



International Federation of Accountants

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Agenda Item

8

Committee: IAASB

Meeting Location: Toronto

Meeting Date: September 18-22, 2006

Special Reports

Objectives of Agenda Item

To review proposed ISA 800, “Special Considerations—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement” and proposed amended 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 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 August 2006 to discuss the comments received during the May 2006 IAASB meeting. It also held two telephone conferences.

Matters for Consideration by the IAASB

DEFINITIONS OF GENERAL PURPOSE FINANCIAL STATEMENTS AND SPECIAL PURPOSE FINANCIAL STATEMENTS

1. At the May 2006 IAASB meeting it was debated whether the definitions of general purpose financial statements and special purpose financial statements should be linked to the purpose for which the financial reporting framework is designed or the purpose for which the financial statements are prepared. The Task Force linked the definitions to the purpose for which the framework is designed in the drafts that were prepared for that meeting.
2. The Task Force was 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 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.

3. The IAASB confirmed the approach taken by the Task Force to link the definitions to the purpose for which the framework is designed. The drafts presented for review at this meeting continue to follow this approach.

DESCRIPTION OF THE FINANCIAL REPORTING FRAMEWORK

4. To clarify that management (and not the auditor) is responsible for identifying the sources that make up the applicable financial reporting framework or the sources that give direction on the application of the financial reporting framework, the related guidance was moved to the section on management's responsibilities in ISA 200 (Agenda Item 8-A). This guidance includes the description of a fair presentation framework. (See paragraphs 36a-36d of ISA 200. (Agenda Item 8-A))
5. The guidance on determining the acceptability of the applicable financial reporting framework was restructured to address IAASB members' concern that most of the guidance will not apply in the majority of cases because, in the majority of cases, the framework will either be specified or in general use. Guidance in the body of ISA 210 (Agenda Item 8-B) explains that certain general purpose frameworks are presumed to be acceptable. Guidance on general purpose frameworks that are not presumed to be acceptable (i.e., the auditor has to determine whether they are acceptable), is presented in the Appendix to ISA 210 (Agenda Item 8-B), while guidance on the acceptability of special purpose frameworks is presented in ISA 800 (Agenda Item 8-D).

Fair Presentation Frameworks

6. At the May 2006 IAASB meeting it was noted that ISA 700 (Revised) and related amendments to ISAs 200 and 210 (issued 2004) were based on the presumption that a general purpose framework achieves fair presentation. The requirements and guidance proposed by this Task Force, however, expect the auditor to determine whether the framework is a fair presentation framework. Concern was expressed that this change in approach may create confusion due to its complicated nature and implications for the requirements and guidance.
7. Paragraph 41 of ISA 200 (issued 2004) states that "... financial reporting frameworks established by organizations that are authorized or recognized to promulgate standards to be used by certain types of entities are presumed to be acceptable for general purpose financial statements prepared by such entities ..." Paragraph 10 of ISA 700 (Revised) (issued 2004) reads as follows: "In the case of financial statements that are within the scope of this ISA, application of a financial reporting framework determined to be acceptable for general purpose financial statements will, except in the extremely rare circumstances discussed in paragraph 15, result in financial statements that achieve fair presentation ..." Paragraph 15 of ISA 200 (issued 2004) discusses extremely rare circumstances when applying the financial reporting framework results in misleading financial information. Neither ISA 200 nor ISA 700 (Revised) (issued 2004) describes what a fair presentation framework is.
8. Based on the objective of an audit (i.e., to express an opinion whether the financial statements are prepared, in all material respects, in accordance with the applicable financial

reporting framework), the Task Force is of the view that that the ISAs should clearly describe a financial reporting framework and a fair presentation framework (see paragraphs 36a-36d of ISA 200 (Agenda Item 8-A)). It is also necessary to distinguish between a fair presentation framework and a compliance framework (see paragraph 36e of ISA 200 (Agenda Item 8-A)), because the distinction affects the auditor's procedures and opinion.

9. However, to address the concern noted in paragraph 6 of this paper, text was added to paragraph 36c of ISA 200 (Agenda Item 8-A), acknowledging the fact that 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 are often designed to achieve fair presentation, for example, International Financial Reporting Standards (IFRSs).

PLACEMENT OF REQUIREMENTS AND GUIDANCE

10. As requested by the IAASB, requirements and guidance were placed as follows:
 - ISA 700 (Revised) deals with the auditor's report on general purpose financial statements (see Agenda Item 8-C);
 - ISA 800 *inter alia* deals with special considerations in the audit of special purpose financial statements (see Agenda Item 8-D);
 - Requirements and guidance relating to determining the acceptability of the financial reporting framework were moved to ISA 210 (see Agenda Item 8-B); and
 - Requirements and guidance on forming an opinion have been retained in ISA 200, but will be moved to the new ISA on forming an opinion (see Agenda Item 8-A).
11. Some Task Force members noted that the ISAs are structured to deal with performance and reporting considerations separately. They are of the view that, in the interest of clarity, the same approach should be followed for the special considerations in the audit of special purpose financial statements.
 - They therefore propose that the requirements and guidance for the auditor's report should be presented as ISA 701 (the independent auditor's report on special purpose financial statements), and the guidance on determining the acceptability of the applicable financial reporting framework should be presented as an appendix to ISA 210. This proposal is reflected in Agenda Item 8-E.
 - They also continue to believe that the individual ISAs should contain special considerations for special purpose financial statements, which could be presented under a separate heading (similar to the small entity audit considerations and public sector audit considerations under the clarity drafting conventions).
 - In addition, and based on the limited number of additional requirements and guidance in proposed ISA 701 (i.e., paragraph 7-11 of ISA 701 in the split proposal (see Agenda Item 8-E)), they argue that those paragraphs should rather be incorporated in a separate section in ISA 700. ISA 700 would then deal with unmodified auditors reports for all kinds of financial statements.

REQUIREMENTS FOR ELEMENTS, ACCOUNTS AND ITEMS OF A FINANCIAL STATEMENT

12. At the May 2006 IAASB meeting it was debated whether the requirements and guidance for audits of specific elements, accounts or items of a financial statement should be withdrawn. The proposed minutes note the discussion as follows: “Some members thought that an increasing demand exists for such audits. Others argued that the proposed requirements and guidance were inadequate. Mr. Sylph noted that withdrawal might be the optimal solution because inadequate requirements and guidance might result in problems in practice. Some members were concerned that withdrawal might lead to inconsistency in practice. A member noted that the International Standard for Assurance Engagements (ISAE 3000) might be appropriate for these audits. Mr Kellas suggested that staff prepare a paper that addresses this issue for further consideration by the IAASB.”
13. The Task Force considered the IAASB’s comments and presents its views at part of this paper.

Extant ISA 800, the Exposure Draft and Proposed ISA 800

14. The Task Force reconsidered the standards and guidance in extant ISA 800, the exposure draft, and proposed ISA 800. Paragraphs 12 to 17 of extant ISA 800 address the following in the requirements and guidance related to an audit of a specific element, account or item of a financial statement:
 - The engagement does not result in an auditor’s report on the financial statements as a whole. Accordingly, the auditor would express an opinion only whether the single element, account or item subject to audit is prepared, in all material respects, in accordance with the identified basis of accounting.
 - In determining the scope of the engagement, the auditor should consider those financial statement items that are interrelated and which could materially affect the information on which the audit opinion is to be expressed.
 - The auditor should consider the concept of materiality in relation to the specific element, account or item subject to audit.
 - To avoid giving the user the impression that the auditor’s report relates to the entire financial statements, the auditor would advise the client that the auditor’s report on a specific element, account or item is not to accompany the entity’s financial statements.
 - The auditor’s report should include a statement that indicates the basis of accounting in accordance with which the specific element, account or item is presented or refers to an agreement that specifies the basis.
 - The opinion should state whether the specific element, account or item is prepared, in all material respects, in accordance with the identified basis of accounting. (The examples in Appendix 2 contain “true and fair / presents fairly, in all material respects,” opinions.)
 - When an adverse opinion or disclaimer of opinion is expressed on the entity’s financial statements, the auditor should report on a specific element, account or item of the financial statements only if that element, account or item is not so extensive as to constitute a major portion of the entity’s financial statements.
15. The exposure draft of proposed ISA 701, “The Independent Auditor’s Report on Other Historical Financial Information” contains requirements and guidance for auditors’ reports

on historical financial information other than a complete set of general purpose financial statements prepared in accordance with a fair presentation framework. Other historical financial information includes specific elements, accounts or items of a financial statement. The proposed requirements and guidance in ED-ISA 701 therefore apply to audits of specific elements, accounts or items of a financial statement. Of particular importance are paragraphs 6 to 8 of ED-ISA 701, which explains that the requirements in ISA 200 for the auditor to comply with ethical requirements and each of the ISAs relevant to the audit applies to audits of specific elements, accounts or items.

16. In addition, ED-ISA 701 contains standards and guidance similar to those of extant ISA 800:
 - Adequate disclosure of the applicable financial reporting framework is discussed in paragraph 13;
 - The wording of the audit opinion is discussed in paragraphs 14-19, providing for a “true and fair / presents fairly, in all material respects” opinion when the applicable financial reporting framework is designed to achieve fair presentation of the specific information presented;
 - Paragraph 35 discusses the auditor’s procedures when the entity intends to publish an audited element account or item together with the entity’s financial statements of which it forms a part;
 - Paragraphs 36 and 37 explain the auditor’s procedures when a modified auditor’s report is issued on the entity’s financial statements of which the audited element, account or item forms a part.
 - Paragraph 38 refers to ISA 705, “Modifications to the Opinion in the Independent Auditor’s Report” and discusses piecemeal opinions.
17. ED-ISA 701 does not provide guidance on the interrelationship of financial statement items (paragraph 13 of extant ISA 800) or materiality in the context of an audit of a specific element, account or item of a financial statement (paragraph 14 of extant ISA 800).

Responses to the Exposure Draft

18. A majority of respondents to ED-ISA 701 agreed that the ISAs should contain requirements and guidance for audits of specific elements, accounts or items of a financial statement. A small number of respondents (e.g., APB, ICAS), however, were of the view that the ISAs should not address such engagements.
19. A small number of respondents (e.g., AUASB, CICA, FEE, KPMG, PWC) disagreed with, or questioned the completeness of, the proposed requirements and guidance. In particular, respondents were concerned about leaving it to the auditor’s judgment to determine which ISAs, or requirements thereof, are relevant to the audit of a specific element, account or item of a financial statement. They also proposed that the ISA deal with the interrelationship of financial statement items, materiality, the fact that understatement of the specific element, account or item is a key risk, the extent to which the auditor should consider disclosures in the entity’s financial statements to identify those relevant to the specific element, account or item of a financial statement, and the extent to which the auditor should consider additional disclosures that may be necessary because the materiality

for the specific account, item or element may be different to that for the entity's financial statements.

20. Many respondents were concerned about using the phrase "true and fair / presents fairly, in all material respects" in the audit opinion on a specific element, account or item of a financial statement. See paragraph 25-26 of this paper.

Additional Responses from National Standard Setters

21. IAASB Staff has asked members of the IAASB-National Standard Setters Group about engagements to audit specific elements, accounts or items of a financial statement in their respective countries. Responses were received from Australia, Canada, Germany, Japan, New Zealand, South Africa and the United States.
- Except for New Zealand, they indicated that such engagements are being conducted in their respective countries. In New Zealand work performed on specific elements, accounts or items of a financial statement tends to be in the form of agreed-upon procedures.
 - Most of the engagements appear to be voluntary in nature (e.g., performed pursuant to contract agreements or lending arrangements). In Germany, however, a number of them are required by an authority or by German Commercial and Company Law.
 - Except for Japan and New Zealand, the National Standard Setters have issued guidance for such engagements.

Way Forward

22. Based on the responses to the exposure draft and additional responses from National Standard Setters, the Task Force continues to recommend that the proposed requirements and guidance for audits of single elements, accounts or items of a financial statement be retained and presented in proposed ISA 800. Conforming amendments to proposed ISA 800 should be processed when necessary when other ISAs are revised.
23. The Task Force compared the requirements and guidance in proposed ISA 800 (see Agenda Item 8-D) to those in extant ISA 800 to ensure that they address the special considerations noted in extant ISA 800. For example, proposed ISA 800 now includes guidance on the interrelationship of financial statement items and materiality.
24. The Task Force could not find a reason supporting the withdrawal of the requirements and guidance in extant ISA 800. The Task Force agrees with those IAASB members and respondents who are of the view that withdrawal of the requirements and guidance may lead to inconsistency in practice. The Task Force does not agree with those IAASB members and respondents who are of the view that the proposed requirements and guidance are inadequate; although they may be incomplete. However, the incomplete nature of the proposed requirements and guidance are to be addressed as other ISAs are revised.

Wording of the Opinion on a Specific Element, Account or Item of a Financial Statement

25. As noted in paragraph 20 of this paper, many respondents to ED-ISA 701 were concerned about using the phrase "true and fair / presents fairly, in all material respects" in the audit opinion on a specific element, account or item of a financial statement.

26. The concept of a fair presentation framework vs. a compliance framework is explained in paragraphs 36c-36d of ISA 200 (see Agenda Item 8-A), and the effect that it has on the auditor's procedures and opinion is explained in paragraphs 51d-51e of ISA 200 (see Agenda Item 8-A) and paragraphs 28-29 of ISA 700 (see Agenda Item 8-C). The Task Force is of the view that this applies to all forms of historical financial information, i.e., irrespective of the form and content of the information and of the financial reporting framework adopted in preparing and presenting the information. The Task Force argues as follow:
- Paragraph 36c of ISA 200 (see Agenda Item 8-A) sets forth the criteria for determining whether a financial reporting framework is a fair presentation framework (i.e., a framework that, either implicitly or explicitly, requires disclosures beyond the specific requirements of the framework when necessary to achieve fair presentation of the financial statements, or, a framework that explicitly requires, in extremely rare circumstances, departures from a specific requirement of the framework when necessary to achieve fair presentation of the financial statements).
 - The fact that a specific element, account or item of a financial statement, rather than a complete set of financial statements, is prepared in accordance with a fair presentation framework does not alter the fact that that the applicable financial reporting framework is a fair presentation framework and, therefore, that the criteria for a fair presentation framework continue to apply. For example, if a schedule of accounts receivable, including related explanatory notes, prepared and presented in accordance with the requirements of US GAAP relevant to accounts receivable does not fairly present accounts receivable, then US GAAP requires additional disclosures in the related explanatory notes so that the schedule of accounts receivable fairly presents accounts receivable in accordance with US GAAP).
 - Consequently, to indicate to users of the financial statements that the applicable financial reporting framework applied in preparing and presenting a specific element, account or item of a financial statement is a fair presentation framework and, therefore, that the criteria for such frameworks have been applied, the auditor uses the phrase "fair presentation" in the audit opinion on the specific element, account or item of a financial statement.

ED-ISA 701 vs. ISAE 3000

27. In March 2006, it was noted that one respondent to the exposure draft (PWC) was of the view that the audit of a specific element, account or item of a financial statement is an ideal circumstance in which to apply ISAE 3000, "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information." The respondent noted that, within the existing scope of ISAE 3000, auditors already can use that framework for the audit of financial information that is not historical. Auditors can also use it to audit numerical information that is not financial. Thus the framework provides an appropriate basis from which to design and perform an audit of certain financial and other numerical information. Therefore, it seemed quite illogical to the respondent that the scope of ISAE should be restricted to other historical financial information.
28. Two other respondents (IDW and FEE) were concerned that there is a gap in coverage between the ISAs and ISAE 3000. They were of the view that the ISAs cover financial statements and specific elements, accounts or items of a financial statement, while ISAE

3000 only covers subject matters that are not historical financial information. Consequently, IAASB would not cover historical financial information that is not a financial statement or elements, accounts or items thereof, for example a transaction or series of transactions (e.g., shares) pursuant to a contract between two private individuals or an audit of certain historical costs (e.g., associated with construction) presented in accordance with the terms of a contract, industry practice or applicable legislation.

29. At the time, the Task Force explained that the confusion is created by differences in view of the meaning of the term “historical financial information.” The significance of the term is for the cut between the ISAs (historical financial information) and the ISAEs (other information). Rather than change this distinction, it may be preferable to decide where the IAASB want that cut to be, and to describe “historical financial information” accordingly. Possibilities might include:
- All information of a financial nature that is historical. This would apply the ISAs to everything that is expressed in financial terms (e.g., an audit opinion on average share prices, or asset values).
 - Information derived primarily from an entity’s accounting system – irrespective of its form (e.g., information about expenditure in pursuance of a contract or project, such as is often required by a grant provider).
 - Information included in financial statements.
30. The Task Force supports the description in the second bullet. Consequently, paragraph 1a of ISA 200 (see Agenda Item 8-A) was added to provide a description of historical financial information.

Material Presented

Agenda Item 8-A (Pages 2245 – 2254)	Proposed Amended ISA 200, “Objective and General Principles Governing an Audit of Financial Statements” (CLEAN)
Agenda Item 8-B (Pages 2255 – 2260)	Proposed Amended ISA 210, “Terms of Audit Engagements” (CLEAN)
Agenda Item 8-C (Pages 2261 – 2268)	Proposed Amended ISA 700 (Revised), “The Independent Auditor’s Report on General Purpose Financial Statements” (CLEAN)
Agenda Item 8-D (Pages 2287 – 2304)	Proposed ISA 800, “Special Considerations—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement” (CLEAN)
Agenda Item 8-E (Pages 2305 – 2320)	Proposal to Split ISA 800
Agenda Item 8-F (Pages 2321 – 2330)	Proposed Amended ISA 200, “Objective and General Principles Governing an Audit of Financial Statements” (MARK-UP)
Agenda Item 8-G (Pages 2331 – 2340)	Proposed Amended ISA 210, “Terms of Audit Engagements” (MARK-UP)

Agenda Item 8-H
(Pages 2341 – 2366)

Proposed Amended ISA 700 (Revised) and Proposed ISA 701
(MARK-UP)

Action Requested

The IAASB is asked to consider the matters highlighted in this paper and to review ISAs 200, 210, 700 (Revised) and 800. **AGENDA ITEMS 8-A, 8-B, 8-C AND 8-D (I.E., THE CLEAN VERSIONS OF ISAs 200, 210, 700 AND 800) WILL BE USED FOR PURPOSES OF THIS DISCUSSION.**

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