

## Clarity ED and Consultation Paper – Respondents’ Comments – General Statements

### Comment

AASB CICA	<p>The AASB fully supports the IAASB’s efforts in this area and is following the IAASB project with great interest. The AASB believes that it is important to improve both the clarity of professional standards and the structure of standards. It has undertaken a project that will address this issue with respect to Canadian auditing and assurance standards. The AASB’s task force is undertaking this project in two phases. The first phase is to develop a hierarchy of the authority of the auditing and assurance guidance that a practitioner may refer to when performing an assurance engagement. The AASB issued an exposure draft on this hierarchy in October 2004 titled “Authority of Auditing and Assurance Standards and Other Guidance”. We find that the proposals in the ED are largely consistent with the Canadian exposure draft. The second phase of the AASB project is to monitor the IAASB’s Clarity Project and consider the implications of that project on the terminology and structure of Canadian auditing and assurance standards.</p>
ACCA	<p>At its simplest level, the Proposed Policy Statement could be viewed as proposing simple changes to reduce possible ambiguity in existing pronouncements. Because of the difficulty of making some changes (for example, eliminating the use of the present tense), however, IAASB proposes that such changes be made on a prospective basis. This would mean that users would have to cope with two sorts of presentation of standards in the medium term. Moreover, the fact that such an extensive change is thought to be necessary calls into question the advisability of making it without also incorporating the benefits of proper consideration of the wider issues of clarity.</p> <p>We believe that establishing the fundamental principles of auditing is an important driver of the quality of auditing standards. We also believe that extensive change is required to International Standards on Auditing (ISAs) to make them usable outside major capital markets as well as inside. A change to a ‘think small first’ basis of preparation is vital to facilitate the adoption of ISAs in jurisdictions where small and medium-sized enterprises are the drivers of economic growth and development.</p> <p>The examples that have been provided in the exposure draft show how existing standards might appear after the application of certain of the proposals. We are all concerned that the number of mandatory requirements has substantially increased. If, when revising standards, similar thinking were applied in a real-life situation, many hundreds of extra requirements would be added to ISAs. This would be incompatible with the proper application of a principles-based approach. It is important that auditors devote sufficient attention to the specific circumstances they face in order to respond appropriately to risk. There is a danger that attention will be diverted to performing procedures in a mechanical fashion and this ‘box ticking’ approach will devalue the audit. In addition, such a mechanical process will not attract talented individuals into the auditing profession and that may result in long-term problems in audit quality that are inherently difficult to redress.</p> <p>We welcome the decision to issue a Consultation Paper allowing consideration of the wider aspects of clarity in relation to the Proposed Policy Statement. We believe that the time is right to begin a full consideration of the fundamental principles of auditing and the objectives and nature of auditing standards. We caution against making short-term changes to the presentation of existing standards when resources would be better devoted to improving their quality and usability for all audits.</p> <p>We do not underestimate the difficulty of, or time needed for, such considerations. It is important that, at the beginning, IAASB undertakes a separate and rigorous process of stakeholder engagement to identify the fundamental principles underlying an audit.</p>

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AICPA

We are concerned that if a narrowly focused clarity project goes ahead in the short term it will result in a proliferation of mandatory requirements. These will detract from the many advantages of a principles-based approach to auditing in which auditor judgement plays a vital role. A ‘tick-box’ approach to auditing will not serve investors well if a new Enron is in prospect.

We would like to commend the International Auditing and Assurance Standards Board (IAASB) on the issuance of this exposure draft. We support the goal of improving the clarity of International Standards issued by the IAASB. However, as we discuss below, we believe that most of the proposals in the exposure draft do not go far enough to increase clarity, and will in most cases, lead to less clear guidance for practitioners.

We believe that the following conditions are necessary for determining the clarity of an International Standard:

- The most important condition for clarity is the clear and consistent use of the English language. If this condition is not met, professional accountants cannot be expected to interpret and apply the standards appropriately; and translations into other languages are more likely to misconstrue the spirit and intent of the standards.
- The authority in the standards to impose a requirement (or presumptive requirement) should be clearly defined by the language that imposes the requirement.
- The clarity of the standards should not be determined by their length.
- Auditing standards should be based on fundamental principles, however we believe that auditors around the world benefit from clear and concise guidance on how to apply those principles.

We believe that clarity cannot be achieved unless these foregoing conditions are met.

The mission of the IAASB is to establish high quality auditing, assurance, quality control and related services standards and to improve the uniformity of practice by professional accountants throughout the world, thereby strengthening public confidence in the global auditing profession and serving the public interest. We believe that to achieve its mission, the first step is for the IAASB to adopt the definitions of shall (or must, as we recommend) and should as outlined in this exposure draft. Further, we believe that in order to implement this proposal, the IAASB must establish a set of principles to be followed in setting the standards that will define what is or is not a requirement. Finally, we believe that the structure of each standard should be considered on a case by case basis, but that each standard needs to include all the requirements that are necessary to achieve the objective and provide sufficient context for the auditor to understand the requirements.

APB

...Although APB has adopted ISAs in their entirety, the Board has noted that the more recent standards issued and proposed by IAASB are:

- Increasingly long and detailed,
- Contain a large number of imperative ‘shoulds’, and
- Seem to be written mainly for the audits of large entities.

APB is concerned that this recent trend may not necessarily result in improvements in audit quality and, if accentuated, could conversely lead to a deterioration in audit quality. In APB’s view a number of the proposals included in the IAASB paper on clarity seem likely to accentuate the trend. In particular, the APB fears that the proposals contained in the

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IAASB Exposure Draft will lead to an overwhelming number of requirements that will be applied with a 'check list mindset' which will detract from experienced practitioners adopting a thoughtful and sceptical assessment of the risks of financial statements being misstated and then performing work in response to such risks.

### *1. Strong APB support for the development of 'fundamental principles.'*

APB believes that IAASB should give a high priority to developing a framework of fundamental principles and should not commence its project to clarify the language in existing ISAs until this has been finalised. A framework of principles would:

- Inform IAASB when distinguishing 'shall' and 'should' requirements,
- Assist auditors and users of financial statements understand what is required of auditors, and why.
- Avoid a 'rules-based' mindset from developing where auditors follow the 'letter' rather than the spirit of the Standards, and
- Reduce the risk that by building from the 'bottom-up', IAASB will create an unacceptably complex set of auditing standards which will have a negative impact on audit quality.

### *2. Strong APB support for undertaking all aspects of the 'clarity' project simultaneously.*

APB supports IAASB in seeking to ensure that international auditing standards should be clear to all parties; without this there will be inconsistencies in the application of the standards and an inadequate basis for audit monitoring and disciplinary actions. However,

APB does not see this as a 'burning priority' and believe that this should be undertaken as part of a broader 'clarity' initiative, all aspects of which should be undertaken simultaneously. Features of a broader project that APB would support are:

- Writing the standards in simple English using short sentences to facilitate understandability and translation,
- Separating the Standards from application guidance,
- Integrating auditing and ethical standards for auditors, and
- Conforming, as far as possible, the style and structure of international auditing standards with international accounting standards.

### *3. Encouragement to IAASB to link the 'clarity' project with an international convergence strategy.*

Rather than treating 'clarity' as a discreet project APB believes that it should be seen as part of the wider challenge of 'convergence' in international auditing standards. One approach to the issue of convergence would be to identify those aspects of the Standards that need to be implemented throughout the world consistently (and may therefore need to be translated verbatim) from those aspects that are best tailored to national circumstances (and for which a more flexible translation approach can be adopted). The benefit of this approach would be that guidance could be written in a manner to achieve effective implementation of the standards in different languages and cultures. Adopting this viewpoint would also assist IAASB in determining which, if any, of the existing IAPs need to be retained.

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*4. Encouragement to IAASB to defer implementing any of the aspects of the current ‘clarity’ project until the important ISAs have been updated and the fundamental principles have been developed and then to adopt a ‘big-bang’ approach to implementation.*

APB believes that revising the ISAs on a prospective basis is likely to be confusing for auditors, audit regulators and users of audited financial statements. We strongly recommend a big-bang’ approach having completed the:

- Updating of the remaining ISAs using the existing convention,
- Development of the fundamental principles, and
- The adoption of an international convergence strategy.

Achieving clarity in IAASB pronouncements is vital but, as previously explained, the APB is very concerned that some of the current IAASB proposals, if taken in a piecemeal manner, could lead to deterioration in audit quality. The APB encourages IAASB to defer implementing any of the aspects of the current ‘clarity’ project until all of the important ISAs have been updated and the fundamental principles have been developed.

AUASB

The AUASB supports the IAASB’s proposals to improve the clarity, consistency and degree of responsibility attached to professional requirements in International Standards on Auditing (ISAs). Our comments on the questions listed in the exposure draft are attached. As you are probably aware, the AUASB was recently reconstituted as a statutory authority. The AUASB is required over a two-year transition period to make and issue auditing standards as delegated legislation, which will be enforceable by the Australian Securities & Investments Commission from 1 July 2006. Accordingly, the AUASB believes requirements in auditing standards need to be clear and capable of being readily complied with by auditors.

To that end, the AUASB’s preference is for the IAASB to expeditiously proceed towards concluding upon its principles, conventions, procedures and overall approach to adoption of the clarity proposals for re-engineering ISAs. Consequently, we encourage the IAASB to begin redrafting ISAs in accordance with the clarity proposals, with a view to re-issuing all ‘clarified’ ISAs at the one time. A full and complete (‘big bang’) approach will ensure auditing standards are operative on a consistent basis, without the need for two subsets of standards, that is, ISAs that have versus those that have not been subject to the clarification proposals. We do not believe it is desirable to have auditing standards with differing degrees of responsibility in the market at the same time.

Alternatively, if a retrospective approach (wherein all ISAs are revised and reissued at the one time) is not adopted, we strongly encourage the IAASB to:

- finalise the clarity proposals, in regards to the principles, conventions, protocols and methodology that it will adopt to make ISAs in accordance with the new drafting conventions; and
- publish a Work Program indicating the likely time frame for redrafting ISAs in accordance with the clarity proposals.

Additionally, under the alternative option, we support the proposal to issue exposure drafts, issued during the transition period, that reflect the new drafting conventions.

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The clarity project proposals will impact on the AUASB in finalising the way in which auditing standards in Australia are redrafted as disallowable instruments having the force of law. To that end, if the clarity proposals can be finalised within the AUASB's timeframe, that is, preferably in the first half of 2005, then there is potentially an opportunity for redrafting some AUSs and ISAs concurrently, while also retaining significant convergence between Australian auditing standards and ISAs. Of course, if timely agreement on the clarity proposals is not possible, in view of the AUASB's statutory obligations and time constraints, the AUASB will need to determine its own approach.

Basel The Basel Committee on Banking Supervision has a strong interest in high quality and independent audits of banks. Adequate arrangements for the drafting of international standards for auditing ensuring that they are understandable, clear and capable of consistent application are therefore important for banking supervisors.

CEBS As banking supervisors, we...have an interest in ensuring that auditing standards which are the basis for audit work are of a high quality and are clear and capable of consistent application. In general we support the clarity project and the approach that is being proposed in clarifying the proposed categories of professional requirements and the related obligations they impose on auditors. However, we do have some reservations about the precise words that are being proposed and the way in which it is suggested the project will be implemented. Though we do not have strong feelings about the restructuring of the ISAs, we do believe it is important that a principles based approach is taken to the ISAs, supported by detailed requirements to ensure that there is clear and consistent application of the ISAs. We would therefore welcome the proposed identification of fundamental principles of auditing.

CGA We generally agree with the approach that has been taken and wish to lend our support to the positions expressed in the exposure draft. The direction that the IAASB is progressing, in our opinion, is appropriate. With regards to the concern about the length and complexity issue, as we all know these are complex times in the accounting profession. It is better to be lengthy and cover all the relevant issues than to be too brief and leave the readers wondering what the point is.

CIPFA We agree that the issue of clarity in auditing standards is of great importance and that the increasing length and complexity of some recently issued auditing standards represents a considerable burden, particularly on small auditing practitioners, without any proportionate benefit in terms of audit quality. We do not however believe that the current consultation addresses the issues in a satisfactory manner. In particular, we are extremely concerned at the IAASB's stated intention that 'the delay in resolving the issues addressed in the consultation paper should not preclude the adoption of the proposals in the exposure draft, subject to comments received on exposure.' The consultation paper attempts to make the case for a number of radical changes on the basis of arguments from principles. The policy statement, on the other hand, proposes to make major changes in the wording of international standards on auditing, justified on the basis that the current wording conventions are confusing but without any attempt to explain why the proposed changes are superior to other alternatives.

We believe that the proposed changes in the policy statement should not be implemented without a high level of international agreement over the fundamental principles dealt with in the consultation paper. Accordingly, we do not agree that the new requirements contained in the proposed policy statement should be implemented for periods commencing on or after 15 June 2005. Implementation should not proceed until there is a significant degree of consensus on the fundamental principles set out in the consultation paper; this will require a postponement of at least one and possibly two years.

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### *Simultaneity of the two aspects of the project*

The two French Institutes first wish to express their support to IFAC (and the IAASB) in its stated goal to achieve international convergence in audit on the basis of the ISAs. The French Institutes believe in the benefits for everybody of achieving international convergence in audit. The two French Institutes have, however, repeatedly expressed their concerns for at least the last two years about the increasing length and complexity of the IAASB standards and the related drift towards standards which are becoming more and more “rules based”, despite the continuing assertion by the IAASB that they are “principles based”. They have highlighted the risks of the impact of this drift on the overall audit approach per se, which could become more procedural, as well as the difficulties this creates in the adoption of international standards within national standards and the application of the standards by auditors in the audits of entities of all sizes including SMEs. They believe that this drift could constitute a threat to the achievement of international convergence in auditing on the basis of ISAs. These difficulties were expressed in January 2004 at the national standard setters meeting and were shared by a vast majority of the countries represented. The same concerns were also expressed in a report by Peter Wong published in September 2004, on this very topic: “Challenges and Successes in Implementing International Standards: Achieving Convergence to IFRSs and ISAs”. On page 13 it is noted that “participants were of the view that the international standards are increasingly becoming longer, more complex, and rules-based, and the structure and complexity of the standards are affecting largely, in an adverse way, both their adoption and implementation”. On that same page, the report also states that “it is recommended that the international standards setters become more attuned to the challenges national standard setters and preparers, auditors and users of financial statements face in adopting and implementing the international standards. In particular, participants recommend that international standard setters develop standards that continue to be principles based and the structure of which lends itself to incorporation in national law or regulation and to implementation.”

Clarity is not only to be sought for the regulator. It should also serve the auditor and it is therefore not only an issue of codifying where the requirements lie in a standard; it is also a question of producing a text which is sufficiently and universally understandable so as to drive the behaviour of the auditor in every cultural context. Culture is a very important element in the debate between long detailed “rules based” standards and shorter more “principles based” standards. What can be seen as driving the behaviour of the auditor in one cultural context can be counterproductive in another.

For this reason, the two French Institutes wish to clearly state that they support the overall “clarity” project only if the two aspects of the project, i.e. the “codification of the language” and the “restructuring” are carried out simultaneously.

They consider the “codification of the language” side of the project would entail great risks if it were to be carried out alone, since they consider that it would not solve in any way the problem of understandability and clarity of the standards.

They consider that “codification of the language” alone carries with it a significant risk of drifting towards even more “rules based” standards because it can only result in an increase of the number of “shall(s)” and “should(s)”. Such an increase could turn the audit into a purely procedural (“tick the box”) approach where the role of the auditor’s professional judgement would no longer be prevalent. The French Institutes consider that it could therefore result in a decline of the overall audit quality.

The French institutes consider that what is most important is the clarity and understandability of the standards for all the practitioners, including those responsible for the audits of

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small entities and who perceive the standards to be more and more irrelevant to their audits. Similar views are also expressed in the Wong report where it is stated on page 16; “with respect to ISAs, participants were of the view that the focus of ISAs has changed from the audits of financial statements of entities of all sizes to the audit of financial statements of large, complex, public interest, and often multinational entities. The ISAs are progressively becoming more difficult to apply to the audits of financial statements of small entities.”

The French Institutes therefore support the clarification of the ISAs which should be achieved by:

- Working on identifying the fundamental principles underlying an ISA audit.
- Separating in two distinct documents the principles and the requirements from the application guidance.

The French Institutes consider that by first separating the principles and the requirements from the application guidance this would help to clarify where the exact responsibilities of the auditor lie. This could then be followed by the “codification of the language” aspect of the project.

The French Institutes therefore only support the exposure draft on the proposed policy statement “Clarifying Professional Requirements in International Standards issued by the IAASB” if the following aspects of the Consultation Paper “Improving the Clarity and Structure of IAASB Standards and Related Considerations for Practice Statements” are re-inserted in the exposure draft:

- The definition of the fundamental principles underlying an ISA audit
- The use of those fundamental principles as the driver to a “shall” requirement
- The application of option A to, at least, the standards of the audit risk model (ISA 315 and ISA 330) and “Fraud” (ISA 240), where the work has already been done, as this will provide illustrative examples and test the proposal.

### *International Convergence*

The French Institutes consider that the restructuring of the standards would certainly help the IAASB to adopt a clear convergence policy which would be viable for most Member Bodies and Regulators. A strict convergence policy could be set for the “professional requirements and principles” side of the standard whilst, at the same time, allowing more flexibility to adapt the application guidance to the national environment. This would facilitate the acceptance and, consequently, the implementation in practice of the standards by national practitioners. It would also indicate to the Regulators and other stakeholders that the professional requirements and fundamental principles of an audit are harmonised around the world and that international convergence is progressing.

### *Translation*

The French Institutes foresee translation difficulties, if “shall” and “should” are to be used to identify professional requirements in the standards. The nuance between the two would be difficult to convey in French. Furthermore, irrespective of the of the translation difficulties, the French Institute considers that the word “must” is clearer than “shall” in the English language.

DnR In general, we welcome the proposals which should serve to enhance the clarity of IAASB standards. The perceived clarity of the ISAs is particularly important at this time in

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Norway and elsewhere in Europe as the adoption by law of ISAs is being considered. In general, we support the main proposals which reflect sound reasoning about important issues of great importance to the future auditing standard setting. However, we urge that IAASB consider the possibility of taking some of the proposals further, as set out in our comments to your specific questions below.

We are strongly supportive of IAASB’s overall objective to serve the public interest by setting high quality international auditing standards, and continually improving those standards over time, and believe the proposed Policy Statement and Consultation Paper, taken together, are a significant contribution towards establishing the means of achieving that objective.

We especially see them as an important factor in ensuring that the standards are understandable by those who perform audits, are clear and are capable of consistent application.

As noted in the Consultation Paper, the challenge for IAASB is to issue high quality auditing standards that, among other things, meet the three following objectives:

- They are recognized by the various regulators around the world;
- They are accepted by the profession at the international and national levels;
- They are applicable to and are applied in practice by all auditors for all audits, regardless of the size and structure of their firm or of the entity audited.

Successfully balancing these objectives is a significant challenge. To better understand this challenge we identified three major issues with respect to the clarity of auditing standards:

- Definition of the terms to describe requirements and guidance
- Principles by which the board determines requirements including the level of their specificity
- The organization of requirements and guidance

We agree with the Board’s proposal to define requirements and presumptive requirements and discontinue the use of the present tense. Because the Board did not address the issue of how to determine the requirements, we do not believe that the ED and CP provide a basis for resolving the continuing issues about the number and specificity of requirements. We provide some thoughts on the matter below. Some of our member firms believe that restructuring is essential. Others do not believe it is necessary or urgent. Nevertheless, we support option B provided that the requirements are sufficiently specific to meet the principles we propose below.

The Board must address the three issues mentioned above substantively and timely to retain credibility as a standard setter. Accordingly, the Board needs to demonstrate action rather than entirely relegate the issues to lengthy study. Actions to address clarity issues must also engage the user community constructively to agree on the level of specificity of requirements. To accomplish this we propose the following actions:

1. Agree on the definition of terms as described in the ED by December 2005. In so doing, the Board will be taking decisive and substantive action on a timely basis to promote convergence and to clarify what is required in the existing literature. The question of whether the requirements are sufficient or overly detailed in the existing literature is a different question that should be addressed prospectively.
2. Seek a dialog with regulators, investors and appropriate parties concerning the level of detail of the requirements and the principles on which the board decides what the



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requirements are and their level of specificity. The obvious forums for discussions are the Consultative Advisory Group (CAG) and the national standard setter's forum. If the various parties are willing to make a good faith effort to achieve a satisfactory compromise, the resulting prize of a single set of internationally recognized, high quality auditing standards, realistically capable of being implemented by audit practitioners around the globe, would be well worth that effort. We will be pleased to contribute in this debate.

3. Agree on principles by which the Board will determine what requirements are, their level of detail and whether they are absolute or presumptive by December 2005. Our thoughts are:

Requirements should:

- Describe an audit in sufficient detail to provide a framework for understanding the objectives of the audit and appropriate responses by the auditor to those objectives,
- Be necessary to performing an effective audit,
- Promote a reasonable degree of consistency in performance, and
- Be capable of reasonable measurement of performance.

Absolute requirements generally should be applied to higher level descriptions of principle. Presumptive requirements are better suited to more detailed descriptions of procedures or considerations because all circumstances cannot be foreseen.

Implementation of changes all at once is not possible because of the length of time it would take to revamp all the existing standards. Accordingly we recommend

- Apply the definitions of requirements to existing standards as of January 1, 2006
- Apply the principles for determination of the requirements and the new structure of standards to exposure drafts issued beginning January 1, 2006
- Update all the existing standards as of January 1, 2006 over a 5 year cycle.

This approach combines immediate action to promote understanding of the requirements with an orderly approach to resolving the use of the present tense in the existing standards.

EC The IAASB should give the highest possible priority to this project, in particular compared to the development of new standards. This is of paramount importance for the EU which might move to ISA in the next years. As such, the language and structure of standards with which the EU is going to live for a long period of time are key matters. At this point in time, we particularly welcome this initiative to consult on both language and structure of the standards. This is a unique opportunity to meet the criteria for a smooth adoption by the EU.

We have summarised our views below:

- We generally support upgrading the language and structure of ISAs. Language: we support the use of "should" and "shall" (although we have a slight preference for "must" instead of "shall"). Structure: separating the standards from the guidance in one way or another is key. We favour Option A offered in your exposure draft.
- The European institutions have decided to improve their legislative approach through the Better Regulation program. This is meant to ensure that regulation is proportionate, but also effective and enforceable once adopted under EU law. Ensuring that the regulatory environment and effective implementation is simple and of high quality is a key

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objective of the European Union.

- We invite the Board to ensure that ISAs will remain as principle based as possible. We believe that principle based approaches are the best way to address all types of situations in the field. Principle based approach leaves enough room for “professional judgment”, and avoid the inflation of too detailed prescription. The prominence of ethical professional behaviour is reminded in the Commission proposal for a Directive on statutory audit. In addition, a principles based approach is bound to help auditing standards converge throughout the world. We consider that this will be a key for the future success of ISAs.
- We would support any consideration to accommodate the specificities of the audits of SMEs, and inclusion of the Board’s conclusions in the conduct of the “Clarity” project.
- When going through the policy statement and consultation paper, it appears clearly to us that it would be more effective to revise the standards, not only in respect of their language, but also in respect of their structure. This is why we support designing a set of clear drafting guidelines encompassing such issues as language (use of “shall” or “must”, “should”), principle based approach, provisions proportionate to the objective pursued, and considering SME issues. We urge the Board to state such drafting guidelines in Statements with sufficient authority.
- Finally, the question of how to apply “Clarity” to the existing standards, and the timing thereto, is key. The Commission and assisting committees may start reviewing certain aspects related to ISAs starting 2005 or 2006 with the view of a possible subsequent adoption of ISAs. We therefore support the retrospective application, even at the cost of delaying the Board’s current work program for a few months. The Board should publish an agenda for the review of the standards with “Clarity”, so that the complete revision of the standards is performed by mid 2007.

EY

We welcome the opportunity to contribute to the debate over the clarity, style and structure of International Standards issued by the IAASB. It is important that the structure, style and clarity of International Standards drive the delivery of quality audit and assurance services, and we believe that having a rigorous and effective set of standards that are capable of consistent application hinges on getting them clear, unambiguous and understandable.

We have some comments on the proposed Policy Statement and Consultation Paper, and our views are described in detail later in this letter. However, in summary, our overall conclusions are:

- We support the IAASB’s proposal to discontinue the use of the present tense in relation to actions by the professional accountant;
- We support the use of bold lettered text to highlight the professional requirements and related obligations imposed on the professional accountant;
- We support the use of ‘should’ to denote a professional requirement, but have concerns over the attempt to distinguish professional requirements and presumptive requirements by the use of ‘shall’ and ‘should’ for reasons that are set out in detail later in this comment letter;
- We support the proposal to document any departures from professional requirements;
- We strongly prefer the current structure of International Standards, with the use of bold lettered text to denote requirements, and grey letter text for guidance, rather than the other options proposed;
- We support the IAASB’s proposal to apply changes on a prospective basis, but would recommend that IAASB also embark on a project to reword the entire body of ISAs over a three year period, giving priority to the recently issued standards on risk assessments and fraud;
- We would support a debate and further consultation about the adoption of ‘fundamental principles of auditing’, which we believe would be of value.

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### Overall Comments

- 1 We considered our response to the proposed Policy Statement and the Consultation Paper together, and these overall comments apply to both documents. The answers to the questions posed within the documents have been cross referenced to this section where applicable.
- 2 References to paragraph numbers in normal style refer to the numbered paragraphs within this letter; references to paragraph numbers in *italics* refer to the numbered paragraph within the Policy Statement or Consultation Paper.
- 3 We will also refer to the illustrative examples which were provided in making many of our points below. We would like to compliment the IAASB on the inclusion of these examples – they served the purpose of demonstrating the changes proposed by the IAASB very clearly.

### *Present tense*

- 4 We support the IAASB’s proposal to discontinue the use of the present tense in relation to actions by the professional accountant. We believe that this change will aid clarity and make standards and other guidance easier to understand and translate.
- 5 Whilst the benefit of the use of the present tense provides the simplest and most direct sentence structure, the point raised in the Explanatory memorandum to the Proposed Policy Statement (page 7) is valid – the use of the present tense can be confusing in interpreting whether an action is optional or imposes an obligation. This would be a particular issue on translation from English.
- 6 In addition, reading the illustrative examples was easier where the text has been amended to demonstrate the proposed changes, because the wording was less stilted as the tense was drafted to make the IAASB’s intentions clearer.

### *Use of Should and Shall*

- 7 We support the use of bold lettered text and language to highlight the professional requirements and related obligations imposed on the professional accountant. However, we believe that the use of ‘shall’ and ‘should’ to distinguish ‘requirements’ and ‘presumptive requirements’ is an unnecessary distinction which is hard to sustain.
- 8 We therefore recommend that a single word be used throughout to denote a ‘requirement’, with a very strong and explicit presumption that this requirement would seldom be departed from. Where a departure occurs, a documented explanation, as set out in *paragraph 4* of the Policy Statement (ie the action to be taken for a presumptive requirement) would be required in all cases.
- 9 The distinction between ‘requirements’ and ‘presumptive requirements’ will not add to clarity, especially for non-native English speakers. Firstly, it is more difficult for a non-native English speaker to understand when reading the English text. And, it is also more difficult to ensure an accurate translation - not all languages have an easily translatable distinction between ‘shall’ and ‘should’.
- 10 In developing the drafting rules for requirements, care should be taken over two other matters, as explained below.
- 11 Firstly, we have a particular concern with the use of ‘should consider’. The illustrative example demonstrated how difficult it is to use appropriately. For example,

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in *paragraph 25*, ‘The auditor should consider whether local regulations specify...’, its use is entirely appropriate. However, in *paragraph 9*, ‘The auditor should consider performing *other procedures* where *in the auditor’s judgement* the information *may* be helpful...’ (italics added for emphasis), it produces a presumptive requirement that is vague and too widely drafted. Another example where the use of ‘should consider’ results in too vague a requirement is to be found in *paragraph 14*, in which the ‘the auditor should consider whether information ... *may* be helpful...’ We do not believe that it is appropriate that these examples would be presumptive requirements.

- 12 Because statements with ‘should’ require an explanation if they have been departed from, the auditor will need to evidence that a ‘should consider’ has been dealt with: the level of documentation quickly becomes an issue when attempting to justify a decision against a widely drawn requirement where the auditor has judged that no further procedures would be helpful, ie where there are no additional procedures to evidence that the requirement has been considered.
- 13 Secondly, requirements need to be complete. For example, in the illustrative example, there are a number of instances where the ‘should’ or ‘shall’ is qualified, for example, at *paragraph 36*, ‘..., including performance measures used by management *and others...*’ or, at *paragraph 8(a)*, by ‘...inquiries of *others...*who *may* have information...’. Where a requirement exists, it should not be qualified in a way that is vague or open-ended, for the reasons set out in paragraphs 11 and 12 above.

FAR

FAR has introduced new standards on auditing in Sweden RS effective for statutory audits for periods commencing on or after 1 January 2004. The RSs are based on a translation of the ISAs with additions of requirements and guidance imposed by Swedish laws and regulations.

However having had no obvious difficulties with clarity and structure of the translated ISAs so far, the length and complexity of the ISAs issued by IAASB in recent years in our view highlights such matters as overview, understanding and user friendliness of the ISAs. Thus, to us, the issue of clarity is more about those matters than about restructuring the professional requirements. A restructuring that would risk opening for a process resulting in additional requirements without obvious merit (see also our answers to Policy Statement-questions 2, 3 and 7 below).

The challenge for IAASB is to produce standards and guidance that strike the proper balance of being excellent and logical technically and being understandable and operational for everyday use by the auditor as well as being understandable for those representing the public interest. IAASB would need to accept that such a balance is necessary as (or if) the Board wants to achieve that the ISAs should be internationally accepted and seen good enough for an audit regardless of the size both of the practitioner’s operation/firm performing the audit and of the entity’s operation being the subject of the audit. We believe that there should be and in fact is no contradiction in achieving this proper balance. And we believe that taking into account our comments and proposals below would be helpful for the IAASB in such efforts.

### *Improving overview, understanding and user friendliness of the ISAs*

We would like to share with you for your consideration the following views related to improving overview, understanding and user friendliness of the ISAs and thus being important drivers to improve clarity and structure of the ISAs as well as the quality of audits. Our proposals below are not related to the restructuring, if any, of the ISAs as a result of your exposure. They are relevant regardless of any action from IAASB in that respect.

The present trend noted above towards longer, more detailed standards is a problem. One overarching problem is to see, overview and understand the message of the standard. In addition one major shortcoming of the present ISAs is the lack of description of the thinking behind the standard. We propose the following.

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- Introduce the standard better including establishing a linkage between fundamental principles underlying an ISA audit and professional requirements in the standard. At present the purpose of a standard is very scantily and technically mentioned. The requirements of the standard are counted at the beginning of a standard however not put in the broader audit context where the standard is a mean. It would be better to describe briefly but still comprehensively the audit objective that is to be met by the standard and the role the particular standard has in the whole ISA-picture. Summarize, applicable to the standard in question, the audit environment and the thinking behind it. Picture how the objective is supposed to be met by linking the thinking to the fundamental principles underlying an ISA audit. Picture in its turn how that would result in audit steps that would make either of the two categories of professional requirements fairly obvious. The aim of such a summary would be to help putting the professional requirements of the particular standard into an overall context. It would contribute to a (better) understanding of the choice and why the choice of the specific respective professional requirements and it would give a clear picture of the objective of the standard, all at the very beginning of the standard. Such a summary is not about to describe the requirements as in paragraph 3 of the present ISA 315 or in paragraph A2. in ISA 315 Application Material in Exhibit 2. In our mind is more a restructure and refocus in line with the above of what is said in paragraph 4 of the present ISA 315 or in paragraph A3. in ISA 315 Application Material in Exhibit 2.
- See and use headings as a pedagogic tool, i.e. make use of more sub-headings so that the “road of thinking” through the standard becomes (more) obvious. Reflect this in the Contents-section to map the standard. To illustrate our point: with reference to ISA 315 Standards in Exhibit II paragraphs 3-7, 8-16 and 17-19 should have sub-headings. A recent very good example to the point from you is the contents section of the proposed revised ISA 540 (10-A page 1 in the New Orleans background papers). It illustrates a very helpful roadmap of the standard and should be the good example for all other ISAs.

FEE strongly supports the initiative of the IAASB to improve the clarity of International Standards on Auditing (“ISAs”). The present standards have been developed over a period of years during which the drafting conventions have changed, and it is timely to consider improving their presentation and clarity as the implementation of ISAs throughout the European Union gathers momentum. This said, FEE also recognises that the existing standards should not be dismissed as in some way inadequate. While their clarity can certainly be improved, FEE believes that they provide sufficient basis for an expert auditor to undertake a good audit or to assess the quality of an audit after its completion. It would be wrong to view the clarity project as a signal that ISAs are not ready to be implemented.

### *...Determining the outcome of the proposals*

Certain paragraphs in section “III Understandability of IAASB Standards” of the Proposed Consultation Paper indicate that the IAASB has yet to determine what the specific outcome of the proposals included in the Proposed Policy Paper and Proposed Consultation Paper will be. It appears that IAASB has not performed significant research to determine for instance to what extent the number of professional requirements will increase. FEE is very concerned at this apparent step into the unknown.

The illustrative examples suggest that adopting the proposed new approach will result in myriad presumptive requirements or “shoulds”, which may have long term consequences for the nature and quality of the auditing profession. This approach will encourage a box-ticking approach rather than the exercise of skilled professional judgement, particularly given the proposed documentation approach. Together, these proposals suggest a narrow view of audit quality which risks emphasising documentation over insight and compliance over thought. We believe that IAASB must be very comfortable that each proposal to add a further “should” is carefully tested to make sure that it will in practice result in better audit quality at an appropriate cost to stakeholders. This is very important as the proposals made will result in radical changes. In FEE’s opinion, it is essential that IAASB should

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link the proposals included in the Proposed Policy Paper to the issues included in the Proposed Consultation Paper. No clarity project resulting in more standards should be carried out without considering and improving the style of the International Standards, including the restructuring of the professional requirements, the identification of fundamental principles and clarification of the status of the Practice Statements; all issues which are considered in the Proposed Consultation Paper.

*Exposure Draft - Proposed Policy Statement, "Clarifying Professional Requirements in International Standards Issued by the IAASB"*  
*Preference for objectives-based International Standards*

FEE has always been a strong proponent of "principles-based" or "objectives-based" International Standards on Auditing. This does not mean FEE supports lightweight standards, with no "rules", from which it is impossible to judge the quality of audit work. Rather, a "principles-based" or "objectives-based" system is one in which specific objectives must be achieved at each stage of an audit in support of the overall opinion, but in which the procedures set out in the standards as necessary to achieve those objectives are limited to those that are essential and where other procedures have to be developed by the expert auditor to fit the circumstances. The onus is on the auditor to explain in the working papers how the objectives have been achieved and how the opinion has been supported. In a "rules-based" or "detailed procedures-based" system, there is an inevitable tendency to lose sight of the objectives while focusing on following all the required procedures. Preparing audit papers that comply with the mandatory procedures becomes an objective in its own right, in the mistaken belief that compliance is an adequate defence after an audit has failed and investors have suffered loss.

FEE is of the opinion that it is essential to the auditing profession that international professional standards are based on a set of robust principles or clear objectives, as opposed to more detailed procedure-based standards. High quality standards based on basic principles or objectives will best serve the public interest by eliciting thoughtful auditor assessment of the particular circumstances of each engagement. In its 2002 Annual Report, IAASB also expresses such a clear preference for the principles-based approach. Once principles or objectives have been set out clearly it is unnecessary to over-elaborate the procedures and actions to achieve these objectives. The professional must be able to exercise judgement on what is appropriate to the circumstances. In deciding on the objectives and how much detail needs to go into standards we believe that:

- An objectives-based approach is appropriate because it provides a flexible framework for a multi-cultural, multi-lingual and multi-jurisdictional environment. Adoption of objectives-based standards and the application of them by numerous countries (in casu member states of the European Union) will work as a driver of high audit quality;
- Standards must be responsive to the changing needs of the public interest, which can be achieved in a more effective way through achievement of objectives than through technical compliance with procedures;
- Auditing is a highly judgemental process that has to adapt to an infinite range of circumstances. An objectives-based approach allows for the use of professional judgement;
- An auditing approach based on robust principles or objectives allows for responsiveness in complex situations or following new developments;
- For auditing techniques to continue to develop there must be space for innovation. Innovation, which is largely driven by competition between firms, would be restricted if their audits were required to follow procedures which have become out of date;
- Quality auditing relies to the greatest extent on the abilities and attitudes of the people in the profession. A profession that puts compliance with procedures above thought and professional judgement, in which innovation and initiative are suppressed by excessive regulation, will not be able to attract and retain people with the ability needed to fulfil their public duty;

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- A unique set of objectives supports the conviction that “an audit is an audit”, according to which the same objectives are applicable to the audit of all entities, regardless of their juridical form, size and ownership (government/private owners), which allows for the harmonisation of professional standards at the national, European and international level;
- Although an objectives-based approach must be supported by a number of essential procedures, that number must be carefully considered, and the “objectives-based” character of the standards must be preserved.

FEE therefore believes that the objectives-based approach to International Standards on Auditing (ISAs) must be retained and strengthened in the future. Any restructuring or clarification of standards must achieve this aim. Because FEE believes in standards being based on principles or objectives it is important that IAASB develops in further detail its proposals for fundamental principles underlying an ISA audit. We comment later on the proposals in Section IV of the Proposed Consultation Paper.

### *Think small first*

We encourage IAASB to give high priority to considering the applicability of its proposals to the audit of small and medium size entities. FEE is especially concerned that some of the findings of the study “Challenges and Successes in Implementing International Standards: Achieving Convergence to IFRSs and ISAs” and of the study “Implementation of International Accounting and Auditing Standards – Lessons Learned from the World Bank’s Accounting and Auditing ROSC Program, September 2004” seem not to have had sufficient influence in the proposals of the Proposed Policy Paper and Proposed Consultation Paper. FEE believes that IAASB should give more weight to the “think small first” principle. If the objectives and essential procedures had regard to their applicability to all entities this would result in clearer and more effective standards. The basic standards could be extended with additional procedures specific for certain sectors or more complex situations.

FEE agrees with IAASB that in addition to objectives, a number of rules or requirements should be included in International Standards, as long as the number of professional requirements remains within acceptable limits. However, FEE is concerned that the proposals for requirements and presumptive requirements as included in the Proposed Policy Paper and as commented on hereafter, risk increasing the number of requirements in an unacceptable way. This is not compatible with an objectives-based standard setting approach and will be a significant additional burden for professional accountants, with a significant risk that it will result in reduced audit quality, both in the short term as attention is diverted to box-ticking when time could be better spent on thoughtful analysis and responses to risks; and in the long term to the extent that talented people may be inhibited from joining the profession. These risks are especially grave for small and medium-sized practitioners on whom an excess of requirements will have a disproportionate impact.

FEE recommends that SME issues should be at the heart of the standard-setting process, not an afterthought. For example, the approach taken in ISA 315 and 330 of adding a few paragraphs on SME audits is not satisfactory and needs reconsideration. There is genuine concern that ISAs are becoming more complex and over-lengthy for all practitioners but in particular for SMPs. Principles-based standards are essential for SMPs since this will help reduce the size and complexity of standards and the burden on them.

### *The use of presumptive requirements and the related documentation issues*

FEE is concerned that the proposals for two categories of professional requirements, i.e. requirements and presumptive requirements, included in paragraphs 2 to 5 of the Proposed Policy Paper, will increase the number of bold type requirements to such an extent that audit quality will not be served. Therefore, FEE recommends IAASB to reconsider the

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proposals as follows:

- Departure from presumptive requirements should be allowed, in fact encouraged, in circumstances where application of such requirements is not meaningful and a more thoughtful approach will achieve the audit objective. Therefore, FEE proposes deletion of the stipulation that the professional accountant may depart from the presumptive requirement only “in rare circumstances”. FEE is especially concerned about the term “in rare circumstances” for characterisation of a presumptive requirement as it results in presumptive requirements that are so close to “shall” requirements as hardly to be distinguishable;
- We agree that departure from presumptive requirements should be allowed if alternative procedure(s) have been performed that are sufficient to achieve the objectives of the presumptive requirement. But it should be unnecessary in this case to impose a documentation burden on the professional accountant in addition to having to document the alternative procedures performed;
- Should presumptive requirements should be imposed as little as possible and should be restricted to those circumstances where performing those procedures or actions is clearly the most effective way to achieve the objective of the presumptive requirement. We note that adopting an objectives approach will require careful drafting by IAASB;
- We favour more frequent use of the presumptive requirements indicated by the words “should consider” whereby the professional accountant is required to consider compliance with the presumptive requirement in all cases in which the circumstances exist to which the presumptive requirement applies but the professional accountant may use his professional judgement to consider to depart from the requirement in the circumstances and is allowed flexibility depending on the circumstances of the audit engagement. This should in our view be encouraged, rather than over-emphasising “should” requirements that may not always be the most efficient and effective procedure;
- We consider that the proposed documentation requirement surrounding the “should consider” requirement needs to be clarified. It seems to be proposed that documentation of the “should consider” is only required if the procedure or action was not considered, but if the auditor has to document not considering the matter does that not effectively mean that the matter will have to be considered. We consider that ordinarily, where procedures are performed and documented it should not be necessary to separately document the “considering”. Also, as above, if satisfactory alternative procedures are performed it should be unnecessary to document why a different procedure was not performed.

### *Basis of application*

In paragraph 12 of the Proposed Policy Paper, it is explained that the provisions of the Policy Statement will apply on a prospective basis. FEE is of the opinion that such approach will be problematic and that the provisions of the Policy Statement included in the Proposed Policy Paper should apply to all existing International Standards as well as to future exposure drafts on the date of final approval of the Proposed Policy Statement. From a practitioner perspective the “first approach” described by IAASB in its Explanatory Memorandum as ‘consisting of developing and issuing for exposure at a single point in time a complete package of all International Standards on Auditing (ISAs), revised following the conventions proposed in the Proposed Policy Statement’, is preferable to a stepped approach whereby the revision of the existing standards is performed following a predetermined time schedule in order to resolve the staff resource issue without compromising the IAASB due process. FEE recommends the ‘first approach’ for the following reasons

- IAASB’s first priority should be to get the existing ISAs adopted by regulatory authorities around the world, including the endorsement of the ISAs by the European Commission. After this is done the IAASB should take the time necessary to clarify and restructure all the ISAs, if necessary putting on hold the issue of new ISAs during this



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restructuring period. This holding period could last from six months to one year and the objective would be to allow countries a stable period for the initial implementation of ISAs. It would also create the opportunity for the IAASB staff and board to do both clarification and restructuring at the same time and to implement “the first approach”;

- Endorsement of International Auditing standards (ISAs) which are based on two distinct approaches or which will all need to be amended in the near future will in our view be more difficult. The existence of two separate sets of ISAs (old and new style ISAs) will not be perceived as contributing towards the quality of auditing;
- In case the ISAs become a statutory instrument, such instrument cannot assign different meanings to identical terminology. From a legal point of view, the language, words and terms used in International Standards should each time mean the same and need to be understood in a uniform way. This would not be the case where two sets of International Standards (old and new) exist. Taking the example of “should”, in many existing International Standards this term is used for requirements which are mandatory whereas in the new International Standards “should” would be used for presumptive requirements, from which the auditor may deviate within certain conditions. If both applications remain unchanged and are to be applied simultaneously it will lead to legal uncertainty and inconsistent application internationally and ultimately undermine acceptance of the ISAs. It would be extremely difficult, for third parties in particular, to ascertain the level of authority pertaining to for instance, “should” statements in any given ISA;
- It will at best potentially be confusing and may not be practicable that professional accountants will need to perform an audit based on two different sets of standards which differ significantly in the level of applicability of technical requirements, types and categorisation of requirements, language, structure and words and terms used. This would result in reduced understanding of the procedures and actions to be performed, personal interpretation of the meaning of International Standards and consequently decreased audit quality;
- Certain EU member states are already adopting the “first approach” to the introduction of ISAs. In those countries it has been widely accepted as a clearer and better approach than piecemeal introduction, because it provides greater certainty and a stronger implementation focus.

### *Other comments*

- The terms “professional requirements”, “requirements” and “presumptive requirements” are used in the Proposed Policy Paper starting in paragraph 2 and afterwards. These terms do not form part of the current IAASB lexicon of the auditor; these terms are not defined in the IFAC Auditing and Assurance Glossary of Terms. FEE therefore suggests that these terms as well as the detailed criteria for using these terms are further clarified and included in the Glossary of Terms whereby the link and distinction between requirements and objectives is further detailed. We also recommend IAASB to clarify the objectives of new standards “at two levels”. We suggest that when issuing new Exposure Drafts the IAASB should clearly explain in the accompanying material why a distinction is made between “shall” and “should” proposals in the specific Exposure Draft proposals.
- Although we appreciate that the Practice Statements are further discussed in the Proposed Consultation Paper, we believe that consideration of the status of the Practice Statements is imperative in the section on “Explanatory Material (paragraphs 7 and 8)” in the Proposed Policy Paper. We are of the opinion that a Policy Statement on Clarifying Professional Requirements in International Standards Issued by the IAASB should not be approved and become part of the International Standards without also considering the status of the Practice Statements. We refer to our responses to Questions 2, 12 and 12 (bis) of the Proposed Consultation Paper and to our comments on Practice Statements as explained in our main comment on the Proposed Consultation Paper on “status of application material and Practice Statements” for further details.
- Related to the appendices as described in paragraph 9, FEE is of the opinion that the application or use of the appendices should be clarified. It should be made clear that the

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appendices should never include any “requirements” but could be useful to provide the professional accountant with explanatory material, examples and checklists.

### *Status of application material and Practice Statements*

Following careful consideration of the Restructuring Options A and B as described in paragraphs 19 and 20 of the Proposed Consultation Paper, FEE is of the opinion that a restructuring similar to Restructuring Option A is preferable. The restructuring option favoured by FEE would require:

- All professional requirements (shall or must – as explained in further detail hereafter) and presumptive requirements (should and should consider) are included in the standard (ISA);
- All definitions, concepts, clarification of terms and further description (essential application material) or material needed in order to understand and apply the requirements and presumptive requirements are also included in the standard (ISA) so that the standard can be understood and used as a stand-alone document;
- All other material, including additional application material not needed to understand the requirements and presumptive requirements, all other explanatory material, all interpretative guidance, all additional guidance, all best practices, all other considerations, all examples, etc, do not form part of the standard and are therefore to be included in a Practice Statement (IAPS);
- The Practice Statement would not form part of ISA but would be referred to in ISA as material having IAASB authority and that therefore should be considered by auditors applying ISAs.

The advantages of the restructuring option as described above are as follows:

- Such restructuring would be expected to result in shorter, more understandable, less complex standards – such shorter ISAs would however contain all principles and requirements applicable to all audits;
- Such restructuring follows a structure and approach similar to existing ISAs whereby bold and grey lettering and application material continues to be included in the standard itself, but whereby only necessary application material is retained in the standard;
- This will be a more evolutionary than revolutionary approach and will likely be seen as more straightforward to implement;
- Having essential application guidance after the relevant standards allows for readier understanding of the points relevant to considering how the principle or essential procedure should be applied;
- Adopting the different wording convention in the same document clearly indicates the different impact of the convention on both the requirements and the application guidance; there is for example no doubt what is a requirement (bold type) and what is application guidance (grey type);
- Using Practice Statements for supplementary application notes and explanatory material gives flexibility for such statements to cover different situations, including different regulatory environments, different types and complexity of entities;
- As the Practice Statements may not need to go through the same due process as the standards, the guidance can be prepared and updated more easily.

However, a restructuring as preferred by FEE will also require that certain items, which it can be argued are currently not completely clear, are further considered and clarified by the IAASB:

- It is crucial that for the restructuring option as described above to work properly in practice, the status or authority of a Practice Statement (IAPS) versus a standard is clarified

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by IAASB;

- This results from the fact that IAPS currently cover several different types of statements and the contents includes, it would appear, material that may need to be in future ISAs that should contain essential application material;
- The status or authority of a Practice Statement (IAPS) should be authoritative in the sense that it is issued by the IAASB but the guidance contained therein is advisory in nature, comprising good practice;
- The auditor would be expected to be able to justify why the guidance in the Practice Statement has not been followed but it would be unnecessary to document why it has not been followed;
- Where the ISA makes reference to the IAPS, the auditor would be expected to consider the IAPS;
- During the period where both “old” and “new” IAPSs exist together, a transitional arrangement for the status of the IAPSs will be required.

It should be noted that the illustrative examples as included in the Supplement to the Proposed Consultation Paper only demonstrate the impact of the proposals included in the Proposed Policy Statement on the clarification of the professional requirements and the resulting wording changes and do not illustrate the effects of any restructuring option. We have therefore chosen not to comment on the illustrative examples as included in the Supplement to the Proposed Consultation Paper.

GT We support the Proposed Policy Statement and believe that it is in the public's best interest to adequately describe the professional accountant's responsibilities by using clear, concise and definitive imperatives. Such imperatives not only promote consistent application, but also enhance the understandability and clarity of professional standards by distinguishing the professional requirements from the explanatory material. We further believe that the Proposed Policy Statement is appropriate and necessary for the convergence of international and national standards and that it will be accepted by regulators, legislators and the profession.

### *Alternative approaches to implementation*

We understand the IAASB's concerns related to the importance of completing current projects and the time and resource constraints that would be imposed by converting existing standards to the conventions in the Proposed Policy Statement. However, we also note the significance of the audit risk and fraud standards to the performance of quality audits. These standards build the foundation of the audit risk model by, among other things:

- requiring a comprehensive understanding of the entity, its environment, and its internal control
- presenting a rigorous approach to risk assessment based on that understanding
- requiring linkage between such risk assessments and the audit procedures performed
- distinguishing the auditor's responsibilities with respect to fraud and error
- providing for adequate procedures to assess and respond to the risk of fraud.

Accordingly, in light of the current environment and the importance of the audit risk and fraud standards to the performance of a quality audit and to the further development of International Standards on Auditing (ISA), we prefer that the IAASB adopt the second approach to implementation to redraft and reissue these standards using the proposed

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conventions. We believe this would help to ensure consistent application and further increase the quality of audits by clearly identifying the professional requirements imposed on the professional accountant.

We would like to stress, however, our opposition to restructuring the ISAs by separating the professional requirements from the explanatory material. We believe, for the reasons set forth in Appendix B, that such separation would adversely affect the consistent application and the quality of audits, regardless of whether or not the explanatory material carried the same level of authority. second approach, we would support the prospective approach, as long as the audit risk and fraud standards are reviewed and revised within the near future.

H3C The H3C has found the subject matter highlighted in the abovementioned documents of great interest. The scope of the subject matter plays a role of great importance in the proper exercise of tasks undertaken by the profession of statutory auditor.

The quality of auditing standards is a matter of great interest to the H3C. As a regulatory body which oversees the supervision of the auditing profession, it has observed the effect of these standards on the overall audit approaches by practitioners. On this matter, it wishes to express that current auditing standards are excessively long, with a lacking in clarity in the exposure of important principles, and imply difficulties in application. All of which contribute to the decline in overall audit quality and reaffirm the need for better understandability in standards which provide clear, concise principles, without the creation or usage of separate terms in the endeavour for improvement.

It is equally the opinion of the H3C that the focus of current ISAs has been on audits of financial statements of large, public interest entities, with insufficient attention given to the difficulty of their application on the audit of medium-small entities. Without further clarification on this matter, the risk of standards being perceived as irrelevant to audits of medium-small practices shall continue to run high, and the creation of specialized ISAs for these entities highly foreseeable. It is the position of the H3C that an audit firm should be made to comply with the principles of ISAs, regardless of the size and nature of the entity.

On matters of translation, it is highly foreseeable that translation difficulties would be encountered for the proposed terms of “shall” and “should”, in that such nuances would not be clearly conveyed in the French language. In order for a clear establishment of professional requirements, a mandatory status would need to be imposed on standards through the usage of “must”.

ICAEW The issue of clarity in auditing standards is long overdue for consideration. We believe that the increasing complexity, length and structure of recently issued auditing standards represents a considerable burden on practitioners, most of all small practitioners, without a proportionate corresponding benefit in terms of audit quality. Whilst we fully appreciate the correlation between increasing complexity in business and auditing standards, we do not believe that the right balance has yet been struck. Complexity and length represent:

- a significant threat to the proper adoption of IAASB standards internationally and therefore to the status and credibility of IAASB;
- a potential threat to audit quality to the extent that the ever-increasing level of prescription encourages a compliance mentality;
- an increasingly unmanageable burden on small practitioners and the businesses that they serve.

We believe that much greater account of the needs of small practitioners should have been taken in the drafting of these important proposals. The findings of the recent Wong and

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World Bank reports on accounting and auditing standards emphasise the need for standard-setters to address the needs of small practitioners as a matter of priority.

ICAI We support to objectives of the exposure drafts in concept. We support the proposals to improve clarity through the use of requirements and presumptive requirements using the words “shall” and “should” respectively. We believe that if implemented the clarification will assist in improving audit quality and compliance with the professional standards. The transition period proposed for the implementation of the proposed Policy Statement is somewhat aggressive and we would recommend an implementation date some time after 1st January 2006.

While supporting the proposal we believe that there is a significant risk that the revised format could result in standards which are rule based and not principle based. There is a risk that with the development of new standards and the revision of the existing standards in line with the new framework, using the requirements and presumptive requirements, that the number of “required” procedures as opposed to “required” principles will become excessive. If the proposed framework is adopted the board and its staff must take great care to ensure that the standards do not become a procedure based framework and remain a principle based framework.

ICANZ Overall it is encouraging that the IAASB is actively working to improve the clarity and structure of IAASB Standards. This is an important issue and one which will have a significant impact on many jurisdictions that have adopted the ISAs or are in the process of doing so.

ICAS The ‘Clarity Project’ is a timely development which we believe is necessary to address the increasing length, complexity and structure of recently issued international standards on auditing. Recently issued standards represent an increasing burden on practitioners without demonstrably comparable improvements in audit quality. The greatest burdens are placed on smaller practitioners who have more limited resources with which to address developments in auditing and accounting; and regulation more generally. There is also a growing perception that the phrase ‘an audit is an audit’ (meaning that an audit is a homogeneous product for all entities, regardless of their size or nature) cannot be justified as developments in standards are clearly targeted towards the audit of listed companies.

The ‘Clarity Project’ is an opportunity to stand back and reflect not only on the detailed text and structure of international standards but also on the impact on audit quality of a more rules based approach to standard setting. We believe that this is an opportunity for the IAASB to demonstrate that its approach to standard setting is principles based, a move which the Institute would keenly support.

IDW *General Matters Relating to Both the Policy Statement and Consultation Paper*

IAASB pronouncements represent information for their users. To be of benefit to users, the information in pronouncements must both be inherently useful (that is, it must fulfil the purpose for which it has been designed) and understandable. We consider the IAASB pronouncements to be the best standards currently available for an international environment. However, we are concerned about current tendencies in the latest standards issued by the IAASB that may affect the usefulness and understandability of these standards.

The recognition of the ISAs as the standards to be applied for audits of financial statements required by law or regulation (statutory audits) invariably results in these standards becoming de facto or de jure legal instruments. In the European Union, the anticipated recognition of the ISAs as being required for statutory audits in the EU is predicated upon the ISAs becoming a part of the EU legal framework. Unfortunately, the ISAs and related pronouncements have not been prepared using the principles of legal drafting, which has

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resulted in ambiguity with respect to the obligations of the auditor.

### *Usefulness of Standards*

We are under the impression that some regulators appear to believe that increasingly definitive and detailed standards containing more requirements will strengthen audit quality. We do not believe that the increasing complexity of, and detail in, the ISAs with more requirements and the consequent reduction in the room left for professional judgment actually improves audit quality. In fact, we believe that the reduction in the room for professional judgment due to increasingly complex and detailed standards endangers the quality of audits.

This is particularly the case where detailed rules and guidance are supposed to be applied across different jurisdictions, languages and cultures, since detailed rules and guidance may drive very different behaviour depending upon the environment in which they are applied. In addition, the more rules and guidance that standards include, the greater the risk that inconsistencies among these rules and guidance may arise or that the rules and guidance become inapplicable or ineffective in certain jurisdictions. Consequently, in our view, principles-based international standards that encompass the objectives that requirements are to achieve have a greater potential to influence auditor behaviour in a global environment than detailed rules that are followed slavishly, possibly irrespective of whether they meet the objectives.

The issue here is whether the IAASB wants standards to control auditor input or output. We believe that controlling auditor output (the objectives to be achieved) using a principles-based approach is more effective, efficient and robust (i.e., not subject to constant change) than trying to control auditor input (procedures to be performed) by means of detailed rules. To put it bluntly, in this context, sometimes less is more. Nevertheless, we are not suggesting that standards gloss over complex matters: the standards should be as simple as possible – but not simpler. On this basis, we support the notion that “an audit is an audit” – regardless of the size of the entity – and that in developing objectives and principles upon which to base auditing standards, it may be useful to “think small first”.

### *Understandability of Standards*

We have also become increasingly concerned about the understandability of the ISAs – without which their inherent usefulness ceases to be beneficial to users. This concern appears to be shared by others, as was noted in the IFAC report “Challenges and Successes in Implementing International Standards: Achieving Convergence to IFRSs and ISAs” (the so-called “Wong Report”) and in meetings of the national standards setters under the auspices of the IAASB. Standards that fail to be understandable will not gain acceptance and hence may not be applied or applied properly. To this effect, we welcome the IAASB’s initiative to clarify professional requirements by using clearly defined terms to represent requirements and eliminate the ambiguous use of the present tense.

However, overall we consider the drafting style of the ISAs to be somewhat repetitive and that in many cases the use of terminology and definitions is not performed with enough care to ensure understandability across different jurisdictions, languages and cultures. Imprecision in the use of words and concepts is magnified upon translation and further impairs understandability. These matters are critical in those jurisdictions in which IAASB standards may become statutory instruments of some sort. The structure of headings and subheadings does not allow enough depth to allow readers to follow the logical flow of concepts in the standards.

The length of standards also has an impact on understandability. In our view, it may be better to have a few short standards dealing with different aspects of certain issues rather

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than to try to have a single standard encompass too many issues

In our view, the IAASB must make a concerted effort to improve the understandability of its standards. Without such improvement, the IAASB may endanger its position as the international standards setter, for unlike standards and rules issued by regulators, IAASB standards are issued by a private organization and hence are relevant only if they are widely applied.

### *The Impact of the Regulatory Environment on Structure and Drafting*

As IAASB pronouncements become statutory instruments of some sort in the jurisdictions in which governments or regulatory authorities recognize them, IAASB pronouncements will be subjected to legal analysis to determine the nature and level of obligations that they impose upon professional accountants. While writing useful and understandable standards that clarify levels of obligation within a standard is an important step in the right direction to help ensure IAASB standards stand up to legal analysis, this step alone will not alleviate difficulties caused by the incorporation of additional guidance, examples, best practice and other material into the standards that do not clearly impose obligations on the auditor, but that may have legal implications. In other words, clarifying levels of obligation and improving drafting so that it can stand up to legal analysis cannot be separated from the structure of IAASB pronouncements. For these reasons, our comments will tend to address issues of structure together with wording issues.

### *General comments - ED*

The approach applied in this document does not appear to be principles-based because it concentrates on the requirements (i.e., rules regulating auditor input, or procedures) and there is little reference to the objectives to be achieved. In our view, a top-down approach would highlight the fact that it is essential for the professional accountant to establish what to achieve and why before addressing professional procedural requirements, considering guidance, and applying professional judgement in selecting alternative or additional procedures designed to achieve a particular objective.

Along these lines, we believe that the reference to objectives in paragraph 7 of the proposed Policy Statement does not emphasize the objectives to be achieved enough. Explanatory material should not merely contain the objectives included in the standard; rather these objectives should be made more prominent in the standards and then be supported by the requirements and presumptive requirements. First it must be clear to the professional accountant what must be achieved and why, and then what must, or may need to, be done to achieve these objectives can be addressed. The IAASB has hitherto not accorded a high priority to the identification of these objectives; consequently, the IAASB standards are not as principles-based as they ought to be.

...We appreciate the enormity of the task, but nevertheless continue to urge the IAASB to accord this project the highest priority and to actively seek a solution to the practical problems of implementing it.

IOSCO

### *The ED is a welcome step toward improving the clarity of standards*

Improving the clarity of the International Standards on Auditing (ISAs) and other guidance issued by the IAASB is an undertaking of the highest importance. The issuance of the Exposure Draft is an important step toward improving the clarity of ISAs and we commend the IAASB for proposing to use clear and unambiguous terminology.

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We understand that the subject of adding requirements and other guidance that makes standards longer has raised concern among some IAASB members and others in the profession. We want to emphasize that we recognize that each audit is unique and that all audits require the exercise of considerable judgment on the part of the auditor. At the same time, we are firmly convinced that there are certain procedures that should be required in all audits of public listed companies, and other procedures that should be presumptively required. We therefore support the ED’s overall approach to communicating the two levels of requirements. We do have a number of comments regarding details of the approach, which we will outline later in this letter.

### *The proposals in the Consultation Paper for restructuring*

We understand the desire to explore alternative forms of organizing the information in auditing standards to improve understandability among those who use the standards and we agree that understandability is of paramount importance in developing and using auditing standards. However, we are concerned about the assertion that the present form of ISAs needs to be completely restructured. We are troubled by statements that trained professional auditors are finding it difficult to understand and use some of the recently issued auditing standards simply because they are longer and more detailed. In our view, the recently-issued ISAs have been improvements over earlier versions, and to reverse course now would be a step backward.

We understand and agree that international auditing standards need to be principles-based. High quality standards should contain substantive objectives and clear principles that are consistent with a sound conceptual framework. It is also important that standards contain a sufficient amount of implementation guidance to make the application of the principles clear. We think that the complexities of the business world and of the listed companies whose financial statements are the subject of audits will tend to add requirements and length to audit standards over time. Length of a standard should not be viewed as a problem in and of itself.

Where understandability of a standard is a concern, regardless of length, additional work should be done in the development process to ensure that the standard is clear and understandable by all who will use it. In our view, provided that such additional work is done, clarity can be accomplished within the present format of standards without the necessity for a restructuring of standards. Ultimately, ISAs must contain whatever specific requirements are needed to address public interest concerns and support high-quality audits.

We are also not convinced that restructuring of ISAs is necessitated by legal requirements in some jurisdictions. While some of our members do have two-level auditor guidance in place today, we do not consider that the existence of such national approaches creates a legal requirement for ISAs to be written in two parts. We note that in some jurisdictions auditing and accounting standards are incorporated into law by general reference to the body of standards, rather than by including the entire text of each standard in legislation. Such a practice eliminates the necessity to seek a change in the text of legislation each time that any change in an auditing standard, however minor, is made.

We believe that convergence and consistency in national and international standards will not be impeded as long as ISAs and national standards are consistent in their contents. In our view, a significant measure of convergence can be achieved while improving the standards, if the Board focuses on clarifying the content and the objectives, principles, and requirements involved in each standard, as it works on agenda projects. As we comment later in this letter, if the IAASB decides to pursue a project on fundamental principles, presenting such principles in a separate ISA would not necessarily conflict with national standards. Regardless of whether the sets of standards presently do or do not contain



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descriptions of such high level principles in separate standards, consistency can be achieved so long as the principles themselves appear in both sets of standards.

Our members do not reject the idea that some changes in formatting or presentation of standards might be useful in making standards more easily readable. For example, we think that ISAs might be enhanced if each future standard would begin with short statements of objectives and principles. We have addressed possible approaches for doing this without a major restructuring in all the standards later in this letter, in our responses to the questions in the ED and Consultation Paper (see Parts I and II). However, in any exploration of other ways to write or format standards, it will be extremely important to ensure that changes made do not create, or appear to create, reduced requirements for auditors. We also think it would be wrong to encourage auditors not to read the full content of standards.

### *Implementation of the ED changes should occur as quickly as possible*

We believe it is very important that the implementation of clarified language for ISAs should not be delayed while consideration is given to broader issues of other ways that standards might be improved, including any potential restructuring, separate work on overarching principles, and other longer-term matters. The adoption of the ED changes and consideration of other matters should be two separate streams of effort. We urge the IAASB to implement the ED's language changes promptly, as a matter of priority.

### *How to introduce the changes described in the ED*

We understand that a prospective-only approach might be the easiest and quickest way for the Board to get started in using a new approach in standards; however, revising standards one at a time as they come up on the Board's regular project agenda would implement clarity changes far too slowly. Such an approach also would not address some important ISAs that need prompt clarification because of their broad impact on other ISAs and on audits. If it were possible to do an "all at once" revision of standards on a timely basis, our members believe that this would be the most desirable approach. Realistically, however, such an approach would involve a protracted length of time before the entire body of clarified ISAs could become available. It would be very undesirable to wait an extended period of time before clarifying ISAs.

Our members therefore urge the IAASB to undertake a "modified prospective" approach that would involve a rewrite of a few of the more recently-issued ISAs into the new language over a relatively short period of time, and would couple this priority revision effort with the gradual replacement of all other standards. A modified prospective approach such as this would be capable of executing much-needed improvements in a more timely fashion. The Audit Risk and Fraud standards should be rewritten quickly to ensure that these standards are clear. The fundamental nature of the Audit Risk standard, and its pervasive effect on all aspects of the audit process, demand clarity. The Fraud standard has particular significance given recent major reporting and audit failures. Some members have also cited the Quality Control standards as also warranting priority updating to clarify requirements. As to the transition period where both old and new standards will be in existence, our members are naturally concerned about the understandability, consistency, and enforceability of having two types of standards in wide use. It will be important to distinguish between "old format" and "new format" standards, and to set out very clear instructions as to the interpretation of bold letter text and "should" statements in the old standards. In another transition issue, the ED is interpreted by some to consider all previously bold lettered text as only "presumptive requirements" during the transition period, while others understand the intent to be that bold text and "should" statements in previous standards would continue to have the same status as they have in their present text, i.e., are procedures that could only be departed from if such action would "more effectively" achieve the objectives. Which of these interpretations is correct needs to be made clear in the final policy paper.

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### *The illustrative rewrite of ISA 315*

When we reviewed the illustrative revision of ISA 315 contained in the Exposure Draft, some of the “shall” and “should” statements included were not what we would have expected. For example, the statement in paragraph 13, “When the auditor intends to use information about the entity and its environment obtained in prior periods, the auditor should determine whether changes have occurred that may affect the relevance of such information in the current audit.” We understand that this is just an illustrative example and that ISA 315 was not re-discussed by the Board, but one would think that paragraph 13 would be a mandatory requirement if the auditor intends to rely on previously-obtained information. We have other comments about the illustrative rewrite later in this letter.

### *Departures from presumptive requirements*

The inclusion of appropriate mandatory and presumptive requirements in audit standards is an important part of supporting high quality audits, as is having good criteria for departing from a presumptive requirement. A departure from a presumptive requirement should be permitted only if the auditor judges the alternative procedure to be as good as or better than the stated requirement and concludes that the alternative procedure will adequately protect the interests of investors. Without such criteria, we are concerned that departures from presumptive requirements will not be “rare” as stated in the ED. This creates the further concern that audit quality will not be supported and enhanced by the standards.

IRE The IRE wants to express its support to the IAASB in its stated goal to achieve international convergence in audit on the basis of the ISAs. The IRE believes in the benefits for everybody of achieving international convergence in audit. The IRE also recognises that the existing ISAs should not be dismissed as in some way inadequate. While their clarity can certainly be improved, the IRE believes that they provide sufficient basis for an auditor to undertake a good audit or to assess the quality of an audit after its completion. It would be wrong to view the clarity project as a signal that ISAs are not ready to be implemented. Moreover, the IRE believes that it is essential to the auditing profession that international professional standards are based on a set of robust principles as opposed to detailed rules-based standards:

- Auditing is a highly judgmental process, and a principles-based approach within the ISAs allows for the use of professional judgment;
- Auditing principles encourage compliance with the final objective of an audit of financial statements (substance over form), whilst detailed auditing rules and procedures encourage technical avoidance and a ‘tick the box’ mentality;
- An auditing approach based on robust principles disposes of the flexibility to be applied in complex situations or following new developments;
- Auditing principles constitute a flexible tool within a multi-jurisdictional environment, and the application of them by numerous countries (in casu member states of the European Union) will work as a driver of high audit quality;
- A unique set of principles supports the conviction that ‘an audit is an audit’, according to which the same principles are applicable to the audit of all entities, regardless of their juridical form, size and ownership (government/private owners), which allows for the harmonization of professional standards at the national, European and international level;
- Standards must be responsive to the changing needs of the public interest, which can be achieved in a more effective way through compliance with principles than through technical compliance with rules;
- If a principles-based approach must be supported by a number of rules, that number must be limited to a strict minimum, and the ‘principles-based’ character of the standards

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must be highlighted.

Up to now, a clear preference for the principles-based approach has been expressed by the IAASB itself (cf. IAASB, Annual Report, 2002, p. 9): “The IAASB continues to believe that high quality standards based on basic principles and essential procedures will best serve the public interest by eliciting thoughtful auditor assessment of the particular circumstances of each engagement.” The IRE agrees with this viewpoint, and believes that the principles-based approach to international standards on auditing (ISAs) must be retained in the future, regardless of the options that the IAASB will take into account in relation to a possible restructuring of ISAs in the future.

We would like to refer to the Peter Wong Report published on the IFAC website in September 2004, on the topic: ‘Challenges and Successes in Implementing International Standards: Achieving Convergence to IFRSs and ISAs’. On page 13, it is noted that: “participants were of the view that the international standards are increasingly becoming longer, more complex, and rules-based, and the structure and complexity of the standards are affecting largely, in an adverse way, both their adoption and implementation”.

On that same page, the report also states that “it is recommended that the international standards setters become more attuned to the challenges national standard setters and preparers, auditors and users of financial statements face in adopting and implementing the international standards. In particular, participants recommend that international standard setters develop standards that continue to be principles based and the structure of which lends itself to incorporation in national law or regulation and to implementation.”

Clarity is not only to be sought for the regulator. It is also to serve the auditor and it is therefore only an issue of codifying where the requirements lie in a standard; it is also a question of producing a text, which is sufficiently understandable and universal to drive the behaviour of the auditor in every cultural context.

For this reason, the IRE wishes to clearly state that it supports the overall ‘clarity’ project only if the two aspects of the project, i.e. the ‘codification of the language’ and the ‘restructuring’ are carried out together and simultaneously. Our institute considers the ‘codification of the language’ side of the project would entail great risks if it was to be carried out alone, since they consider that it would not solve in any way the problem of understandability and clarity of the standards.

It considers that the ‘codification of the language’ alone bears the great risk of drifting towards even more ‘rules based’ standards because it cannot but result in an increase of the number of ‘shall(s)’ and ‘should(s)’. Such increase could turn the audit into a purely procedural approach (‘tick the box approach’) where the role of the auditor’s professional judgement would not be prevalent anymore. The IRE considers that it could therefore result in a decline of the overall audit quality.

The IRE considers that what is most important is the clarity and understandability of the standards for all the practitioners, including those working for small clients who progressively perceive the standards as being irrelevant to their audits. Similar views are also expressed in the Wong report where it is said on page 16; “with respect to ISAs, participants were of the view that the focus of ISAs has changed from the audits of financial statements of entities of all sizes to the audit of financial statements of large, complex, public interest, and often multinational entities. The ISAs are progressively becoming more difficult to apply to the audits of financial statements of small entities.”

The IRE therefore supports clarifying the ISAs by:

- Working on what the fundamental principles underlying an ISA audit are;
- Separating the principles and the requirements from the application guidance.

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The IRE considers that separating the principles and the requirements from the application guidance would better serve the objective of clarifying where the exact responsibilities of the auditor lie pursued by the ‘codification of the language’ aspect of the project. The IRE would therefore only support the exposure draft on the proposed policy statement ‘Clarifying Professional Requirements in International Standards issued by the IAASB’ if the following aspects of the Consultation Paper ‘Improving the Clarity and Structure of IAASB Standards and Related Considerations for Practice Statements’ were re-inserted in the exposure draft:

- The definition of the fundamental principles underlying an ISA audit;
- The use of those fundamental principles as the driver to a ‘shall’ requirement;
- The implementation of option A to, at least, the standards of the audit risk model (ISAs 315, 330 and 240), where the work has already been done to provide illustrative examples, and test the proposal, although it is preferable that all existing ISAs be modified according to option A and a new related exposure draft is issued, hereby taking into account all comments received by IAASB on the ‘clarity’ ED and consultation paper.

According to the principle ‘an audit is an audit’, the fundamental principles within the ISAs should be applicable to all entities, including smaller and less complex entities. The IAASB should keep in mind that regulators always have the possibility to impose additional specific rules to entities of public interest (cf. actual situation in e.g. the US and in France).

JICPA Generally, we support this Exposure Draft and agree with the modifications outlined in the Exposure Draft.

KPMG Before providing our views on the proposals, it is important to emphasize that we believe International Standards issued by IAASB are of high quality and that the current conventions and language used in ISAs generate an appropriate level of performance from auditors. However, we also recognize that existing ISAs are a mixture of recently revised Standards that are long and detailed and other Standards developed a number of years ago by the IAPC, which had a different mandate than the IAASB. The Clarity project therefore provides IAASB with a unique opportunity to improve existing ISAs by bringing them all under a common Framework and set of drafting conventions.

We therefore agree that there is merit in reconsidering drafting conventions and the structure of International Standards and commend IAASB for undertaking such a project. We support the issuance of a proposed Policy Statement that clarifies professional requirements in International Standards issued by IAASB. We also support a project aimed at changing the structure of International Standards. However, we have some concerns with the proposals. These concerns along with our comments, recommendations and responses to the questions posed in the exposure draft and consultation paper are set out below.

### *Need for a Framework that underlies International Standards on Auditing*

We believe that the development of individual ISAs should be based on a Framework that defines the objectives and key elements of an audit conducted in accordance ISAs and the fundamental principles that underlie such an audit. While the fundamental principles included in the Consultation Paper are important, they need to be rewritten and organized in the context of a Framework that provides IAASB with the necessary foundation under which existing and future individual ISAs can be drafted and organized. We recommend that IAASB undertake a project, on a high priority basis, to develop a Framework that defines the objectives and key elements of an ISA audit and the fundamental principles that

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underlie it.

### *Scope of the Requirements Category*

While we agree with the proposal to have two categories of professional requirements, we are concerned that excessive use of the 'requirements' category may have the effect of turning an audit of financial statements into a procedural exercise that focuses the auditor's attention away from the audit and onto the completion of checklists and documentation requirements. To avoid this, we recommend that IAASB limit use of the "requirements" category to the fundamental principles which we believe should form part of the Framework underlying an ISA audit.

### *Proposal for Prospective Application*

While, as stated above, we agree with issuing a proposed Policy Statement whose objective is to clarify the professional requirements of International Standards, we disagree with the proposal to apply the provisions of the Policy Statement on a prospective basis to Exposure Drafts approved for issue after final approval of the Policy Statement.

### *Recommendations for Future Action by IAASB*

We agree that the IAASB should undertake a project that is aimed at improving the language and structure of ISAs so that they flow from fundamental principles and the Framework we refer to above. While ideally, it would be best for IAASB to revise all existing ISAs and expose the revisions in one document, we recognize that the size of the undertaking does not make this a viable alternative.

We therefore recommend that, as part of the Clarity project, IAASB:

- Agree on an appropriate structure for ISAs that will be referred to in drafting new ISAs. We believe such a structure should be comprised of: (i) A Framework that describes the objectives and key elements of an ISA audit and that includes the fundamental principles that underlie it (i.e., mandatory requirements); and (ii) Specific ISAs that support the Framework and include presumptively mandatory requirements;
- Establish policies relating to the structure and language to be used in drafting the specific ISAs. Our preference, as we discuss below, is to structure the ISAs along the lines of Option A because it is the easiest way of differentiating requirements from explanatory paragraphs and examples. However, we also do not object to Option B.
- Establish a work program that is aimed at identifying how and in what order existing ISAs will be revised so that they conform to the approved policies relating to structure and language.

Until the work program is completed, we believe that the structure and language of existing ISAs, when coupled with the current Preface (that requires auditors to "consider the whole text of a Standard to understand and apply the basic principles and essential procedures), is clear enough to generate appropriate behaviour from auditors.

To strengthen existing ISAs, we recommend that IAASB revise the Preface now to require auditors to document a departure from basic principles and essential procedures (bold text), assuming the departure is relevant and not insignificant to the specific circumstances of the audit being carried out. We believe that such departures should be rare and that it is in the public interest to require auditors to document the rationale for a departure and how the alternative procedure performed achieved the objective of the bold letter requirement. Implementation of this type of documentation requirement will essentially result in clarifying that all bold letters in existing International Standards are

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presumptively mandatory.

**LSCA** Our committee has considered the ICAEW response in detail. We particularly commend the ICAEW’s clearly thought-out and logical exposition of the so-called ‘principles (or objectives-oriented) vs rules’ debate, and the reasons why it is so fundamentally important for the IAASB to agree the guiding approach to setting its standards and issuing other authoritative material before going much further with its work to produce and amend standards. Failure to do so will lead to constant argument going forward and the resulting standards are likely to be poorer for it.

**NASBA** As regulators, we applaud the IAASB’s efforts to enhance clarity of requirements.

**NIVRA** We strongly support the initiative of the IAASB to improve the clarity of International Standards on Auditing (“ISAs”). We believe that it is important to emphasize our view that the ISA’s should focus on clear principles. We would be concerned if the ISA’s become a set of detailed and too prescriptive rule-based standards.

**PAAB** South Africa has adopted International Standards on Auditing and the related pronouncements with effect from 1 January 2005. We believe that it is important that a stable platform exists which will support those countries that have adopted the international standards and that such platform be updated periodically to reflect developments in business, while maintaining a balance between the benefits derived and costs of doing so. We support initiatives that will assist in achieving this objective.

We believe that it is important that the International Auditing and Assurance Standards Board (IAASB) does not lose sight of the main reasons for initiating these projects, which are to support auditors and ensure consistent application of International Standards. We fully support initiatives that will achieve these objectives. We further believe that careful consideration should be given to incurring costs and expending effort on projects which may not justify the benefits and indeed, may result in more confusion and inconsistencies, and we also caution against trying to balance the needs and requirements of various and diverse constituencies and organizations and in doing so lose focus of the main aims of the project.

We continue to support standards that are based on principles. Careful consideration should therefore be given to attempting to write standards that will apply in every possible situation which the auditor will encounter. Attempting to base the application of professional requirements on rigid rules exposes the profession to the risk that the auditor’s professional judgment is no longer one of the most important discretions that the auditor is required to exercise. We wish to emphasise the importance of the auditor’s need to apply professional judgment. No matter how rigid the rules for the interpretation of standards are, it cannot protect the auditor against litigation in all circumstances.

We recommend that the IAASB consider establishing a drafting policy for all standards. The manner in which standards are drafted depends on individual preferences and given the unavoidable changes in members of the secretariat and the IAASB, it is important that the drafting remain consistent. It is also important to consider who uses the standards and then to ensure that the language and clarity satisfies their needs. Current users consist of experienced auditors at the one extreme and university students on the other. The standards should be written in a manner to address the needs of both extremes. Whichever option is followed in clarifying and restructuring the standards, the project will require substantial capacity. It will therefore be critical that, should it proceed, those who are responsible for the initiative display real leadership and commitment to the project to ensure consistency and see it through to completion.

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In conclusion, we fully support the IAASB's objective to issue clear, concise and definitive Standards that can be applied consistently. With the adoption of International Standards in South Africa, it is particularly important that a stable platform is established from which to apply these Standards. However, we do not believe that clarity will necessarily be achieved by further complicating drafting conventions or by restructuring the Standards.

Finally, we again emphasise that it is important that the IAASB does not lose sight of the aims it wishes to achieve with the project while simultaneously paying careful attention to the benefits and costs involved in doing so.

PCAOB

### PROPOSED POLICY STATEMENT

In general, we very much support the IAASB's proposed Policy Statement to clarify professional requirements in its standards. In fact, the PCAOB recently adopted PCAOB Rule 3101 which defines imperatives used to describe the different degrees of an auditor's responsibility when conducting engagements in accordance with professional standards. We agree with the proposed definitions of the terms "shall", "should", and "should consider" in the proposed Policy Statement as they are largely consistent with the categories of professional requirements in PCAOB Rule 3101. In addition, the IAASB's proposed Policy Statement includes a documentation requirement for a departure from a presumptive requirement, which is similar to a requirement adopted by the PCAOB. Such consistency should promote common application of auditing requirements among auditors and further enhance the quality of audits. However, we believe that the proposed Policy Statement could be improved in several respects and offer our comments below.

### *Implementation*

The IAASB proposes to implement the proposed Policy Statement prospectively and not to revise existing or recently exposed standards to conform to the provisions of the Policy Statement in the near term. The proposed definition of the term "should" is significantly different than the use of that same term in the existing International Standards on Auditing ("ISAs"). Specifically, we believe that many auditors currently understand "should" in the context of a bold-lettered paragraph in the existing ISAs similar to the way the proposed Policy Statement defines "shall." As a result, we question whether auditors will understand the difference between the meaning of the word "should" in an existing ISA and the meaning of the same term in an ISA issued under the proposed Policy Statement. There will be an extended period of time during which different definitions of the same term will apply to different portions of the body of the ISAs. There is a risk that auditors will apply the new definition to the existing ISAs which could result in reduced audit quality. In addition, we are concerned that auditors will find it difficult to follow and interpret two sets of standards – those under the current drafting convention and those under the new convention. We believe the IAASB's proposal does not adequately address these risks.

### *Authority of the standards in the "Preface to the International Standards on Quality Control, Auditing, Assurance and Related Services"*

The Explanatory Memorandum to the proposed Policy Statement states that "the provisions of the Policy Statement will be adopted through amendment to the Preface to the International Standards on Quality Control, Auditing, Assurance and Related Services." The Preface includes, among other things, a discussion of the number of IAASB members, procedures for IAASB members who absent themselves from meetings, and the procedures for the appointment of task forces. We are concerned that auditors will not recognize the significance of the proposed Policy Statement's provisions, or recognize that these provisions are an integral part of the ISAs, if they are included with this other information. Accordingly, we recommend that the IAASB present the information regarding the authority of the standards and definition of terms in a manner that more

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clearly indicates its significance. Creating a stand-alone document, for example, would further enhance the IAASB's objective of establishing standards that are "understandable, clear and capable of consistent application."

### *Authority of the appendices*

According to the proposed Policy Statement, "Appendices are an integral part of an International Standard." It is not clear, however, whether the appendices carry the same level of authority as a standard. Without a clear designation of the authoritative status of appendices, auditors may be confused as to whether appendices need to be considered. We recommend that the IAASB designate the appendices as authoritative because they are an integral part of a standard.

### *Use of bold type lettering*

We recommend that the IAASB discontinue the use of bold type lettering. Bold type lettering, by its nature, places special prominence and distinction on the highlighted text. The proposed Policy Statement recognizes that "[p]rofessional 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)." To ensure that auditors read the entire text, and not just the bold letters, the bold type lettering should be discontinued.

### *Number of bold type requirements*

If the IAASB decides to continue its use of bold type lettering, we are not concerned about any anticipated increase of bold type requirements that may result from implementation of the proposed Policy Statement. The IAASB should increase the number of bold type requirements if it considers it necessary to clarify the ISAs. The IAASB's proposal is intended to enhance the clarity of the standards' requirements and more clearly describe the requirements that the IAASB intended. Therefore, there should be no concern that the number of bold type requirements may increase.

## CONSULTATION PAPER

The IAASB seeks comment on whether the ISAs should be restructured in light of their increasing length and perceived complexity. Specifically, the Consultation Paper requests comment on three restructuring options... We recommend that the IAASB continue its policy of including professional requirements together with related guidance in the ISAs. Much of the explanatory material is necessary to fully understand the requirements, and the balance serves to increase consistency in application. If such guidance is included in a separate section in an ISA or in a Practice Statement, much duplication from the standards section of the ISA will be needed to understand the explanatory material, thus increasing the overall length of the documents issued by the IAASB. Further, there is a risk that auditors will not pay appropriate attention to the separate section or Practice Statement, which could result in diminished audit quality.

PWC

### *Overall support for the objective of clarity in the ISAs*

We support IAASB's initiative to consider ways to improve the clarity of the ISAs. In doing so, we do not want to give the impression that we believe that the existing ISAs are not high quality auditing standards. Indeed, the fact that our global methodology uses the ISAs as our common policy platform demonstrates our belief that the ISAs provide a



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sound basis for high quality audits. Applying the existing ISAs in the conduct of an audit requires appropriate application of the professional judgement, but we do not believe this brings into question the quality or clarity of those standards. Indeed, we believe that if auditing standards are to drive high quality audits, they must embrace the exercise of professional judgement in applying them. Thus, our support for the initiative is not based on a concern regarding the quality of the existing standards; rather, we support the initiative because we believe that a commitment to quality carries with it a commitment to continuous improvement.

### *Serious concerns about proposals*

Although supporting the overall initiative, we have serious concerns about the proposals in both the Exposure Draft and Consultation Paper and would not support issuing the proposed Policy Statement. As explained more fully below, we are concerned that, if implemented as proposed, the recommendations will inevitably result in much more detailed, procedural-oriented standards and excessive documentation requirements. This would, in our view, negatively affect audit quality because it would inevitably drive behaviour towards a preoccupation with compliance with the standards rather than focus auditor attention on the application of judgement to achieve the objective of the audit. The longer term effects could also include a decline in the quality of people attracted to the profession, which would further impact audit quality. This is clearly not in the public interest.

We can appreciate what the proposals are trying to achieve but have come to the conclusion that any short term solutions that attempt to retrofit the existing body of standards are ill-advised. Rather, we strongly encourage IAASB to take the time to develop a concept-based framework for the ISAs and a robust structure that can guide the drafting of individual standards in future. In our response, we offer some suggestions to illustrate our vision for a cohesive body of objective-based auditing standards built on such a framework. We do not believe that this necessarily needs to be done at the cost of progressing other projects in IAASB’s current work programme, but rather could be developed over time. We would urge, however, that priority be placed on developing the conceptual framework and an agreed structure for individual ISAs so that new and revised ISAs can begin to be drafted using the new model.

Our concerns and proposals are described more fully below. In Appendices 2 and 3, we also comment specifically on the questions identified on pages 9 to 10 of the Explanatory Memorandum, and those identified throughout the Consultation Paper.

### *Field-testing the proposals*

When we first read the Exposure Draft and Consultation Paper, our initial reaction was that we were broadly supportive of the proposals for “clarifying the professional requirements” as long as they were judiciously implemented. To ensure that we fully understood the impact of the proposals, however, we applied the proposed wording conventions to two additional ISAs—ISA 505, External Confirmations, and ISA 570, Going Concern. The Supplement to the Exposure Draft included an illustration of how the wording conventions would be applied to ISA 315, but this is a recent ISA that was written during a time when the IAASB was already conscious of the views held by some that the use of the present tense in the guidance should be kept to a minimum. We thought therefore it would be useful to test the impact of the proposals on ISAs that had been drafted earlier.

Applying the principles to older ISAs proved to be very illuminating. For example, when we applied the proposed wording conventions to ISA 570, we found that, with the exception of definitions, virtually all of the guidance could become bold-lettered requirements. There are nine bold-lettered requirements in the existing ISA 570 that describe the

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auditor’s work effort (i.e., excluding the section on audit conclusions and reporting). This could increase to more than twenty-five if all sentences in the guidance that are in the present tense were made bold-lettered requirements. In ISA 505, the numbers of bold-lettered requirements leapt from eleven to thirty-eight. For the ISAs as a whole, we counted more than 350 existing individual bold-lettered requirements and at least 300 more sentences in guidance that describe responsibilities of auditors using the present tense. Whilst we acknowledge that it is unlikely that IAASB would conclude that every existing present tense sentence in the guidance should become a bold-lettered requirement, there is no doubt that many would. Thus, we concluded that implementing the proposals would result in a substantial increase in the number of requirements and – equally important – in the specificity of the procedural requirements.

The result of implementing the proposals in ISAs 505 and 570 did not, in our view, improve the “clarity” of those ISAs and their requirements. In fact, it detracted from it because it obscured the key objectives governing the auditor’s work effort. Nor did we believe that the additional documentation that would be necessary under the proposals in the Clarity and Documentation Exposure Drafts would improve the quality of the audit process and judgements made. Indeed, we are very concerned that the proposed requirement in the Exposure Draft to document all departures from presumptive requirements will effectively create a presumption that failure to document how the auditor has addressed each requirement indicates that the requirement was not carried out. The need to document how the auditor complied with every professional requirement in the ISAs would result in a significant increase in documentation that, in our view, will not add value to the audit process and will detract from audit quality (which would be exacerbated if more present tense sentences became bold-lettered requirements). We also found it very difficult to decide which requirements should be mandatory “shall’s” versus presumptively mandatory “should’s”. This demonstrated to us that trying to distinguish between requirements and presumptive requirements has little, if any, merit.

As a result, we concluded that we had serious concerns about applying the proposals to the existing ISAs. We also came to the conclusion that there would be merit in a longer term project to reflect on the approach, format and structure of the ISAs as a whole.

### *An alternative model*

Having come to the conclusion that an alternative approach is needed, we started by reflecting on what we believe would constitute a robust model for a cohesive body of high quality international auditing standards. Whilst admittedly our vision is preliminary and would require further development, we thought it important to provide a vision of a possible structure and approach to the body of ISAs in order to show the nature and extent of the revision that we believe IAASB should be undertaking.

### Premises underlying our vision

Our proposals are based on the following premises:

- The ISAs should be seen as a body of standards in their own right rather than as a framework establishing a basis for convergence among national standards. Thus, they should constitute a complete and cohesive body of standards. Adoption of the ISAs into national standards should be a translation rather than transformation exercise. Additional guidance at a national level (for jurisdictions adopting the ISAs) should be limited to guidance that provides greater clarity on how specific requirements apply in the context of the jurisdiction’s legal and regulatory environment, or additional standards or guidance that are needed to address specific additional requirements relating to the scope of the statutory audit in that particular jurisdiction. This is a necessary premise if the ISAs are to serve as the global benchmark for audit quality worldwide.

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- The ISAs should be written with auditors as the primary audience. Whilst there are others who will undoubtedly need an understanding of the ISAs and their requirements, including those who read and use audit reports, other forms of communication in addition to the ISAs may be better able to meet those information needs. The primary purpose of the ISAs should be to set out clearly the objectives and professional requirements with which auditors are expected to comply in the conduct of audits.
- The ISAs should be viewed as an integrated body of standards. Thus, each ISA need not be written as a stand-alone exploration of all aspects of a particular topic. This will avoid unnecessary repetition in the overall body of ISAs.
- As an international body of auditing standards, ISAs have to be written to allow professional judgement in their application because they will be applied in the context of different legal and regulatory structures in different jurisdictions and countries, and in audits of not only large, global public companies, but also small, owner-managed businesses, partnerships, and not-for-profit entities. This does not mean that it is not possible to have a set of international standards that can effectively serve as a global benchmark for audit quality. We believe it is both possible and important that the ISAs serve that purpose. But it does mean that the ISAs need to focus on the objective to be achieved rather than how to do it and to enable auditors to exercise appropriate judgement in applying the requirements in the various circumstances that will be faced by different auditors around the globe. Certain limited differential requirements, for example, with respect to documentation and other communication responsibilities, may also be justified, as explained below.

### *A possible model for objective-based standards*

In Appendix 1, we illustrate an alternative structure for the ISAs as a coherent body of objective-based standards. The illustration is not intended to demonstrate how all existing standards and guidance in the existing ISAs would be repositioned under this new approach. Rather, it shows how a conceptual framework could be developed that would provide an appropriate framework to guide the application of professional judgement by auditors in designing and performing audit engagements to achieve the objective of the audit. Such a framework would also avoid the need for excessive guidance in setting out specific requirements as the framework would provide the underpinning for any specific requirements in the ISAs.

The conceptual framework envisaged includes a description of the objectives of an audit; the preconditions necessary to support audit quality (such as independence and ethical requirements, due care and competence); underlying auditing concepts (such as materiality, audit risk, reasonable assurance, professional scepticism, and the definitions of and auditor's responsibilities in relation to misstatements due to fraud and error); the audit process; and concepts underlying elements of the audit process (for example, for obtaining evidence).

Although not shown in the overview in Appendix 1, we can also see a role for audit technique guidance. This would be practical guidance on how to perform, for example, tests of control, analytical procedures, sampling techniques, or specific types of substantive procedures. In our view, such guidance would serve a valuable role in the auditing literature and is a necessary element of audit training, but should not need to be embedded in auditing standards.

### *Impact on existing ISAs*

Implementing this model would involve a fundamental rewriting of the existing ISAs, but we believe that this could be accomplished over time. Whilst this would result in some

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overlap in the short term, we do not believe it would result in any fundamental conflicts or discrepancies.

Much of the material that would form the basis for the conceptual framework already exists but is spread out in a number of the ISAs. Thus, developing the conceptual framework would be more a restructuring exercise than a fundamental reconceptualisation of the ISAs themselves. As such, we re-emphasise and strongly believe that our proposal does not bring into question the quality of the existing body of ISAs. Rather it reconstitutes them and provides a better framework for their future development. Guidance related to underlying concepts that is now found in a number of ISAs would form the starting point for developing the underlying conceptual framework and, eventually, as existing ISAs are rewritten under the new approach, such guidance could be eliminated from individual ISAs containing specific requirements.

Once the conceptual framework is in place, ISAs containing specific requirements could be rewritten over time as they are revised in response to specific needs or as part of a planned revisions programme. We believe that, in eliminating guidance that repeats what would now be included in the conceptual framework, the revised ISAs would be considerably shorter. In redrafting them, appropriate attention could be paid to identifying the requirements that are necessary in the circumstances and the wording of those requirements so that they are described in the context of the objectives in the conceptual framework. Guidance in the body of the ISAs could be kept to a minimum and include only the definitions and guidance necessary to ensure that the objectives of the requirements are clear and to identify any relevant matters that need to be considered in exercising judgement in implementing them. For example, we were intrigued by the illustrative restructured ISA 240 that was included in Agenda Item 2-D.1 for the June 2004 IAASB meeting. We thought that the nature and extent of the guidance included in the Standards section of that example had about the right level of detail we envisage for the ISAs. That being said, we believe that there would be considerable merit in supporting each ISA with a Basis for Conclusions that would explain the rationale for the requirements and how they fit within the conceptual framework. Other explanatory guidance, including illustrative examples that are now included within the body of the ISAs or in accompanying appendices, should be moved to supporting Practice Statements.

We also believe that IAASB should develop a consistent format and structure for the ISAs that constitute the Requirements under our model. For example, at a minimum, they should include a clear statement of the audit objective(s), set out relevant definitions, identify the main requirements to fulfil the objective(s) and then, separately, set out the basis for conclusions and any necessary implementation guidance. A significant benefit of our proposed approach—in contrast to the approaches proposed in the Exposure Draft and Consultation Paper which simply retrofit the existing standards—is that the existing body of literature can be rationalised.

A consistent approach is also needed to documentation and communication requirements, in particular whether they are included in each individual ISA or whether documentation and communication responsibilities are addressed comprehensively in a separate ISA. In viewing the ISAs as an integrated body of standards, the latter approach is probably preferable because it avoids the risk of duplication in the requirements and confusion if requirements that are intended to complement one and other fail to do so because different words have been inadvertently used to describe them.

In rewriting the ISAs under this approach, we would not anticipate that the number of bold-lettered requirements would significantly increase, if at all. We would, however, anticipate that they could be better articulated because they would be clearly based on the application of a consistent underlying set of concepts.

*Need to consider the impact on smaller audit engagements*

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It seems almost inevitable that as standard setters respond to the current regulatory preoccupation on audits of public interest entities, the compliance burden on audits of smaller entities increases disproportionately. The cost/benefit of the requirements always needs to be considered, but it is particularly important to be mindful of the impact on new requirements on that segment and to challenge whether all of the requirements are necessary in all circumstances. We are not proponents of differential auditing standards in relation to the underlying concepts and audit process itself, but do question whether the cost-benefit of proposed requirements regarding documentation and communication are justified in all circumstances. A significant advantage of the proposed structure is that it would enable IAASB to establish different requirements responsive to specific circumstances in these areas whilst retaining the common conceptual framework underpinning all audits.

### *Implementation of the proposals*

We have indicated above that we would support implementing this approach over time. Developing and issuing for exposure the complete package of ISAs has obvious advantages. On the other hand, such a project would dominate IAASB's agenda and resources for the foreseeable future. Full due process is vital and IAASB should not underestimate the debates that will inevitably ensue in implementing any of the proposals or approaches. Our vision contemplates quite significant revision of each ISA and doing so incrementally seems logical. As noted in our introductory remarks, however, at a minimum, we strongly encourage IAASB to place priority on developing the conceptual framework and an agreed structure for individual ISAs so that new and revised ISAs can begin to be drafted using the new model. Should IAASB decide that it would be best to devote all resources for a shorter period time to accomplish an overall revision of the entire body of ISAs, we would not oppose that decision.

### *Closing remarks*

We do not underestimate the importance of this Exposure Draft and Consultation Paper and commend IAASB for tackling the complex and controversial matters in them. Practitioners and stakeholders alike have strongly held views on this topic and we anticipate that IAASB may face significant challenges in reconciling the various views it receives on this exposure. IAASB may also face pressure to seek a short-term solution from certain stakeholders.

For the reasons set out above, however, we do not believe that a “quick fix” is either needed or desirable. In fact, we strongly caution IAASB against adopting the short-term solutions proposed in the Exposure Draft and Consultation Paper as we have serious concerns about the negative impact any strategy to retrofit the existing ISAs will have on audit quality. We urge IAASB to give serious consideration to the alternative strategy that we propose in this response and to the merits of developing objective-based international auditing standards firmly supported by a robust conceptual framework.

RM Since bold type letters represent standard sentences and plain type letters represent background or understanding information for the standard sentences, in my opinion these should be continued. Present tense discontinuation in future is welcome. Equal authority is necessary for compliance review purposes as otherwise only bold type sentences are only standards. The word “should” need not be treated as a presumptive requirement. For presumptive requirement the word must be used in future standards, as it is a new requirement of mandatory compliance with documentation for deviation/alternative procedure.

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