Proposed ISA 200 (Revised and Redrafted)

Objective of Agenda Item
1. To approve proposed ISA 200 (Revised and Redrafted).1

Task Force
2. The members of the Task Force are:
   • John Kellas (Chairman) – IAASB Chairman
   • Denise Esdon – IAASB Deputy Chair
   • John Fogarty – IAASB Member
   • Jon Grant – IAASB Member
   • Gérard Trémolière – IAASB Member
   • Jim Sylph – Executive Director, IFAC

Activities Since Last IAASB Discussion
3. The Task Force met in April 2008 to discuss comments received from the IAASB and Representatives of the IAASB Consultative Advisory Group (CAG) at their March 2008 meetings, and from the IFAC Small and Medium Practices Committee (SMPC).

Matters for IAASB Consideration
4. In general, the IAASB, IAASB CAG and SMPC expressed support for most of the substantive changes proposed by the Task Force to Exposure Draft (ED)-ISA 200. The general view was that the revised draft is an improvement from the ED, and that the Task Force demonstrated responsiveness to the comments received on exposure. However, in addition to a number of detailed drafting points, there were a few matter requiring further drafting revisions. These are summarized below.

1 ISA 200 (Revised and Redrafted), “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing.”
A. AN AUDIT OF FINANCIAL STATEMENTS

A.1 Purpose of an Audit

5. Paragraph 3 of proposed ISA 200 (Revised and Redrafted) states: “The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements.”

6. Some IAASB CAG Representatives suggested that the purpose of an audit should be “to enhance the credibility of the financial statements.” A few Representatives, however, cautioned change to the current proposed wording to avoid unintended consequences, including questions of liability.

7. The Task Force is of the view that the current proposed wording should be retained. It parallels the wording contained in the International Framework for Assurance Engagements, as well as the IFAC Code of Ethics for Professional Accountants (IFAC Code), and it is desirable that consistency among pronouncements be maintained. Further, the Task Force does not believe that the statement that ‘an audit enhances the credibility of the financial statement’ is fully accurate – a modification to the auditor’s opinion, such as an adverse opinion, would not suggest that the financial statements are credible. Finally, the current wording is substantively consistent with that proposed in ED-ISA 200 and no specific concerns were raised by respondents on exposure.

8. Accordingly, no change to the wording discussed at the March IAASB meeting is proposed. See paragraph 3 of Agenda Item 4-A.

A.2 Inherent Limitations, and Other Reporting and Communication Responsibilities

9. The IAASB strongly urged the Task Force to give greater emphasis to the inherent limitations of an audit in the Introduction section of the ISA, in light of the importance of the limitations to a proper understanding of reasonable assurance. A few IAASB CAG Representatives suggested the same in order to explain more fully the concept of reasonable assurance.

10. The IAASB also asked the Task Force to revise the final paragraphs in the Introduction section describing other reporting and communication responsibilities to make clear they relate to matters flowing from the audit.

11. In response the Task Force proposes the changes shown in paragraphs 5 and 9, respectively, of Agenda Item 4-A.

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2 Paragraph 7 of the Framework states: “Assurance engagement” means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.

3 Two respondents made reference to the ‘purposes of an audit’: APB (which suggested wording similar to that used in the March draft), and Basel (which suggested that the purpose of an audit be explained rather than setting out the overall objective of an audit).
B. DEFINITIONS

B.1 Auditor

12. The IAASB agreed with the Task Force’s observation that the extant definition of ‘auditor’ is confusing and unnecessarily complex. It supported revision along the lines suggested in the March Issues Paper. The Task Force’s proposed definition is as follows: (Changes to the Glossary definition are shown in paragraph 13(d) of Agenda Item 4-A)

“Auditor – The person or persons conducting the audit, usually the engagement partner and engagement team, and in some cases, the firm. Where an ISA expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term “engagement partner” rather than “auditor” is used.”

13. The Task Force believes that this definition is clearer than the Glossary version, and appropriate in light of other ISAs and definitions therein, including ED-ISQC 1 (Redrafted) and ED-ISA 220 (Redrafted) which define “engagement partner,” “engagement team,” and “firm.”

C. REQUIREMENTS

C.1 Ethical Requirements

14. An IAASB member questioned whether it is appropriate or necessary to include reference to independence in the requirement to comply with relevant ethical requirements. (See paragraph 14 of Agenda Item 4-A.)

15. In developing ED-ISA 200, the IAASB was of the view that auditor independence is of sufficient importance to merit emphasis in the requirement as well as the related application material. Only two respondents to ED-ISA 200 suggested removing the reference to independence to avoid singling out one aspect of the ethical requirements.

16. The Task Force notes, however, that the construct used in ED-ISA 200 is inconsistent with how references to relevant ethical requirements are made in ED-ISQC 1 (Redrafted) and other ISAs. Accordingly, the Task Force believes that it would be appropriate to delete reference to independence in the requirement of ISA 200, as suggested, recognizing that

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4 Proposed ISQC 1 (Redrafted), “Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements.”

5 As per ED-ISA 220 (Redrafted), “Quality Control for an Audit of Financial Statements:”

“Engagement partner–The partner or other person in the firm who is responsible for the audit engagement and its performance, and for the auditor’s report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.”

“Engagement team – [Partners and staff performing the engagement and any individuals engaged by the firm who perform audit procedures. This does not include auditor’s external experts.]”

“Firm – A sole practitioner, partnership, corporation or other entity of professional accountants.”

6 KPMG-SA and IRBA.
the matter is given sufficient emphasis in the application material supporting the requirement. Proposed changes are shown in **paragraph 14 of Agenda Item 4-A**.

17. In regard to guidance to paragraph 14, it was also suggested that the guidance could be improved by making reference to the requirements of ED-ISA 220 (Redrafted) in connection with independence, thereby providing greater context to the statement that the engagement team is entitled to rely on a firm’s system of quality control. The Task Force agrees with this suggestion. Proposed changes are shown in **paragraph A16 of Agenda Item 4-A**.

C.2 Read and Understand Entire Text of an ISA

18. Paragraph 21 of ED-ISA 200 stated that the auditor “shall consider the entire text of an ISA...” In response to comments received on exposure, the Task Force proposed strengthening the requirement to “shall read and understand the entire text...” (See paragraph 19 of Agenda Item 4-A.)

19. Some IAASB members and the SMPC were of the view that this proposed change suggests that the auditor needs to read the ISAs in every audit instance. They also felt that it does not give recognition to other means by which the content of the ISAs may be communicated (i.e., through methodology). Further, it may be unreasonable to require an ‘understanding’, that being a matter of mental capacity.

20. The intent of the Task Force was to make clear the authority of the application guidance and other explanatory material in the ISAs and to dispel the notion that such material is entirely optional. The Task Force believes that the proposed requirement is clear, and that it would be unreasonable to interpret it as requiring the auditor to read the ISAs in every audit instance. Further, the definition of ‘auditor’ includes the firm – the requirement therefore does not prevent a firm using methodology or other guidance as the vehicle for communicating the ISAs, so long as the entirety of the ISAs is considered in its development. Finally, the Task Force considers alternative wording, such as ‘the auditor shall take account of the entire text’, to be less clear and likely problematic for translation. Accordingly, no change has been proposed. **See paragraph 19 of Agenda Item 4-A**.

21. The Task Force has, however, refined the guidance to paragraph 19 to better explain that the entire text of an ISA is relevant to the understanding required to be obtained. Proposed changes are shown in **paragraph A57 of Agenda Item 4-A**.

C.3 Objectives

22. Two issues were raised by a few IAASB members regarding objectives. These related to:

- The use and achievement of individual objectives, and documentation when there is a failure to achieve an objective; and

- The linkage between the achievement of objectives and the inherent limitations of an audit.
Use and Achievement of Individual Objectives, and Documentation of a Failure

23. An IAASB member expressed strong concern about the material addressing the auditor’s obligations with respect to individual objectives and the documentation of a failure to achieve an objective. The concern echoed comments in a few response letters: the effect of the material may be to focus the auditor’s ‘end game’ on the achievement of the individual objectives, rather than the overall objectives of the auditor while taking account of the ISAs collectively. In addition, it was argued that proposed deletion of the following explanatory material (highlighted by italics) from the requirements section of ED-ISA 200 were substantive in terms of loss of essential context:

ED paragraph 23 – “Each ISA contains an objective or objectives, which provide the context in which the requirements of the ISA are set. These objectives support the overall objective of the auditor set out in paragraph 5 of this ISA.”

ED paragraph 24 – “To achieve overall objective of the auditor, the auditor shall use the objectives…”

ED paragraph 24 – “The proper application of the requirements of the ISAs will ordinarily provide a sufficient basis for the auditor’s achievement of the objectives. However, the ISAs cannot anticipate all circumstances that may arise.”

24. Regarding the failure to achieve an objective, the member was strongly concerned with the application material in paragraph A75 of the March version of ISA 200. It was suggested that documentation of a failure to achieve an objective implies the need to document achievement of the objectives – although the application material specifically says that this is not so. This implication, were it valid, would drive a checklist approach and constrain how objectives might be used in audit.

25. Other IAASB members, however, accepted the basis for the Task Force’s proposed changes to ED-ISA 200. It was noted that it is not in the public interest to lead the auditor to believe that mere compliance with the requirements of the ISAs is expected, nor to give the auditor a false sense of security that the ISAs address the procedures necessary in all circumstances. Nevertheless, the Task Force was asked to consider whether it had gone too far, and to consider how some boundaries with respect to the expected use of the objectives might be expressed.

26. The Task Force does not believe that substantive change should be made to the text of the March draft of ISA 200. In the Task Force’s view, the text achieves an appropriate balance in response to comments received on exposure. Further, the proposed ISA 200 articulates accurately the expected use of objectives, and gives sufficient emphasis throughout the ISA to the overall objectives of the auditor thereby minimizing the likelihood that they are inadvertently overlooked when the auditor is using individual objectives for the specified purposes.

27. The Task Force proposes, however, a few changes to help provide greater context to the requirement. The proposed changes are shown in:
• **Paragraph 21 of Agenda Item 4-A**, to bring back reference to the overall objectives as context to the required use of individual objectives (consistent with the ED).

• **Paragraph A69**, to acknowledge that the requirements of the ISAs, if properly applied, are expected to provide a sufficient basis for the auditor’s achievement of the objectives (edited slightly from the ED).

28. Regarding the guidance on documentation of a failure to achieve an objective, other IAASB members and the IAASB CAG seemed content with the Task Force’s proposals. The Task Force also notes that that material is also generally consistent with paragraph A11 of ISA 230 Redrafted. 7 Accordingly, no changes are proposed. See paragraph A75 of Agenda Item 4-A.

Linkage Between Achievement of Objectives and the Inherent Limitations of an Audit

29. An IAASB member questioned whether the linkage between the achievement of objectives and the inherent limitations of an audit is clear. This issue is that, while most objectives are either within the control of the auditor (audit documentation, for example) or refer to sufficient appropriate audit evidence which includes the notion of the inherent limitations of an audit, there are other important objectives (for example in ISA 240 (Redrafted) to “identify and assess the risks of material misstatement of the financial statements due to fraud”) which are also subject to the inherent limitations of an audit. It was suggested that some redrafting could help make clear this point.

30. The Task Force agrees in principle with this observation. The Task Force’s proposed changes are shown in:

• **Paragraph A67 of Agenda Item 4-A**, to make clear that objectives (including those that do not directly relate to sufficiency and appropriateness of audit evidence) are equally subject to the inherent limitations of an audit.

• **Paragraph A74 of Agenda Item 4-A**, to reflect that fact that judgments is inherent in any evaluation of whether an objective has been achieved.

D. APPLICATION AND OTHER EXPLANATORY MATERIAL

D.1 Professional Judgment

31. Paragraph A50 of the revised draft of ISA 200 presented to the IAASB in March stated:

“Whether the exercise of professional judgment in any particular case is reasonable is based on the facts and circumstances that were known, or could reasonably be expected to have been known, by the auditor at the time the judgment was made. Professional

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7 ISA 230 (Redrafted), “Audit Documentation”, paragraph A11 includes the following: “Further, the preparation of such a summary may assist the auditor’s consideration of the significant matters. It may also help the auditor to consider whether, in light of the audit procedures performed and conclusions reached, there is any individual relevant ISA objective that the auditor is unable to meet that would prevent the auditor from achieving the overall objectives of the auditor.”
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judgment can be evaluated based on what most other experienced auditors, having knowledge of all relevant information, would reasonably conclude to be appropriate, including whether the judgment reached is consistent with the facts and circumstances and the proper, competent application of auditing and accounting principles.”

32. The IAASB and SMPC expressed concern about this ‘test’ of professional judgment, in particular the phrase “most other experienced auditors.” It was noted that it is not in the public interest to suggest that the auditor need find only one other auditor who would support the judgment made; on the other hand, it is impracticable to suggest considering a majority view. The Task Force was asked to consider whether the phrase could be deleted, or whether a parallel could be drawn to the guidance in the IFAC Code8.

33. The Task Force’s has refined the proposed ‘test’ of professional judgment as follows (see paragraph A25 of Agenda Item 4-A):

> “Professional judgment can be evaluated based on whether the judgment reached reflects a proper, competent application of auditing and accounting principles and is appropriate in the light of, and consistent with, the facts and circumstances that were known at the time the judgment was made.”

34. The above reflect the following views of the Task Force:

- It is unnecessary to specify the hypothetical party or parties against which a judgment should be evaluated. The ‘test’ is more objective if it focuses on the relevant facts and circumstances and how these were addressed when applying the relevant accounting and auditing requirements.

- It is also unnecessary to extend the ‘test’ to ‘facts and circumstances that could reasonably be expected to have been known by the auditor.’ This deals with the auditor’s evidence gathering process and whether the auditor has obtained sufficient appropriate audit evidence as a basis for the auditor’s conclusions, rather than the evaluation of the judgments made.

Proposed changes are shown in paragraphs A24-A25 of Agenda Item 4-A.

35. In addition, the Task Force has amended the final sentence of paragraph A26 of Agenda Item 4-A to avoid limiting its scope to only matters related directly to the evidence gathering process (i.e., to encompass judgments relating to matters such as materiality, etc.).

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8 Paragraph 200.11 of the Code includes the following: “A professional accountant in public practice should exercise judgment to determine how to best deal with an identified threat. [A self-interest threat, for example.] In exercising this judgment a professional accountant in public practice should consider what a reasonable and informed third party, having knowledge of all relevant information, including the significance of the threat and the safeguards applied, would reasonably conclude to be acceptable.”
D.2 Inherent Limitations

36. In general, the IAASB was of the view that a good balance has been achieved between factual content and length in the discussion of inherent limitations of an audit, and that the material provides clear explanation of the limitations, their sources and consequences, and the responsibilities established by ISAs that counterbalance the limitations. There were, however, calls by some Board members and CAG Representatives for the Task Force to make the material more concise and less defensive, particularly in relation to:

- The nature of the financial reporting.
- The legal and practical limitations on the auditor’s ability to obtain audit evidence.
- Limitations with respect to fraud (including the duplication of material on authentication of document that is also contained in the discussion of professional skepticism).

37. Proposed changes are shown in paragraphs A44-A51 of Agenda Item 4-A.

D.3 Considerations Specific to Audits of SMEs

38. The IAASB asked the Task Force to clarify whether the ISAs’ guidance for audits of smaller entities (SMEs) is, or is not, applicable to smaller listed-entities. In addition, other drafting changes were suggested to improve the qualitative characteristics typical of SMEs.

39. Proposed changes are shown in paragraphs A62-A64 of Agenda Item 4-A.

Additional Matters for IAASB Consideration

PREFACE

40. The explanatory memorandum to ED-ISA 200 stated the following: “Because proposed ISA 200 (Revised and Redrafted) incorporates the provisions of the amended Preface relevant to ISAs, the IAASB intends to remove them from the amended Preface. Instead, the amended Preface would refer readers to ISA 200 (Revised and Redrafted) for the authority attaching to ISAs.”

41. Respondents to ED-ISA 200 that did comment on this matter supported the proposed treatment, which is consistent with how the statement of the authority of ISQCs is presented in the Preface.

42. Proposed changes to the Preface are shown in Exhibit I of Agenda Item 4-A.

CONFORMING AMENDMENTS

43. Exhibit II of Agenda Item 4-A contains proposed conforming amendments to final clarified ISAs. The conforming amendments are mainly editorial in nature.

RE-EXPOSURE

44. For information, Agenda Item 4-B presents a mark-up of the draft revised of the proposed ISA 200 (Revised and Redrafted) showing changes from the ED, and a comparison of
certain text in ED-ISA 200 and the proposed ISA. The Task Force is of the view that the changes made are responsive to matter respondents have raised on exposure, and do not introduce new principles or represent other changes of substance compared with the ED. Accordingly, the Task Force is of the view that re-exposure is not necessary.\footnote{IAASB Working Procedures regarding re-exposure state: “Situations that constitute potential grounds for a decision to re-expose may include, for example: substantial change to a proposal arising from matters not aired in the exposure draft such that commentators have not had an opportunity to make their views known to the IAASB before it reaches a final conclusion; substantial change arising from matters not previously deliberated by the IAASB; or substantial change to the substance of an International Standard or Practice Statement.”}

Material Presented (Note: Agenda Item 4-A will be used for purposes of discussion at the meeting)

Agenda Item 4-A  Proposed ISA 200 (Revised and Redrafted) (Mark-up from March IAASB Meeting)  
(Pages 757 – 792)

Agenda Item 4-B  Proposed ISA 200 (Revised and Redrafted) (Mark-up from ED and Comparison)  
(Pages 793 – 840)

Action Requested

The IAASB is asked to consider the matters and recommendations noted above, and to approve the proposed revised ISA 200 (Revised and Redrafted).