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**Basis for Conclusions:  
ISA 700 (Redrafted), Forming an  
Opinion and Reporting on  
Financial Statements**

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*Prepared by the Staff of the International Auditing and  
Assurance Standards Board*



**International Federation  
of Accountants**

**BASIS FOR CONCLUSIONS:  
ISA 700 (REDRAFTED), FORMING AN OPINION AND REPORTING ON  
FINANCIAL STATEMENTS**

This Basis for Conclusions has been prepared by staff of the International Auditing and Assurance Standards Board (IAASB). It relates to, but does not form part of, ISA 700 (Redrafted), “Forming an Opinion and Reporting on Financial Statements,” which was unanimously approved by the IAASB in September 2008.<sup>1</sup>

**Background**

1. In September 2006, the IAASB agreed the conventions to be used in drafting future International Standards on Auditing (ISAs). These conventions are commonly referred to as the IAASB’s Clarity conventions.<sup>2</sup>
2. The IAASB has undertaken to redraft all of its ISAs in accordance with the Clarity conventions. This approach responds to the desire for all ISAs to be consistently drafted, and subject to a single statement of their authority and effect. The IAASB has agreed, in response to the general call for the Clarity project to be completed within a reasonable time, that while a significant number of the ISAs are under substantive revision as well as redrafting to reflect the new conventions, others will be subject to a limited redrafting to reflect only the conventions and matters of clarity generally. Extant ISA 700<sup>3</sup> is in the latter category.
3. The project to revise extant ISA 800<sup>4</sup> gave rise to conforming amendments to extant ISA 700. ISA 700 amended as a result of ISA 800 (Revised)<sup>5</sup> (ISA 700 (Amended)) formed the basis of proposed ISA 700 (Redrafted).
4. The IAASB issued an exposure draft of proposed ISA 700 (Redrafted)<sup>6</sup> (ED-ISA 700) in August 2007, with a comment date of November 30, 2007. The exposure draft included amendments in addition to those relating to the application of the Clarity conventions. They are discussed in paragraphs 40-65 of this paper.

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<sup>1</sup> See minutes of the September 15-19, 2008 IAASB meeting at <http://www.ifac.org/IAASB/Meeting-Minutes.php?MID=0143>.

<sup>2</sup> The IAASB’s Clarity conventions, and the authority and obligation attaching to them, are established in ISA 200 (Revised and Redrafted), “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing.”

<sup>3</sup> Extant ISA 700, “The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements.”

<sup>4</sup> Extant ISA 800, “The Independent Auditor’s Report on Special Purpose Audit Engagements.”

<sup>5</sup> In October 2006, the IAASB approved the Close Off Document of ISA 800 (Revised), “Special Considerations—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement” and related conforming amendments in the “old style” (i.e., following the IAASB’s current drafting conventions). ISA 700 amended as a result of ISA 800 (Revised), under the title “The Independent Auditor’s Report on General Purpose Financial Statements,” formed part of the Close Off Document of ISA 800 (Revised).

<sup>6</sup> Proposed ISA 700 (Redrafted) “The Independent Auditor’s Report on General Purpose Financial Statements.”

5. The IAASB received fifty comment letters from a variety of respondents, including IFAC member bodies and other professional organizations, national auditing standard setters, audit firms, public sector organizations, regulators and oversight authorities. Input was also received from IFAC's Small and Medium Practices Committee. The IAASB made changes to ED-ISA 700 in response to these comments. In addition, the IAASB discussed significant issues in the development of ED-ISA 700, and the finalization of ISA 700 (Redrafted), with its Consultative Advisory Group (CAG). Significant concerns raised by the CAG are reflected in this paper.
6. In general, ED-ISA 700 received strong support from respondents in terms of how ISA 700 (Amended) had been redrafted in accordance with the Clarity conventions. Some respondents, however, commented on the approach of extant ISA 700 to the auditor's report and, in particular, challenging, in different areas, the principle underlying extant ISA 700 that there should be consistency in an auditor's report issued in accordance with the ISAs. Other comments focused on specific aspects of the auditor's report.
7. This Basis for Conclusions explains the more significant issues raised by respondents on ED-ISA 700, and how the IAASB addressed them.

## Scope of the ISA

8. Respondents to ED-ISA 700 and the exposure draft of proposed 800 (Revised and Redrafted)<sup>7</sup> (ED-ISA 800) expressed concern about the split between the respective scopes of ISA 700 (Redrafted) and ISA 800 (Revised and Redrafted).
9. Paragraph 14 of the Basis for Conclusions: Close Off Document—ISA 800 (Revised)<sup>8</sup> notes that the IAASB was of the view that restricting the scope of ISA 700 (Amended) to auditors' reports on general purpose financial statements and the scope of ISA 800 (Revised) to auditors' reports on special purpose financial statements would provide a clear indication as to where to look for requirements and guidance relevant to auditors' reports. It explains that:
  - The terms "general purpose financial statements" and "special purpose financial statements" are defined with reference to the purpose for which the applicable financial reporting framework is designed. In the case of general purpose financial statements, the framework is designed to meet the common financial information needs of a broad range of users; and in the case of special purpose financial statements, the framework is designed to meet the special financial information needs of specific users.
  - Both ISA 700 (Amended) and ISA 800 (Revised) specify that the applicable financial report framework can be either a fair presentation framework or a compliance framework.

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<sup>7</sup> ISA 800 (Revised and Redrafted), "Special Considerations—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement."

<sup>8</sup> The Basis for Conclusions: Close Off Document—ISA 800 (Revised) can be accessed at <http://www.ifac.org/IAASB/Resources.php#BasisForConclusions>.

- Further, since the term “financial statements” in the ISAs refer to a complete set of financial statements or a single financial statement, both ISA 700 (Amended) and ISA 800 (Revised) address reporting on complete sets of financial statements and single financial statements. (In fact, ISA 800 (Revised) goes further and extends all of the above concepts to auditors’ reports on specific elements, accounts or items of a financial statement prepared in accordance with a general purpose of special purpose framework.)
10. A few respondents to ED-ISA 700 and ED-ISA 800 noted that ambiguity between the scopes of the two ISAs will make it difficult for practitioners to implement those ISAs. For example, a respondent to ED-ISA 700 questioned whether the ability to include a Restriction on Distribution or Use paragraph in the auditor’s report should be limited to ISA 800 (Revised and Redrafted) when users of financial statements prepared for a special purpose may nevertheless determine that a general purpose framework can meet their special purpose needs. Some respondents argued that considerations relevant to auditors’ reports on specific elements, accounts, or items of a financial statement are equally applicable to auditors’ reports on single financial statements. Addressing those matters in ISA 700 as well as ISA 800, however, would unduly complicate the ISAs.
  11. Acknowledging the controversial nature of the matter and the fact that there was not clear consensus in earlier debates, the IAASB concluded that most of the concerns could be addressed by the following:
    - (a) Limiting the scope of ISA 700 (Redrafted) to complete sets of general purpose financial statements. They may be prepared in accordance with a fair presentation framework or a compliance framework and, as a result, ISA 700 (Redrafted) provides for fair presentation opinions and for compliance opinions. This is in line with extant ISA 700.
    - (b) Moving special considerations in audits of single financial statements and of specific elements, accounts or items of a financial statement to a separate ISA with the title “Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement.” This avoids the impression that single financial statements are always special purpose financial statements and reduced the need for duplication of requirements and guidance as special considerations relating to audits of specific elements, accounts or items of a financial statement apply equally to audits of single financial statements.
    - (c) Amending ISA 700 (Redrafted) to explain that it is written in the context of a complete set of general purpose financial statements and that other ISAs deal with special considerations in audits of financial statements prepared in accordance with a special purpose framework and in audits of single financial statements and of specific elements, accounts or items of a financial statement. See paragraph 3 of ISA 700 (Redrafted).
    - (d) Further amending ISA 700 (Redrafted) to explain that reference to “financial statements” in the ISA means “a complete set of general purpose financial statements, including the related notes.” See paragraph 8 of ISA 700 (Redrafted).

- (e) Changing the title of ISA 700 (Redrafted) to “Forming an Opinion and Reporting on Financial Statements.” This is in line with the titles of some of the other ISAs, and represents the content of ISA 700 (Redrafted).
- (f) In line with the above, changing the title of ISA 800 (Revised and Redrafted) to “Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks.”

12. The application of the ISAs in the different circumstances can be presented as follows:

Complete set of financial statements		Single financial statement or specific element, account or item of a financial statement	
General purpose framework (fair presentation / compliance)	Special purpose framework (fair presentation / compliance)	General purpose framework (fair presentation / compliance)	Special purpose framework (fair presentation / compliance)
ISAs 100-706	ISAs 100-706, adapted as per 800	ISAs 100-706, adapted as per 805	ISAs 100-706, adapted as per 800 and 805

13. The IAASB was of the view that the restructuring will enhance the clarity of ISA 700 (Redrafted), as it results in ISA 700 focusing on auditors’ reports on complete sets of general purpose financial statements, which is the most common circumstance. This is an important standard for adopters of the ISAs, and including special considerations (such as those relating to auditors’ reports on single financial statements) in the ISA, as had been proposed in ED-ISA 700, could complicate the adoption thereof in some jurisdictions.

## Objectives

14. ED-ISA 700 contained the following objectives:

The objectives of the auditor are to:

- (a) Form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and
- (b) Express clearly that opinion through a written report that explains the basis of the opinion.

15. The majority of respondents to ED-ISA 700 supported the objectives. Most agreed with the need for two objectives; i.e., one that focuses on forming the opinion, and another that focuses on the auditor’s report. There were, however, specific suggestions for refinement. For example, some respondents suggested ways in which the wording of the objectives could be more closely aligned with that in ISA 200 (Revised and Redrafted), or with other ISAs (e.g., focusing on the evaluation of audit evidence obtained rather than on conclusions drawn from the audit evidence obtained). A few respondents suggested that the first objective refer to “the financial statements *as a whole*.” A respondent was concerned that the second objective could be interpreted as requiring a more discursive explanation of the basis for the specific opinion (i.e., the findings of the particular audit engagement).

16. The IAASB concluded that the objectives appropriately represent the requirements of the ISA and, together with the objectives of the other ISAs, will assist the auditor in achieving the overall objectives stated in ISA 200 (Revised and Redrafted). In particular, the first objective on forming an opinion appropriately builds on the objective in ISA 500 (Redrafted)<sup>9</sup> “to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor’s opinion.” The IAASB also noted that the phrase “financial statements *as a whole*” is normally used in conjunction with “free of material misstatement.” It was thus not appropriate to insert it in the first objective.
17. As ISA 700 (Amended) anticipates a standard description of an audit, the IAASB was of the view that “describes the basis for the opinion” may be a better articulation of the second objective. That is: “(b) Express clearly that opinion through a written report that also describes the basis for the opinion.” Part (a) of the objectives remained as presented in ED-ISA 700. See paragraph 6 of ISA 700 (Redrafted).

## Definitions

18. A few respondents suggested that the Definitions section either refer to the description of a fair presentation framework and a compliance framework in ISA 200 (Revised and Redrafted), or include that description. A respondent indicated that it may not be clear to the readers of the ISAs or of an auditor’s report what a “summary of significant accounting policies and other explanatory notes” is. Another respondent suggested including a definition of “modified opinion” in ISA 700 (Redrafted).
19. Based on the comments on ED-ISA 700 and amendments processed to ED-ISA 800, the IAASB agreed the following:
  - (a) To further enhance the clarity of ISA 700 (Redrafted):
    - (i) The terms “fair presentation framework” and “compliance framework,” which are important in the context of the ISA, should be described in the ISA (see paragraph 7(b) of the ISA); and
    - (ii) A definition of the term “unmodified opinion” should be added. This will distinguish the auditor’s opinion in ISA 700 (Redrafted) from that in ISA 705 (Revised and Redrafted),<sup>10</sup> which deals with modified opinions in the auditor’s report. The following definition was included: “Unmodified opinion – The opinion expressed by the auditor when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework” (see paragraph 7(c) of the ISA).
  - (b) The ISA should explain that reference to the term “financial statements” includes the related notes and that the related notes ordinarily comprise a summary of

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<sup>9</sup> ISA 500 (Redrafted), “Audit Evidence.”

<sup>10</sup> ISA 705 (Revised and Redrafted), “Modifications to the Opinion in the Independent Auditor’s Report.”

significant accounting policies and other explanatory information (see paragraph 8 of ISA 700 (Redrafted)). This is in line with paragraph 10(e) of IAS 1,<sup>11</sup> which reads as follows: “A complete set of financial statements comprises ... notes, comprising a summary of significant accounting policies and other explanatory information ...”

20. In addition, the IAASB agreed that the ISA should explain that reference to “International Financial Reporting Standards” means International Financial Reporting Standards issued by the International Accounting Standards Board and reference to “International Public Sector Accounting Standards” means International Public Sector Accounting Standards issued by the International Public Sector Accounting Standards Board (see paragraph 9 of ISA 700 (Redrafted)). That is to clarify that such references do not include modified versions of those frameworks.

## Requirements

21. The majority of respondents to ED-ISA 700 were of the view that the criteria identified by the IAASB for determining whether a requirement should be specified have been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and reporting, and the use of professional judgment by auditors. Although some respondents commented on the appropriateness of some of the requirements, or suggested refinement, few single requirements received a significant number of comments.

## Forming an Opinion on the Financial Statements

### *Disclosure of Significant Accounting Policies and Interpretations*

22. ED-ISA 700 required the auditor to evaluate whether, in view of the specific requirements of the applicable financial reporting framework, the financial statements adequately disclose the significant accounting policies selected and applied, and significant interpretations by management of regulatory or legal requirements. It explained that, 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.
23. A few respondents questioned the reference to “significant interpretations by management of regulatory or legal requirements.” They noted that management is not expected, requested or required to interpret regulatory or legal requirements, or to disclose such interpretations. The IAASB was of the view that management may interpret regulation or law to make it operational in determining its accounting policies. However, the IAASB agreed that the reference may be interpreted incorrectly and therefore should be deleted. See paragraph 13(a) of ISA 700 (Redrafted).
24. Some respondents were of the view that the explanation regarding financial reporting frameworks that are so codified as to preclude any choice should be moved to the

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<sup>11</sup> International Accounting Standard (IAS) 1, “Presentation of Financial Statements.”

application material or deleted. It was noted that there will be very few situations where management will not have to make important accounting policy choices. It was also noted that the explanation may contradict the requirement for the auditor to include a reference to the summary of significant accounting policies and other explanatory notes in the introductory paragraph of the auditor's report (paragraph 23(d) of ISA 700 (Redrafted)). The IAASB agreed with these comments. The IAASB therefore deleted the explanation as moving it to the application material would not have resolved the contradiction. See paragraph 13(a) of ISA 700 (Redrafted).

#### *Example in a Requirement*

25. ED-ISA 700 required the auditor to evaluate whether, in view of the specific requirements of the applicable financial reporting framework, 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 many general purpose frameworks, the entity's financial position, financial performance and cash flows. A few respondents were of the view that the example should be moved to the application material. The IAASB agreed with this comment and, in line with the Clarity conventions, moved the example to the application material. See paragraphs 13(e) and A4 of ISA 700 (Redrafted).

#### **Form of Opinion**

26. ED-ISA 700 contained the following explanation in the Requirement section: "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. However, in extremely rare circumstances, the auditor may conclude that such financial statements are misleading. In such a case, the auditor shall discuss the matter with management and, depending on how it is resolved, determine whether, and how, to deal with it in the auditor's report." Neither ISA 705 (Revised and Redrafted) nor ISA 706 (Revised and Redrafted)<sup>12</sup> provides any guidance on how this should be addressed in the auditor's report.
27. A few respondents were of the view that the second and third sentences of the paragraph should be moved to the application material as they address matters that may arise only in extremely rare circumstances. In accordance with the Clarity conventions, the Requirements section ought to include matters that occur on virtually all audits.
28. The IAASB noted that it is appropriate, under the Clarity conventions, to include conditional requirements where the action would be required in the specified circumstances. The IAASB was also of the view that this paragraph in ISA 700 (Redrafted) provides an important "hook" for the references in some ISAs to financial statements prepared in accordance with a compliance framework that may be misleading; those references are underpinned by the

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<sup>12</sup> ISA 706 (Revised and Redrafted), "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report."

requirement for the auditor not to be associated with misleading information in the *Code of Ethics for Professional Accountants*. As a result, the IAASB concluded that the paragraph should be retained in the Requirements section, but agreed that the second and third sentences should be redrafted to read as follows: “However, if in extremely rare circumstances the auditor concludes that such financial statements are misleading, the auditor shall discuss the matter with management and, depending on how it is resolved, shall determine whether, and how, to communicate it in the auditor’s report” (see paragraph 19 of ISA 700 (Redrafted)). In addition, paragraph A12 of the ISA explains that it will be extremely rare for the auditor to consider financial statements that are prepared in accordance with a compliance framework to be misleading if, in accordance with ISA 210 (Redrafted),<sup>13</sup> the auditor determined that the framework is acceptable.

### **Other Matters**

29. ED-ISA 700 explained that law or regulation may require the auditor, or the auditor may consider it appropriate, to elaborate on matters that provide further explanation of the auditor’s responsibilities in the audit of the financial statements or of the auditor’s report thereon. It required the auditor to address such matters under the heading “Other Matters” in the auditor’s report.
30. Respondents held diverse views on this paragraph. Some suggested that the paragraph be deleted and the matter dealt with in ISA 706 (Revised and Redrafted). A few suggested that the relationship between the requirements relating to Other Matters and Other Reporting Responsibilities in ED-ISA 700 be clarified. A few requested that an example of such an Other Matter paragraph be included in an illustrative example in the appendix to the ISA.
31. Based on the comments received on ED-ISA 700, and on the exposure draft of proposed ISA 706 (Revised and Redrafted), the IAASB agreed that the requirement to include an Other Matter paragraph in the auditor’s report in prescribed circumstances, including the presentation and position of such a paragraph, should be dealt with in ISA 706 (Revised and Redrafted) only. The IAASB also concluded that the examples of Emphasis of Matter paragraphs and Other Matter paragraphs in ISA 706 (Revised and Redrafted) were sufficient.

### **Other Reporting Responsibilities**

32. A few respondents suggested amendments to more clearly differentiate what should be included in the Report on the Financial Statements section of the auditor’s report from what should be included in the Report on Other Legal or Regulatory Requirements section. These respondents were concerned that, without further clarification, the requirements could be interpreted differently in different jurisdictions, resulting in a lack of comparability. In their view, the first part of the auditor’s report should be limited to the “ISA audit opinion;” that is, whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Any

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<sup>13</sup> ISA 210 (Redrafted), “Agreeing the Terms of Audit Engagements.”

other opinions or conclusions, even if related to the financial statements, ought to be included as other reporting responsibilities.

33. The matter of other reporting responsibilities was discussed extensively in finalizing ED-ISA 700.<sup>14</sup> At the time, the IAASB concluded that proposed ISA 700 (Redrafted) should be flexible in this regard, and that the existing text provided for such flexibility. Thus, an amendment to make the ISA more prescriptive in this regard could be regarded as extending beyond the application of the Clarity conventions.
34. However, in response to the comments on ED-ISA 700, arguing that consistent application of the standard is important, the IAASB clarified the related requirement as follows: “If the auditor addresses other reporting responsibilities in the auditor’s report on the financial statements that are in addition to the auditor’s responsibility under the ISAs to report on the financial statements, these other reporting responsibilities shall be addressed in a separate section in the auditor’s report that shall be sub-titled ‘Report on Other Legal and Regulatory Requirements,’ or otherwise as appropriate to the content of the section.” See paragraph 38 of ISA 700 (Redrafted). Paragraph 39 of the ISA deals with the placement of the section in the auditor’s report. The related application material has been amended accordingly. See paragraphs A33-A35 of ISA 700 (Redrafted).

#### **Auditor’s Report for Audits Conducted in Accordance with Both Auditing Standards of a Specific Jurisdiction and International Standards on Auditing**

35. ED-ISA 700 provided for the auditor’s report to refer to ISAs, in addition to national auditing standards, when the auditor has complied with both ISAs and the national auditing standards, if: (a) there is no conflict between the reporting requirements regarding the auditor’s report in ISAs and those in the national auditing standards that affects the auditor’s opinion or the need to include an Emphasis of Matter paragraph in the particular circumstances; and (b) the auditor’s report includes, at a minimum, each of the elements in paragraph 40(b) of ED-ISA 700 when the auditor uses the layout or wording specified by the national auditing standards. There were a few comments on this requirement – some requesting more flexibility, while others requested less flexibility.
36. A few respondents were of the view that while, in the context of traditional thinking, a number of the elements in paragraph 40(b) of ED-ISA 700 appear to be self evident, others may limit the opportunity of national standard setters to respond, in an innovative manner, to the calls from user groups to revise the auditor’s report to make it more readable and to add to its information value. In particular, one respondent was of the view that, rather than mandating a description of the work that an auditor performs in an audit (paragraph 40(b)(v) of ED-ISA 700), a more flexible approach could be to require the auditor to (a) evaluate the extent to which the annual report or other publicly available information provides the information that ED-ISA 700 would otherwise require the auditor to provide in the auditor’s report; and (b) refer in the auditor’s report to where this information may be found. It encouraged the IAASB to review the elements with a

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<sup>14</sup> See paragraphs 21-31 of Agenda Item 4 of the February 13-16, 2007 IAASB meeting at <http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0089&ViewCat=0704>.

view to limiting them only to those that are absolutely essential. However, the IAASB concluded that introducing further flexibility regarding the minimum elements required in the auditor's report extended beyond the Clarity conventions.

37. A few respondents suggested that paragraph 40(b)(iv) of ED-ISA 700, which dealt with the description of management's responsibility for the financial statements, be deleted. It was noted that Article 4(1)(c) of the EC Transparency Directive requires listed companies to include statements of management's responsibilities within the annual report; repeating them in the auditor's report will cause unnecessary duplication and risk inconsistency.
38. A few respondents, however, were concerned that the authority of the ISAs will be compromised if too much flexibility is allowed. They were concerned that paragraph 40 of ED-ISA 700 allowed precedence to national auditing standards over ISAs in respect of layout and wording of the auditor's report, and that this is not conducive to global convergence. They believed that flexibility should only be allowed when different reporting requirements are established by law or regulation.
39. The IAASB confirmed its view that the requirements allow for flexibility when warranted, noting, however, that it was important to retain the principle of visibility of the authority that drives the different layout and wording of the auditor's report. The IAASB agreed that the requirements, in the first instance, should be directed towards auditors' reports prescribed by law or regulation, followed by auditors' reports for audits conducted in accordance with both national auditing standards and the ISAs. The requirements were restructured accordingly and minor amendments were processed to clarify them. See paragraphs 43-44 of ISA 700 (Redrafted).

## **Amendments in Addition to Those Relating to the Application of the Clarity Conventions**

### **Forming an Opinion on the Financial Statements**

40. In redrafting ISA 700 (Amended), the IAASB considered how the requirements and guidance in the exposure draft of proposed ISA 450 (Revised and Redrafted)<sup>15</sup> (ED-ISA 450) that dealt with the evaluation of whether the financial statements as a whole are free from material misstatement relate to the requirements and guidance in ISA 700 (Amended) that dealt with forming an opinion on the financial statements.
41. The IAASB concluded that, in light of the definition of a "misstatement" in ED-ISA 450, there was not a clear differentiation between the consideration of "qualitative aspects of the entity's accounting practices" in ED-ISA 450 and the matters that the auditor was asked to evaluate in forming an opinion on the financial statements in ISA 700 (Amended). The IAASB agreed that, in the absence of a separate ISA on forming an opinion on the financial statements, the overlap could be addressed by transferring the requirements and guidance in ED-ISA 450 that dealt with the evaluation of whether the financial statements as a whole are free from material misstatement and the consideration of bias to ED-ISA 700.

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<sup>15</sup> Proposed ISA 450 (Revised and Redrafted), "Evaluation of Misstatements Identified during the Audit."

42. Virtually all respondents to ED-ISA 700 supported the proposal to limit the scope of ISA 450 (Revised and Redrafted) to the evaluation of the effect of uncorrected misstatements, and to deal with the evaluation of whether the financial statements as a whole are free from material misstatement in ISA 700 (Redrafted).<sup>16</sup> See paragraphs 11-12 and A1-A3 of ISA 700 (Redrafted).

### **International Auditing Practice Statement 1014**

43. In response to questions about whether the auditor may express more than one opinion when the financial statements represent that they comply with the applicable financial reporting framework and International Financial Reporting Standards (IFRS), the IAASB concluded that it may be helpful to incorporate the guidance in IAPS 1014,<sup>17</sup> appropriately amended, in ED-ISA 700.
44. Virtually all respondents to ED-ISA 700 supported this proposal. See paragraphs A8-A10 and A31-A32 of ISA 700 (Redrafted).
45. In response to comments, the IAASB clarified that, if the financial statements comply with two financial reporting frameworks simultaneously, two opinions are expressed. The two opinions may be expressed in a single sentence. Some respondents were concerned that the wording in ED-ISA 700 suggested that the opinions must be expressed separately. See paragraph A31(a).
46. Paragraph A32 of ISA 700 (Redrafted) deals with financial statements that represent compliance with the applicable financial reporting framework and, in addition, disclose the extent of compliance with another financial reporting. In finalizing ISA 700 (Redrafted), the IAASB agreed to amend the paragraph to clarify that the additional disclosure is supplementary information that is covered by the auditor's opinion as it cannot be clearly differentiated from the financial statements due to its nature and how it is presented. In addition, the IAASB agreed to amend subparagraph (a) to avoid an interpretation that there is an explicit requirement for such disclosure in the applicable financial reporting framework: "~~If the financial statements fail to comply with the applicable financial reporting framework because~~ the disclosure as to the compliance with the other framework is misleading, a modified opinion is expressed in accordance with ISA 705 (Revised and Redrafted)."

### **Description of Management's Responsibility for the Financial Statements**

47. The exposure draft of proposed ISA 210 (Redrafted) (ED-ISA 210) included proposals, including conforming amendments to ED-ISA 700, which would allow for the flexibility requested by the respondents to ED-ISA 700. ED-ISA 210 included a proposed amendment to ED-ISA 700 that would require that management's responsibilities be described in the auditor's report in the manner in which they are described in the terms of the audit engagement; however, importantly, ED-ISA 210 proposed to introduce greater flexibility in

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<sup>16</sup> ISA 700 (Redrafted), "Forming an Opinion and Reporting on Financial Statements."

<sup>17</sup> International Auditing Practice Statement (IAPS) 1014, "Reporting by Auditors on Compliance with International Financial Reporting Standards."

that description. In particular, it would allow the auditor to use the wording of relevant law or regulation to describe management's responsibilities if the auditor has determined that the responsibilities prescribed by law or regulation are equivalent in effect to those set out in ED-ISA 210. For management's responsibilities that are not equivalent in effect, or that are not prescribed by law or regulation, the auditor would use the description in ED-ISA 210. Some respondents to ED-ISA 700 explicitly supported the proposal to introduce greater flexibility in how management's responsibilities are described in ED-ISA 210.

48. The description of management's responsibilities is being finalized as part of the project to redraft ISA 210. The IAASB's conclusions in this regard will be presented in the Basis for Conclusions: ISA 210 (Redrafted). At that time, conforming amendments will be processed to ISA 700 (Redrafted). They will affect the sections on Management's Responsibility for the Financial Statements in the Requirements section and the Application and Other Explanatory Material section and in the illustrations of auditor's reports in the appendix.
49. To address comments on ED-ISA 700 that the reference to management may not be appropriate in all circumstances, the IAASB included the following new requirement in ISA 700 (Redrafted): "This section of the auditor's report describes the responsibilities of those in the organization that are responsible for the preparation of the financial statements. The auditor's report need not refer specifically to 'management,' but shall use the term that is appropriate in the context of the legal framework in the particular jurisdiction. In some jurisdictions, the appropriate reference may be to those charged with governance." See paragraph 24 of ISA 700 (Redrafted).

## **Financial Reporting Frameworks Described by Reference to Another Established Framework**

### *Background*

50. A number of jurisdictions are adopting IFRS. In some cases, the jurisdictions may adopt less than the complete set of current IFRS. This may be because of the time it takes a jurisdiction to introduce new standards locally, such that the issue is merely one of timing. It may be because a jurisdiction regards a certain IFRS as unsuitable for the jurisdiction. Or it may be because a regulator wishes to impose its own rules in respect of certain aspects of financial reporting. In each case, national standard setters, legislators or regulators may mandate how the financial reporting framework is to be described in the financial statements or the auditor's report, or both. For example, the framework may be described as "IFRS as adopted by [industry supervisor or regulator] for use of [industry] in [jurisdiction X]." Such descriptions may be used in the general purpose financial statements of the relevant entities.
51. When the applicable financial reporting framework is described by reference to another established framework, users may mistakenly assume that the applicable financial reporting framework is the same as, or at least very similar to, the other established framework. This would not be the case, however, when there are differences between the applicable financial reporting framework and the other established framework that are significant in the context of the entity's financial statements. A description of a financial reporting framework in terms such as that set out above is not an explicit and unreserved statement of compliance with

- IFRS; but the user may not know what the differences between the financial reporting framework and IFRS are, or where to find them.
52. In some cases, the differences between adopted or modified IFRS and the complete set of current IFRS may be of no significance to some or many entities, such that the effect of using the framework is in fact identical to IFRS in the vast majority of cases. In other cases, however, a difference between adopted or modified IFRS and the complete set of current IFRS may have a significant effect on the reported financial position or performance of some or many entities. As a result, there is a risk that users may misunderstand the basis on which the financial statements are prepared. The IAASB believes that it is, therefore, in the public interest, to promote transparency in order to avoid such a possibility.
  53. This matter has been of concern to the International Accounting Standards Board (IASB), for the reasons set out above. In December 2006, the IASB agreed to issue a proposed amendment to IAS 1 that would add disclosure requirements for entities that refer to IFRS in describing the basis on which their financial statements are prepared, but that are not able to make an explicit and unreserved statement of compliance with IFRS. Such an entity would be required to make disclosures about how its financial statements would have been different if prepared in full compliance with IFRS. The proposed amendment formed part of the annual improvements process of the IASB. The Exposure Draft of the IASB's annual improvements was published in October 2007.
  54. The Explanatory Memorandum that accompanied ED-ISA 700 explained that the IAASB was of the view that, where it is an option, a preferred solution is to avoid references to IFRS in circumstances when a financial reporting framework is such that compliance with it will not result in an explicit and unreserved statement of compliance with IFRS, and instead refer to or describe such framework as "the financial reporting framework applicable in [jurisdiction X]," or "accounting principles applicable to [industry] in [jurisdiction X]." The notes to the financial statements would include an appropriate description of the accounting policies. However, there will be cases where such a solution is not possible because the description of the framework is mandated by law or regulation. In such cases, the auditor's concern is to ensure that the references are not misleading.
  55. To deal with the matter, the IAASB included proposed guidance in paragraphs A9-A11 of ED-ISA 700 (addressing the auditor's evaluation of the description of the financial reporting framework in the financial statements) and paragraphs A33-A34 of ED-ISA 700 (addressing the effect that such description may have on the auditor's opinion). The main element of the proposed guidance was that, if the applicable financial reporting framework was described in the financial statements as being a modified version of another established framework, the auditor should consider whether such description may be misleading if the financial statements did not include appropriate details of the difference between the applicable financial reporting framework and the other established framework. It followed closely the proposed amendment to IAS 1, though it also sought to generalize the relevant consideration to other frameworks.
  56. The Explanatory Memorandum acknowledged that the proposed guidance was based on the proposed amendment to IAS 1, which had not yet been finalized. It indicated that, in the

event that the IASB did not proceed with its current proposal or amended the proposal in a material respect, the IAASB would have to decide how, if at all, to deal with the matter in those changed circumstances.

*Responses to ED-ISA 700*<sup>18</sup>

57. Approximately half of those who responded to this particular matter supported the proposal, although some of them suggested that it be amended in one way or another. A few respondents, for example, did not agree that the auditor's report should include an Emphasis of Matter paragraph if the financial statements adequately describe the difference between the applicable financial reporting framework and the other established framework.
58. Some respondents, however, did not support the proposal. Some argued that the ISAs should be neutral with regard to the financial reporting framework, whereas the proposed guidance was largely directed to IFRS. A few were concerned about the effect that the proposed guidance may have on the "true and fair requirement" for companies and auditors in the European Union (EU). (That is, they considered that the proposal raised the following question: If the applicable financial reporting framework is designed to give a true and fair view, but does not require such disclosure, how can the failure to include such disclosure result in financial statements that do not give a true and fair view?) Others thought that the disclosures would be difficult to enforce in the absence of support in the standards – for example, if the adopting authority did not adopt the proposed amendment to IAS 1, or if the framework was other than IFRS. They argued that it was not the role of auditors to enforce such disclosure when it is not required by the applicable financial reporting framework, or law or regulation. A few were expressly of the view that the matter requires a regulatory rather than an auditing standards solution, though this thought seemed to lie behind other responses as well. Few responses from regulators, however, supported the proposed guidance.

*Relevant Action by the International Organization of Securities Commissions*

59. On February 6, 2008, the Technical Committee of the International Organization of Securities Commissions (IOSCO) issued a Statement on Providing Investors with Appropriate and Complete Information on Accounting Frameworks Used to Prepare Financial Statements, which recommends "that all annual and interim financial statements that are prepared on the basis of national standards that are modified or adapted from IFRS and published by publicly traded companies should include at a minimum the following statements (which should be tailored to the company's circumstances and the markets in which securities may be traded):
  - (a) A clear and unambiguous statement of the reporting framework on which the accounting policies are based;
  - (b) A clear statement of the company's accounting policies on all material accounting areas;

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<sup>18</sup> See paragraphs 6-14 of the Summary of Significant Comments and Task Force Recommendations—ED-ISA 700 at <http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=3976>.

- (c) An explanation of where the accounting standards that underpin the policies can be found;
- (d) A statement that explains that the financial statements are in compliance with IFRS as issued by the IASB, if this is the case; and
- (e) A statement that explains in what regard the standards and the reporting framework used differ from IFRS as issued by the IASB, if this is the case.”

*Consideration By and Decision of the International Auditing and Assurance Standards Board*

60. In June 2008, the Task Force recommended to the IAASB that, based on the importance of the matter and the level of support received, the ISA continue to include guidance that addresses this matter. However, the Task Force recommended that the guidance be amended to focus on whether the reference renders the overall financial statements misleading, rather than simply considering whether the disclosures required by IAS 1 are present.<sup>19</sup>
61. The IAASB debated the proposed revised guidance.<sup>20</sup> The IAASB decided not to focus on whether or not the reference renders “the overall financial statements misleading,” as this could be misinterpreted as implying that the auditor would be concluding that the entity’s financial position and performance are misleading, which was not the intent. Rather the IAASB suggested that the auditor’s evaluation of the adequacy of the description of the applicable financial reporting framework should include consideration whether there is a risk that users may misunderstand the basis on which the financial statements are prepared. If the applicable financial reporting framework is described by reference to another established framework, users may mistakenly assume that the applicable financial reporting framework is the same as, or at least very similar to, the other established framework. If the differences between the applicable financial reporting framework and the other established framework are not significant in the context of the entity’s financial statements, users are unlikely to misunderstand the basis on which the financial statements are prepared. If the differences are significant in the context of the entity’s financial statements, there is a risk that users may misunderstand the basis on which the financial statements are prepared. However, such risk is reduced by being transparent about the applicable financial reporting framework and how it differs from the other established framework. The Task Force was asked to consider drafting guidance accordingly.
62. Based on the above, the Task Force proposed revised guidance<sup>21</sup> to:
- Explain the risk of misunderstanding.
  - Explain that the risk of misunderstanding is likely to be lower in certain circumstances.

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<sup>19</sup> See Agenda Item 11 of the June 16-20, 2008 IAASB meeting at <http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0142&ViewCat=0948>.

<sup>20</sup> See paragraphs A11-A12 and A35 of ISA 700 (Redrafted) presented as Agenda Item 11-B of the June 16-20, 2008 IAASB meeting at <http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=4017>.

<sup>21</sup> See paragraphs A11-A14 and A39-A40 of ISA 700 (Redrafted) presented as Agenda Item 5-A of the September 15-19 IAASB meeting at <http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=4122>.

- Provide examples of how the risk of misunderstanding can be reduced by disclosures in the financial statements.
  - Deal with the circumstances where the applicable financial reporting framework has to be described by reference to the other established framework, but the differences between the two frameworks are not significant in the context of the entity.
  - Explain that, if the differences between the applicable financial reporting framework and the other established framework are significant in the context of the entity's financial statements, the auditor's evaluation of the adequacy of the description of the applicable financial reporting framework involves consideration of whether the financial statements include a description of the differences. It contained a number of examples to illustrate this point, including the possibility of emphasis in the auditor's report and in extreme cases, qualification.
63. The Task Force included the revised guidance in the agenda papers for the IAASB meeting in September 2008<sup>22</sup> and discussed the proposals with the IAASB CAG earlier that month.<sup>23</sup> In addition, in advance of the September IAASB meeting, discussions were held with representatives of the IASB and of IOSCO.
64. It was clear that the IASB would not have approved any relevant amendment to IAS 1 before it was necessary for the IAASB to move ahead with ISA 700 (Redrafted); nor is it yet clear that the approach proposed by the IASB will be acceptable in the light of responses received to its own consultation. The IOSCO representatives noted that the recommendation<sup>24</sup> issued by its Technical Committee to issuers was designed to promote transparency in all cases, whereas the proposed ISA with its inevitable focus on an evaluation by the auditor of whether users might be misled by inadequate disclosure in the circumstances of the particular entity acknowledged that there may be cases where no disclosure could be accepted. Representatives on the IAASB CAG agreed that this matter of transparency needs to be addressed in the public interest; however, the majority did not support dealing with the matter in ISA 700 (Redrafted), and advised the IAASB against doing so. The reasons for this stance varied, but included concern about the subjectivity of the particular proposals and wider concern that this was a matter for relevant regulators to resolve as the auditor ought to form the opinion within the context of the applicable financial reporting framework. They believed that further dialogue amongst the various stakeholders is needed.
65. After giving full consideration to all of the input received, the IAASB concluded that it would not be appropriate to include the proposed guidance in ISA 700 (Redrafted). The IAASB agreed that other bodies are the more appropriate ones to pursue the matter, but

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<sup>22</sup> See Agenda Item 5 of the September 15-19, 2008 IAASB meeting at <http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0143&ViewCat=0968>.

<sup>23</sup> See Agenda Item J of the September 4-5, 2008 IAASB CAG meeting at <http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0132&ViewCat=0984>.

<sup>24</sup> *Statement on Providing Investors with Appropriate and Complete Information on Accounting Frameworks Used to Prepare Financial Statements* issued by the Technical Committee of IOSCO on February 6, 2008.

BASIS FOR CONCLUSIONS:  
ISA 700 (REDRAFTED)

that the IAASB should monitor future developments and be prepared to contribute further if and when it is appropriate to do so.