Issues Paper – Project Objectives, Proposed Drafting Convention and Implementation Plan

Objective of the Agenda Item

1. The objective of this Issues Paper is to obtain IAASB views and agreement on a revised proposal for improving the clarity of IAASB Standards and a proposed implementation plan.

Objectives of the Project to Improve the Clarity of IAASB Standards

2. The following statement comprises the overall objectives of the project to improve the clarity of IAASB Standards:

   To improve the clarity, and thereby the consistent application, of IAASB Standards by:

   - Clarifying that the entire text of an IAASB Standard carries equal authority, irrespective of the typeface convention.
   - Defining a drafting convention that focuses on fundamental principles and procedures, supported by clearly understandable requirements and explanatory guidance for their application.
   - Clarifying the relationship between, and authority of, ISAs and IAPSs and their appendices within the concept of equal authority.

3. These objectives serve as the basis on which the Task Force has formulated its proposal to improve the clarity of IAASB Standards. A description of each component of the proposal, along with the basis for the conclusion of the Task Force, is contained below.

Action:

*The IAASB is asked to review the revised proposal outlined below and to indicate whether it agrees with the conclusions of the Task Force. If not, the IAASB is asked to provide guidance as to possible alternative solutions for further consideration by the Task Force.*
A. Equal Authority

4. Proposed drafting convention:

The entire text of an IAASB Standard carries equal authority irrespective of the typeface convention (that is, both bold and plain type sentences have equal authority).

A Standard communicates the requirements of the auditor¹ by the language and the meaning of the words used in the text of the Standard.

5. At its July meeting, the IAASB did not object to this aspect of the original proposal and noted that there is strong merit in establishing ‘equal authority’ to bold and plain type lettering in IAASB Standards. It was noted that text which has been through the same IAASB due process might be deemed to have ‘equal authority’ whether or not it is in bold type, and that a statement of ‘equal authority’ might further clarify the responsibility of the auditor to consider all aspects of a Standard, not just the bold type sentences.

6. The Task Force believes that the concept of ‘equal authority’ eliminates any ambiguity over the auditor’s responsibility to apply the entire text of a Standard. It also eliminates the need to define the difference between a ‘basic principle and essential procedure’ from other, equally important, principles and procedures that may be contained in a Standard.

B. Proposed Drafting Convention for IAASB Standards

BOLD TYPE LETTERING

7. Proposed drafting convention:

Bold type lettering is a convention used to emphasize the ‘principles-based approach’ to the setting of IAASB Standards. It is used to identify the ‘fundamental principles and procedures’ on which a Standard is based. Bold type lettering also contributes to the overall readability and understandability of a Standard.

Bold type lettering, however, is not used to denote the only requirements to be followed by an auditor.

¹ For purposes of this document, the term “auditor” has been used generically, and has the same meaning as ‘professional accountant’ as referred to in the Preface to the International Standards on Quality Control, Auditing, Assurance and Related Services.
8. In July, the IAASB generally agreed that the current phrase ‘basic principles and essential procedures’ might erroneously imply that the bold type paragraphs are the only procedures that the auditor has to consider and apply. Members indicated that an alternative term ‘main principles’ might not be appropriate as it may indicate the existences of secondary (subsidiary) principles, which is not the case. There was however general support to the suggestion of re-characterizing the term as ‘fundamental principles and procedures’.

9. The Task Force deliberated the manner in which bold type lettering may best be characterized. The Task Force observed that the use of ‘equal authority’, combined with the adoption of greater flexibility in the language used to describe auditor requirements in plain type sentences, eliminate de facto any potential hierarchy of the requirement included in a Standard. The Task Force concluded that identifying ‘fundamental principles and procedures’ in bold type lettering benefits IAASB Standards by supporting the ‘principles-based approach’ used in the standard setting process, by facilitating the identification of the broad objectives or overarching “thrust” of a Standard and by providing a structural “road-map” to a Standard.

10. The Task Force also considered whether there is a need to provide a definition distinguishing ‘fundamental principles and procedures’ from other principles and procedures contained in a Standard. It was concluded that a definition was not necessarily needed within the concept of ‘equal authority’.

**USE OF THE WORD “SHOULD”**

11. Proposed drafting convention:

<table>
<thead>
<tr>
<th>The use of the word “should” is used to identify a procedure or action which the auditor is required to carry out in all circumstances (or whenever a stipulated condition(s) is (are) met). It is used in either bold type or plain type sentences.</th>
</tr>
</thead>
<tbody>
<tr>
<td>If the word “should” is used in a plain type sentence, the sentence contains a mandatory principle or procedure.</td>
</tr>
</tbody>
</table>

12. In July, the IAASB gave recognition to the fact that the present tense as used in IAASB standards may be variously interpreted as being more, or less, definitive than the use of “should,” and therefore may be problematic when interpreting and translating IAASB Standards. There were, however, differing views expressed on whether the word “should” should be used in the plain type lettering.

13. Some members were concerned, and expressed disagreement, with using the word “should” in plain type sentences under any circumstance. This view was premised on the fact that readers of ISAs, for instance, look to the bold type lettering (and the corresponding use of the word “should” therein) to ascertain the principles and procedures that underlie the basic objectives of the audit. It was viewed that an intermittent inclusion of the word “should” in the plain type lettering might in fact hinder the clarity and understandability of the Standards. Rather, if a procedure is deemed to be a mandatory procedure, then it should be established in bold type lettering.
14. Other members generally supported the view that greater flexibility in the language used in plain type sentences when describing the requirements of the auditor to carry out a procedure (including the use of the word “should” therein) is fundamental to improving the clarity of the Standards. It was also noted that without this flexibility, a proliferation of bold type sentences may occur with no resolution over the ambiguity as to the use of the present tense.

15. The Task Force has concluded that, within the concept of equal authority, the use of the word “should” within plain type sentences is critical to the ability to clearly communicate the required procedures and actions of the auditor. In arriving at its conclusion, the Task Force was sensitive to the concern over the possibility of a proliferation of the word “should” in the plain type sentences. The Task Force was of the view that greater discipline would need to be applied when drafting a standard in ascertaining whether in fact a procedure is deemed to be mandatory.

16. The Task Force also noted that the one possible drafting construct that may help mitigate concern over the number of “shoulds” was through drafting (where possible) explanatory material that focused on explaining the importance of the subject/topic identified in the bold type paragraphs rather than using the present drafting construct that starts off by describing an action by the auditor. Appendix I provides an illustrative example of how this drafting convention may assist in distinguishing explanatory material from the requirement of the auditor.

17. In addition, the Task Force saw this proposal as opening ways to actually reduce the extent of bold type sentences, and to allow these sentences to better present the overarching principles and procedures of a Standard (in contrast to the current trend of expanding bold type lettering). Appendix II illustrates how the proposal to use the word “should” within plain type sentences might improve the drafting of a Standard.

18. The Task Force also considered whether an alternative term to “should”, such as “shall” or “must”, is desirable. The Task Force concluded that the term “should” is appropriate, consistent with the views of the IAASB in July that “shall” and “must” imply unconditional compliance and do not provide for professional judgment.
MODIFIERS

19. Proposed drafting convention:

<table>
<thead>
<tr>
<th>Procedures or actions to which an unconditional requirement for the auditor to carry out the specified activity is not intended are to be described using appropriate modifiers, as follows:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• ‘ordinarily’ – used to express a procedure or action that is commonplace or normally used, but which may not be applicable or appropriate in all circumstances</td>
</tr>
<tr>
<td>• ‘may’ – used when providing the auditor a choice as to whether a procedure or action is to be undertaken</td>
</tr>
<tr>
<td>• ‘for example’ or ‘such as’ – used when describing a procedure or action for illustrative purposes and not intending to provide a comprehensive list of requirements.</td>
</tr>
</tbody>
</table>

20. In July, the IAASB expressed general support for this aspect of the proposal, recognizing that the “unmodified” present tense may be variously interpreted as being more, or less, definitive than is intended and, therefore, problematic when interpreting and translating Standards.

21. The Task Force concluded that the original proposal to modify the present tense when dealing with the expected, but not mandatory, activities of an auditor should be adopted. It recommended however that guidance be provided around the preferred types of modifiers and the circumstance in which they are to be used. The Task Force recognizes that the above list is not all-inclusive and that other modifiers may be identified as the IAASB gains experience with this drafting convention.

22. To avoid any misunderstanding, the Task Force recommends that only a select few adverbs or other modifiers be used within standards, and that use of synonyms be avoided where possible. For example, the consistent use of “ordinarily”, and not its synonym “normally”, might assist in eliminating any perceived difference between these adverbs when describing an auditor’s expected course of action.

23. The Task Force also considered the use of the modifying phrase “in the auditor’s professional judgment”. It was agreed that it is not necessary to repeat this phrase throughout ISAs since this application of professional judgment underlies the entire conduct of an audit. It was also viewed that its use in the context of specific procedures within an individual Standard may inadvertently diminish the clarity of the auditor’s expected performance. The Task Force however recognized that, in some circumstances, it may be necessary for a Standard to emphasize this consideration.

24. The Task Force also believed the modifier “in some cases” could be ambiguous and therefore would not consider it a suitable modifier.

25. Appendix III provides illustrative examples of the use of modifiers to the present tense.

*The IAASB is asked to consider whether this list is suitable for purposes of drafting Standards, and to indicate whether there are any possible translation problems that might arise?*
WORDS AND PHRASES

26. Proposed drafting convention:

The words used in a Standard are to be based on their generally understood meaning or on the definition of the word as contained in the Glossary of Terms.

Words and phrases, other than those defined in ISAs and therefore included in the Glossary of Terms, that express a specifically intended meaning by the IAASB are to be communicated to users of IAASB Standards.

27. In July, one IAASB member suggested that consideration should be given to using an external body of experts to comment on the understandability of a small number of existing ISAs. The IAASB did not object to this suggestion, and was generally supportive of the use of ‘plain English’ if it helps the clarity of ISAs.

28. As indicated, Staff has engaged an expert in ‘plain English’ to review a selected ISA in order to identify ways in which the drafting of IAASB Standards may be improved. The Task Force is presently considering the findings of the ‘plain English’ expert. However, one preliminary conclusion from this review is that an explanation of the use of the word “should” and how the present tense and related modifiers are used and to be understood should be communicated to users.

29. In September 2002, Staff presented a proposed policy statement entitled “IAASB Words and Phrases”. This policy statement set out the policies the IAASB uses when drafting its Standards and Practice Statements. At that time, the IAASB did not see merit in including the policy statement as part of the Preface exposure draft, and recommended its internal use only.

30. With the objective of improving the clarity of IAASB Standards, the Task Force believes that a document of this type should be further developed and used as a vehicle to communicate, in all or in part, the proposed changes to the drafting convention of IAASB Standards. The revised document would be subject to approval by the IAASB and, once approved, published either as an addendum to the Preface or as an operating policy.

PROPOSED STATEMENT OF AUTHORITY

31. Based on the proposed drafting convention for IAASB Standards outlined above, it is proposed that the Statement of Authority presented at the beginning of each ISA (and related provision in the Preface) be revised to state:

_ International Standards on Auditing (ISAs) contain paragraphs in bold type and plain type, which have equal authority. Paragraphs in bold type indicate fundamental principles and procedures. Paragraphs in plain type further explain the objectives of the fundamental principles and procedures, and elaborate upon the procedures which are either required or ordinarily expected to be undertaken, or which may be applied, in an audit conducted in accordance with ISAs. ISAs are therefore to be read and applied in their entirety._
In exceptional circumstances, an auditor may judge it necessary to depart from a requirement of an ISA in order to more effectively achieve the objective of an audit. When such a situation arises, the auditor should be prepared to justify the departure.

APPENDICES TO IAASB STANDARDS

32. Proposed drafting convention:

Appendices form part of the text of a Standard. The purpose and intended use of an appendix are clearly explained in the body of the Standard or within the title and introduction of the appendix itself. Appendices however do not include requirements expected of an auditor.

33. The Task Force deliberated whether equal authority should extend to the material included in an appendix to a Standard. It was noted that appendices have been used historically for different purposes and that no clear rules have been established around their use. In some cases, for example ISA 240, the appendix has been used to provide non-exclusive examples of fraud risk factors typically faced by auditors in a broad range of situations. Similarly, the appendices to ISA 800 provide example auditor’s reports for illustrative purposes. In other cases, for example ISA 545, additional material is provided in the appendix to assist readers in understanding the context in which the Standard is set.

34. The Task Force observed that the approved Preface has clarified the fact that appendices form part of a Standard. The Task Force agrees with this conclusion based on the fact that the development of an appendix follows the same due process afforded to the main body of the Standard itself.

35. Given the extension of equal authority to appendices (by virtue of being a component of a Standard), however, the Task Force felt that it is important that the purpose and intended use of an appendix are clearly explained in the body of the Standard or within the title and introduction of the appendix itself. The Task Force also noted that appendices should not include any required actions or procedures of the auditor; such requirements should be contained within the main body of a Standard.

C. THE AUTHORITY OF IAPSS

36. In July, some members expressed the view that since IAPSSs are issued by an authoritative body and included in the same handbook as the ISAs, IAPSSs might in fact be deemed to have the same authority as the ISAs. It was further noted that a move to ‘equal authority’ in ISAs may compound the concern over the authority and status of IAPSSs. The issue of the actual (and perceived) interrelationship of the authority of IAPSSs and ISAs was considered by one member to be sufficiently important that it was suggested it may be necessary for the IAASB to consider the issuance of separate guides on certain subject matters, as opposed to IAPSSs, to clearly demarcate the intended authority of such guidance.

37. The Task Force believes that the present, relatively diverse mix of IAPSSs makes it extremely difficult to consider amending the authority of IAPSS from that presently provided in the Preface. Initial consideration of existing IAPSSs by the Task Force would
suggest that some IAPSs could be re-written as ‘industry or topical’ ISAs (for example, banking-related IAPS 1004 and IAPS 1006), some IAPS might be re-described as ‘ISA Interpretations’ (for example, IAPS 1014), while others may be retained as IAPSs providing practical assistance and promoting good practice.

38. The Task Force concluded that a more in-depth study is needed of the intended purpose of IAPSs, the type of guidance to be included therein, the authority thereof and the related due process to be followed. In the interim period, however, the Task Force suggests that the IAASB revision process consider the clarity of the language used in IAPSs and reconsider whether each IAPS should be retained as an IAPS, reformulated into a Standard or withdrawn.

39. Until further study is completed, the Task Force recommends that the present description of the authority attaching to IAPS as set forth in the Preface\(^2\) should be retained without modification.

D. Way Forward

40. If the IAASB is in general agreement with the revised proposal, the Task Force intends to discuss the proposal with the CAG in November 2003. The Task Force would then provide the IAASB in December 2003 with the following material for approval as an Exposure Draft:

- Revised proposal based on comments received from the IAASB and the CAG.
- A proposed Policy Statement (or equivalent) which describes the words and phrases used in IAASB Standards, the drafting and style conventions used in formatting Standards, and guidance on the use and intended purposes of appendices.
- Selected ISAs re-drafted to illustrate the application of the proposals (not for exposure, but to help demonstrate to the IAASB the impact of the proposals would have on an ISA)

\(^2\) Paragraph 19 and 20 of the Preface states:

International Auditing Practice Statements (IAPSs) are issued to provide interpretive guidance and practical assistance to professional accountants in implementing ISAs and to promote good practice.

Professional accountants should be aware of and consider Practice Statements applicable to the engagement. A professional accountant who does not consider and apply the guidance included in a relevant Practice Statement should be prepared to explain how the basic principles and essential procedures in the Engagement Standard(s) addressed by the Practice Statement have been complied with.
41. The Task Force proposes that the IAASB approve and issue in December an Exposure Draft explaining the proposed changes to the authority of, and the drafting convention to be used for, IAASB Standards. The exposure period would be for 60 days ending February 29, 2004.

42. The Task Force believes the only practical implementation of the proposal is on a prospective basis. That is, all new or revised Standards issued after approval of the Exposure Draft would be written following the new drafting convention and contain the proposed revised Statement of Authority (as described in paragraph 31 of this proposal).

43. During the exposure period, Task Forces responsible for current projects would be encouraged to consider how their draft standards may be amended so that they would be ready to be issued in accordance with the revised drafting convention after February 28, 2004. The objective would be to capture as many new and revised Standards issued before June 30, 2004 as possible.

44. A full revision of all other existing IAASB Standard (i.e., those Standards not presently subject to Task Force revision) is not contemplated before June 2004. Rather, existing would be reviewed following the normal cycle of revision and as circumstances dictate.

45. The Task Force also recommends that each ISA clearly identify its original date of issue together with dates of subsequent amendments. The manner in which such dates is to be presented in Standards is being presently addressed by Staff. This dating of Standards will assist users in understanding whether the existing or revised drafting conventions have been used in the development of the standard.

46. It is envisioned that the exposure draft would not only request comments on the proposals, but specifically solicit views on whether there are any transitional issues that might be of consequence to stakeholders.

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3 The Preface states that the exposure period will ordinarily be no shorter than 90 days. However, a 90 day exposure period would result in IAASB review and approval of the proposed Exposure Draft in June 2004 and, consequently, may impede the ability of the IAASB to adopt the new drafting convention for new or revised IAASB Standards scheduled for approval in April and June 2004. Due to these circumstances, a 60 day exposure period is therefore proposed.

4 Assuming projects progress according to the Project Timetable (Agenda Item 1-C of the IAASB October 2003 meeting material), current projects that would adopt the proposed drafting conventions in either their exposure draft or final version include:
- revised ISA 240, Fraud (if approved as final in April);
- revised ISA 700, Auditor’s Report;
- revised ISA 300, Planning;
- Group Audits;
- revised ISA 540 Accounting Estimates;
- revised ISA 320, Materiality;
- revised ISA 230, Documentation;
- new ISA 701, Modifications to the Auditor’s Report;
- revised ISA 260, Communication; and
- all new projects to be commenced.
Illustrative application of the proposed drafting convention – Removing imperatives from explanatory material

As indicated in the proposal, one drafting solution that may be adopted within IAASB Standards to clarify and distinguish explanatory guidance from the requirements expected of auditors is to draft explanatory material (where possible) that focused on explaining the importance of the subject/topic identified in the bold type paragraphs, rather than using the drafting construct that starts off by describing an action by the auditor.

As an example of this concept, ISA 570 contains the following bold type sentence and the related explanatory guidance:

“In planning the audit, the auditor should consider whether there are events or conditions which may cast significant doubt on the entity’s ability to continue as a going concern.” (Paragraph 11, ISA 570)

“The auditor considers events and conditions relating to the going concern assumption during the planning process, because this consideration allows for more timely discussions with management, review of management’s plans and resolution of any identified going concern issues.” (Paragraph 13, ISA 570)

Paragraph 13 could be revised to exclude the phrase “The auditor considers…” and redrafted to focus on why the auditor’s consideration of event or considerations is important.

Accordingly, paragraph 13 might be amended to state:

“Consideration of events and conditions relating to the going concern assumption during the planning process allows for more timely discussions with management, review of management’s plans, and resolution of any identified going concern issues.”

Similarly, paragraph 16 of ISA 570 might be re-drafted as follows:

“The auditor considers the existence and effect of identified events or conditions may affect the auditor’s when making preliminary assessments of the components of audit risk and, consequently therefore, their existence may affect the nature, timing and extent of the auditor’s procedures.”
Appendix II

Illustrative application of the proposed drafting convention – Use of the word “should” in plain type sentence

The Task Force has considered the application of the proposal to include the use of the word “should” in plain type sentences on one selected ISA (ISA 570, Going Concern). The following illustrates one paragraph in ISA 570 containing a procedure (currently described in a plain type sentence using the present tense) that is, in the Task Force’s view, a procedure that is expected to be carried out by auditors but which does not constitute a fundamental principle or procedure.

Accordingly, paragraph 29 of ISA 570 might therefore be re-drafted as:

“When analysis of cash flow is a significant factor in considering the future outcome of events or conditions the auditor should consider:

(a) The reliability of the entity’s system for generating such information; and
(b) Whether there is adequate support for the assumptions underlying the forecast.

In addition the auditor should compare:

(c) The prospective financial information for recent prior periods with historical results; and
(d) The prospective financial information for the current period with results achieved to date.”

Re-consideration of fundamental principles and procedures - Use of the word “should” in plain type sentence

The Task Force also observed that paragraph 26 of ISA 570 could be re-drafted to reduce the extent of bold type lettering. Permitting the use of the word “should” in plain type sentences, within the concept of equal authority, allows for a more concise drafting construct.

Paragraph 26 of ISA 570 presently states:

“When events or conditions have been identified which may cast significant doubt on the entity’s ability to continue as a going concern, the auditor should:

(a) Review management’s plans for future actions based on its going concern assessment;
(b) Gather sufficient appropriate audit evidence to confirm or dispel whether or not a material uncertainty exists through carrying out procedures considered necessary, including considering the effect of any plans of management and other mitigating factors; and
(c) Seek written representations from management regarding its plans for future action.”
Paragraph 26 of ISA 570 might be redrafted as follows:

“When events or conditions have been identified which may cast significant doubt on the entity’s ability to continue as a going concern, the auditor should gather additional appropriate audit evidence to confirm or dispel whether a material uncertainty exists.

In gathering sufficient appropriate evidence, the auditor should carry out procedures considered necessary, including:

(a) Review of management’s plans for future actions based on its going concern assessment;
(b) considering the effect of any plans of management and other mitigating factors; and
(c) seeking written representations from management regarding its plans for future action.”
Appendix III

Illustrative application of the proposed drafting convention – Use of modifiers

The following example illustrates the proposed use of modifiers to the present tense. Paragraph 27 of ISA 570 might be amended as follows:

“Events or conditions which may cast significant doubt on the entity’s ability to continue as a going concern may be identified during the planning of the engagement or in the course of performing audit procedures. The process of considering events or conditions continues as the audit progresses. When the auditor believes such events or conditions may cast significant doubt on the entity’s ability to continue as a going concern, certain procedures may take on added significance. The auditor’s inquiry of management inquires of management as to its plans for future action may cover such matters as, including its plans to liquidate assets, borrow money or restructure debt, reduce or delay expenditures, or increase capital.”

Similarly, for illustrative purposes, paragraph 14 of ISA 570 might be amended as follows:

“In some cases, management may have already made a preliminary assessment at the early stages of the audit. If so, the auditor ordinarily reviews that assessment to determine whether management has identified events or conditions, such as those discussed in paragraph 8, and management’s plans to address them.”