Issues Paper and Proposal - Clarity of IAASB Standards

Introduction

1. The paper is set out in the following sections:

    I.   Background

    II.   Overview of Respondents' Comments

    III.   Overview of Task Force Recommendations

    IV.   Elements of the Proposal and Basis of Recommendations

    V.   Illustrative Application of the Proposal

    VI.   Implementation

    VII.   Benefits

    VIII.   Way Forward

I.   Background

2. The Clarity project began in 2003, but the IAASB failed to agree on a way forward at the end of that year. Following the discussion at the December 2003 Board meeting and the 2004 IAASB- national auditing standards setters (NSS) meeting, the IAASB broadened the scope of the project, and in September 2004 issued the Exposure Draft (ED), Proposed Policy Statement, "Clarifying Professional Requirements in International Standards Issued by the IAASB," and the Consultation Paper, "Improving the Clarity and Structure of IAASB Standards and Related Considerations for Practice Statements." The objective of the project is to identify ways to improve the clarity, and thereby the consistent application, of International Standards issued by the IAASB

3. The ED included the following proposals, to be implemented principally on a prospective basis:

    - To reaffirm the responsibility of the professional accountant to consider all aspects of a standard, not just the bold type sentences, and to establish that the obligations imposed on the professional accountant are to be communicated by the use of specific language.

    - To clarify the professional requirements of a standard by specifying and defining two categories of professional requirements: requirements ("shall" statements) and presumptive requirements ("should" statements), along with a requirement for professional accountants to document departure from a presumptive requirement.

    - To discontinue the use of the present tense in plain type paragraphs of the standards when describing actions by the professional accountant.

4. Comments were sought on each aspect of the ED as well as on whether concern exists over a possible increase in the number of professional requirements in the standards (arising from the elimination of the present tense), whether the proposals will enhance the quality and consistency of audits, and on the proposed prospective approach for implementation.

5. The Consultation Paper addressed other wider aspects of clarity arising from concerns about the length and complexity of standards, the way in which they are structured and their applicability to both large and small-and medium-sized practices (SMPs), matters

echoed in the findings of the report "Challenges and Successes in Implementing International Standards" (the "Wong" report). Comments were sought on:

- The understandability of IAASB standards, including: (i) whether the length and style of the standards have aided or impaired their understandability and clarity; (ii) whether the degree of detail provided in the standards has aided or hindered adoption or implementation of ISAs; and (iii) options that the IAASB should consider in addressing such concerns.

- The structure of ISAs and possible restructuring, including: (i) whether the IAASB should continue with its present style of ISAs, or whether ISAs should be restructured; (ii) which of the identified options should be pursued; and (iii) other options that should be considered by the IAASB.

- Possible "fundamental principles underlying an ISA audit," including: (i) the benefits of establishing such principles; (ii) how the principles should be developed and matters they should contain; and (iii) whether the establishment of such principles should be consider a high, medium or low priority of the IAASB for the immediate future.

- Related considerations for Practices Statements.

6. This paper excludes an analysis of comments pertaining to Practice Statements which are not planned for discussion at this meeting.

II. Overview of Respondents' Comments

7. The following sets out a high level summary of the main views of respondents by major issue. It highlights: (i) aspects of the issue that most respondents appear to share a common view on, and where agreement might reasonably be achieved; and (ii) aspects where there is a divergence of views. Resolving the latter is fundamental to determining the way forward.

Issue:	Clarifying Professional Requirements			
General agreement	- Eliminate ambiguity of the present tense - Follow a "principles-based" / "objectives-based" approach - Significant concern over increase in professional requirements / Avoid undue proliferation of requirements - Establish a basis for determining extent and specificity of requirements - Fuller understanding of impact of the proposals needed - Statement of "equal authority" is unnecessary			
Divergence of views – *Way forward*	Develop conceptual framework	Develop / adopt "fundamental principles" and/or restructuring	Develop criteria / drafting guidelines or convention	Apply based on IAASB judgment / feedback on EDs

In respect of the divergent views on the way forward in clarifying professional requirement, the balance of respondents' views was broadly toward the need to couple the ED proposals with the development of fundamental principles and/or restructuring, or the development of some form of drafting guidelines.

Issue:	Categories of Professional Requirements and Documentation of Departures		
General agreement	• Reconsider whether distinction between categories is justified • Establish basis for deciding between "shall" or "should" statements (e.g., "shalls" to reflect principles/objectives; "shoulds" to reflect procedures?) • Use "must" instead of "shall" • Clarify expectations with respect to "should consider" • Clear identification of the objective(s) of a presumptive requirements is prerequisite		
Divergence of views – *Proposed categories*	Distinction impossible / problematic; revert to one class of requirement	Adopt categories only if linked to "fundamental principles"	Retain / enhance alignment with PCAOB
Divergence of views – *Departures and documentation*	Relax threshold for departure (e.g. remove expectation that departures are to be "rare") and remove documentation requirement	Retain existing threshold which is seen as adequate	Strengthen threshold for departure

There was no clear indication of the balance of respondents' views on the proposed categories of professional requirements or the proposed requirement to document departures.

Issue:	Length and complexity of standards			
General agreement	• Seen by many as being problematic, affecting understandability and may hinder convergence in some jurisdictions • Measures need to be taken			
Divergence of views – *Way forward*	Fundamental change: conceptual framework / "think small first" / holistic approach	Restructuring (balanced towards Option B)	Improve drafting	Maintain /develop stable platform of ISAs / Make greater use of Practice Statements

In respect of the divergent views on the way forward in addressing the length and complexity of standards, the balance of respondents' views was broadly towards a restructuring of the ISAs and (irrespective of a restructuring) to improve the drafting of the standards.

Issue:	Fundamental Principles		
General agreement	• Highly desirable • Preliminary set of principles provides a good basis, but more work needed		
Divergence of views – *Priority and way forward*	Nice to have, but not essential to clarity / Develop based on sound conceptual framework	Essential to principles-based (objectives-based) standards / Pursue separate consultation	Essential to implementation of categories / Finalize as part of ED

In respect of the divergent views on the priority of work on the fundamental principles, the balance of respondents' views was broadly toward the further development of the principles as part of the Clarity project.

Issue:	Implementation			
General agreement	• Prospective approach is problematic / undesirable			
Divergence of views – *Way forward*	Do not attempt to "retrofit" existing standards	Update existing ISAs / establish stable platform	Modified prospective approach, with definitive work plan	Big bang

In respect of the divergent views on the approach to be taken for implementing the proposals, the balance of respondents' views was broadly toward the 'big-bang' approach.

8. Different views were expressed by respondents from, and amongst respondents within, each of the regulatory, NSS, public accounting (firms and practitioners), and other professional accountancy organization communities. As the above indicates, there was no clear consensus on the direction that the IAASB should take towards enhancing the clarity of its standards. For example, respondents' from one stakeholder group (say, regulators) may generally agree with elements of the ED but differ widely in their views on the need to consider a restructuring of the ISAs and on the method of implementing the proposals.

9. For reference, Agenda Item 9-D presents a collation of the general comments made by respondents on the ED and Consultation Paper. Agenda Item 9-D.1 and D.2 collate the comments to the questions posed in the ED and Consultation Paper, respectively.

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III.   Overview of Task Force Recommendations

10. Respondents have put forth strong arguments in support of their views. The Task Force has studied and deliberated these views and respondents' recommendations, and the options that could be pursued. The Task Force[1] has come to the following general conclusions:

   - While many respondents expressed their satisfaction with the current standards, the responses nevertheless indicate a clear need to progress the project, and to achieve improvement in the clarity of the standards, on a timely basis. Accordingly, those options that can result in improvement in the near term should be given priority consideration.

   - It may not be possible to formulate a response that will satisfy all of the views of all respondents, and attempting to fulfill too many objectives may prevent timely achievement of the main goals of the clarity project. Accordingly, it is necessary to consider the balance of views of respondents and to seek a compromise that will be acceptable to most stakeholders.

   - The approach to improving clarity may need to include matters raised in the Consultation Paper.

   - Where possible, the solution should assist, rather than impede, international convergence.

   - The solution must not result in a weakening of the existing standards.

11. Based on the above, the Task Force has identified a proposal comprising six elements. The Task Force believes that the six elements when taken together represent a solution that may best meet the needs of the widest range of stakeholders and users of the standards, whether auditors, national standard setters or regulators.

12. The six elements of the proposal are:

   1. To establish fundamental principles.

   2. To identify in ISAs the objective(s) to be achieved by auditors.

   3. To define the language used for requirements of ISAs and to require the documentation of departures.

   4. To eliminate or elevate sentences in the present tense.

   5. To restructure ISAs.

   6. To redraft ISAs to reduce or eliminate duplicate material.

   Each element of the proposal and the basis of the recommendations are discussed in Section IV of this paper. The benefits of the proposal are summarized in Section VII.

13. The Task Force recommends that the above six elements be considered together as a package.

14. If agreement on the whole set of elements, or an acceptable subset of them, cannot be reached (or the IAASB is not satisfied that they will achieve the objectives of the project), then it is recommended that the IAASB continue with the present style of ISAs and

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[1]   The Task Force has approved this paper for consideration by the IAASB. References to the views of the Task Force do not imply that all members of it agree with the direction proposed for each of the individual elements of the proposal.

eliminate the present tense and improve drafting on a prospective basis. The Task Force does not consider that another alternative would be worth pursuing.

Action Requested

The IAASB is asked to consider the elements of the proposal outlined above, and discussed in detail below. In doing so, the IAASB is asked to consider the following:

- Do the proposals adequately respond to the concerns and views raised by respondents?

- Do the proposals clarify the ISAs in such a way that they will be read in a consistent manner and thereby facilitate consistent application?

- Do the proposals present a significant benefit to the national standard setters and legislators in terms of convergence with or adoption of ISAs?

- Do any elements weaken the ISAs (in which case they should not be pursued)?

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IV.   Elements of the Proposal and Basis of Recommendations

A.   Fundamental Principles

Recommendation

15. The IAASB should proceed with identifying the fundamental principles of auditing as part of the Clarity project.

 A draft proposed statement of fundamental principles is presented in Appendix 1, which should be read with paragraphs 29-32 below.

Basis of Recommendation

The Further Development of Fundamental Principles of Auditing

16. The majority of respondents expressed support for the further development of the fundamental principles of auditing, and many would afford a project to do so a high priority. Some respondents suggested that the development of such principles is essential to the development of future ISAs from a 'top down' or a 'principles-based' perspective, and that the absence of a framework of principles may lead the IAASB to determine future requirements in ISAs on an ad-hoc basis or by an "if in doubt, mandate" approach. In addition, respondents noted that such principles could enhance the quality of audits by setting the proper tone for professional accountants and the foundation for their responsibilities, thereby indirectly guiding professional judgment. Respondents were generally of the view that the principles should be considered at the same time as the other clarity proposals.

17. The Task Force believes that the arguments in favor of establishing the principles outweigh the views of a minority of respondents that the principles need not be pursued as they are not critical to the development, understandability and application of ISAs. The Task Force recognizes, however, that an inability to agree on the principles themselves should not preclude progress on other elements of clarity.

18. The Task Force noted the view of a few respondents that a more systematic approach (based on a conceptual foundation) should be taken to the development of the principles. However, such an approach would significantly delay their development and result in their consideration in the future separately from the consideration of others aspects of clarity. The Task Force also noted that many respondents considered that the draft principles presented in the consultation document were broadly right. In the circumstances, development based on the judgments and expertise of the IAASB and further consultation (i.e., public exposure) should prove adequate and timely.

Content of the Principles

19. Respondents expressed divergent views as to what should be included in the principles.

20. Some respondents were of the view that the principles were too general and overarching in nature. As such, they did not provide: (i) an adequate basis to guide specific actions and decisions needed in an audit; (ii) an adequate foundation for auditing standards; nor (iii) useful and specific guidance to the IAASB (as to what should be required in a standard) and to auditors.

21. In the Task Force's view, it is the role of the IAASB to draft the ISAs so as to translate the principles underpinning auditing into specific statements of objectives and requirements, and it is those objectives and requirements that set the expectations and drive the performance of auditors. By their nature, principles alone are not intended to achieve this result.

22. Another objection by a few respondents was that the principles did not address a number of underlying conceptual topics, including for example: "reasonable" and "limited" assurance and their relationship to sufficient appropriate evidence and audit risk; the relationship between the audit environment and audit systems and processes; and the relationship between the various parties to the engagement and the relationship among their respective responsibilities.

23. Such principles would be more like a framework underpinning an audit or assurance engagement. In putting forward the principles, it was not intended that they should provide an alternative framework. Rather, they were directed at the basics of auditor behavior. Further, undertaking a framework project would delay significantly the date by which improvements could be made to the clarity of IAASB's standards.

24. Another criticism concerned the degree of detail with which the draft principles were written. In this regard, the preliminary set of principles had attempted a degree of precision that would enable a direct link to be made to the overarching bold type requirements of the ISAs. That approach drew comment that it not only resulted in a degree of repetition, but also reflected current auditing practice rather than the underpinnings thereof. The Task Force accepted this view.

25. The Task Force agreed that the number of fundamental principles should be few (not more than six to eight elements), and that they should be briefer and less procedural. Accordingly, the Task Force has revised the principles on the basis that they should:

- Be consistent with the overall objective of an audit and represent behaviors from which auditors are not expected to depart.

- Be clear and succinct such that they are understandable and memorable both by professional accountants and other readers of ISAs. In this regard, they should not be

hedged with qualifying and defensive words. (The Task Force has introduced an explanatory note to each of the proposed principles to assist in understanding further the intent of the principles.)

- Be universally applicable to all audits.

26. In revising the draft principles, the Task Force accepted a number of recommendations by respondents to reduce repetition, increase clarity and render them more consistent with the objective of an audit.

Status of the Principles

27. The difference in respondents' views indicated differing expectations as to the objective and purpose of the principles. Accordingly, the Task Force has prefaced them with words intended to clarify their purpose.

28. Further, the Task Force has used the present tense for the principles themselves. This seems consistent with their axiomatic nature, and distinguishes them from the standards (and in particular, from the requirements in ISAs).

Role of the Principles

29. The Task Force has not concluded on the final role of the draft proposed principles.

30. Subject to further consultation, one option may be to adopt the proposed statement of principles and present it above, or along side, the *International Framework for Assurance Engagements.* Under this option, the status and role of the principles would be as described in Appendix 1, with the principles becoming a standing element of the IAASB Handbook.

31. The Task Force may find, however, that in redrafting ISA 200 the more effective presentation is to include the principles within ISA 200 as a revision of the (incomplete) principles therein, thereby having the principles serve as a more authoritative statement of expectations. This approach requires that the IAASB is satisfied with the implied degree of authority of the principles and of compliance expected of auditors therewith.

32. A third option is for the IAASB to use the principles solely as an internal guide to the development of the objectives of the ISAs.

Action Requested

The IAASB is asked to consider and advise on the proposed revised 'Fundamental Principles of Auditing', the status that should be attributed to them, and the role that they should serve.

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B.   Objectives

Recommendation

33. Each ISA should clearly identify, in a separate section of an ISA, the objective(s) to be achieved by the auditor.

The requirements of an ISA ("should" statements) would follow in a separate section, specifying those actions or procedures that are of sufficient importance as to be generally required if the auditor is to achieve the stated objective(s). (Subsidiary objectives may be included in this section to clarify the specific purpose of certain requirements. See discussion of departures from requirements – paragraphs 50-53 below.)

The auditor would have an obligation to meet the stated objective(s), and should comply with the requirements of the ISA in doing so by performing procedures that, in the auditor's judgment and based on the ISAs, are deemed appropriate in the particular circumstances. In the event that the requirements of an ISA include everything that the auditor need do to meet an objective, the drafting of the objective would make that clear.

Basis of Recommendation

Identifying Objectives

34. The majority of respondents expressed significant concern over the potential increase in the number of requirements that may arise as a result of the proposals in the ED. The IAASB was therefore urged to follow a 'principles-based' approach in setting its standards. Further, several respondents recommended that an 'objectives-based' approach be considered, whereby the focus is on the required outcome of the auditing procedures, rather than the procedures *per se*.

35. The Task Force considers, for all intents and purposes, 'principles-based' and 'objectives-based' standards, as used by respondents, are broadly equivalent. It believes that there is merit in strengthening this characteristic of ISAs by identifying the objective(s) to be achieved by the auditor in following the requirements of an ISA, for the following reasons:

    • First, clear objective(s) may help auditors understand further the context of the requirements. In turn, this may assist in the evaluation of whether the objective(s) has been met, and thereby, the objectives of the audit.

    • Secondly, it may assist the IAASB in determining the requirements to be established as it considers the treatment of present tense statements. This would respond, in part, to respondents' recommendations calling for the IAASB to establish some basis for determining the extent of the requirements in the standards.

    • Thirdly, the IAASB currently uses a convention at the beginning of its standards to summarize the overarching requirements of an ISA. Expanding this convention as a means to identify the objective(s) would strengthen this element of the ISAs.

Relationship between Objectives and Fundamental Principles

36. Respondents noted that one of the primary benefits of a 'principles-based' or 'objectives-based' approach to standard setting is the development of ISAs from a 'top-down' perspective. The role of objectives in this regard would therefore be to create a conceptual link between the general objectives/fundamental principles of auditing and individual ISAs. The contribution to the clarity of the standards comes from the auditor's understanding of the objectives, and the IAASB consideration of them in developing or revising its standards.

Distinguishing Objectives from Requirements

37. To maintain the essential quality of the objective(s) as the desired outcome to be achieved, and to distinguish them from the procedural requirements of an ISA, it is recommended that the principal objective(s) of an ISA be set out in a section separate from the requirements.

Obligation to Consider Whether the Objective(s) Has Been Achieved

38. It is proposed that the auditor have an obligation to meet the stated objective(s) by not only complying with the requirements of the ISA, but by performing procedures that, in the auditor's judgment and based on the ISAs, are deemed appropriate in the particular circumstances. This has the effect of emphasizing that while ISAs are designed to cover substantially all relevant circumstances (that is, an auditor should generally be able to accept that the objective(s) of an ISA has been achieved when the auditor has complied with all of the relevant requirements), they are not necessarily complete as it is not practical for ISAs to specify requirements that address all possible circumstances. There may be circumstances, however, where the intention of the IAASB is that certain required procedures are the full extent of what is required to be done by the auditor; in such cases the objective would make that clear.

39. From a standards-setting point of view, identifying objectives and establishing an obligation to consider whether those objectives have been met promotes further the establishment of requirements that are not so procedural in nature, nor so comprehensive, as to drive a compliance mentality to the detriment of the use of professional judgment.

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C.   Requirements and the Documentation of Departures

Recommendation

40. The IAASB should not proceed with its proposal to establish two categories of professional requirements, as set forth in the ED.

    Instead, the IAASB should continue with its existing convention of the use of "should" statements to communicate requirements, along with the threshold for departure described in the current Preface (i.e., those exceptional circumstances where the professional accountant judges it necessary to depart from a requirement to achieve *more effectively* the objective of the [engagement]).

    The IAASB should, however, adopt its proposal to establish a documentation obligation in respect of such departures (i.e., to require the professional accountant to document how the alternative procedure(s) performed in the circumstances achieved more effectively the objectives of the requirement).

Basis of Recommendation

Reverting to the Existing "Should" Convention

41. The Task Force considered three main factors in formulating its recommendation not to continue with the proposal to establish two categories of professional requirements. First were the concerns raised by approximately one-quarter of respondents that the proposed distinction between the two categories was insufficiently significant and difficult to make. Some considered the definition of *presumptive requirements* ("should" statements) along with the proposed documentation requirement for departures effectively puts them on the same level of authority as a *requirement* ("shall"). Further, it was made clear that the proposals would create difficulty for certain national standard setters that intend to adopt ISAs by way of legislation; in some jurisdictions, all standards are normative and quasi-legislative, with no distinction between different requirement levels. Similarly, concerns were noted in the Wong Report in relation to the difficulties in translation presented by the use of words such as "shall" and "should" and the present tense to indicate different levels

of obligation. Distinguishing the requirements would therefore create confusion and introduce a degree of complexity with only marginal benefit.

42. The Task Force did in fact explore possible drafting guidelines that could provide a basis for the use of "shall" and "should" statements (as suggested by some respondents), and attempted to redraft a few ISAs on that basis. The Task Force concluded that the degree of subjectivity involved (and thereby potential inconsistency) in deciding on whether a requirement was to be a "shall" or a "should" made it difficult to justify any such decisions.

43. Secondly, the Task Force became concerned, based on indications in certain respondents' comments, that internationally a more liberal view may be taken of the degree of flexibility to depart from a presumptive requirement (based on the proposed definition) than was originally intended. Further, one respondent observed that the proposals could be interpreted as lowering the criteria for a departure, in that an alternative procedure was simply required to be "sufficient" to meet the objective, rather than to do so "more effectively."

44. Thirdly, a number of respondents were of the view that changing the definition of "should" statements would create a significant degree of confusion, and potential for misapplication, particularly if the same terms were used concurrently with different definitions as a result of the proposed prospective implementation approach. On the grounds that it is not practical to revise all ISAs at once (see discussion in Section VI - Implementation), retaining the existing definition should avoid such concerns.

45. The Task Force acknowledges that there was general support by approximately one-half of respondents for the proposals. On balance, however, the Task Force believes that the use of a single level of requirement, with the documentation of a departure, is clearer and leaves less scope for confusion and interpretation. It also simplifies the process of developing standards, by helping to reduce the debate as to whether a requirement is a 'should' or a 'shall', which is of lesser significance than the question whether something should be a requirement at all. Further, the Task Force believes that any real or perceived weakening of the ISAs would be avoided by retaining the existing "should" convention, including permitting departure only where the auditor judges it necessary to depart to achieve *more effectively* the objective of the *requirement* (as to which, see discussion below).

Obligation to Document Departure

46. Respondents expressed mixed views over the proposed requirement to document departure from a "should" statement. Some viewed the requirement in the current Preface (i.e., "…to be prepared to justify the departure") as well balanced and sufficient. It was thought to be particularly appropriate for smaller audits where (it was argued) a documentation requirement for departure from a requirement may be impractical and inefficient. These respondents feared the creation of additional work with no corresponding benefit in terms of audit quality. The view was also expressed that the proposal may discourage auditors from incurring the cost and risk of a departure where an alternative procedure was necessary. Other respondents, however, viewed the proposal to be of benefit by encouraging careful consideration of the need to depart and assisting with monitoring and compliance activities. These respondents did not see the proposed requirement as particularly onerous.

47. The Task Force believes that the proposal is more rigorous than the present requirement for the professional accountant to "be prepared to justify the departure." The Task Force

believes the additional documentation requirement responds to the public interest and is appropriate for what should be a rare occurrence.

48. The Task Force noted that a number of respondents appeared to think that documentation of a departure would apply even where the circumstances were such that the relevant requirement was not applicable. This was not the intention, and the Task Force recommends that this be clarified both in the clarity proposal that goes forward and in the ISA addressing audit documentation (see draft revised ISA 230 (Revised), Audit Documentation, in the Board's agenda material); this should assist in lightening the perceived burden in the case of the audit of an SME.

49. The Task Force agrees, however, with respondents' views that there is little merit in requiring documentation of the *reason* for a departure if the documentation of the alternative procedure demonstrates how the required objective has been achieved. Accordingly, it is recommended that that aspect of the proposed documentation requirement be dropped.

Point of Reference for Departures

50. The Task Force reconsidered whether the departure from a requirement should be made in the context of:

- The objective(s) of the requirement (as proposed in the ED);

- The objectives that are to be set out in individual ISAs; or

- The objective of the audit (engagement) (as per the current Preface).

51. The Task Force is of the view that the formulation proposed in the ED is correct – that is, the auditor should consider the objective(s) of the requirement in determining the need, and in justifying the decision, to depart. The basis of this conclusion is that requirements, established after due process, represent actions or procedures of sufficient importance as to be generally required of the auditor. A decision to depart should therefore be met by the performance of an alternative procedure(s) that can achieve more effectively the intended objective. This formulation is not inconsistent with the notion that departure should be a rare occurrence (a statement made in both the current Preface and in the ED).

52. If the expectation of the IAASB, however, is to permit greater flexibility in how the auditor may seek to achieve the overall objective of the audit, then the point of reference for a departure should be one of the above noted alternatives. The Task Force, however, does not believe that doing so will enhance the consistency of application of ISAs.

53. A few respondents observed that the consequence of setting the point of reference for a departure at the requirements-level is that the ISAs will need to explain clearly the objective(s) of a requirement (when such objective(s) are not otherwise self-evident). The Task Force accepts this point as a matter to be considered when redrafting the ISAs under the Clarity proposal (see discussion of objectives, above)

Other matters

54. Several respondents observed that the status of "should consider" with regard to documentation is unclear and recommended that it should be clarified. In particular, respondents noted that if an auditor did not consider a matter, that would appear to give rise to a documentation requirement which, in itself, would give rise to consideration of the unconsidered matter.

55. The Task Force does not necessarily believe that the proposed documentation requirement for departures introduces an increase in documentation, by virtue of the logic noted above. Because the "should consider" terminology is widely used in ISAs, the Task Force believes that the auditor should use his or her professional judgment in determining how to document the consideration of the specific action or procedure, and in complying with the documentation requirements of ISA 230.

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D.   The Present Tense

Recommendation

56. The IAASB should adopt its proposal to discontinue the use of the present tense in ISAs to describe auditor actions.

    In reviewing or revising ISAs, sentences containing the present tense should be redrafted so as to make any requirement clear (elevated by using "should"), or redrafted (by eliminating the present tense) to make it clear that there is no intention to create a requirement.

    Application should be determined on a case-by-case basis, bearing in mind the stated objective(s) to be achieved by the auditor (see section   B) and the benefits and disadvantages that an increase in the extent and specificity of requirements within ISAs may have.

Basis of Recommendation

Discontinuing the Use of the Present Tense

57. Nearly all respondents supported the proposal to eliminate the ambiguity arising from the use of the present tense in ISAs to describe auditor actions. The Task Force believes that this aspect of the proposal will improve the clarity of the ISAs. Accordingly, this element should be adopted irrespective of the views on other elements of the proposal.

Managing the Impact of the Change

58. The majority of respondents expressed significant concern over the potential increase in the number of requirements in the standards that may arise from eliminating the use of the present tense. In particular, respondents argued that this may have a detrimental effect on the quality of audits as a result of a compliance mentality that more procedural standards might engender. Respondents also emphasized the need for the IAASB to maintain a "principles-based approach" to standard setting, echoing the findings of the Wong Report, as it is likely to enhance the convergence of auditing standards in an international environment.

59. Respondents were also of the view that it may be necessary for the IAASB to set out the basis it will use to determine the extent and level specificity of the requirements of the standards. Such a basis would also support decisions about whether a given procedure described in the present tense should be a requirement, or an option or consideration. Respondents' comments, however, indicated fundamentally different philosophies towards standards that contain a greater number of detailed requirements versus those that set 'higher-level' requirements. As such, a significant challenge exists in designing, and reaching agreement with stakeholders on, criteria which the IAASB could use for this purpose.

60. The Task Force agrees that it is necessary to manage the risk of an inflation of requirements so that audit quality is not diminished. The Task Force believes that a clear focus on objectives, together with certain required procedures will achieve an appropriate balance that enables and supports professional judgment.

61. The Task Force's approach to ensure that redrafting is conducted in a consistent way that avoids missing valid requirements and an undue inflation of requirements, has been as follows:

    - Ascertain whether the statement is clearly intended to be explanatory in nature.

    - If the statement is not clearly intended to be explanatory (or there is uncertainty), determine whether establishing the action as a requirement is warranted. (Is the procedure or action important in the context of the stated objective(s) of the ISA such that its establishment as a requirement would enhance the ability of the auditor to meet the objective(s)? Is the procedure or action expected to be relevant and applicable to all audits irrespective of the jurisdiction or governance structure (unless otherwise specified)?)

    - Consider whether, on balance, the resulting requirements are appropriate having regard to the importance of the objective. The purpose of this last step – effectively a 'stand-back' test – is to consider and reflect upon the extent to which the resulting number of requirements may inadvertently interfere with the proper application of professional judgment and thereby, the quality of an audit. (This might be described as a test of 'proportionality'.)

    This process – which may be refined as further experience is gained – links the decision-process to the stated objectives of the ISA (see section B) and incorporates an assessment of the benefits and disadvantages that an increase in the extent and specificity of the requirements within ISAs may have.

    Ultimately, the decision on the treatment of any specific present tense statement will be based on the judgment of the IAASB in light of due process. The above guide may assist that judgment.

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E.   Restructuring ISAs

Recommendation

62. The IAASB should restructure ISAs whereby ISAs are presented in three principal sections:

    - objective(s) (see section B);

    - requirements along with essential explanatory material; and

    - application guidance that supports proper application of the ISA.

    The need for the current bold type lettering convention would no longer exist.

    Consistent with the current authority attaching to ISAs (and that proposed in the ED), the auditor would be required to (a) comply with the standards section, and (b) consider the application material section as part of understanding and applying the requirements.

    For reference, Appendix 2 presents a proposed overall structure of a restructured ISA.

Basis of Recommendation

Concern over the Length and Complexity of ISAs

63. A majority of respondents re-emphasized the views, recognized in the Clarity Consultation Paper, that the length of some of the more recent ISAs has affected their usefulness and understandability. They were seen as less likely to be read, and these features may pose a threat to overall audit quality, international convergence and their applicability to the audit of SMEs. It was noted that the extent of detail provided in the standards may be counterproductive in some jurisdictions. Further, the degree of detail has posed some challenges to implementation in audit methodologies and by auditors of small and medium sized entities, and in documenting compliance.

64. In contrast, several respondents noted that the style of recent ISAs has helped improve quality of the standards by contributing to a better understanding of the issues. It was noted that additional explanatory material is often needed in order to deal with complex issues. In today's environment, more detail is required in standards to make them effective in achieving consistently high quality audits.

65. This contrast in views was also present in the findings of the Wong Report. Respondents were generally of the view, however, that length is an issue to the extent that it impairs the clarity of ideas being expressed.

66. Based on respondents' comments, the Task Force believes that measures need to be taken to address the length and complexity of ISAs, and in particular to assist international convergence and adoption of ISAs.

Restructuring

67. Restructuring of the standards was seen by a majority of respondents as a possible solution to these issues. The SMP Task Force indicated that restructuring may assist in making the standards more relevant and applicable to auditors who serve SMEs, and that it would not support the proposals to clarify the requirements of ISAs unless some form of restructuring is carried out in conjunction therewith. A number of others made their support for elements of the proposals conditional on restructuring.

68. Others believe that restructuring may impair the convergence effort, and a significant minority recommended that no restructuring be pursued. The principal concern cited was that separation of explanatory material from requirements would adversely affect consistent application and would result in loss of important context. It was also feared that restructuring may exacerbate standards overload by creating an inordinate amount of repetition, an outcome contrary to the objectives of a restructuring.

69. The Task Force is of the view, on balance, that a restructuring of the ISAs may help the auditor to focus on the principal things that the auditor needs to do and know, thereby enhancing the quality of audits. It is also particularly influenced by the views of certain national standards setters who are engaged in implementing ISAs in their jurisdictions (as also reflected in the findings of the Wong Report). It is of the view, however, that restructuring needs to be combined with some redrafting to eliminate duplication (see Section F below).

70. Of the different restructuring options outlined in the Consultation Paper, the Task Force has concluded that restructuring of ISAs into separate sections within one document (Option B in the Consultation Paper) presents the option most likely to be accepted by the majority of

stakeholders. Of those favoring restructuring, there was a small balance in favor of Option A. However, several respondents expressed strong concern with any restructuring option that would result in a separation of application guidance from the requirements in two separate documents. Further, amongst those respondents preferring no restructuring or Option A, a number indicated that Option B would acceptable, or more acceptable than the alternative, in the event that a restructuring were to be undertaken.

Status of the Application Material

71. A fundamental condition to the clarity project is that nothing is done to weaken ISAs. This principle therefore implies that no requirement of the existing ISAs should become guidance in the new structure; it also suggests that the other material that is retained from existing ISAs should have a status at least as high as at present.

72. Accordingly, the Task Force is of the view that all of the sections of a restructured ISA together comprise *the ISA*, and should be labeled as such. Doing otherwise would increase the risk that the application material may be overlooked or ignored by auditors. It is therefore proposed that the auditor have an obligation to consider the entire text of an ISA in carrying out work on an engagement.

Essential Explanatory Material

73. The Task Force is of the view, on balance, that if the entire document is the ISA and the application material is given the status referred to above, then the question whether explanatory material is in the 'requirements section' or the 'application material section' should not present an issue. However, the section of the ISA containing the requirements should be understandable by an experienced auditor. To this end, it may be necessary to include a certain minimum amount of 'essential' explanatory material within the requirements section to clarify the purpose or nature of a specific requirement (where not otherwise self-evident). The redrafted ISAs (315 and 240) have been redrafted by the Task Force on that basis.

Flexibility in Adapting the Application Material

74. As indicated in the Consultation Paper, restructuring may further assist in national adoption or implementation of ISAs, providing national standard setters with scope to incorporate national requirements and guidance more easily within the ISA framework. From a convergence point of view, however, there is a question about how much flexibility, if any, should be allowed in terms of adapting the application guidance. This question – which applies equally to the explanatory material in extant ISAs and to the proposed application material section of redrafted ISAs as a result of restructuring – is beyond the scope of this project. The Task Force has not come to a view on the matter.

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F.   Redrafting ISAs

Recommendation

75. The IAASB should redraft the ISAs, where appropriate, to reduce or eliminate duplication, thereby improving their overall clarity through more effective presentation of the ISAs. Other redrafting improvements should be sought where practicable, but not through a wholesale and systematic redraft of the ISAs.

Basis of Recommendation

76. A significant majority of respondents urged the IAASB to consider additional ways to improve the readability and understandability of its standards and to minimize their length, irrespective of whether a restructuring takes place. Respondents identified a number of drafting matters that reduce the understandability of the ISAs or translation thereof, and recommended certain improvements for consideration by the IAASB.

77. The Task Force believes that substantial redrafting of the ISAs to accommodate all concerns or some of the more fundamental recommendations about the way in which the standards are written would not be cost beneficial. However, significant improvements may nevertheless be achieved in more modest ways. This may include greater use of techniques that improve the understandability and flow of the standards, such as shorter sentences, bullet points and other formats, and separate sections to highlight considerations in the audit of SMEs.

78. The Task Force has observed that some ISAs contain a substantial amount of material that is present or repeated[2] in other ISAs (for example, when comparing ISA 240 to ISAs 200, 315, 330 and 500). This material, of course, has been included to ensure that the ISAs provide for a comprehensive consideration of the issues and that they respond to the various comments that had been received on exposure of those ISAs. However, the Task Force notes that embracing the notion that the body of ISAs, read and taken as a whole, may offer opportunities to redraft ISAs to avoid repetition and achieve a clearer focus on the main requirements introduced in a specific ISA. (It is not the intent, of course, for redrafting to change the substance of an ISA, or to remove or eliminate material that is important to the understanding or application of the ISAs.)

79. In addition to dealing with repetition, other improvements may be made. Appendix 3 presents a checklist used by the Task Force in redrafting ISAs 315 and 240. It is based on respondents' suggestions, input from the IFAC plain language specialist and matters identified through staff's review. It may be refined as further experience is gained.

Consequences of the Above

80. The more substantial the redrafting the more the exercise presents risks and challenges. Extensive redrafting may result in a perception that an ISA has been revised, which would not be the case. It also would require a significant degree of deliberation by the IAASB to ensure that any redrafted does not result in a change in the substance of a standard. In any event, the IAASB will be presented with papers that demonstrate how the material in the current ISAs has been reflected in the redrafted documents.

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[2] A respondent referred to this as 're-telling the story'.

V.   Illustrative Application of the Proposal

Illustrative Redrafted ISAs

81. The proposal has been applied in redrafting two ISAs – ISA 315 and ISA 240 – to illustrate its general effect. These redrafted ISAs are presented in Agenda Items 9-B and 9-C. Given the importance of the effect of the proposal on the way in which ISAs may be drafted (or redrafted) in the future, it is anticipated that a good portion of the allotted Board discussion time in June will focus on the illustration of the proposal through these redrafted ISAs.

82. For reference purposes, each redrafted ISA is accompanied by papers that analyze the proposed application of the proposal and the decisions that have been made by the Task Force. In particular, the supporting papers:

- map the material of each extant ISAs to the redrafted ISAs, as well as from the redrafted ISAs back to the extant ISAs;

- identify existing sentences in the present tense and the proposed treatment as either a "should" requirement or as application material; and

- identify any explanatory material that is proposed to be eliminated or repositioned as a result of redrafting to reduce duplication.

The Task Force has reviewed the redrafted ISAs against the extant ISAs, and is satisfied that there is no loss of any of the existing bold type requirements. It is also satisfied that sentences in the present tense have been afforded appropriate treatments as requirements or application material, and that no material of significance to the ISAs has been eliminated.

83. Two ISAs have been presented because the general effect of the proposal may differ significantly depending on the nature of the ISA. Redrafted ISA 315, generally considered to be an 'overarching ISA,' illustrates how restructuring may improve the ability to identify the requirements and navigate a longer ISA. Although the ISA is not very much shorter than before, its length is more manageable. The Task Force is generally satisfied with the outcome of the application of the proposal to this ISA.

84. Redrafted ISA 240 demonstrates the effect of redrafting if maximum opportunity is taken to reduce or eliminate the repetition existing amongst the ISAs, using the relationship between that ISA and the requirements and guidance contained in other ISAs (i.e., ISAs 200, 315, 330, 500, etc.). It does not represent a recommendation by the Task Force as to the final redrafting approach to be taken for the ISA, but rather demonstrates what may be possible in redrafting. A more limited approach to redrafted ISA 240 could have been taken.

85. There are divided views amongst the Task Force on the result of this redrafting. Some believe that the impression is conveyed that fraud has been downplayed in the ISAs, and that its treatment is less comprehensive and comprehensible. The contrary view is that by eliminating duplication it is clearer that consideration of fraud is central to the general approach to the audit, and that ISA 240 now deals appropriately with additional specific procedures and responses to deal with fraud. To some extent the views depend on how one considers standards should be used and read. In any event, the question to be considered is whether such elimination of duplication improves or impairs the overall understandability and effectiveness of the standard. The views of the IAASB, national standard setters, legislators, auditors and others will be important in considering the extent to which redrafting of ISAs should be considered.

86. Another issue to be considered is the treatment of guidance for SMPs. In ISA 315, it has been presented at the end of the Application Material as a separate section; in ISA 240, it has been included at relevant points, suitably headed, within the Application Material. The Task Force considers that SMPs should be assisted by separating requirements from application guidance, and by highlighting references to smaller entity considerations.

Illustrative Preface Wording

87. Appendix 4 compares the wording of the current Preface describing the authority attaching to IAASB's International Standards with: (i) the wording proposed in the ED; and (ii) the preliminary draft revised wording that arises from the proposal.

Action Requested

The IAASB is asked to consider the redrafted ISAs presented in Agenda Items 9-B and 9-C and to reflect and comment on the following broad considerations:

- Has the application of the proposal (re-drafting) achieved the objective of enhancing the clarity and understandability of the ISA?

- Has the issue of the present tense been dealt with appropriately and are the requirements set at the right level?

- Has the re-drafting weakened any aspect of the ISA?

- Has the re-drafting improved the ISA in terms of its usability by small- and medium-sized practitioners?

- Are there other redrafting suggestions of principle that could be readily incorporated?[3]

- Is the treatment of considerations for smaller entities helpful?

The IAASB is also asked for its views on redrafted ISA 240, in particular on the way in which redrafting is to be undertaken.

The IAASB is also asked whether they found the supporting analysis of the proposed changes to the extant ISAs helpful, or whether another form of analysis would be more effective for purposes of reviewing future redrafted ISAs?

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VI.   Implementation

Recommendation

88. The IAASB should adopt an implementation approach that can achieve improvement in the clarity of as many ISAs as practical in the shortest timeframe possible.

The following implementation plan is recommended:

- To apply the proposal described above by redrafting and exposing[4] the following ISAs for the first exposure of the proposals:

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[3] Members are encouraged to provide staff with any detailed editorial comments outside of the meeting discussions in June.

[4] The exposure and re-exposure of the redrafting of the identified ISAs and EDs, respectively, would seek respondents' views on the changes as a result of applying the Clarity proposal. Comments would not be sought on other issues. If such comments are received, however, they would be noted for purposes of future consideration if and when the ISAs are subsequently revised.

(i)   the audit risk ISAs (ISAs 315, 330);

(ii) the fraud ISA (ISA 240); and

(iii) ISAs addressing the objectives and general principles of an audit and audit evidence (ISAs 200 and 500).

These ISAs would be exposed together with the proposed fundamental principles and a timetable for the redrafting and exposure/re-exposure of other recently issued ISAs and EDs.

- Subject to comments on the above exposure:

  –   To redraft and re-expose[2] the following recently released EDs:

      (i)   materiality and estimates (ISAs 320 and 540);

      (ii) communications, related parties and group audits (ISAs 260, 550 and 600s); and

      (iii) modifications to the auditor's report (and EOM) and special purpose audit reports (ISAs 705s and 800s), along with exposure of a redrafted ISA 700.

      From a process point of view, the respective task force would bring first to the IAASB an analysis of issues arising from exposure, such that those issues could be dealt with separately from the issue of clarity/redrafting. The task force would be asked to present a revised ISA that takes into account both the resolution of the issues on exposure and the redrafting changes in conformity with the clarity proposal. The IAASB would then approve the revised and redrafted ISA for re-exposure.

  –   To redraft and expose the following recently issued ISAs: quality control (ISA 220), documentation (ISA 230 – assuming approval in September); and planning (ISA 300).

- To extend the project timetable for work on revising the ISAs on management representation and using the work of an expert (ISAs 560 and 620) to allow the respective task forces to issue those EDs in conformity with the clarity proposal.

- To apply the clarity proposal to the remaining set of ISAs, in conjunction with the revision and updating thereof, on a prospective basis in accordance with a schedule to be determined.

Appendix 5 presents a preliminary implementation timetable reflecting the above (changes from the current IAASB project timetable shown in Agenda Item 1-B are shown in mark-up). It suggests that 14 ISAs could be conformed to the clarity proposal by June 2007 (and 17 ISAs by September 2007). One effective date (say, January 1, 2008) could be established for this set of redrafted ISAs.

This timetable is tentative. It is not possible to anticipate fully the extent of debate that the redrafting of ISAs may engender.

Basis of Recommendation

Change from a Prospective Implementation Approach

89. Nearly all respondents were of the view that the IAASB should make improvements to clarity on a more timely approach than a prospective approach offers. These views

reflected, in part, the timing of national developments such as the adoption of ISAs in the EU and elsewhere, the direction of the clarity project having an important bearing.

90. Respondents noted further that a prospective approach may expose practitioners to a constant stream of detailed changes, and that it is important to have a stable platform as soon as practicable. The EC expressed concern that any change made to the standards after initial adoption will result in costly and time consuming procedures, compared to the added value.

Big bang approach

91. Significant support was expressed by respondents for a big-bang approach. The Task Force considers that a full big-bang approach, while ideal, is not practicable. Specifically, there are a number of 'older' ISAs (generally shorter in length and containing less detail) where: (i) there is relatively less explanatory material, thereby making a restructuring of the ISAs less effective in comparison to restructuring the ISAs that have been revised recently; and (ii) redrafting without a corresponding revision of the ISAs may not be appropriate. Redrafting such ISAs without such updating would create a potential risk that they are believed to have been revised, which would not be the case. The alternative – to include the revision of older ISAs as part of the big bang approach – would unnecessarily extend the period of time before improvement can be made.

92. Respondents also called for the IAASB to adopt a full big-bang approach to avoid the inconsistency in the meaning of 'should' between 'old' and 'new' ISAs. This would be confusing. The Task Force recommendations to retain the existing definition of "should" statements and not to pursue two distinct categories in describing professional requirements (as explained in section C) mitigate these concerns.

Benefits and Consequences of the Recommended Approach

93. The recommended approach is designed to introduce improvement in the clarity of ISAs in a timely and practical manner. It also offers the following advantages:

- The up-to-date core audit standards would be addressed first allowing the focus to be on present tense elimination, and on length and complexity, and thereby allowing them to act as a foundation for the revision of the remaining standards to which further updating would be necessary.

- Effectively necessitates a 'moratorium' on the issue of new ISAs. This would assist those that have indicated concern (either in response to the ED and Consultation Paper, or as evidenced in the Wong Report) about the speed and volume at which new international standards are promulgated.

94. The consequences of the proposed work plan to the current and future timetable of the IAASB include:

- The likely need to add one or more IAASB meetings in 2006 and 2007.

- Deferral by up to a year or more of the finalization of a number of EDs in progress.

- Deferral of new projects recently approved (e.g., Using the Work of an Expert).

- Temporary reduction or elimination of the ability to undertake new projects.

* * * *

VII.   Benefits

95. The proposal is designed to improve the standards by making the standards clearer; and to do this in a way that will assist adoption of IAASB's standards and facilitate international convergence. It seeks a solution to the broad range of views that exist internationally, with the goal of being acceptable to those who use the standards, whether as auditors, national standards setters or regulators.

96. Principally, it deals with the issue of the use of the present tense, a convention that has resulted in some confusion over whether a sentence using the present tense imposes an obligation on auditors. It does so, however, in a manner that also addresses other matters, such as the length and complexity of the standards, that are seen as essential to improving the overall understandability and clarity of the standards.

97. The proposal also responds in a timely and demonstrable manner to many of the finding of the Wong Report. In particular:

- Translation difficulties – by retaining one convention only to indicate the requirements of a standard (i.e., not introducing different terminology to indicate different levels of obligation), by eliminating the present tense, and by simplifying the wording of the standards through redrafting.

- Understandability, including challenges posed by the length and complexity of the standards – by restructuring and redrafting, and by setting out objectives to be achieved by the auditor in each ISA.

- Challenges for SMEs and SMPs – by addressing issues of length and complexity, as noted above, and by the inclusion of highlighted SMP considerations within or at the end of the application material. Issues concerning relevancy and appropriateness of the standards to SMEs and SMPs will continue to be addressed through the process of input by the IFAC SMP Task Force to the work of the IAASB.

- Frequency of changes – by a work plan that will provide users of the standards with a time during which no new or revised ISAs will become effective.

- International convergence – by establishing fundamental principles and objectives, thereby supporting the development of ISAs following a "principles-based" approach, and by restructuring that may accommodate different national strategies for the adoption of ISAs or international convergence, including legislative adoption. However, one issue that may be critical to national adoption or convergence not addressed relates to the degree of flexibility, if any, that should be allowed by national standard setters in making changes to the application material of ISAs. This matter will require further consideration by the IAASB and consultation with stakeholders.

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VIII.   Way Forward

Clarity Forum

98. It is critical for IAASB to know whether there is broad acceptance of these proposals before embarking on such a major initiative. Accordingly, a meeting of interested parties, including national standards setters, regulators, firms and others, together with representatives of the IAASB, has been scheduled in Brussels on July 11th. The purpose of this meeting is to provide an opportunity for those attending to appreciate the views of

others and, with an understanding of the divergent needs of different stakeholders, to advise whether the proposed approach is appropriate and of sufficient benefit to be taken forward.

99. The decision of the IAASB in June, along with input received from this forum, will serve as the basis for moving forward on this project.

Involvement of National Auditing Standard Setters

100. At the February 2005 IAASB-National Auditing Standard Setters meeting, there was strong interest by many of the national standard setters to be involved in, and to assist with, the process of improving the clarity of the standards. The Task Force will consider further how best to take up this offer of support. In particular, there may be an opportunity to introduce a further measure of quality control to the redrafting process by asking national standard setters to review preliminary redrafted ISAs developed by the Task Force.

Next IAASB Meeting

101. Subject to the views of the IAASB and outcome of the July 11th forum, the Task Force intends to pursue the timeline as set out in Appendix 5.

102. For the September meeting, the Task Force anticipates bringing the following to the IAASB:

- A revised Policy Statement reflecting the relevant elements of the proposal above, along with a draft basis of conclusions document, for approval;

- Proposed fundamental principles for approval for exposure;

- Proposed Re-drafted ISAs 200, 240, 315, 330, and 500 for approval for exposure; and

- A draft work plan, revised as necessary.

Appendix 1

Proposed Statement of the General Objective and Fundamental Principles of Auditing

General Objective of an Audit

The objective of an audit is to enable an auditor to express an opinion whether financial information, the preparation of which is the responsibility of another party, taken as a whole is free from material misstatement, thereby enhancing the degree of confidence of users in the financial information.

The Public Interest

The auditing profession accepts its responsibility to the public. Accordingly, the auditor has regard to the public interest in the course of the audit. This entails carrying out the audit to a high standard so as to maintain the public's confidence in the profession, recognizing the importance of the audit to the users of the auditor's report.

The following essential attributes of behavior of an auditor support this responsibility. The essential attributes are presented in the form of fundamental principles designed to enhance the quality of audits by providing auditors with a clear statement of the performance to which they should aspire in carrying out their work.

Fundamental Principles of Auditing

In achieving the general objective of an audit, an auditor applies professional judgment, having regard to the public interest, in adhering to the following fundamental principles of auditing.

1. **An auditor acts with integrity, objectivity, professional competence and due care, and professional behavior, and respects the confidentiality of information.**

    This principle is drawn from the IFAC Code of Ethics. It emphasizes the importance for an auditor to act ethically and to be satisfied that relevant ethical requirements, including those pertaining to independence as an essential support to objectivity, are complied with.

2. **An auditor applies skepticism.**

    An auditor brings to bear an independent, questioning mind to achieve a critical assessment of audit evidence, recognizing the possibility that circumstances may exist, including fraud, that cause the financial statements to be materially misstated and notwithstanding an auditor's past experience with the entity.

3. **An auditor has an appropriate basis upon which to plan and perform an effective audit and to form reasonable conclusions for purposes of the audit opinion.**

    An audit entails evidence gathering procedures through an iterative, systematic process designed to obtain an adequate quantity and quality of evidence upon which an auditor can draw reasonable conclusions. It includes an understanding of the entity and the engagement circumstances, which provides a frame of reference for exercising professional judgment throughout the audit, including judgments about the risks of

material misstatements and how to respond to such risks. The auditor acknowledges the interests of users by having regard to their reasonable expectations, materiality and cost benefit considerations in judging what is sufficient and appropriate.

4. **An auditor takes responsibility for the quality of the work performed and the audit opinion.**

This principle underlines the responsibility of the engagement partner for the audit engagement and its performance and for the audit report. This responsibility encompasses the need for an engagement partner to have an adequate level of involvement in the engagement, and to be satisfied that those persons carrying out the audit collectively possess the requisite skills and knowledge. Appropriate quality control procedures both at the firm and engagement level encourage a culture whereby all members of the engagement team take responsibility for the quality of their work, and thereby help support the issue of an audit report that is appropriate in the circumstances. This principle also underlies the need for an auditor to keep an appropriate record of the audit work to demonstrate the basis of the audit opinion.

5. **An auditor is not associated with misleading information.**

An auditor's association with information instills a degree of confidence in users about the credibility of the information. An auditor takes appropriate steps to avoid becoming associated with misleading information, or to remedy association with misleading information that an auditor has not otherwise reported upon as such.

6. **An auditor provides a clear report of the results and conclusions of the work performed.**

An auditor's written expression of opinion, or report that an opinion cannot be formed, informs users of the outcome of an audit. An auditor's regard to the public interest includes an auditor's consideration of other reporting responsibilities, such as communicating with those charged with governance and others, including third parties, when it is appropriate to do so.

The above principles are also designed to assist the IAASB in the development of future ISAs and the review of existing ISAs. In particular, the IAASB will consider the principles in identifying the objectives to be achieved by auditors in complying with ISAs and in establishing related requirements.

The principles do not constitute an ISA, and do not define a standard for any particular auditing issue. Nothing in the principles overrides any specific ISA.

Appendix 2

Overall Structure of a Restructured ISA

The following presents a proposed structure to the restructured ISAs.

Introduction

- The topic of the ISA and its purpose

- The effective date of the ISA.

Objectives

- The objective(s) to be achieved by the auditor and any explanation of the importance or context in which the objective(s) is set.

Definitions (as necessary)

- Definitions or explanation of specific terms and concepts introduced in that ISA.

Requirements

- The requirements of the ISA.

- Any essential explanatory guidance considered necessary to understand the objective(s), importance or purpose of a requirement.

Application Material

All other explanatory or application material, including:

- The responsibilities of management and others.

- Further explanation of the requirement contained in the requirements section above and any interpretive guidance.

- Auditor considerations when exercising professional judgment, including examples and suggested procedures.

- Public sector and small- and medium-sized accounting firms considerations.

- Appendices.

Descriptive headings and appropriate cross-references would link the requirements of the ISA and the related application material.

The bold type lettering convention would not be used.

Redrafting Checklist

Structure

• Does the introduction to the ISA clearly explain:
 	
  o its purpose and the objective(s) that the auditor must achieve?
 	
  o how the individual ISA fits within the corpus of standards?
	If not, consider redrafting.

• Are appropriate headings and subheadings used to assist in navigating the standard?	If not, consider redrafting.

Length

• Is the material discursive in nature?	If so, consider deletion.
• Is the material "background" or "educational" in nature?	If so, consider deletion.
• Is the material repetitive or duplicative of guidance expressed elsewhere?	If so, eliminate and cross-reference, as necessary.
• Does the scope of the ISA result in a substantial degree of repetition with other ISAs?	If so, consider whether the material in the ISA or the related ISAs can be redrafted to reduce or eliminate duplicate material.
• Is there more than one example provided for illustration purposes?	If so, consider whether the additional examples are necessary, or whether the requirement needs to be clarified.
• Does the material deal with matters that are relevant globally?	If not, consider deletion.

Understandability

• Are sentences concise and written in simple English?	If not, consider redrafting.
• Are sentences written in the active voice?	If not, consider redrafting.
• Is the paragraph very long?	If so, consider whether: (i) it can be split into two or more paragraphs; or (ii) the use of bullet points or tables would assist in readability.
• Is the phraseology used complex or are there phrases that could be defined once to avoid cumbersome drafting?	If so, consider deletion or redrafting.
• Are considerations relating to the audit of smaller entities easily identifiable?	If not, consider use of appropriate headings or a separate section in the application material to highlight relevant guidance.
• Are words used known to result in translation problems?	If so, consider alternative wording or define the word.

Appendix 4

Comparison of Current and Draft Preliminary Revised Preface Wording

Current Preface Wording	Exposure Draft Wording	Draft Preliminary Revised Wording
<u>Para. 16:</u> The IAASB's Standards contain basic principles and essential procedures (identified in bold type lettering) together with related guidance in the form of explanatory and other material, including appendices. The basic principles and essential procedures are to be understood and applied in the context of the explanatory and other material that provide guidance for their application. It is therefore necessary to consider the whole text of a Standard to understand and apply the basic principles and essential procedures. <u>Para. 17:</u> The nature of the IAASB's Standards requires professional accountants to exercise professional judgment in applying them. In exception circumstances, a professional accountant may judge it necessary to depart from a basic principle or essential procedure of an Engagement Standard to achieve more effectively the objective of the engagement. When such a situation arises, the professional accountant should be prepared to justify the departure."	**Professional Requirements** International Standards contain professional requirements together with related guidance in the form of explanatory and other material, including appendices. The professional requirements contained in International Standards are to be understood and applied in the context of the explanatory and other material that provides guidance for their application. Professional accountants have a responsibility to consider the entire text of an International Standard in carrying out their work on an engagement and in understanding and applying the professional requirements of the relevant International Standard(s). Not every paragraph of an International Standard carries a professional requirement that the professional accountant is expected to fulfill. Rather, the professional requirements are communicated by the language and the meaning of the words used in the International Standard and as described in this Policy Statement. International Standards use two categories of professional requirements, identified by specific terms, to describe the degree of responsibility that International Standards impose on professional accountants, as follows: Requirements – The professional accountant is required to comply with a requirement in all cases in which the	International Standards contain objectives and requirements together with related guidance in the form of application material, including appendices. Professional accountants are required to consider the entire text of an International Standard in carrying out their work on an engagement. Professional accountants are required to meet the objective(s) stated in an International Standard by complying with the relevant requirements of the International Standard, and by performing procedures that, in the professional accountant's judgment, are deemed appropriate in the particular circumstances. The requirements are contained in a separate section of each International Standard. They are identified by the use of the word "should." Requirements are relevant to an engagement when material matters exist that make the requirements of the International Standard applicable. The requirements are to be understood and applied in the context of the stated objectives and the application material that provides guidance for their application. The nature of the International Standards requires professional accountants to exercise professional judgment in applying them. In exceptional circumstances, a professional accountant may judge it necessary to depart

circumstances exist to which the requirement applies. International Standards use the word "shall" to indicate a requirement.

Presumptive requirements – The professional accountant is also required to comply with a presumptive requirement in all cases in which the circumstances exist to which the presumptive requirement applies; but, in rare circumstances, the professional accountant may depart from a presumptive requirement provided that the professional accountant documents why the professional accountant decided to do so and how the alternative procedure(s) performed in the circumstances were sufficient to achieve the objectives of the presumptive requirement. International Standards use the word "should" to indicate a presumptive requirement.

If an International Standard provides that a procedure or action is one that the professional accountant "should consider," the consideration of the procedure or action is presumptively required, while carrying out the procedure or action is not.

The professional requirements of an International Standard are to be understood and applied in the context of the explanatory and other material that provides guidance for their application.

A professional accountant complies with the professional requirements of International Standards that are relevant to the engagement, that is, when material matters exist that make the professional requirements of the standard applicable. A professional accountant should represent compliance with International Standards only upon

from a requirement of an International Standard to achieve more effectively the objective(s) of the requirement. When such a situation arises, the professional accountant should document how the alternative procedure(s) performed in the circumstances achieved more effectively that objective(s).

If an International Standard provides that a procedure or action is one that the professional accountant "should consider," the consideration of the procedure or action is required, while carrying out the procedure or action is not.

A professional accountant should represent compliance with International Standards only upon complying with all relevant requirements of the International Standards.

The application material contained in International Standards is intended to provide further explanation and guidance on the requirements, and may identify and describe other procedures or actions relating to the activities of the professional accountant. While a professional accountant has a responsibility to consider the whole text of an International Standard in carrying out the work on an engagement, such guidance is not intended to impose a requirement for the professional accountant to perform the suggested procedures or actions. Rather, these procedures or actions require the professional accountant's attention and understanding; how and whether the professional accountant carries out such procedures or actions in the engagement will depend on the exercise of professional judgment in the circumstances consistent with the objective of the International Standard.

Appendices, which form part of the application material, are

complying with all relevant professional requirements of the International Standards.

Bold type lettering is used in paragraphs within an International Standard to identify professional requirements for purposes of aiding overall readability.

Explanatory Material

International Standards contain explanatory material that is intended to provide further explanation and guidance on the professional requirements. Such explanatory material is intended to be descriptive rather than imperative. That is, it explains the objective of the professional requirements (where not otherwise self-evident), why the professional accountant should consider or employ particular procedures, depending on the circumstances, and provides additional information for the professional accountant to consider in exercising professional judgment in performing the engagement.

Explanatory material may also identify and describe other procedures or actions relating to the activities of the professional accountant. While a professional accountant has a responsibility to consider the whole text of an International Standard in carrying out the work on an engagement, such guidance is not intended to impose a professional requirement for the professional accountant to perform the suggested procedures or actions. Rather, these procedures or actions require the professional accountant's attention and understanding; how and whether the professional accountant carries out such procedures or actions in the engagement will depend on the exercise of

an integral part of an International Standard. The purpose and intended use of an appendix are clearly explained in the body of the related International Standard or within the title and introduction of the appendix itself. The use of appendices may vary depending on the subject of the International Standard.

	professional judgment in the circumstances consistent with the objective of the standard. **Appendices** Appendices are an integral part of an International Standard. The purpose and intended use of an appendix are clearly explained in the body of the related International Standard or within the title and introduction of the appendix itself. The use of appendices may vary depending on the subject of the International Standard.	

Tentative Project Timetable - Clarity   **Appendix 5**

Projects	June-05	Sept-05	Dec-05	Mar-06	May-06*	July-06	Sept 06	Dec 06	Mar 07	June 07
Clarity of IAASB Standards										
• Revised proposals and draft re-drafted ISAs 315 and 240	Full Review									
• Re-drafted ISAs 200, 315, 330, 240, 500 and principles		Issue ED		Update	Full review and Issue Final					
• Re-drafted ISA 700							Issue ED			Full review /Issue Final
• Re-drafted ISA 220 and 300								Issue ED		
Estimates (revised ISA 540)**		~~Full Review~~	Full Review ~~Issue Final~~		Issue Re-ED (redrafted)			Full review / Issue Final		
Materiality (revised ISA 320)		~~Full Review~~	Full Review ~~Issue Final~~		Issue Re-ED (redrafted)			Full review / Issue Final		
Documentation (revised ISA 230)	Full Review	Issue Final						Issue ED		
Communications (revised ISA 260)			Full Review	~~Issue Final~~		Issue Re-ED (redrafted)			Full review / Issue Final	
Related Parties (revised ISA 550)	Issue ED			Full Review	~~Issue Final~~	Issue Re-ED (redrafted)			Full review / Issue Final	
Group Audits (revised ISA 600)			Full Review	~~Issue Final~~		Issue Re-ED (redrafted)			Full review / Issue Final	
Special Purpose Audit Engagements (revised ISA 800)	Issue ED			Full Review	~~Issue Final~~		Issue Re-ED (redrafted)			Full review /Issue Final
Modifications to the Auditor's Report (new ISA 701)			Full Review	~~Issue Final~~			Issue Re-ED (redrafted)			Full review /Issue Final
Representations (revised ISA 580)	Issues Paper	First Read	~~Issue ED~~			~~Full Review~~	Issue ED ~~Issue Final~~			Full Review
Review of Interim Fin. Information	Issue Final									
Using the Work of an Expert		~~Issues Paper~~	Issues Paper	First Read		Issue ED			Full Review	Issue Final

* Additional IAASB Meeting

** Consideration will be given to whether the redrafted ISA 540 (following the clarity proposal) should subsume some or all aspects of ISA 545, as part of the effort to reduce duplicate guidance.