

## IAASB CAG PAPER

IAASB CAG Agenda (March 2008)

Agenda Item C.3.3.4

Clarity – Proposed ISA 805 (Revised and Redrafted)

### Matters for CAG Consideration—Proposed ISA 805 (Revised and Redrafted), “Engagements to Report on Summary Financial Statements”

1. Thirty-nine comment letters were received. On balance, respondents were in agreement with the application of the clarity conventions.
2. One respondent strongly disagreed with the IAASB’s conclusion that the requirements and guidance for engagements to report on summary financial statements should be issued as an ISA. The primary reasons for this respondent’s position were: (a) these engagements are *not* audit engagements and the reports are *not* audit reports; and (b) in many jurisdictions requirements relating to the auditor’s responsibilities with regard to reporting on summary financial statements are established in law or regulation; this may give rise to conflicts with the requirements and guidance in the standard.

#### Objective

3. The proposed ISA contained the following objective:

*“The objective of the auditor is to express an opinion whether the summary financial statements are a fair summary of the audited financial statements in accordance with the applied criteria.”*
4. Less than half of the respondents explicitly supported the proposed objective; a few suggested refinement. Many other respondents, however, did not support the proposed objective; mostly because they were concerned about / disagreed with the wording of the opinion in the auditor’s report on summary financial statements (see below). A few respondents were of the view that the objective was not aligned with the requirements, as the requirements also dealt with engagement acceptance and performance.
5. One respondent was of the view that the objective was repeated as a requirement in **paragraph 12 of proposed ISA 805 (Revised and Redrafted)**. To avoid repetition and promote consistency between the objectives of the ISAs, this respondent suggested rewording the objective as follows: “The objectives of the auditor are to (a) form an opinion on the summary financial statements based on an evaluation of the conclusions drawn from the procedures performed; and (b) express that opinion through a written report that explains the basis of that opinion.”
6. One respondent suggested that the objective be reworded as follows to be more outcomes oriented: “The object of the auditor is to determine whether the summary financial statements are a fair summary of the audited financial statements in accordance with the applied criteria and to report accordingly.”

#### Requirements

7. The majority of respondents 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.

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#### Significant Comments that Do Not Related to the Application of the Clarity Conventions

##### *Wording of the Opinion in the Auditor's Report on Summary Financial Statements*

8. Representatives may recall that extant ISA 800<sup>1</sup> was subject to full revision in a project that led to the finalization of a close off document. (A close-off document is a final version of a standard whose revision had commenced before the clarity drafting conventions had been finalized. Absent the Clarity project, a final standard would have been issued rather than a close off document and the project would have ended at that time. It was the IAASB's intention that any close off document should be converted to a clarified version without further consideration of substantive issues.) Inevitably, as the proposals in relation to the form of opinion on summary financial statements included in the exposure draft of proposed ISA 800 (Revised)<sup>2</sup> (issued in June 2005 in the "old style") were quite controversial, some respondents took the opportunity to seek to reopen this issue in their responses on the exposure draft of proposed ISA 805 (Revised and Redrafted).
9. Extant ISA 800 requires the auditor to report whether "the summary financial statements are consistent, in all material respects, with the audited financial statements from which they are derived." This wording is currently used in certain jurisdictions. However, standard setters in other jurisdictions have chosen different phrases, such as "fairly stated, in all material respects, in relation to ..." and "fairly summarized, in all material respects, ..."
10. The explanatory memorandum that accompanied the exposure draft of proposed ISA 800 (Revised) noted that the IAASB revised the wording of the opinion because it was concerned that the extant wording may be subject to different interpretation, perhaps because of translation issues.
11. In developing the abovementioned exposure draft, the IAASB considered alternative phrases such as "fairly stated, in all material respects" and "fairly summarized, in all material respects." However, the IAASB concluded that use of these phrases was not appropriate because of a concern that they may be confused with "present fairly" used in the context of the underlying audited financial statements. The IAASB therefore proposed that the auditor express an opinion whether "the summary financial statements are an appropriate summary of the audited financial statements from which they are derived, in accordance with the specified established criteria or the basis described." A small majority of respondents to that exposure draft did not support the proposed wording of the opinion. Some preferred the extant phrase "consistent, in all material respects."

<sup>1</sup> Extant ISA 800, "The Independent Auditor's Report on Special Purpose Audit Engagements" included material on special purpose financial statements and on summarized financial statements. In revising and redrafting the standard, it was divided into two standards, i.e., proposed ISA 800 (Revised and Redrafted), "Special Considerations—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement" and proposed ISA 805 (Revised and Redrafted), "Engagements to Report on Summary Financial Statements."

<sup>2</sup> Proposed ISA 800 (Revised), "The Independent Auditor's Report on Summary Audited Financial Statements."

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12. The IAASB debated the abovementioned responses and concluded that the original concerns were not sufficient to propose new wording of the opinion that is not currently used to any great extent. It agreed that, based on the procedures in **paragraph 11 of proposed ISA 805 (Revised and Redrafted)** (issued in August 2007 in the “clarity style”), and any other procedures that the auditor may consider necessary in the circumstances, the auditor should form an opinion whether “the summary financial statements are a fair summary of the audited financial statements in accordance with the applied criteria.” The procedures specified in **paragraph 11 of proposed 805 (Revised and Redrafted)** included an evaluation whether, in view of the applied criteria, the summary financial statements contain the information necessary so as not to be misleading in the circumstances. In addition, **paragraph 10 of proposed ISA 805 (Revised and Redrafted)** provided for circumstances where national law or regulation governing reporting on summary financial statements prescribes wording for the opinion that is different from that described above.
13. A few respondents to the exposure draft of proposed ISA 805 (Revised and Redrafted) explicitly supported the wording of the opinion. One respondent noted that it was the clearest and most unambiguous wording out of the various options. Another was of the view that the proposed ISA was sufficiently flexible, providing for circumstances where law or regulation prescribes wording that is different from that described in the proposed ISA.
14. Approximately half of the respondents, however, did not agree with the wording of the opinion (i.e., the summary financial statements are a fair summary of the audited financial statements in accordance with the applied criteria). Their concerns included the following:
- The information provided may be consistent with the audited financial statements, but may not be a fair summary because an important disclosure is missing.
  - “Fair summary” can too easily be confused with the concept of “fair presentation” used in the context of the audit of a complete set of financial statements. Only a complete set of financial statements, prepared and presented in accordance with a fair presentation framework, gives a true and fair view or presents fairly, in all material respects, the financial affairs of the entity. Furthermore, the ISA does not provide any explanation as to what constitutes a “fair summary.”
  - The potential for misunderstanding will, in some cases, be exacerbated when the term “fair presentation” is translated. There are languages in which the translation of the term “true and fair” only consists of one word (mainly reflecting the term “fair,” rather than the term “true”). Since the term “fair” in the context of proposed ISA 805 (Revised and Redrafted) relates to a summary of financial statements, the translation of this term might conflict with the translation of the term “true and fair,” which is used when expressing an opinion on the financial statements.
  - Requiring the auditor to opine on whether the summary financial statements are a “fair summary,” in addition to forming an opinion on whether the complete set of financial statements “present fairly, in all material respects,” or “give a true and fair view” of or the

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financial affairs of the entity, creates a second layer of judgment and subjectivity regarding “fairness.”

- The auditor’s responsibility in respect of summary financial statements is not to audit them, but to apply procedures to ensure that they agree with or can be recalculated from the related information in the underlying audited financial statements. Although the auditor is required to evaluate whether the summary financial statements contain the information necessary so as not to be misleading in the circumstances, this is equivalent to the auditor’s ethical responsibility not to be associated with misleading information. This is not a basis for concluding on the “fairness” of the summarization – particularly in circumstances when there is not a generally accepted set of criteria for preparing summary financial statements.

15. While approximately half of the respondents did not agree with the proposed wording of the opinion, there was no consensus amongst the respondents as to alternative wording.

- A few respondents were satisfied with the reference to “appropriate summary” in the June 2005 exposure draft.
- Many respondents preferred the wording of the opinion in the extant standard, i.e., “the summary financial statements are consistent, in all material respects, with the audited financial statements from which they are derived.” A few respondents noted that, if the summary financial statements were prepared in accordance with regulatory or other requirements specifying the information that should be contained therein, the auditor could, in addition, opine on whether the summary financial statements are prepared in accordance with those requirements.
- One respondent was of the view that the objective of the auditor was to express an opinion whether the summary financial statements are *properly derived from* the audited financial statements in accordance with the applied criteria.
- Another respondent suggested “the summary financial statements properly summarize the audited financial statements.”

#### **Matters for Consideration by CAG:**

- Q1. Do Representatives have any views with regard to the comments relating to the proposed objective?
- Q2. What advice would Representatives give to the IAASB in relation to the responses that raised the issue of the wording of the opinion in the auditor’s report on summary financial statements?
- Q3. Are there any other comments that Representatives may wish to raise?

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### **Material Presented – IAASB CAG REFERENCE PAPERS**

Available at

<http://www.ifac.org/Guidance/EXD-Details.php?EDID=0094>

Exposure Draft of Proposed ISA 805 (Revised and Redrafted) (including the explanatory memorandum)