a particular entity, derived primarily from that entity’s accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.
- 1ab. The most common form of historical financial information subject to audit is financial statements. Consequently, the ISAs are written in the context of an audit of financial statements and are adapted, as necessary in the circumstances, to audits of other historical financial information. For purposes of the ISAs, the term “financial statements” can refer to a complete set of financial statements, or a single financial statement.¹ A financial statement is a structured representation of the historical financial information, which ordinarily includes accompanying related explanatory notes, derived from accounting records and intended to communicate an entity’s economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The financial reporting framework may be designed to meet the common financial information needs of a wide range of users (“general purpose financial statements”) or to meet the financial information needs of specific users (“special purpose financial statements”). For purposes of the ISAs, the term “financial statements” can refer to a complete set of financial statements, or a single financial statement. Examples of a single financial statement are listed in Appendix 1 to this ISA. [From extant ISA 200.34]
- 1c. ~~The ISAs are written in the context of an audit of financial statements. The ISAs apply to audits of both general purpose and special purpose financial statements. An auditor may, however, be engaged to audit one or more specific elements, accounts or items of a financial statement. See paragraphs 51i-51l.) [From extant ED-ISA 701.6]~~

Objective of an Audit of Financial Statements

2. ~~The objective of an audit of financial statements is to enable the auditor to express an~~

¹ Examples of a single financial statement are listed in the Appendix to this ISA.

~~opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. The wording the auditor uses to express the opinion (i.e., the form of opinion) depends on the applicable financial reporting framework and, when applicable, legislative and regulatory requirements governing the auditor's report (see paragraphs 51a-51c).~~

- ~~3. An audit of financial statements is an assurance engagement, as defined in the International Framework for Assurance Engagements. The Framework defines and describes the elements and objectives of an assurance engagement. The ISAs apply the Framework in the context of an audit of financial statements and contain the basic principles and essential procedures, together with related guidance, to be applied in such an audit. Paragraphs 33-36 discuss management's responsibility for the financial statements. [Part of text of this paragraph moved to 36a]~~

[The Special Reports Task Force is not proposing changes to paragraphs 2 and 3, which are considered as part of the Clarity project.]

Ethical Requirements Relating to an Audit of Financial Statements

[No changes are proposed to paragraphs 4-5. As a result, they have not been reproduced here.]

Conduct of an Audit of Financial Statements

[No changes are proposed to paragraphs 6-9. As a result, they have not been reproduced here.]

Scope of an Audit of Financial Statements

[No changes are proposed to paragraphs 10-14. As a result, they have not been reproduced here.]

Professional Skepticism

[No changes are proposed to paragraphs 15-16. As a result, they have not been reproduced here.]

Reasonable Assurance

[No changes are proposed to paragraphs 17-21. As a result, they have not been reproduced here.]

Audit Risk and Materiality

[No changes are proposed to paragraphs 22-32. As a result, they have not been reproduced here.]

Responsibility for the Financial Statements

- ~~33. While the auditor is responsible for forming and expressing an opinion on the financial statements, the responsibility for preparing and presenting the financial statements in accordance with the applicable financial reporting framework is that of the management²~~

² ~~The term "management" has been used in this ISA to describe those responsible for preparing and presenting the financial statements. Other terms may be appropriate depending on the legal framework in the particular jurisdiction.~~

~~of the entity, with oversight from those charged with governance.³ The audit of the financial statements does not relieve management or those charged with governance of their responsibilities. [Management's responsibility for the financial statements (which includes establishing a control environment and designing, implementing and maintaining controls), as well as the oversight responsibility of those charged with governance, are being considered by the Written Representations Task Force and the Clarity Task Force. The Special Reports Task Force therefore is not proposing changes to paragraph 33, but instead will accept the proposals of the other two Task Forces.]~~

34. ~~[Moved to ISA 200.1a elsewhere.]~~

35. ~~[Moved to ISA 200.1b elsewhere.]~~

36. Management is responsible for identifying the financial reporting framework to be ~~used~~ adopted in preparing and presenting the financial statements. Management is also responsible for preparing and presenting the financial statements in accordance with that framework, and adequately describing that framework in the financial statements. This Management's responsibility for preparing and presenting the financial statements includes:

- Designing, implementing and maintaining internal control relevant to preparing and presenting financial statements that are free from material misstatement, whether due to fraud or error (see paragraph 33);
- Selecting and applying appropriate accounting policies; and
- Making accounting estimates that are reasonable in the circumstances.

36ea. The applicable financial reporting framework ~~may also often~~ encompasses financial reporting standards established by an authorized or recognized standards setting organization, or legislative or regulatory requirements. In some cases the financial reporting framework may encompass both financial reporting standards established by an authorized or recognized standards setting organization and legislative or regulatory requirements. Some financial reporting frameworks may also encompass other sources, or may encompass only such other sources. In other cases, such other sources may which provide direction on the application of the sources described in paragraph 36b financial reporting framework; sSuch as the following other sources may include:

- The effect of the legal and ethical environment, including statutes, regulations, court decisions, and professional ethical obligations in relation to accounting matters;
- Published accounting interpretations of varying authority issued by standards setting, professional or regulatory organizations;
- Published views of varying authority on emerging accounting issues issued by standards setting, professional or regulatory organizations;

³ ~~The structures of governance vary from country to country, reflecting cultural and legal backgrounds. Therefore, the respective responsibilities of management and those charged with governance vary depending on the legal responsibilities in the particular jurisdiction.~~

- General and industry practices widely recognized and prevalent; and
- Accounting literature. ~~[From ED-ISA 701.10]~~

~~36d. The auditor identifies the different sources encompassed in the applicable financial reporting framework, and considers their relative authority.~~ Where conflicts exist amongst the sources that encompass the financial reporting framework, or between the financial reporting framework and the sources from which management has obtained direction on the application of the framework, the source with the highest authority prevails.

~~4b36b.~~ The requirements of the applicable financial reporting framework determine the form and content of the financial statements. Although the framework may not specify how to account for or disclose all transactions or events, it ordinarily embodies sufficient broad principles that can serve as a basis for developing and applying accounting policies that are consistent with the concepts underlying the requirements of the framework.

36c. Some financial reporting frameworks:

- (a) Acknowledge explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond the specific requirements of the framework; or
- (b) Acknowledge explicitly that, in extremely rare circumstances, it may be necessary for management to depart from a specific requirement of the framework to achieve fair presentation of the financial statements.

For purposes of the ISAs, such frameworks are referred to as “fair presentation frameworks.” Financial reporting frameworks that encompass primarily the financial reporting standards established by an organization that is authorized or recognized to promulgate standards to be used by entities for preparing and presenting general purpose financial statements (see ISA 210, “Terms of Audit Engagements”) are often designed to achieve fair presentation, for example, International Financial Reporting Standards (IFRSs).

36d. Other financial reporting frameworks only require compliance with the specific requirements of the framework, that is, the acknowledgements in paragraph 36c do not exist. For purposes of the ISAs, such frameworks are referred to as “compliance frameworks.”

~~4b36e.~~ The requirements of the applicable financial reporting framework also determine and what constitutes a complete set of financial statements. ~~For certain financial reporting frameworks, a single financial statement such as a cash flow statement and the related explanatory notes constitute a complete set of financial statements. For example, the International Public Sector Accounting Standard (IPSAS), “Financial Reporting Under the Cash Basis of Accounting” states that the primary financial statement is a statement of cash receipts and payments when a public sector entity prepares and presents its financial statements in accordance with that IPSAS. Financial statements prepared by reference to International Financial Reporting Standards (IFRSs), on the other hand, In the case of many frameworks, financial statements~~ are intended to provide information about the financial position, financial performance and cash flows of an entity. For such frameworks,

Aa complete set of financial statements ~~under IFRSs~~ would includes a balance sheet; an income statement; a statement of changes in equity; a cash flow statement; and related explanatory notes, comprising a summary of significant accounting policies and other explanatory notes. For some other financial reporting frameworks, a single financial statement and the related explanatory notes might constitute a complete set of financial statements. For example, the International Public Sector Accounting Standard (IPSAS), “Financial Reporting Under the Cash Basis of Accounting” states that the primary financial statement is a statement of cash receipts and payments when a public sector entity prepares and presents its financial statements in accordance with that IPSAS. [From extant ISA 200.35]

[Paragraphs 37-48h have been moved to ISA 210 and ISA 800.]

Description of the Financial Reporting Framework in the Financial Statements

~~48i. Criteria need to be available to the intended users to allow them to understand how the subject matter has been evaluated and measured. To enable the intended users to understand the applicable financial reporting framework, it is necessary to refer to or describe that framework adequately in the financial statements. The description includes information about the basis of preparation of the financial statements and the accounting policies selected and applied for significant transactions and other significant events. If the financial statements do not adequately refer to, or describe, the applicable financial reporting framework, the auditor should consider whether to modify the audit opinion in the auditor’s report in accordance with ISA 705. [From extant ISA 200.46 and ED-ISA 701.13]~~

Forming of an Opinion on the Financial Statements

49. [Paragraph deleted]

50. [Paragraph deleted]

51. [Paragraph deleted]

~~51a. The form of opinion depends on whether the applicable financial reporting framework is a fair presentation framework. A fair presentation financial reporting framework is a framework that:~~

- ~~(a) Provides a context for the evaluation of the fair presentation of the financial statements;⁴ and~~

⁴ ~~Although the framework may not specify how to account for or disclose all transactions or events, it ordinarily embodies sufficient broad principles that can serve as a basis for developing and applying accounting policies that are consistent with the concepts underlying the requirements of the framework. Thus, the framework provides a context for the auditor’s evaluation of the fair presentation of the financial statements, including whether the financial statements have been prepared and presented in accordance with the specific requirements of the framework for particular classes of transactions, account balances and disclosures.~~

- (b) ~~Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond the specific requirements of the framework; or~~
- (c) ~~Acknowledges explicitly that, in extremely rare circumstances, it may be necessary for management to depart from the specific requirements of the framework to achieve fair presentation of the financial statements.~~

~~51b. Unless required by law or regulation to use different wording, the auditor's opinion on financial statements prepared and presented in accordance with a fair presentation financial reporting framework states whether the financial statements:~~

- ~~“give a true and fair view of” or “present fairly, in all material respects,” the information conveyed in the financial statements⁵ in accordance with the applicable financial reporting framework; or~~
- ~~“are presented fairly, in all material respects,” in accordance with the applicable financial reporting framework.~~

~~The above phrases are equivalent for purposes of the ISAs. Which of these phrases is used in any particular jurisdiction is determined by the law or regulation governing the audit of financial statements in that jurisdiction, or by established practice in that jurisdiction. Where law or regulation requires the use of different wording, the auditor's responsibility to evaluate the fair presentation of financial statements prepared and presented in accordance with a fair presentation framework is the same (see paragraph 51g). [From ISA 700R.6 and ED-ISA 701.14-15]~~

~~51c. In all other cases, the auditor's opinion states whether the financial statements “have been prepared, in all material respects,” in accordance with the applicable financial reporting framework.~~

Forming an Opinion on the Financial Statements

51da. The auditor should evaluate the conclusions drawn from the audit evidence obtained as the basis for forming an opinion on the financial statements. [From ISA 700R.11 and ED-ISA 701.20]

51eb. When forming an opinion on the financial statements, the auditor evaluates whether, based on the audit evidence ~~obtained~~ acquired, ~~there is~~ reasonable assurance has been obtained about whether the financial statements taken as a whole are free from material misstatement. This involves concluding whether sufficient appropriate audit evidence has been obtained to reduce to an acceptably low level the risks of material misstatement of the financial statements⁶ and evaluating the effects of uncorrected misstatements identified.⁷ **[From ISA 700R.12 and ED-ISA 701.21]**

⁵ For example, in the case of financial statements prepared and presented in accordance with IFRSs, the entity's financial position, financial performance and cash flows.

⁶ See ISA 330, “The Auditor's Procedures in Response to Assessed Risks.”

⁷ See ISA ~~320~~ 450, ~~“Audit Materiality~~ Evaluation of Misstatements Identified during the Audit.”

51**fc**. The auditor evaluates whether the financial statements have been prepared and presented in accordance with the specific requirements of the applicable financial reporting framework. This evaluation includes considering whether, in view of the specific requirements of the applicable financial reporting framework:

- (~~e1~~**a**) The financial statements adequately refer to or describe the applicable financial reporting framework; ~~[From ED-ISA 701.22(f)]~~
- (~~e2~~**b**) The financial statements adequately disclose the significant accounting policies selected and applied, and significant interpretations by management of regulatory, ~~or legal or contractual~~ requirements. In jurisdictions where the applicable financial reporting framework is so codified as to preclude a choice of accounting policies or significant interpretations by management, a reference to the applicable financial reporting framework may suffice; ~~and [From ED-ISA 701.22(g)]~~
- (**ac**) The accounting policies selected and applied are consistent with the financial reporting framework and are appropriate; ~~[From ISA 700R.13(a)]~~
- (**bd**) The accounting estimates, ~~if any,~~ made by management are reasonable; ~~[From ISA 700R.13(b)]~~
- (**ee**) The information presented in the financial statements is relevant, reliable, comparable and understandable; ~~[From ISA 700R.13(e)]~~
- (**df**) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements, for example, in the case of financial statements prepared and presented in accordance with IFRSs, the entity's financial position, financial performance and cash flows; ~~and [From ISA 700R.13(d)]~~
- (~~a1~~**g**) The terminology used in the financial statements, including their titles, is appropriate; ~~[From ED-ISA 701.22(a)]~~

51**gd**. Forming an opinion ~~as to whether the~~ on financial statements ~~give a true and fair view or are presented fairly, in all material respects, prepared and presented~~ in accordance with ~~the applicable financial reporting a fair presentation~~ framework ~~(as described in paragraph 51b)~~ also involves evaluating ~~the whether those financial statements achieve~~ fair presentation ~~of the financial statements in the context provided by the applicable financial reporting framework. The auditor considers whether the financial statements, after any adjustments made by management as a result of the audit process, are consistent with the auditor's understanding of the entity and its environment.~~ The auditor considers the overall presentation, structure and content of the financial statements. The auditor also considers whether the financial statements, including ~~the related explanatory notes disclosures,~~ faithfully represent the underlying transactions and events in a manner that ~~gives a true and fair view of or presents fairly, in all material respects, the information conveyed in the financial statements in the context of the financial reporting framework achieves fair presentation.~~ Analytical and other procedures performed at or near the end of the audit help to corroborate conclusions formed during the audit and assist in arriving at the overall conclusion as to the fair presentation of the financial statements. There may be cases where

the financial statements, although prepared and presented in accordance with the specific requirements of the applicable financial reporting framework, do not achieve fair presentation. Where this is the case, management provides disclosures beyond the specific requirements of the framework or, in extremely rare circumstances, departs from a specific requirement in the framework to achieve fair presentation of the financial statements, as explained in paragraph 36c. If management does not do so, the auditor considers the need to modify the opinion in the auditor's report in accordance with ISA 705, "Modifications to the Opinion in the Independent Auditor's Report." ~~[From ISA 700R.14 and ED-ISA 701.23]~~

51e. In cases where a compliance framework is required to be used, or is otherwise accepted by the auditor as an appropriate financial reporting framework in the circumstances of the entity, it is likely that the framework is both generally understood and accepted by preparers and users of the financial statements. It is therefore extremely rare for the auditor to consider financial statements prepared and presented in accordance with a compliance framework, which the auditor has determined to be acceptable in the circumstances of the entity, to be misleading in the circumstances of the entity. However, if the auditor encounters such extremely rare circumstances (i.e., where, in the auditor's professional judgment, the financial statements are misleading), the auditor discusses the matter with management and considers the need to modify the auditor's report. The modification to the auditor's report, if any, will depend on how management addresses the matter in the financial statements.

~~Extremely Rare Circumstances when Applying the Financial Reporting Framework Results in Misleading Financial Statements~~

51h. ~~As discussed in ISA 210, the auditor considers the acceptability of the applicable financial reporting framework when considering whether to accept the engagement. In extremely rare circumstances, however, application of a specific requirement in a framework that has been determined to be acceptable may result in financial statements that are misleading in the particular circumstances of the entity. As explained in paragraph 51a, some financial reporting frameworks implicitly or explicitly acknowledge that it may be necessary for management to provide disclosures beyond the specific requirements of the framework, or explicitly acknowledge that in extremely rare circumstances it may be necessary for management to depart from a specific requirement in the framework, to achieve fair presentation of the financial statements.. If the auditor encounters circumstances that lead the auditor to conclude that the financial statements are misleading, the auditor considers the need to modify the opinion in the auditor's report. The modifications, if any, that are appropriate to the opinion will depend on how management addresses the matter in the financial statements and how the financial reporting framework deals with these rare circumstances (see [proposed] ISA 705). [From ISA 700R.14 and ED-ISA 701.23]~~

[Paragraphs 51i-51l have been moved to ISA 800.]

Effective Date

52. This ISA is effective for audits of financial statements for periods beginning on or after [date].

Public Sector Perspective

[No changes are proposed to the PSP. The PSP is also not necessary to provide context to the proposed changes. As a result, it has not been reproduced here.]

Appendix 1

Examples of a Single Financial Statement and Examples of a Specific Element, Account or Item of a Financial Statement

Examples of a single financial statement include the following:

- Balance sheet and related explanatory notes.
- Statement of income or statement of operations and related explanatory notes.
- Statement of retained earnings and related explanatory notes.
- Statement of cash flows and related explanatory notes.
- Statement of changes in owners' equity and related explanatory notes.
- Statement of assets and liabilities that does not include owners' equity and related explanatory notes.
- Statement of revenue and expenses and related explanatory notes.
- Statement of operations by product lines and related explanatory notes.
- Statement of cash receipts and disbursements and related explanatory notes.

~~Examples of specific elements, accounts or items of a financial statement include the following:~~

- ~~• Accounts receivable, allowance for doubtful accounts receivable, inventory, the liability for accrued benefits of a private pension plan, the recorded value of identified intangible assets, or the liability for "incurred but not reported" claims in an insurance portfolio.~~
- ~~• A schedule of externally managed assets and income of a private pension plan.~~
- ~~• A schedule of net tangible assets.~~
- ~~• A schedule of disbursements in relation to a lease property.~~
- ~~• A schedule of profit participation or employee bonuses.~~

~~[From ED-ISA 701]~~