IFAC
International Auditing and Assurance Standards Board

October 2002

Exposure Draft

Response Due Date January 15, 2003

Reporting on Compliance with International Financial Reporting Standards

Proposed International Auditing Practice Statement

Issued for Comment by:

The International Federation of Accountants

This International Auditing Practice Statement (IAPS) of the International Federation of Accountants has been prepared by the International Auditing and Assurance Standards Board. It was approved for publication in September 2002. The exposure draft may be modified in the light of comments received before being issued in the form of an International Auditing Practice Statement

The approved text of this Exposure Draft of the International Auditing and Assurance Standards Board is that published in the English language.

Comments should be submitted so as to be received by January 15, 2003, preferably by e-mail, or on a computer disk or in writing. All comments will be considered a matter of public record. Comments should be addressed to:

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Paragraphs

International Auditing Practice Statements ("Statements") are issued by the International Auditing and Assurance Standards Board ("IAASB"), which is a committee of the Intemational Federation of Accountants, to provide practical assistance to auditors in implementing the International Standards on Auditing ("ISAs") or to promote good practice. Statements do not have the authority of ISAs.

This Statement is issued as a supplement to ISA 700, "The Auditor's Report on Financial Statements." It does not establish any new basic principles or essential procedures: its purpose is to assist auditors, and the development of good practice, by providing guidance on the application of ISA 700 in cases when financial statements are prepared using International Financial Reporting Standards (IFRSs) or include a reference to IFRSs. The extent to which any of the guidance described in this Statement may be appropriate in a particular case requires the exercise of the auditor's judgment in the light of the requirements of ISA 700 and the circumstances of the entity. Statements are effective on the date they are issued.

The Public Sector Perspective (PSP) issued by the Public Sector Committee of the International Federation of Accountants is set out at the end of an IAPS. Where no PSP is added, the IAPS is applicable in all material respects to the public sector.

Introduction

1. ISA 200, "Objective and General Principles Governing an Audit of Financial Statements" states that the objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework. ISA 700, "The Auditor's Report on Financial Statements" establishes standards and provides guidance on the form and content of the auditor's report. In particular, paragraph 17 of that ISA requires that the auditor's report clearly indicate the financial reporting framework used to prepare the financial statements. The purpose of this International Auditing Practice Statement (IAPS) is to provide additional guidance when the auditor expresses an opinion on financial statements prepared:

   (*a*) in accordance with International Financial Reporting Standards (IFRSs);

   (*b*) in accordance with both IFRSs and relevant national standards or practices; or

   (*c*) in accordance with relevant national standards or practices, but which disclose in the notes to the financial statements the extent of compliance with IFRSs.

   The guidance provided in this practice statement may be applied, adapted as necessary, to reporting on whether financial statements have been prepared in accordance with other financial reporting frameworks. This IAPS does not establish any new requirements for the audit of financial statements, nor does it establish any exemptions from the requirements of ISA 700.

Financial Statements Prepared in Accordance with International Financial Reporting Standards

2. Examples have arisen of entities stating that their financial statements have been prepared in accordance with IFRSs when, in fact, they have not complied with all the requirements that IFRSs impose. Paragraphs 10–19 of IAS 1 (Revised 1997),

"Presentation of Financial Statements"[1] set out the requirements to be met before an entity's financial statements can be regarded as having been prepared in accordance with IFRSs. In particular, paragraph 11 makes clear that financial statements should not be described as complying with IFRSs unless they comply with all the requirements of each applicable standard and each applicable interpretation of the Standing Interpretations Committee.[2] Examples such as the following descriptions of the basis on which the financial statements have been prepared are therefore illustrations of financial statements that have not been prepared in accordance with IFRSs.

- The financial statements include a note indicating that they have been prepared in accordance with IFRSs but then go on to specify certain departures. For example, a note to the financial statements states that the financial statements are prepared in accordance with IFRSs except for the non-disclosure of sales for geographical segments.
- A note to the financial statements identifies specific IFRS requirements that the entity uses to prepare the financial statements, but these do not include all the requirements that are applicable to an entity fully complying with IFRSs.
- The financial statements include a note disclosing partial compliance with IFRSs without reference to specific departures. For example, a note states that the financial statements are "based on," or "comply with the significant requirements of" or "are in compliance with the accounting requirements of" IFRSs.

3. An unqualified opinion may be expressed only when the auditor is able to conclude that the financial statements give a true and fair view (or are presented fairly, in all material respects) in accordance with the identified financial reporting framework. In

[1] On 15 May 2002, the IASB issued an exposure draft of improvements to IASs, including an exposure draft of a revised version of IAS 1. In that exposure draft, the relevant paragraphs are paragraphs 10–17, with paragraph 11 requiring compliance with all applicable standards. The final version of this IAPS will refer to the revised version of IAS 1 (or the equivalent IFRS) that the IASB issues at the end of its due process.

[2] The Standing Interpretations Committee was renamed the "International Financial Reporting Interpretations Committee" subsequent to the issue of IAS 1 (Revised 1997).

all other circumstances, the auditor is required to disclaim an opinion or to issue a qualified or adverse opinion depending on the nature of the circumstances. Accordingly, the auditor does not express an unqualified opinion that indicates that financial statements have been prepared in accordance with IFRSs if the financial statements contain any departure from IFRSs and the departure has a material effect on the financial statements. When the auditor has been asked to report on whether the financial statements have been prepared in accordance with IFRSs and the financial statements contain a material departure from IFRSs, such a departure results in a disagreement with management regarding the accounting policies selected or the adequacy of financial statement disclosures. Paragraphs 36–40 of ISA 700 provide guidance for deciding whether a qualified opinion or an adverse opinion is necessary and on the information to be included in the auditor's report.

4. A description of the financial reporting framework in the auditor's report that contains any qualification or limitation of that framework does not meet the requirement in paragraph 17 of ISA 700 that the opinion paragraph of the auditor's report should clearly indicate the financial reporting framework used. For example, an opinion paragraph that indicated that "the financial statements give a true and fair view and are in substantial compliance with International Financial Reporting Standards" does not meet the requirements of ISA 700.

Compliance With More Than One Financial Reporting Framework

5. The financial statements may state that they have been prepared in accordance with more than one framework. For example, the notes may indicate that the financial statements comply both with International Financial Reporting Standards and with national financial reporting requirements. For financial statements to have been prepared in accordance with more than one framework, they must comply with each of the indicated frameworks individually. A set of financial statements that has been prepared in accordance with one framework and that contains a note or supplementary statement reconciling the results to those that would be shown under another framework has not been prepared in accordance with that other framework. This is because the financial statements themselves do not show

all the information required in the manner required by that framework. The financial statements must comply with both frameworks simultaneously and without any need for reconciling statements if they are to be regarded as having been prepared in accordance with both. In practice, simultaneous compliance with both IFRSs and a national financial reporting framework is unlikely unless the country has adopted IFRSs as its national financial reporting framework. In other cases, even if the requirements are similar enough to be able to prepare one balance sheet, one income statement and one cash flow statement, the notes to the financial statements are likely to be confusing for all but the most straightforward entities. This could threaten the understandability of the financial statements.

6. It is helpful for the auditor to discuss financial statements that purport to have been prepared in accordance with more than one financial reporting framework with management and those charged with governance. The purpose of the discussion is to help decide which of the financial reporting frameworks is predominant, given that the ability to comply fully with more than one financial reporting framework is rare. The auditor encourages management to prepare the financial statements in accordance with the predominant financial reporting framework only. The auditor's report is then worded in terms of whether the financial statements have been prepared in accordance with that financial reporting framework.

7. If, however, management insists on indicating that the financial statements have been prepared in accordance with more than one framework, the audit report may refer to those frameworks. However, the auditor considers each framework separately. If the auditor is of the opinion that the financial statements are in accordance with only one of the frameworks then the auditor expresses an unqualified opinion on compliance with that framework and a qualified opinion or an adverse opinion on compliance with the other framework or frameworks.

Financial Statements Prepared In Accordance with Another Acceptable Financial Reporting Framework

8. Entities that prepare their financial statements in accordance with an acceptable financial reporting framework other than IFRSs may disclose, in the notes to those statements the extent to which they comply with IFRSs. In these circumstances, the auditor considers whether assertions made in the notes with respect to the extent of such compliance are factually correct and not misleading. The auditor then considers the effect of that disclosure on the auditor's report. For example, when the effect of applying a certain IFRS would be material and pervasive to the financial statements, an assertion that the financial statements have been prepared in accordance with IFRS except for the application of that particular standard may be misleading without fully disclosing the effect of not applying that standard. In such circumstances, it may be more appropriate for the notes not to comment about the extent of compliance with IFRS or to state that the financial statements have not been prepared in accordance with IFRS. Similarly, a note to the financial statements that indicates only partial compliance with IFRSs without reference to specific departures misleads readers because it implies compliance while failing to provide sufficient information for readers to determine the extent to which the financial statements do not comply with IFRSs. (For example, a note to the financial statements indicating that the financial statements "are based on," or "comply with the significant requirements of" or "are in compliance with the accounting requirements of" IFRSs.)

9. A note to the financial statements containing disclosure about compliance with IFRSs is treated no differently from any other note to the financial statements. All such notes contain management assertions and the auditor obtains sufficient appropriate audit evidence to support the assertions. If the note contains a reference to compliance with IFRSs, the auditor considers whether the note contains misleading information such that the financial statements fail to comply with the entity's financial reporting framework because of inadequate or inaccurate disclosure in the financial statements. This is likely to be the case in circumstances where the reference to compliance with IFRSs:

(*a*) contains untruthful or materially inaccurate information; or

(*b*) misleads readers of the financial statements because it implies compliance with IFRSs without providing sufficient information for readers to determine the extent to which the financial statements fail to comply with IFRSs (for example, quantification).

If the financial statements fail to comply with the entity's financial reporting framework because the disclosures are misleading, the auditor's report expresses a qualified or an adverse opinion. An illustration of a qualified opinion that may be given in such circumstances follows:

> Note X to the financial statements indicate that the financial statements have been prepares in accordance with [relevant national financial reporting framework] and are substantially in accordance with International Financial Reporting Standards (IFRSs) except that they do not comply with ISA 39, 'Financial Instruments: Recognition and Measurement.' Given the significant effect in this case on the company's financial statements of non-compliance with IAS 39 and given that the company has not disclosed the effect of this departure from IFRSs, the reference to compliance with IFRSs is considered to be misleading and accordingly is unacceptable within financial statements prepared in accordance with [relevant national framework].
>
> In our opinion, except for the inclusion of the reference to compliance with IFRSs, the financial statements give a true and fair view of (or 'present fairly in all material respects') the financial position of the Company as of December 31, 20X1, and of the results of its operations and its cash flows for the year then ended in accordance with [title of financial reporting framework with reference to the country of origin] (and comply with [refer to relevant statutes or law]).