International Federation of Accountants
545 Fifth Avenue, 14th Floor, New York, NY 10017 USA
Tel +1 (212) 286-9344 Fax +1 (212) 286-9570 www.ifac.org

Agenda Item
6

Committee: IAASB

Meeting Location: Warsaw

Meeting Date: July 9-13, 2007

ISA 700 (Redrafted), "The Independent Auditor's Report on General Purpose Financial Statements"

Objectives of Agenda Item

1. To approve proposed ISA 700 (Redrafted), "The Independent Auditor's Report on General Purpose Financial Statements" to be issued as an exposure draft.

ISA 700 Redrafting Task Force Members

2. The Task Force members are Diana Hillier (Chair), John Kellas and Sylvia Smith.

Activities of the Task Force

3. The Task Force used ISA 700 amended as a result of ISA 800 (Revised and Redrafted), "Special Considerations—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement" as the basis for preparing proposed ISA 700 (Redrafted).

4. Proposed ISA 700 (Redrafted) was reviewed by a small team designated by the Financial Audit Guidelines Subcommittee of INTOSAI to consider proposed clarity redrafted ISAs. The team concluded that it is not necessary to include public sector audit considerations in the proposed redrafted ISA.

5. The IAASB conducted a first read of proposed ISA 700 (Redrafted) in February. Agenda Item 6-A reflects the changes processed based on the Task Force's consideration of the IAASB's comments.

Matters for IAASB Consideration

OVERLAP BETWEEN PROPOSED ISA 450 (REVISED AND REDRAFTED) AND PROPOSED ISA 700 (REDRAFTED)

6. As requested, the Task Force considered the perceived overlap between proposed ISA 450 (Revised and Redrafted), "Evaluation of Misstatements Identified during the Audit" and proposed ISA 700 (Redrafted). In particular, the Task Force was asked to consider how the requirements and guidance in proposed ISA 450 (Revised and Redrafted) that deal with the evaluation whether the financial statements as a whole are free from

material misstatement relate to the requirements and guidance in proposed ISA 700 (Redrafted) that deal with forming an opinion on the financial statements.

7. The Task Force agreed that, in light of the definition of a misstatement in proposed ISA 450 (Revised and Redrafted), there is not a clear differentiation between the consideration of "qualitative aspects of the entity's accounting practices" in proposed ISA 450 (Revised and Redrafted) and the matters the auditor is asked to evaluate in forming an opinion in extant ISA 700. The Task Force concluded that, in the absence of a separate ISA on forming an opinion on the financial statements, the overlap could be addressed by:

   (a) Removing the requirements and guidance in proposed ISA 450 (Revised and Redrafted) that deal with evaluating whether the financial statements as a whole are free from material misstatement (i.e., paragraphs 18-19 and A22-A24 of proposed ISA 450 (Revised and Redrafted));

   (b) Amending the objective of proposed ISA 450 (Revised and Redrafted) accordingly (see paragraph 3(b) of Agenda Item 6-C);

   (c) Clarifying in proposed ISA 700 (Redrafted) that the auditor's evaluation of whether the financial statements are prepared and presented in accordance with the specific requirements of the applicable financial reporting framework includes consideration of the *qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments* (from proposed ISA 450 (Revised and Redrafted)) (see paragraph 9 of Agenda Item 6-A);

   (d) Transferring the application material regarding evaluating whether the financial statements as a whole are free of material misstatement and the consideration of bias from proposed ISA 450 (Revised and Redrafted) to proposed ISA 700 (Redrafted) (see paragraphs A1-A2 of Agenda Item 6-A); and

   (e) Restructuring the Forming an Opinion section in proposed ISA 700 (Redrafted) first to reflect the matters taken into account and conclusions reached in forming an opinion (see paragraphs 8-12), followed by the final requirement to form an opinion whether reasonable assurance has been obtained about whether the financial statements taken as a whole are free from material misstatement (see paragraph 13 of Agenda Item 6-A).

8. If the Task Force's proposal is accepted, proposed ISA 450 (Revised and Redrafted) will deal with the evaluation of the effect of uncorrected misstatements, while proposed ISA 700 (Redrafted) will deal with the evaluation whether the financial statements as a whole are free from material misstatement.

Action Requested

Does the IAASB agree with the Task Force's proposal to amend proposed ISA 450 (Revised and Redrafted) and proposed ISA 700 (Redrafted) as explained in paragraph 7 above?

MISLEADING TEST

9. In February, the Task Force noted to the IAASB that the ISAs do not include a requirement for the auditor to evaluate whether financial statements prepared and presented in accordance with a compliance framework are not misleading. This seemed inconsistent with the requirement in proposed ISA 700 (Redrafted) for the auditor, when forming an opinion on financial statements prepared and presented in accordance with a fair presentation framework, to evaluate and conclude whether those financial statements achieve fair presentation. The IAASB asked that the Task Force develop a requirement for consideration at its July meeting.

10. The Task Force debated whether proposed ISA 700 (Redrafted) should include a requirement for the auditor to evaluate whether financial statements prepared and presented in accordance with a compliance framework are not misleading. Based on the fact that it will be extremely rare for financial statements prepared in accordance with a compliance framework to be misleading, the Task Force concluded that it may be sufficient to address the matter by way of essential guidance.

11. Paragraph 10 of proposed ISA 700 (Redrafted) (see Agenda Item 6-A) contains the following requirement: "When the financial statements are prepared and presented in accordance with a fair presentation framework, the auditor shall evaluate whether the financial statements achieve fair presentation …" Proposed new paragraph 11 (see Agenda Item 6-A) explains that, when the financial statements are prepared and presented in accordance with a compliance framework, the auditor is not required to evaluate whether the financial statements achieve fair presentation but may nevertheless, in extremely rare circumstance, conclude that financial statements prepared and presented in accordance with a compliance framework are misleading. (See also paragraph 14 of Agenda Item 6-A)

Action Requested

Does the IAASB agree with the Task Force's proposal?

AUDITS CONDUCTED IN ACCORDANCE WITH BOTH NATIONAL AUDITING STANDARDS AND INTERNATIONAL STANDARDS ON AUDITING

12. The IAASB asked that the Task Force expand the first requirement in the section on Auditor's Report for Audits Conducted in Accordance with Both International Standards on Auditing and Auditing Standards of a Specific Jurisdiction or Country (see paragraph 41 of Agenda Item 6-A) to deal with conflict between International Standards on Auditing and national law or regulation. As drafted, it only dealt with conflict between International Standards on Auditing and the national auditing standards.

13. The Task Force reviewed the wording in extant ISA 700. Given that the underlying principle in the ISA was "consistency in the auditor's report when the audit has been

conducted in accordance with ISAs …," the Task Force concluded that paragraph 66[1] of extant ISA 700 was intended to be read with paragraph 65[2] of extant ISA 700, which refers to two sets of auditing standards (i.e., International Standards on Auditing and the national auditing standards). The heading of the section also confirms that the requirements and guidance relate to the application of two sets of auditing standards; the primary set being the national auditing standards. The requirements and guidance were designed to enable auditors to assert that, in addition to the national auditing standards, they have followed International Auditing Standards, even though the form of auditor's report required in terms of the national auditing standards may be different. If an auditor's report on general purpose financial statements adopts a report layout and wording required by a different authoritative source, those alternative national auditing standards ought to be identified in the auditor's report too. This ensures full transparency and avoids an "ISA-brand" issue developing.

14. It is relevant to keep in mind that the *Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services* explains that the IAASB's pronouncements "do not override the local laws or regulations that govern the audit of historical financial statements or assurance engagements on other information in a particular country required to be followed in accordance with that country's national standards." Thus, law or regulation in another country retains the right to mandate a different report wording or layout. It continues to state: "In the event that local laws or regulations differ from, or conflict with, the IAASB's Standards on a particular subject, an engagement conducted in accordance with local laws or regulations will not automatically comply with the IAASB's Standards. A professional accountant should not represent compliance with the IAASB's Standards unless the professional accountant has complied fully with all of those relevant to the engagement."

15. The Task Force proposes that paragraphs 41-42 and A45-A47 of proposed ISA 700 (Redrafted) (see Agenda Item 6-A) be amended to clarify the above matter.

Action Requested

Does the IAASB agree with the Task Force's interpretation of paragraph 66 read with

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[1] Paragraph 66 of extant ISA 700 reads as follows: "The auditor may be obliged by national law or regulation to use a layout or wording in the auditor's report that differs from that described in this ISA. When the differences only relate to the layout and wording of the auditor's report, the auditor will be considered to have complied with the reporting requirements of the ISAs provided that the auditor's report includes, at a minimum, each of the elements identified in paragraph 65 – even if using the layout and wording specified by national laws or regulations. Where specific requirements in a particular jurisdiction do not conflict with ISAs, the auditor adopts the layout and wording used in this ISA so that users can more readily recognize the auditor's report as a report on an audit conducted in accordance with ISAs."

[2] Paragraph 65 of extant ISA 700 reads as follows: **"When the auditor prepares the auditor's report using the layout or wording specified by the law, regulation or auditing standards of the specific jurisdiction or country, the auditor's report should refer to the audit being conducted in accordance with both International Standards on Auditing and the auditing standards of the specific jurisdiction or country only if the auditor's report includes, at a minimum, each of the following elements …"**

paragraph 65 of the extant ISA 700? If so, does the IAASB agree with the Task Force's proposed amendments?

SUPPLEMENTARY INFORMATION PRESENTED WITH THE FINANCIAL STATEMENTS

16. The Task Force has redrafted the requirements relating to supplementary information presented with the financial statements. Paragraph 43 of Agenda Item 6-A now contains essential guidance, which explains that "supplementary information that, because of its nature and how it is presented, is an integral part of the audited financial statements and, accordingly, is covered by the auditor's opinion."

17. Paragraph 44 of Agenda Item 6-A requires the auditor to evaluate whether supplementary information that is presented together with the audited financial statements (but that is not an integral part thereof) and that is not intended to be covered by the auditor's opinion is clearly differentiated from the audited financial statements. If such supplementary information is not clearly differentiated from the audited financial statements, the auditor has to ask management to change how the unaudited supplementary information is presented. If management refuses to do so, the auditor has to explain in the auditor's report that that information has not been audited.

Action Requested

Does the IAASB agree with the requirements in paragraphs 43-44 of Agenda Item 6-A?

FINANCIAL REPORTING FRAMEWORKS DESCRIBED BY REFERENCE TO IFRSS

18. As agreed by the IAASB, the Task Force has incorporated the proposal regarding financial reporting frameworks described by reference to International Financial Reporting Standards in proposed ISA 700 (Redrafted). See paragraphs A9-A11 of Agenda Item 6-A, which deals with the auditor's evaluation of the description of the financial reporting framework in the financial statements, and paragraphs A34-A35 of Agenda Item 6-A, which deals with the effect that such description may have on the auditor's opinion.

19. The approach in proposed ISA 700 (Redrafted) is based on a proposal of the International Accounting Standards Board (IASB) to amend International Accounting Standard (IAS) 1, "Presentation of Financial Statements," as described in paragraph A9 of Agenda Item 6-A. The proposal of the IASB will form part of its annual improvements process. The exposure draft of the IASB will be published on October 1, 2007 with a 90-day comment period. It is expected that the amendment to IAS 1 will be published on April 1, 2008 and take effect January 1, 2009.

20. According to the current IAASB project timetable, the exposure drafts of the redrafted reporting ISAs, including proposed ISA 700 (Redrafted), will be approved at the July IAASB meeting. Approval of the final redrafted reporting ISAs is scheduled for March 2008. The IAASB, therefore, needs to consider the implications of referring in proposed ISA 700 (Redrafted) to the proposed amendment to IAS 1 before such amendment is exposed for public comment.

21. One approach may be to delay issue of the exposure draft of proposed ISA 700 (Redrafted) until the exposure draft of the proposed amendment to IAS 1 is issued (i.e., October 1, 2007). This would, however, affect the issue date of the exposure drafts of the other redrafted reporting ISAs and could impair the Clarity timetable.

22. Another approach may be to clearly explain in the explanatory memorandum to the exposure draft that finalisation of the proposed guidance is dependent on the IASB's timetable and due process (either as explanatory context to the wording in proposed ISA 700 (Redrafted); or to include the proposed guidance in the explanatory memorandum, explaining that the IAASB plans to incorporate it in proposed ISA 700 (Redrafted) once IASB has finalized its due process). The explanatory memorandum could explain that the proposal of the IAASB is based on a proposal of the IASB that has not yet been exposed for public comment. Respondents could be asked to comment on the proposed application material. Their comments, and any changes that the IASB may agree based on comments received on its exposure draft, could be taken into account in finalizing ISA 700 (Redrafted). At that time, the IAASB could evaluate whether it is necessary to "re-expose" the relevant application material.

Action Requested

(a) Does the IAASB agree with the application material in paragraphs A9-A11 and A34-A35, which deals with financial reporting frameworks described by reference to International Financial Reporting Standards?

(b) What is the IAASB's view with regard to the difference in IAASB and IASB exposure draft dates?

INTERNATIONAL AUDITING PRACTICE STATEMENT (IAPS) 1014

23. In considering the proposal regarding financial reporting frameworks described by reference to International Financial Reporting Standards, and based on a discussion at the IAASB-National Standards Setters meeting about the auditor expressing more than one opinion when financial statements represent that they comply with the applicable financial reporting and International Financial Reporting Standards, the Task Force is of the view that it may be helpful to incorporate the text of IAPS 1014, "Reporting by Auditors on Compliance with International Financial Reporting Standards" in proposed ISA 700 (Redrafted).

24. To enable the IAASB to consider this proposal, the text of IAPS 1014, appropriately amended, has been incorporated in paragraphs A4-A8 of Agenda Item 6-A, which deals with the auditor's evaluation of the description of the financial reporting framework in the financial statements, and paragraphs A32-A33 of Agenda Item 6-A, which deals with the effect that such description may have on the auditor's opinion.

25. Should the IAASB agree with the application material in paragraphs A4-A8 and A32-A33, the Task Force proposes that IAPS 1014 be withdrawn.

Action Requested

What is the IAASB's view with regard to incorporating the text of IAPS 1014, appropriately amended, in proposed ISA 700 (Redrafted)?

Material Presented

Agenda Item 6-A (Pages 1901-1928)	Proposed ISA 700 (Redrafted) (MARK-UP BASED ON FEBRUARY IAASB DRAFT)
Agenda Item 6-B (Pages 1929-1956)	Proposed ISA 700 (Redrafted) (CLEAN)
Agenda Item 6-C (Pages 1957-1968)	Proposed Conforming Amendments to proposed ISA 450 (Revised and Redrafted)
Agenda Item 6-D (Pages 1969-2044)	Proposed ISA 700 (Redrafted): Mapping Documents

Action Requested

26. The IAASB is asked to approve as an exposure draft:

- Proposed ISA 700 (Redrafted);
- Proposed conforming amendments to proposed ISA 450 (Revised and Redrafted); and
- A proposal to withdraw IAPS 1014.

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