



International Federation of Accountants

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## Agenda Item



**Committee:** IAASB Consultative Advisory Group

**Meeting Location:** Toronto

**Meeting Date:** September 11-12, 2006

### Proposed New ISA—Forming an Opinion on the Financial Statements

#### Objectives of Agenda Item

1. To consider the scope of a proposed new International Standard on Auditing (ISA) XXX, *Forming an Opinion on the Financial Statements*, which is to be developed as part of the Clarity project.

#### Background

2. The possibility of creating a new ISA on Forming an Opinion on the Financial Statements was discussed by the IAASB at the September and October 2005 meetings. A draft outline of the possible content for such an ISA was presented by the Materiality Task Force at the December 2005 IAASB meeting. The vision was to put together in one place all of the requirements and guidance in the ISAs relevant to forming the opinion on the financial statements. At that time, the IAASB directed the Materiality Task Force to continue with the proposed structure for ISA 320, “Materiality in Planning and Performing an Audit” and ISA 450, “Evaluation of Misstatements Identified During the Audit” for the purposes of approving their close-off versions,<sup>1</sup> but agreed that a new ISA on Forming an Opinion on the Financial Statements should be considered as part of the Clarity project.
3. At its meeting in July 2006, the Clarity Task Force considered an outline of a possible new ISA, prepared by staff based on the December 2005 paper of the Materiality Task Force, and agreed that there are sufficient requirements and guidance in other ISAs that could be moved to a new ISA. Thus, the Steering Committee approved the creation of a task force to develop the new ISA further as part of the Clarity project.
4. A primary objective of the session at the IAASB meeting in September will be to seek agreement on the scope of the new ISA so that the Clarity versions of the other ISAs affected by this project can progress. **The views of CAG Representatives would be a useful input to that discussion.**

<sup>1</sup> The term “close off” is used in the context of proposed standards currently under exposure. The intention is to revise the proposed standard based on comments received on exposure, and to obtain the IAASB’s agreement on the revised proposed standard before it is redrafted for clarity purposes. This step is referred to as “close off.” The next step is to expose the changes arising from redrafting the revised proposed standard in the clarity format.

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##### Proposed Approach

5. As a Clarity project, the intent is not to develop new requirements and guidance, but rather to reposition requirements and guidance that already exist in other ISAs into a new ISA in a coherent and logical way. The most difficult issue will be to decide which requirements and guidance should move to the new ISA, and which should remain in the ISAs in which they are currently placed. The Task Force will be seeking IAASB's views on a number of areas in which choices need to be made in this respect.

##### Objective and Scope of the New ISA

6. The Task Force proposes that the objective of the auditor in the new ISA is to form an opinion on the financial statements through (a) evaluating whether sufficient appropriate audit evidence has been obtained, and (b) evaluating whether the financial statements as a whole are free from material misstatement.
7. Consequently, the new ISA will incorporate requirements and guidance relating to evaluating audit evidence, evaluating whether the financial statements as a whole are free from material misstatement, and considering the form of opinion that is appropriate in the circumstances. The requirements and guidance will be drawn from the following ISAs (as summarized in the following table):
- ISA 330, "The Auditor's Procedures in Response to Assessed Risks;"
  - ISA 450, "Evaluation of Misstatements Identified During the Audit;"
  - ISA 500, "Audit Evidence;"
  - ISA 520, "Analytical Procedures;"
  - ISA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements;" and
  - ISA 705, "Modifications to the Opinion in the Independent Auditor's Report."

Reference	Requirements proposed to be moved to new ISA
ISA 700	<ul style="list-style-type: none"><li>• Evaluating the conclusions drawn from the audit evidence obtained as the basis for forming an opinion on the financial statements (Ref: ISA 700.11)</li><li>• Forming an opinion on the financial statements (Ref: ISA 700.12-14), including:<ul style="list-style-type: none"><li>– Evaluating whether the financial statements have been prepared and presented in accordance with the specific requirements of the financial reporting framework (Ref. ISA 700.13)</li><li>– Evaluating the fair presentation of the financial statements as a whole (when relevant) (Ref: ISA 700.14)</li></ul></li><li>• Consideration of extremely rare circumstances when applying the financial</li></ul>

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Reference	Requirements proposed to be moved to new ISA
	<p>reporting framework results in misleading financial statements (Ref: ISA 700.15)</p> <ul style="list-style-type: none"> <li>• Circumstances when the auditor should express an unmodified opinion (Ref: ISA 700.39)</li> </ul>
ISA 705	<ul style="list-style-type: none"> <li>• Circumstances when the auditor should express a modified opinion (Ref: ISA 705.6 Close Off)</li> <li>• <i>Determining the type of modification (e.g., a qualified opinion, adverse opinion or disclaimer of opinion) that is appropriate in the circumstances (N.B. whether all of these requirements and guidance should be moved from ISA 705 to the new ISA is to be debated)</i></li> <li>• Communications with those charged with governance when the auditor expects to modify the opinion (Ref. ISA 705.38 Close Off)</li> </ul>
ISA 450	<ul style="list-style-type: none"> <li>• <i>Evaluating the effect of uncorrected misstatements identified, considering the effect of uncorrected misstatements related to prior periods, and communication to those charged with governance (N.B. whether these requirements and guidance should be moved from ISA 450 to the new ISA is to be debated)</i></li> <li>• Evaluating whether the financial statements as a whole are free from material misstatement, including considering both the results of the evaluation of uncorrected misstatements and the qualitative aspects of the entity's accounting practices (Ref: ISA 450.17 Close off)</li> <li>• If the auditor concludes, or is unable to conclude whether the financial statements as a whole are materially misstated, considering the effect thereof on the opinion (Ref: ISA 450.18 Close off)</li> </ul>
ISA 330	<ul style="list-style-type: none"> <li>• Concluding whether sufficient appropriate audit evidence in relation to the financial statements as a whole has been obtained (Ref: ISA 330.28 Redrafted (September 2006))</li> <li>• Considering all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements (Ref: ISA 330.28 Redrafted (September 2006))</li> <li>• If the auditor has not obtained sufficient appropriate audit evidence, and further audit evidence cannot be obtained, considering the effect thereof on the opinion (Ref: ISA 330.29 Redrafted (September 2006))</li> </ul>
ISA 520	<ul style="list-style-type: none"> <li>• Application of analytical procedures at or near the end of an audit when</li> </ul>

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Reference	Requirements proposed to be moved to new ISA
	forming an overall conclusion (ISA 520.13)
ISA 500	<ul style="list-style-type: none"> <li>Requirements and guidance matters pertaining to evaluating whether <i>sufficient</i> appropriate audit evidence has been obtained</li> <li>Considering all appropriate audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements. Using professional judgment, and applying professional skepticism in evaluating the quantity and quality of audit evidence and thus its sufficiency and appropriateness (Ref: ISA 500.13 Redrafted (Staff draft))</li> </ul>

**Matters for Consideration by the IAASB CAG:**

1. Do the Representatives support the Task Force's recommendations with regard to the scope of the new ISA?
2. Do the Representatives believe there are other requirements or guidance that should be included in the new ISA?

**Timing of the project**

8. As noted above, as part of the Clarity project this project will reposition requirements and guidance that already exist in other ISAs into a new ISA. However, a difficulty is that the Clarity redrafting of the requirements and guidance in those other ISAs is still in progress.
9. In order to make certain decisions on the new ISA, it is necessary to see how the various affected ISAs fit together. However, the Clarity redrafting of some of the affected ISAs is on different timetables. This may influence (a) how quickly progress can be made on the new ISA; (b) whether requirements and guidance in the affected ISAs should be exposed in the redrafted versions of those ISAs (e.g., ISA 450), or moved and exposed as part of the new ISA; and (c) when the new ISA should be exposed for comment.

**Matters for Consideration by the IAASB CAG:**

3. Do the Representatives have views on the timing of the project?

**Note from David Damant**

The proposed new ISA on Forming an Opinion on the Financial Statements suggests the moving of requirements from certain existing ISAs to the new ISA. This raises the question of whether there should in certain circumstances be duplication, or a reference from the new ISA to the existing ISA, or some other device. **Members of the CAG are asked to consider their views on**

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**duplication as opposed to other solutions, so that the discussion in Toronto can cover this point.**